Role of Local Governments: Lessons from International Practices

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IIPA, New Delhi, October 30, 2007
Outline of the presentation

• Rising tide of local governance; why?
• Conceptual perspectives on local governance
• The Practice: Alternate Models of local Governance
• Current practices
• Some lessons from OECD.
Local Government vs Local Governance

• Local Government: institutions and entities to deliver services in a small area
  – Constitution: Brazil, Denmark, France, India, Italy, Japan
  – State constitutions: Australia, USA
  – Central legislation: NZ, UK
  – State legislation: Canada, Pakistan
  – Executive order: China

• Local Governance: Formulation and execution of collective action at the local level
Local Government responsibilities: Assignment Principles

• The Principle of fiscal equivalency
• The Correspondence Principle
• The Decentralization Theorem
• The Subsidiarity Principle

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Role of Local Government: Fiscal Federalism Perspective

- A handmaiden of higher order governments
- Residuity principle, ultra vires, Dillon’s rule
- Financing model: transfers dominate, limited fiscal autonomy
- Roles under
  - Dual Federalism
  - Coordinate authority model of dual federalism
  - Cooperative federalism with interdependencies
  - Cooperative federalism – independent spheres
  - Competitive federalism
- Criteria for local vs metropolitan assignment: Economies of scale and scope, spillovers, political proximity, budget flexibility, consumer choice
- Public-private divide and partnership: efficiency and equity

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Local and metropolitan responsibilities

- **Local tier**: Fire, police, refuse, neighborhood parks, local streets, traffic, transit, library

- **Metropolitan tier**: primary and secondary education, public transport, water, sewage, refuse disposal, public health, hospitals, utilities, pollution, special police, regional parks and planning, economic development

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New Public Management Perspectives

• Independent facilitator of creating public value
• What they should do: Create public value by tapping free resources (consent and goodwill, good Samaritan values, community spirit) to improve social outcomes
• How to do it better: Make managers manage or let managers manage. Managerial flexibility but accountability for results
Public Choice approach

• Two alternate views: (a) Doctrine of common good (b) advancing self interest – monolithic (elite capture) or composite (Tiebout communities) structure

• To overcome monolithic self interest structure: autonomy and competition. Direct democracy and exit and voice mechanisms
New Institutional Economics: Government as a runaway train

• Local government as the primary agent to reduce transactions costs and deal with the commitment problem
• Facilitator of network form of local governance
• Oversight of shared rule
Synthesis: Towards citizen-centric local governance

• Responsive Governance
• Responsible Governance
• Equitable Governance
• Accountable Governance

⇒ NEW VISION OF LOCAL GOVERNANCE: role reversals for local and higher level governments

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Emerging Vision of Local Government: 20th versus 21st century

- Residuality principle
- Ultra vires
- Focus on government
- Agent of central/provincial governments
- Accountable to higher governments only
- Direct provider
- Dependent on central directives
- Rules driven, bureaucratic, technocratic
- Exclusive with elite capture
- Overcomes market failures
- Boxed in a centralized system

- Subsidiarity principle
- Community governance
- Focus on governance
- Primary agent for citizens and gatekeeper for shared rule
- Accountable to voters
- Network facilitator
- Autonomous
- Managerial flexibility and accountability for results, strengthens voice, choice and exit.
- Inclusive and participatory
- Overcomes market and government failures
- Global and local connectivity

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Back to the future!

• “My idea of village swaraj (independent republic) is that it is a complete republic, independent of its neighbors for its own vital wants, and yet interdependent for many others in which dependence is a necessity”. *Mahatma Gandhi* as quoted in *Alok* (2006)

• Self-governing village communities in India in 1200 BC. *Rig Veda* as quoted in *Alok* (2006)
The Practice: Alternative Models of local governance and central-local relations

- Ancient history: Central governments emerged from acts of cooperation among local governments, wars and conquest.
- The Nordic model: Local government as the primary agent. Broader role in support of a client-oriented welfare state.
- The Swiss Model: Same as above but power belongs to people. Direct democracy provisions.
- The French model: Local government as an instrument for political participation. Strong central command with dual supervision.

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The Practice ……..

• The German Model: Subsidiarity, cooperation and administrative efficiency. Local Governments as administrative arms.
• The British model: stronger role of centrally appointed field officers and sectoral and functional ministries.
• The Indian Model: Birthplace of the good local governance. Vestiges of the colonial history
The Practice ….

- The Chinese Model: Democratic centralism and dual subordination. Local autonomy varies with fiscal capacity.
- The Japanese Model: Mix of French and German features. Centralized control weakened but agency delegation retained.
- The North America Model: Separation of powers and home rule
- The Australian Model: “roads and rubbish only”
Historical Reorganization of local governments

• Franco model: little change in numbers but regional governments gained prominence

• Anglo model: consolidation of school districts in USA and Canada. Limited introduction of 2-tiers. Proliferation of single purpose jurisdictions. Larger role of neighborhood associations.

• Northern Europe: Major consolidation. Numbers reduced by half
Population size of local governments

- Population < 10K: France, Switzerland, Austria, USA, Italy, Norway, Rural India, Kazakhstan, Indonesia
- Population 10K-20K: Finland, Norway, Belgium, Netherlands, Denmark, Germany, Argentina, Poland
- Population 20K-60K: Sweden, Portugal, Japan, Spain, Canada, Brazil
- Population 60K-130K: Chile, Urban India, China, UK
- Population >200K: South Africa, Uganda
- Average: Industrial countries: 10K; Developing countries: 79K

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A comparative perspective on local government share of consolidated public expenditure

- India
- Chile
- South Africa
- Indonesia
- Brazil
- Argentina
- Kazakhstan
- Uganda
- Poland
- China
Local Expenditures as a Share of National GDP, 2001

Note: France (+2) includes municipalities, regions, and départements; Japan (+1) includes cities and prefectures; Denmark (+1) includes municipalities and counties (Amtskommuner).

Source: Shah forthcoming and Werner forthcoming.
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A Comparative Perspective on Local Government Share of Consolidated Public Expenditures

Source: Calculated based on World Development Indicators Online (WDI), Government Finance Statistics, Chapter 2 – 11 (this book), Jan Werner forthcoming.

FIGURE 1.1 A Comparative Perspective on Local Government Share of Consolidated Public Expenditures
Source: Calculated based on World Development Indicators Online (WDI), Government Finance Statistics, Chapter 2 – 11 (this book), Jan Werner forthcoming.

**FIGURE 1.2** Local Expenditures as a Share of National GDP
Composition of Operating Revenues for Local Authorities in 2001

Note: The shared taxes in Germany and Japan are consolidated under transfers. Moreover, local borrowing is excluded from this survey.

Source: Shah forthcoming and Werner forthcoming.

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Composition of Local Tax Revenues, 2001

Note: The shared taxes in Germany (personal income tax and value added tax) and in New Zealand (fuel tax for the regional councils) are excluded.

Source: Shah forthcoming and Werner forthcoming.
FIGURE 1.3 Composition of Operating Revenues for Local Authorities

Source: Calculated based on World Development Indicators Online (WDI), Government Finance Statistics, Chapter 2 – 11 (this book), Jan Werner forthcoming.

FIGURE 1.4 Composition of Local Tax Revenues

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OECD practices in local spending

- No uniform model except for “property oriented” services typically at the local level.
- Education: No role in Australia but more than 60% of total in Canada, UK, and USA. EU: 47%, OECD: 46%
- Health: No role in Australia and UK, 92% in Denmark. EU: 28% and OECD: 19%
- Infrastructure: 27% in Australia, 62% UK, EU: 47% and OECD: 41%
- Significant higher level interventions in social services
- Unfunded mandates in environmental controls

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Local Revenues in OECD

- Income, property taxes and fees major revenue sources
- High property tax reliance (Av. 85%): Australia, Canada, USA, Ireland (100%), Netherlands, NZ, UK
- High income tax reliance (84%): Sweden, Finland, Lux. Denmark, Norway, Germany, Switzerland, Iceland, Belgium, Japan
- Mixed tax sources: Australia, France, Greece, Italy, Portugal, Spain, Turkey
- Averages: Income (EU: 60% OECD:44%), Property (EU:35%. OECD:28%), Sales (EU:14%, OECD:4%, Spain 40%), Fees (EU:13%, OECD: 9%)

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Tools for Financing Local Services and possible applications

- **Local taxes** for services with ‘public’ goods characteristics – streets, roads, street lighting.
- **User fees** for services with ‘private’ goods characteristics – water, sewer, solid waste.
- **Conditional non-matching output-based grants** for merit goods: education, health
- **Conditional matching grants** for compensating for spillovers in some services.
- **Unconditional grants** for fiscal gap and equalization purposes.
Tools for financing local services...2

- **Capital grants** for infrastructure if low fiscal capacity
- **Capital market finance** for infrastructure if higher fiscal capacity.
- **Development Charges** for financing growth. Higher charges for developing land on the outer edge.
- **Public-private partnerships** for infrastructure finance but keep public ownership and control of strategic assets.
Tools for financing local services ..3

• **Tax increment financing districts** (TIFs) to deal with urban blight.
  – Area designated for redevelopment
  – Annual property tax revenues frozen at pre-vitalization levels
  – For a specified period, 15-35 years, all tax revenues above base used for redevelopment.
  – Capacity improvements through municipal borrowing/bonds against expected tax increments

• **Business improvement districts** (BIDs).
Conclusions from International Experiences

• Great diversity in the role of local government but enhanced role consistent with better economic and fiscal outcomes.

• Current local roles and finances inconsistent with growing role of local governments in a globalized world. Greater autonomous, wider and diverse taxing and spending powers needed.

• Stronger role of local governments critical for local economic development.
Lessons .............

• Local governments should have autonomous and unconstrained taxing powers to finance municipal services.
• Local governments should not be asked to finance redistributive (social/welfare) services.
• The way a city manages its finances can either help uplift or ruin the private economy. Examples: St.Louis, USA and Sao Paulo, Brazil, Seoul, Korea, Shanghai, China, Stockholm and Oslo.
• Business should be taxed only for services to business and not for redistributive purposes or financing residential services.
  – Pittsburgh reversed stagnation and decline in 1980s through replacing business taxes by business land taxes and holding the line on wage taxes.
Some conclusions…. 

- Greater predictability and transparency of intergovernmental finance needed.
- Local governments should be unconstrained in seeking innovative ways of financing and delivering local services – e.g. through competitive purchasing, revenue bonds and tax increment financing districts.
- Consolidation of municipal governance and introduction of multi-tiered metropolitan governance

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