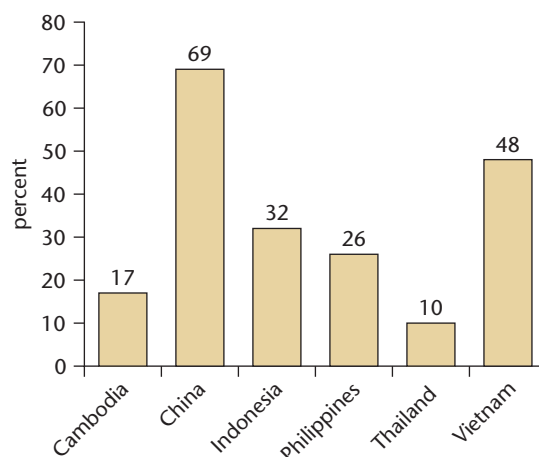


# EAST ASIA DECENTRALIZES

## MAKING LOCAL GOVERNMENT WORK

Decentralization has arrived in East Asia—and it is here to stay. Over the past two decades, subnational governments have taken on core responsibilities for raising and spending public money and for providing critical services and infrastructure. In some cases, like the “Big Bang” in Indonesia, this shift has been rapid. In others, like Vietnam and Cambodia, the process has been much slower. But throughout the region, the transition is under way: now more than ever, the future of East Asian countries depends on the capacity and performance of their provincial and local governments.

**Figure 1 Subnational Expenditures as a Share of Total Public Spending**



Source: Refer to *East Asia Decentralizes*, chapter 5, table 5.1.

Some progress with decentralization has been encouraging. Indonesia and the Philippines have set up intergovernmental fiscal systems and transferred workers to subnational governments without major disruptions in service delivery. In Vietnam, budgetary and financing systems have improved and local participation has expanded. In Cambodia, communes have begun to deliver basic infrastructure.

But fundamental problems remain. Across the region, local governments lack the resources and

power to fulfill their new responsibilities, and they have few incentives to improve their performance. Most countries are caught in an “institutional limbo” between the dissolution of old, top-down service-delivery mechanisms and the emergence of still-weak decentralized structures. Moreover, reform momentum has often slowed. In Indonesia, just four years after decentralization started, new laws have tightened the center’s control over local spending and staff. After a strong start in the Philippines there has been little recent progress in implementing the 1996 Financial Framework or in revising the Local Government Code. In Thailand, clear decentralization policies have not been matched with implementation on the ground.

This situation threatens local economic development, service delivery, and governance. Throughout the world, decentralization has proven to be a long and difficult process. In fact, because relations between central and local authorities are always dynamic, this process never truly ends. But continuing progress is important, particularly in the early stages when poorly designed intergovernmental systems and subnational capacity constraints can become extremely costly. In East Asia, focused action is needed to avoid this fate.

### THE MAIN CHALLENGES

East Asia’s decentralization process is characterized by heterogeneity with some shared features, many of which are common to the decentralization experience of other countries around the world. Clearly, decentralizing countries need policies and strategies that are appropriate to their specific environments. Although these will vary from country to country, policy makers can usefully focus on three broad challenges:

- Improving the organization of the intergovernmental system.

- Strengthening local and intergovernmental fiscal and financial structures.
- Developing the functional and accountability systems that make local governments work.
- Ensure transparency and objectivity in determining the size and boundaries of subnational governments.
- Establish structures and processes to facilitate coordination between subnational governments and central agencies, particularly in planning and investment.

### *Organizing the Intergovernmental System*

Subnational governments in East Asia now have substantial responsibilities, but basic weaknesses in the intergovernmental system limit their ability to fulfill these responsibilities and dampen incentives for them to do so. Often, the structure of local government is poorly designed. Expenditure assignments are not defined clearly, and mechanisms for planning and coordination between different local governments are absent or weak. In the Philippines and Indonesia, overlaps and conflicts in the roles of various levels of government have diluted accountability for results. In China, local governments are saddled with unfunded mandates.

Many intergovernmental structures in the region are unbalanced, with a heavy focus on some levels of government and little attention to others. In Indonesia, provinces have few significant service-delivery responsibilities and have largely been precluded from the oversight and coordination of subprovincial authorities. This has created difficulties for the management of the intergovernmental system as a whole and for planning and investing in infrastructure that crosses city and district boundaries. In Cambodia and Thailand, the lowest levels of subnational government are often too small to be economically viable.

Policy makers can take several steps to resolve these difficulties:

- Review assignments and accountabilities to ensure that the roles of central, intermediate, and local authorities are appropriately balanced.
- Clarify rules for functions and finances at each level of government.
- Ensuring that local authorities have incentives to raise revenues and control expenditures by allocating appropriate revenue sources and expanding local revenue autonomy.
- Building or reforming property taxation systems.
- Developing comprehensive local borrowing frameworks.

### *Improving Local and Intergovernmental Fiscal and Financial Systems*

Strengthening fiscal and financial systems is a second priority. Thus far, progress in this area has been greatest with respect to intergovernmental transfers, which account for most of the revenue of subnational governments. But significant sums are still transferred to local governments in an ad hoc manner. And where modern, formula-based systems do apply, they often encourage inefficiency, and distributional outcomes are sometimes unfair.

Local governments have few of their own local revenue sources, and the control they have over these is usually very limited. Local revenue mobilization is thus discouraged. Finally, subnational borrowing frameworks are incomplete and often pursue contradictory objectives. In some countries, they encourage extensive off-budget borrowing (China); in others, they inhibit the emergence of a sustainable debt market (Indonesia) and squeeze out private sector investors (the Philippines).

Policy makers will need to focus on a few key areas:

- Continuing with improvements to intergovernmental transfer systems and formulas.

### *Developing Functional and Accountability Systems*

The management and accountability systems that are necessary for the appropriate allocation and proper control of resources also require focused attention. For example, local financial management and accounting systems in most East Asian countries are deeply flawed, and effective and timely external audits of local governments are rare. Central control over local staffing, budgets, and pay undermines attempts to devolve authority to subnational managers. And bottom-up accountability relationships through which citizens can hold local governments responsible are stretched very thin.

Together, these weaknesses limit the scope for good governance and efficient service delivery. In Vietnam, there is little scope for local preferences to affect budget decisions. In Indonesia, as recent court cases attest, local corruption is widespread. In Thailand and Cambodia, human resource capacity is weakened by unclear terms of employment and insufficient staffing of local governments. The collection and maintenance of data on subnational finances and service delivery are universally weak. And in all countries in the region, national governments struggle to monitor and oversee the intergovernmental system effectively.

To address these problems, policy makers need to

- deepen and enhance accountability by strengthening systems that allow for the expression of local voice and by improving monitoring and oversight from the top
- strengthen intergovernmental functional and management systems, with timely budgets and the production and auditing of local financial statements

- build human resource capacity so that central and subnational governments can perform their new tasks effectively

## THE WAY FORWARD

The key question East Asian countries face is no longer *whether* to decentralize, but *how* to design and support their intergovernmental structures in ways that give subnational governments the incentives and resources necessary to govern accountably and deliver effectively. If East Asia is to make its way through the institutional limbo in which it finds itself and successfully address the core challenges outlined above, a number of things will need to be accomplished.

First, given the varying conditions within each country, intergovernmental frameworks will need to be crafted with sufficient flexibility to allow for appropriate asymmetries in the design and implementation of decentralization structures and processes. Second, the uneven pace of change and the need to capitalize on opportunities as they arise requires a reform process that will often be more piecemeal than comprehensive. International experience suggests that focusing on a few key areas where change is possible and getting these right is likely to yield greater success than trying to accomplish too much simultaneously on too many fronts.

Finally, the political dynamics that often frustrate progress will need to be confronted. Sometimes these are party-political; sometimes they involve the distribution of authority and resources among central and provincial elites. Often they derive from conflicts among governmental agencies over institutional territory and power. Whatever the case, some means will need to be found to break the decentralization logjams that characterize many countries in the region. A combination of robust political leadership, smart strategic focus, and sound technical effort will be required if East Asia is to meet its decentralization challenges.

This note draws from the book

**East Asia Decentralizes**

**May 2005, ISBN: 0-8213-6059-0, 278 pages, Price: US\$30\***

It is a new World Bank study that surveys the status of intergovernmental reform in East Asia and points out areas for priority action. For an electronic copy, please go to <http://www.worldbank.org/eapdecentralizes>.

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