

A. Fiscal Decentralisation

A.1 Research and Analysis for Cambodia

The review for this section includes research papers conducted within the field of local government finance and governance in Cambodia, and consultants' evaluation of the different issues and key actors in this sphere.

The review provides an overview for understanding the current process of fiscal decentralisation and local financing structure in Cambodia. There are some lessons learned that can be used in the further design and improvement of the implementation of the decentralisation process. This review will primarily provide a structured guidance to the different analyses available for Cambodia as well as exposure to different issues relevant for future value-added research.

Issues commonly touched upon by these reports are on the current inter-governmental transfer system and implications of its present pilot programmes before and after the commune elections in 2002.

1. Chia, C., Ho, P., et al. 2003. **Preliminary Review of the Local Planning and Finance Systems under Cambodia's Emerging Decentralisation.** New York: Robert F. Wagner Graduate School of Public Service, NYU.

This article is a review of the experiences and challenges in commune planning and financial management with reference to two communes. Although limited by short fieldwork duration, difficulty in translation, and large group interviews, the article generally gives a detailed and good overview of the local structure and the processes in place. In addition, it points out several critical issues and challenges that communes face in fulfilling their roles and responsibilities. One year into its first mandate, structure and progress of implementation takes place and awareness of the planning process is considerably higher at the grassroots level.

The findings of this study are: 1) the communes do no long-term planning except their one-year

development and investment plan; 2) needs and priorities identification is not well understood by commune and village representatives as throughout the past 5 years the focus has unremittingly been on infrastructure projects; 3) no clear division of responsibility for service delivery exists among different tiers of government; 4) there is no clear criteria for selection of priority projects--some places use majority vote whilst others use different methods; 4) cooperation and coordination between commune, line department, provincial office and political party in project development and activities is weak. Projects offered by line departments, NGOs and political parties do not necessarily reflect the priority projects identified by the commune.

Participation by women and the poorest groups in the planning and project identification process is limited. Responsibilities are in the hands of the commune chief and the clerk. The commune clerk is in charge of various tasks from administrative duties to payment preparation. Village chiefs and PBCc (planning and budgeting committees) are accountable to their appointers (commune chief and the district) rather than to their constituents (villagers).

The commune seems to be able to prepare and submit their financial management documents. They have no capacity to do forecasting and expenditure estimation and rely very much on technical assistance. Councillors are not aware of their authority and power in areas such as tax collection.

The team suggests a few key research areas which include 1) the issues around deconcentration, 2) a study on the potential conflict in relationships between a province and its staff and the commune, 3) in-depth analysis of the relationship between clerk and commune councillors, 4) a study of local service revenues with emphasis on the structure of local taxation, 5) and an assessment study of the management and technical expertise of the TSS team in fulfilling their duties for the commune.

2. Dom, Catherine. 2002. ***Selected Issues and Recommendations in Relation to CS Financing.*** Issue Paper-TAR 35274. Phnom Penh: Asian Development Bank.

The main objective of this paper is to assess whether the commune/sangkat (CS) financing system is properly designed and can effectively support decentralisation of governance. It also addresses the issues of equity and effective allocation of CS finance, and finally analyses the long-term consistency of the CS Fund system.

Key challenges of the current fiscal decentralisation process in Cambodia include the need for revision of legislation on public finance to recognise commune and sangkat as a new tier of government, and the formulation of clear policy and regulations for fiscal decentralisation. A long-term (3 years) expenditure framework for the commune is needed to secure resource allocation. It is suggested that the CSF annual allocation take place in August instead of October. A formula of national transfers will have to be restructured.

The paper also addresses issues that are relevant to strengthening the current decentralisation process, i.e. formation of a system for commune budgeting and financial management, an accountability system, and a plan for capacity building of the commune and relevant institutions within this area.

3. Fiscal Governance Adviser of DFID. 2002. *Cambodia: Fiscal Governance*. Technical Cooperation Assistance Programme to the Ministry of Economy and Finance. Phnom Penh: DFID.

This report assesses issues and challenges of fiscal governance in the Cambodian context. It provides an analytical review of the current structure and system, then draws on action-oriented strategies for budget and treasury reform, revenue generation, rural finance and liquidity, and provides a vision for a fiscal reform process.

The report recommends a joint research programme between CDRI and MoEF on (i) budget process and sector management reforms at local level, (ii) issues concerning supply of liquidity at the provincial level, and (iii) an analysis of local impact and effects of any additional social sector spending.

4. Pak, Kimchoeun. 2003. *Real Property Taxes and Cambodia: Should and can Cambodia impose the taxes?* New York: Syracuse University (unpublished paper)

Experience from elsewhere shows that real property taxes are the main source of revenue for local government. Real property taxes have the characteristics of local tax, and equity bases suitable for local income. The paper presents some current conditions that need to be taken into account in creating the mechanism for real property taxation. Obviously Cambodia is not yet ready to authorise local government to impose property taxes based on the arguments that Cambodia faces i) weak and insufficient land mapping and registration, ii) lack of data for property value assessment, iii) low levels of skills and competence in the tax authorities, and iv) the low income level of the potential taxpayers. The author calls for government action in setting the stage and getting the pre-conditions right before proceeding with further steps.

5. Pak, Kimchoeun. 2003. *Banking Sector in Cambodia*. New York: Syracuse University (unpublished paper)

The banking sector in Cambodia has undergone large and critical changes over the past 20 years. This paper presents the key developments in the sector with a good overview of current regulations and of the constraints that hinder its progress and growth. Major constraints are a lack of political stability, inhibiting the development of the private sector, institutional and legal frameworks, and payment systems, and a lack of capacity of staff.

6. Romeo, Leonardo G. 2001. *Towards a Regulatory Framework for Decentralised Financing and Planning in Cambodia*.

Consultant report prepared for the Partnership for Local Governance. Phnom Penh: UNDP.

The report provides analysis of existing decentralisation reform and offers advice on realigning decentralised planning, financing, and capacity building in the new decentralised system of elected local government.

Presently the local councils are heavily dependent on national transfers both for their administration and development expenditure. The author stresses the importance of devolving revenue-raising powers to the local councils although the national transfers will remain a critical feature of the local finance systems.

It includes detailed and important analysis of the existing regulations relevant to the formation of the elected local councils, the process and system of local financing, and the division of functions of the different actors pertinent to the local planning process.

7. Romeo, Leonardo R. 2002. *Cambodia*. In P. Smoke and Y. Kim (eds.), *Inter-governmental Fiscal Transfers in Asia: Current Practice and Challenges for the Future*. Manila: Asian Development Bank.

The chapter presents information on progress and challenges with regard to the design and structures of inter-governmental transfers in Cambodia: the Commune and Sangkat Fund (CSF).

It highlights some of the key points that need to be considered in reshaping inter-governmental fiscal transfers as well as the fiscal decentralisation process in Cambodia. Some of them are: 1) the possible establishment of a permanent institution to take over from the CSF Board as overseer of the fiscal decentralisation process, for example the department of local finance; 2) a more well-defined objectives of the CSF allocation needs to develop to lift up output and measurement of commune/sangkat's performance; and 3) the communes to control and manage their own accounts at a commercial bank and the appointment of an accountant on each commune staff.

The author emphasises that fiscal transfers are, from international experience, crucial for local financing in Cambodia, and needs to be carefully designed taking into consideration (i) the correction of vertical and horizontal imbalances, (ii) opening up to external co-financing, and (iii) establishing a gradual and transparent process of commune development funding.

Further areas covered are (i) a detailed review of major conceptual principles and practical experience with inter-governmental transfers around the world. The challenges of designing and implementing inter-governmental transfer programmes are highlighted, focusing in more detail on many of the issues raised by the country case studies. (ii) a review of recent experiences with inter-governmental transfers in India, primarily focusing on the evolution and effects of transfers from central to the state level. The macroeconomic dimensions of transfer programmes are also pointed out. (iii) a review of the history of inter-governmental transfers in Indonesia, focusing particularly on a new revenue-sharing programme intended to help solve some of the serious problems of the previous complex and fragmented system. (iv) an examination of national to provincial fiscal transfers in Pakistan, emphasising the important role of the sub-national tax-sharing programme. It also evaluates a number of other less transparently allocated grants and implicit transfers. And (v) an evaluation of the system in the Philippines, principally focusing on the IRA general revenue-sharing programme, and reviewing other national to sub-national and inter-local transfers.

8. Royal Government of Cambodia. 2002. *Commune and Sangkat Fund of the RGC*. An Interim Progress Report. Phnom Penh: RGC.

This report provides a review of achievements made by the elected commune councillors using their own budgets – the Commune and Sangkat Fund (CSF) allocation for the year 2002. In Cambodia, the CSF is referred to as an inter-governmental fiscal transfer. There are two components of the CSF which are 1) the administrative component to be used for salary and office expenses with an average amount of \$1,714 per year; and 2) the development fund component, not less than two-thirds of the CSF allocation, to be used for development activities and projects at the communes. Communes are divided into two types--category 1A and category 1B; these classifications are used as the basis for development fund allocation.

In the first year of its implementation, the CSF has been used mainly to finance small-scale infrastructure projects including roads, rural water supply, small-scale irrigation, and school

buildings. The report notes that more than 63 percent of the total development component of CSF was used for road construction. It concludes by proposing further delegation of responsibilities and resources to the commune level for local service delivery and to allow communes to raise their own revenues by performing agency functions.

9. Smoke, Paul, and Remy Prud'Homme 2000. *Workshop on Fiscal Decentralisation: Report submitted to the Ministry of Economy and Finance*. Presentation during a fiscal decentralisation workshop in Phnom Penh, Cambodia.

The purpose of the workshop was to begin the process of developing the commune finance system. It covers issues such as 1) the concepts and practice of fiscal decentralisation, 2) commune-generated revenues and transfers, 3) commune financial management and control systems, and 4) the implementation plan of fiscal decentralisation.

The Law on Administration and Management of the Commune/Sangkat allows the commune to collect land taxes, immovable property taxes, rental taxes, and user charges. Discussion during the workshop further identified other sources of revenues for the commune, including i) certain taxes and other revenues already allocated to the provinces (taxes on unused land, business licences, vehicle taxes, and slaughtering taxes), ii) a betterment levy, iii) hotel taxes, iv) taxes on entertainment, v) taxes on sale of drinks, vi) possible shared taxes on turnover and VAT, and vii) non-tax revenues for various licences and services.

The workshop also addressed their concerns regarding the practicalities of implementing the conclusions of the discussions. This requires amendments to current regulations such as to the national tax code, the provincial finance law, and the land ownership law.

In addition, the workshop examined and discussed options and challenges for inter-governmental fiscal transfers, financial management, and steps to be taken in putting forward the process of fiscal decentralisation as well as the coordination roles relevant stakeholders need to play.

A summary of the key steps to be taken by the ministry in processing fiscal decentralisation are (i) the establishment of a task force on fiscal decentralisation, (ii) a follow-up process including short papers and workshops for further discussion and development for the identified issues (such as CS generated revenues, the transfer system, CS financial management, and fiscal decentralisation strategy), (iii) the building of the capacity of staff at the MoEF with regard to local government finance, (iv) the development of an overall plan for fiscal decentralisation reform, and (v) the delegation of responsibility to the taskforce to implement the plan.

10. Smoke, Paul. 2003. *Integrated Fiduciary Assessment and Public Expenditure Review (IFAPER): Decentralisation and Deconcentration*. First draft for comment. New York: New York University.

This article provides an assessment and suggestions for the Government of Cambodia with regard to issues of financial management and systems of operation of cash flow at the commune and provincial levels, as well as on the challenges in deconcentration. It addresses the current structure of the commune/sangkat as well as that of the provincial and district levels.

The key issues that were raised in the report address a need for a clear and well-developed vision for decentralisation policy and a capacity building plan for the elected councils. There is also a need for an extensive and well-formulated implementation strategy and institutional coordination needs to be thoroughly and adequately articulated. Immediate steps need to be taken to tackle these issues, the author emphasises, before additional problems occur as a result of inconsistent and inappropriate strategies.

In response the paper provides some recommendations, including to 1) create a decentralisation secretariat which can be the link between CAR and NCSC; 2) redesign the current implementation strategy especially with regard to commune/sangkat fund allocation and technical assistance to commune councilors; 3) establish a clear plan for capacity development

which considers different approaches and targets a wider audience. It looks at some other issues around fiscal decentralisation and deconcentration with some priority recommendations for both near and long-term needs. It recommends that policy research on sources of revenue collected at the commune level should be developed.

11. World Bank and Asian Development Bank. 2003. *Cambodia: Integrated Fiduciary Assessment and Public Expenditure Review*. A joint document for the Royal Government of Cambodia. Phnom Penh: World Bank and Asian Development Bank.

The document makes four key suggestions on how and where improvement and reforms can be made for better service delivery, including (i) improvements in resource mobilisation for fiscal sustainability, (ii) reduction of fiduciary risk to public funds, (iii) rationalisation of government public expenditure policy and management, and (iv) undertaking of civil service reform.

Cambodia has made some progress in its revenue collection, especially of tax revenues, but further work and reform will need to take place in order to increase revenues for necessary public spending. This can be done through improved tax administration and policy.

The current public expenditure and financial management system allows inefficient allocations and gives rise to high levels of fiduciary risk to public funds. One common challenge is the use of cash-based systems and environments with little, if any, operational control. Major reforms needed include the strengthening of cash management through increased use of bank accounts, improvements in planning priorities for public expenditure, and strengthening legal frameworks and financial control systems.

Government public expenditure has improved in that spending on priority sectors has increased over time. Further steps need to be in place to ensure that high priority expenditure occurs: (i) reduction of expenditure in low priority areas, (ii) generation of savings from possible consolidation of administrative

structure and retrenchment, (iii) reduction of overhead and administrative expenditures. The document also addresses issues for improved external assistance through the consolidation of donors' funds to meet spending goals in the government's high priority sectors.

Finally, the issue of reform in the civil service is addressed. This is an area where the problems of salaries, incentives, and capacity building needs urgent attention. The document recommends that unskilled and superfluous workers should be reduced, and relocation and redeployment of public servants to priority sectors and lower levels of governments is necessary.

The document concludes with some recommendations for the government in its reform agenda in which short and medium term reform options and strategic action steps are provided.

B.2 Research and Analysis Elsewhere

The collection for this section of the review focused upon i) the usefulness of information and broad implications from a literature review in the field of fiscal decentralisation, and ii) the sharing of experience and lessons learned that could be relevant to Cambodia's fiscal decentralisation process. Reports and papers for this review are mainly based on the work of academic institutions as well as professional organisations working to improve the design, implementation and therefore results of fiscal decentralisation in developing countries.

The papers vary from purely theoretical compilations of problems tackling issues in taxation, to inter-governmental transfer system to local planning, and to service delivery of sub-national governments. A large number of reports look more closely at applied case studies from diverse types of government systems; both those that have been exposed to fiscal decentralisation for a number of years and those less experienced with decentralised fiscal governance. Several papers emphasise the relationship and linkages among variables within the decentralisation reform process, for example, the impact of fiscal decentralisation on economic growth and governance.

12. Bahl, Roy. 1999. *Implementation Rules for Fiscal Decentralisation*. Working paper 99-1. Atlanta: Georgia State University.

After decades of experimentation with fiscal decentralisation, there are still many lessons to learn. Debates on the best formula for fiscal decentralisation and what needs to be in place in the structure and design of the process in both developing and in-transition countries continue to be necessary. This paper offers 12 concise rules for policy makers and implementers in the design of fiscal decentralisation, including:

1. Design of a decentralisation system must be comprehensive to accommodate fiscal reforms.
2. Apply the rule of thumb whereby finance follows function, i.e. expenditure requirements must be backed up by the means to bring in the revenues to carry out those expenditures.
3. Most local governments are still weak and therefore the national government needs to be capable of monitoring and evaluating the decentralisation process as it evolves.
4. It is not wrong to have more than one inter-governmental transfer system because urban and rural councils are not the same: some depend heavily on grants, whereas some rely greatly on local taxation.
5. For a genuine fiscal decentralisation it requires significant local government taxing power to be assigned to local government.
6. Usually regulation of fiscal decentralisation is done by the central government--it is therefore necessary that it keeps its promise and implements the regulations; otherwise nothing changes.
7. For system and regulations to be implementable, they should be simple and should not be over burden for both central and sub-national governments.
8. Objectives of the decentralisation reforms and inter-governmental transfers should be complementary.
9. Fiscal decentralisation reform should take into consideration all levels of government, namely central, regional, and local government. By doing this we ensure that power and resource sharing are all in place for a suitable implementation.
10. Tough budget constraints need to be imposed under which local governments

are required to be self-sufficient and autonomous at the year-end in terms of their budget.

11. Central government needs to recognise that inter-governmental transfer systems are always in transition and plan for this.
12. There is a need for strong internal champions who understand the costs and benefits of establishing such a reform programme. In summary, fiscal decentralisation has been held back and needs to be carefully thought through with regard to some of the key issues presented above.

13. Bahl, Roy. 2000. *Sustainable Local Government Financing Strategies in LDC and Transition Countries*. Retrieved from www.urbanicity.org on August 4th 2003.

This short paper addresses the key issues around the actual and theoretical implications of fiscal decentralisation policy, with an emphasis on its impact on economic development. The most important rationale for or advantage of a fiscal decentralisation strategy is to move government closer to the people.

Fiscal decentralisation promotes revenue mobilisation, accountability of elected officials, and grassroots participation in governance, all of which work to stimulate local economic development. However, fiscal decentralisation has not been happening swiftly in LDC and transition countries because fiscal centralisation is often strongly favoured, based on the argument that it facilitates national governments' macroeconomic control, aids in the management of social projects with big externalities, and gives them control over the equalisation potential.

Other discussions in the paper address local tax options in LDC and transition countries. The paper concludes with ten points on political champions and detractors of sustainable local government financing.

14. Berlekom, Maria. 2001. *Introducing Commune and Village Development Budgets: 2 years experience of decentralisation to local*

levels in Northern Vietnam. Vietnam: Ministry of Agriculture and Rural Development.

This is a review of a two-year pilot programme of a new decentralised development approach whereby at the commune and even at the village levels, budget allocations are provided for planning and implementation of development needs in the village and commune. The paper provides a detailed and good overview of different stages and issues within commune and village development budgets (C/VDB). Along with discussions of challenges and the problems encountered, the paper includes interesting case studies for the purposes of illustration.

The findings and recommendations can be summarised as follows: 1) the initiative to introduce a village level budget creates an environment where villagers demand more resources to be allocated to them directly; 2) villagers become involved much more actively in small-scale infrastructure where they take the initiative to monitor and supervise the activities. The same occurs in natural resources management, and 3) by introducing C/VDB to villagers, they are more willing to give both cash and in-kind contributions.

The report concludes that special attention must be given to more efforts to secure the participation of women and the poorest groups in society, current contract bidding procedures and reporting formats must be simplified, and that there is an immediate need for skill upgrades and delegation of responsibilities at the district and provincial levels for their support of the commune and village levels.

15. Bird, Richard, and Francois Vaillancourt (eds). 1998. *Fiscal Decentralisation in Developing Countries*. Cambridge: Cambridge University Press.

Recent years have seen a worldwide trend toward fiscal decentralisation. Many developing countries are turning to various forms of fiscal decentralisation as an escape from inefficient and ineffective government, macroeconomic instability, and inadequate growth.

This collection provides up-to-date research from leading scholars in the field to assess the progress, identify the problems, and analyse the potential for lessons learned from a variety of countries around the world including China, India, Indonesia, Colombia and South Africa.

In summary, the book provides a few critical recommendations for better fiscal decentralisation implementation, including: (i) the imposition of restrictions on the borrowing ability of sub-national governments in order to retain macroeconomic balance, and (ii) the simultaneous implementation of revenue and expenditure decentralisation in order to avoid decreased revenue mobilisation and macroeconomic imbalance. The authors emphasise that fiscal decentralisation and political will can enable efficient and effective service delivery regardless of potential adverse macroeconomic circumstances and poorly functioning public administrations.

Additionally it is possible for local governments to be 90 percent dependent on central government transfers and still be fully accountable for their citizens and/ or the central government depending on the circumstances of each country.

16. Bird, Richard M. 1999. *Rethinking Sub-national Taxes: A New Look at Tax Assignment*. IMF Working Paper 99/165. Washington DC: International Monetary Fund.

The assignment of revenues from central to local government in most developing and transitional countries has arguably facilitated irresponsible behaviour by some sub-national governments. One way to relieve this problem is to strengthen sub-national tax regimes. The paper proposes two approaches to this in developing countries. The first--most applicable to large countries with important regional governments--is to establish sub-national value-added taxes (VATs); the second is to replace the various unsatisfactory state and local taxes imposed on business by a low-rate value-added tax levied on the basis of income (production origin) rather than consumption (destination). (Author's abstract)

17. Bird, Richard M. 2000. *Inter-governmental Fiscal Relations: Universal Principles, Local Applications*. Working paper# 00-02. Atlanta: Georgia State University.

Inter-governmental transfer policy needs to take into account both political and economic constraints. The paper examines four issues around inter-governmental fiscal transfers and addresses their practical implications. First, expenditure assignments for the lowest level of government should be consistent with its efficient performance. The first step in achieving this is to establish clear lines of responsibility and accountability. The author also suggests the use of a medium-term expenditure framework for sub-national budgeting.

Second, sub-national governments should be assigned with appropriate taxes, to be assessed, collected and set by them. It is important that appropriate levels of revenue assignment be given to sub-national governments for a meaningful local autonomy and local accountability.

Third, transfers are necessary regardless of resources made available to local governments. Transfers can also be used to achieve allocative efficiency, distributional equity, and macroeconomic stability. The design of a transfer system should consider (i) the distributable pool, (ii) the distributive formula, and (iii) the conditionality of expenditure.

Finally, the paper analyses the impact of fiscal decentralisation from macroeconomic and institutional aspects. The author concludes that all these aspects can be appropriately and contextually designed to fit individual countries.

18. Bird, Richard M. 2003. *Fiscal Flows, Fiscal Balance and Fiscal Sustainability*. Working paper# 03-02. Atlanta: Georgia State University.

The paper examines three issues. Fiscal flow is used to measure the redistribution of income among levels and areas. This measurement can provide some picture of the geographical incidence of tax and expenditure structures

which can then help guide policy strategy. Measuring fiscal flow is conceptually difficult, but if properly done it can be used to assess the redistribution of income among regions, and can be particularly useful for tax and expenditure analysis. However, the use of fiscal flow is limited due to methodological problems.

Second, fiscal balance looks at which area of a country is paying or receiving too much or too little. The author recommends that areas facing fiscal imbalance should be allowed to keep their own local revenues. Fiscal balance is commonly associated with the notion of vertical and horizontal fiscal imbalances. Vertical fiscal imbalance refers to the differences between expenditure and own-source revenue at the different levels of government. To correct for this type of imbalance, there should be similar revenue and expenditure assignments. Horizontal fiscal imbalance refers to the differences of available resources to governments at the same level. These concepts are not separate. The author emphasises the implications of equalisation transfer programmes for the capacity of local governments. Disparities, and the aims and effects of equalisation programmes need to be clearly defined so that the fiscal capacity of all local governments is similar, and it is not the case that the government which tries least receives the most.

Third, fiscal sustainability might offer some clue for the problems raised with regard to fiscal flow and fiscal balance. However, this indicator can be varied and therefore needs to be carefully designed as its use reflects subjective judgment rather than objective measurement. In conclusion, the uses of these three indicators do not tell the whole story, although they do facilitate an understanding of local governments' performance. The best option is to develop meaningful and comparable fiscal indicators especially with respect to sustainability.

19. Boex, Jamie. 2001. *An Introductory Overview of Inter-governmental Fiscal Relations*. Fiscal Policy Training Programme 2001: Fiscal Decentralisation Course. Atlanta: Georgia State University.

The paper addresses three areas: it gives an overview of fiscal decentralisation, looks at policy relevant to fiscal decentralisation, and assesses the advantages and disadvantages of decentralisation. The author notes that fiscal decentralisation is relevant to all countries regardless whether they are unitary, federal or confederation countries.

There are four pillars of fiscal decentralisation. First is the expenditure assignment and responsibilities of each level of government. Second is the revenue assignment which should correspond to sub-national governments' expenditure responsibilities. Third are the inter-governmental fiscal transfers that sub-national governments should receive from central government in addition to the revenue assignments provided. Finally the paper addresses the issues of borrowing and debts of sub-national governments.

The paper concludes with an interesting discussion on the pros and cons of fiscal decentralisation based on worldwide experience.

20. Castles, Francis G. 1999. *Decentralisation and the Post-war Political Economy*. Discussion Paper No. 399. Canberra: the Australian National University, Research School of Social Science.

This paper uses cross-national data for 21 OECD nations to examine whether there is any evidence of a connection between measures of political and fiscal decentralisation and the major, long-term, performance parameters of the post-war political economy. The findings of this exploratory analysis of a wide range of policy outcomes suggest that low levels of fiscal centralisation appear to have restrained post-war inflationary pressures and were commensurate with higher rates of post-war economic growth. However, no evidence is found to link fiscal decentralisation with post-war labour market performance. While the balance of evidence indicates that measures of political decentralisation do not have any significant impact on political outcomes, the study confirms the standard finding in the literature that federalism and other decentralised constitutional arrangements

impede the expansion of the socially protective state. (Author's summary)

21. Castro-Leal, Florencia., Dayton, Julia., Lionel Demery and Mehra Kalpana. 1999. *Public Social Spending in Africa: Do the Poor Benefit?* The World Bank Research Observer, vol. 14, no.1: 49-72.

Education and health care are basic services essential in any effort to combat poverty and are often subsidised by public funds to help achieve that purpose. This paper examines the effectiveness of public social spending on education and health care in several African countries and finds that these programmes favour not the poor, but those who are better off. It concludes that these targeting problems cannot be solved by adjusting the subsidy programme. The constraints that prevent the poor from taking advantage of these activities must also be addressed if the public subsidies are to be effective. (Authors' abstract)

22. Dethier, Jean-Jacques. 2000. *Some Remarks on Fiscal Decentralisation and Governance*. Paper prepared for presentation at the Conference on Decentralisation Sequencing, Jakarta.

The paper provides a review of challenges and a discussion of major issues by focusing on the linkages of decentralisation and governance. Decentralisation in itself does not create accountability and responsiveness. It argues that the rationale for decentralisation is not clear, and international evidence does not confirm that decentralised governance is better than centralised governance. Some politicians use decentralisation policy to gain the confidence of those at the grassroots level. The author looks at the pros and cons of decentralisation from different aspects such as public provisions, fiscal discipline, and poverty reduction.

India is one of the case studies selected for a discussion of the impact of decentralisation and governance on the welfare of the poor, with an emphasis on health and education sectors. Pro-poor policies mean more investment and money is put into subsidising health and education activities. Such policies need to be

vigilant with regard to corruption of public officials and any attempt to privatise these basic public services.

23. Eaton, Kent. 2002. *The Link Between Political and Fiscal Decentralisation in South America*. Princeton: Princeton University, Center of International Studies

The hypothesis of this paper is that sub-national elections generate pressures for fiscal decentralisation. In Latin America elected officials in local government are selected under a free and fair election process and their accountability leads them to demand more fiscal responsibility. Only sub-national level legislators are involved in sub-national budgeting and policy-making. The devolution of responsibilities to sub-national governments should increase the authority of legislative positions at those levels. This is also the case for the revenue and expenditure side of fiscal policy. From the four case studies, two countries confirm the hypothesis while the other two offer no linkages between political and fiscal decentralisation in which the national political system plays a great role. The paper concludes from the four countries' experience that decentralisation tends to follow democratisation.

24. Ebel, Robert D., and Serdar Yilmaz. 1999. *Inter-governmental Relations: Issues in Public Policy*. World Bank Institute. Washington DC: World Bank.

The paper reviews the recent advances in economic theory and changes in the practice of governance. Fiscal discipline and coordination, the system of inter-governmental fiscal relations and the legal basis on which they operate determine the performance of public sectors.

The authors discuss the functions of government in three key areas where sharing of responsibilities is possible between central and sub-national governments: macroeconomic stabilisation, income redistribution, and resource allocation.

In addition, they conduct a regression analysis in which their conclusion shows that an

increase in the share of sub-national expenditure in total government spending would limit the size of the government in the economy.

25. Fjeldstad, Odd-Helge, and Lise Rakner. 2000. *Dilemmas of Fiscal Decentralisation: A study of local government taxation in Tanzania*. Forum for Development Studies, Vol.27, No.1: 7-41.

This paper reviews the main characteristics of the existing local tax system. It discusses how the present tax system emerged, and why it has been maintained for such a long period in spite of all its weaknesses. Finally, it considers options for reform.

Local taxes represent less than 6 percent of total national tax revenues in Tanzania. However, the large base of these taxes, together with their unsatisfactory nature, means that their economic, political and social impacts are considerably more significant than the revenue figure indicates. (Author's summary)

26. Fjeldstad, Odd-Helge, and Joseph Semboja. 2001. *Why people pay taxes: the case of the development levy in Tanzania*. World Development, Vol.29, No.12, pp.2059-2074.

This paper examines factors determining tax compliance behaviour in local authorities in Tanzania. The case study is the poll tax--locally named the "development levy." The study finds support for the hypothesis that tax compliance is positively related to factors such as ability to pay, the (perceived) probability of being prosecuted, and the number of tax evaders known personally by the respondents. Oppressive tax enforcement, harassment of taxpayers, and discontent with public service delivery seem to increase tax resistance and may explain widespread tax evasion. (Author's summary)

27. Fjeldstad, Odd-Helge, and Lise Rakner. 2003. *Taxation and tax Reforms in Developing Countries: Illustration from Sub-Saharan Africa*. Development Studies and Human Rights, Report 6. Chr. Michelsen Institute.

Many low income countries face problems with respect to taxation: 1) there is an urgent and obvious need for more revenues to enable resource poor states to provide and maintain even the most basic public services; 2) the reality is, however, that those with political power and economic ability are few and do not want to pay tax; and 3) those without political power are many, have almost nothing to tax, and also resist paying taxes. It follows that the challenge for taxation is to raise domestic revenues from consenting citizens in poor and increasingly open economies. Elected governments in poor countries are therefore facing hard choices about taxation. These choices will most likely have profound impacts on the future democratisation itself and on public service provision. They will also have considerable implications for the politics and sustainability of aid.

The report provides interesting accounts on how reforms in tax administration can be achieved in the African countries addressed in the study and the role the donor community can play. It examines options and constraints for policy-making on revenue mobilisation and democratisation. The report concludes with issues for further research.

28. Le Houerou, P, and Taliercio, R. 2002. *Medium Term Expenditure Framework: From concept to practice, a preliminary lessons from Africa*. Africa Regional Working Paper Series No. 28. Washington DC: World Bank.

Do Medium Term Expenditure Frameworks (MTEF) work in practice? This paper undertakes a comparative assessment of the design and impact of MTEF on public finance and economic management in nine African countries. MTEF is objectively set to improve inter- and intra- sectoral resource allocation, macroeconomic balance including fiscal discipline, accountability for budgetary decisions, and public expenditure efficiency and effectiveness.

Findings from the study are 1) there is no evidence that MTEFs have a significant impact on macroeconomic balance; 2) there is some limited and qualified evidence that MTEFs are

linked to reallocation to a subset of priority sectors; 3) there is no support for the contention that MTEFs are associated with greater discipline and less deviation; and 4) only if properly designed can MTEFs create pressure for political accountability.

The paper concludes with some suggestions on how and what needs to be addressed in order to make MTEFs work in different countries.

29. Local Body Fiscal Commission of Nepal. 2002. *Work Plan for the Local Body Fiscal Commission (LBFC)*. Draft work plan funded by DASU/Danida.

This report provides a comprehensive analysis of the existing system of local government finance, the challenges, and recommendations for establishing of a permanent local fiscal commission in Nepal.

The focus is on the main challenges of the administrative structure and the decentralisation reform process, which could hinder the further development of fiscal decentralisation of the local government. The recommendation put forward is to engage both national governments and the donor community in a support process for the implementation of the work plan.

30. Martinez-Vazquez, Jorge, and Robert McNab. 1997. *Tax Reform in Transition Economies: Experience and Lessons*. Prepared for the International Seminar in Public Economies, Tokyo. Atlanta: Georgia State University.

The paper reviews transition experiences in tax reform over the past six years, and draws on the successes and failures of the reform process for lessons learned.

The overall performance of tax systems in the countries in transition (CITs) has been undermined by growing tax evasion. Through review of each key tax reform, the author provides a good account of the CITs' tax structure and their tax reform process. The author's conclusion is that effective and successful tax reform also requires institutional and structural reforms of the economy.

31. Martinez-Vazquez, Jorge, and Robert M. McNab. 1997. *Fiscal Decentralisation, Economic Growth and Democratic Governance*. Presented at the USAID Conference on Economic Growth and Democratic Governance. Georgia: Georgia State University.

The main issues addressed by this paper are i) the link between fiscal decentralisation and economic growth and ii) fiscal decentralisation and democratic governance. It gives a good overview of literature that tests the relationship of these variables. Results for the first hypothesis from most of the tests indicate mixed correlations between fiscal decentralisation and economic growth. However, there is an explicit link between fiscal decentralisation and democratic governance.

In addition to acknowledging the impact of fiscal decentralisation on democratic governance, the authors highlight several challenges within the decentralised systems: i) potential domination of local elites; ii) possibility of decentralised governance to enhance corruption; and iii) limited local capacity to sustain democratic governance. The paper ends with some policy advice.

32. Peterson, George E. 1997. *Decentralisation in Latin America: Learning through Experience*. World Bank Latin American and Caribbean Studies Viewpoints. Washington DC: the World Bank.

This paper examines the current process of decentralisation reform in Latin American countries. It specifically addresses three key issues--fiscal framework, level of government closer to the people, and service delivery of local government.

Several countries in Latin America that have been swept with *silence reform* have experienced some drawbacks. In Mexico and Brazil, problems occurred in the implementation of decentralised policy when national laws left functional responsibilities unclear or assigned the same functions to more than one level of government. Local governments have walked away from services that proved too costly. In addition, local

governments tend to prefer free central transfers to local tax revenues, particularly in poor rural areas. Also, the use of formula-based revenue and grant transfers has decreased the flexibility to make macroeconomic adjustments as necessary according to the changing condition of the public-sector budget. From the point of view of constructing fiscal frameworks, the author suggests that the following are necessary: (i) reconciliation of fiscal frameworks and macroeconomic management, (ii) correction of unbalanced financing strategies to reduce fiscal risk under decentralisation, (iii) control over sub-national borrowings, (iv) local government be given share and control of fiscal resources, and (v) revenues assigned should accommodate responsibility assignments.

Secondly, the issue of local government performance and responsiveness as government is moved closer to the people is addressed. Latin American countries have been transformed, under the decentralisation policy, by the strengthening of the elected leadership. It is rare to find indirect popular election of mayors today and elections of local governments are conducted separately from those at central and state levels. The result has been an increase in the accountability of elected officials to the public at large and an enhanced capacity to respond to local priorities. Moreover, the majority of citizens surveyed in Columbia showed that they trust local government more than the national government. Yet the paper offers a few points for improvement in implementation including, (i) the use of the election of local officials as a greater means for public participation, (ii) the participation of citizens requiring their involvement in actual budget and service cost choices, (iii) the identification of the role of citizens in collaborating with government, (iv) the increased decision-making of citizens in big projects, and (v) sharing of successful models among regions and areas.

Devolving responsibilities from higher levels of government to lower levels of government is good as long as they are able to deliver services to meet the needs at the local level. Local governments require sufficient resources granted to them both in terms of improving the skills of local staff and revenue sources. In addition to this requirement a mechanism to

measure accountability and output needs to be in place for better service delivery. The author goes even further to suggest incorporating market principles into the service delivery of local government-competition. A good structure of transfers and grants should be able to address these issues: (i) transfers of all kinds should follow clear and stable rules, (ii) grants should not be used to compensate local authorities for budget deficits and debt, (iii) specific functions of national importance that are transferred from the central to local authorities should be accompanied by revenue transfers that must be spent on the function.

33. Prud'Homme, Remy. 2003. *Fiscal Decentralisation in Africa: A Framework for Considering Reform*. Public Administration and Development, Vol. 23, No. 1: 17-27.

This article argues that there is no simple (or even complex) uniform model for fiscal decentralisation in Africa. Each country has to devise its own strategy. The article proposes an analytical framework to help countries consider how to structure fiscal decentralisation.

It presents briefly the main decentralisation instruments available--allocation of functions and revenues across the levels of government, development of inter-governmental transfers, institutions of central monitoring and control mechanisms, and the institution of electoral rules.

It then examines various objectives that will be served or impacted by these instruments, including economic efficiency, macroeconomic stability, interregional or interpersonal equity and political efficiency. Selected impacts are reviewed and illustrated to demonstrate how an understanding of these issues in each country is a prerequisite for designing appropriate decentralisation. (Author's summary)

34. Schneider, Aaron. 2003. *Who Gets What from Whom? The Impact of Decentralisation on Tax Capacity and Pro-poor Policy*. IDS Working Paper 179. Brighton: Institute of Development Studies.

This project studies patterns of decentralisation and public finance in 68 countries in 1996. Six

indicators of decentralisation clustered around fiscal, administrative, and political dimensions are examined: these dimensions had independent and surprising relationships with how much tax governments imposed and what they did with their money. First, politically decentralised regimes taxed less overall and spent less on social policies. Second, administrative decentralisation showed a positive impact on social policies, but neither administrative nor fiscal decentralisation had a systematic relationship to tax capacity.

These results suggest that multi-level governance might be best pursued in a partial fashion. Political centralisation favours the actors and interests who seek large amounts of progressive public action; administrative decentralisation allows competition, information, and innovation to lead to efficient and effective public policies. Together, political centralisation and administrative decentralisation may offer the optimal combination to achieve large quantities of effective, efficient, and redistributive public action. Fiscal decentralisation had no statistical impact in any of the models. (Author's summary)

35. Shrestha, Manoj. 2002. *An Overview of Inter-governmental Fiscal Relations in Nepal*. Working paper # 02-05. Atlanta: Georgia State University.

The author provides a comprehensive overview of the achievements and challenges of fiscal decentralisation reforms in Nepal. It also addresses the directions for effective further reform.

There are two tiers of local government in Nepal; one is the district and the other is the municipality and village. Both of these tiers are devolved with many local level functions and taxing powers. The decade long experience of decentralised governance has resulted in many positive achievements. However, the paper highlights several important reform issues: (i) rationalisation of the size of the governing units (there are a large number of small local governments) is considered not economically viable and therefore there are high costs for technical support and capacity building which must be covered by the central government, (ii)

the practice of consensus building to reach decisions has resulted in non-decisions, late decisions, and a loss of accountability, and (iii) the ambiguous relationship between the local councils and the district councils, which has so far resulted in the creation of a subordinate relationship, and an unclear division of responsibilities.

In addition, the paper identifies four categories of major challenges to the reforms. First it discusses issues around expenditure assignments, and identifies two key problem areas. These are (i) overlapping and parallel functions assigned to different levels of government in terms of regulating, financing and implementation. This is also an issue with regard to funding sources from donors and NGOs that are channelled outside local governments' administration, and (ii) LGs are too focused on minor capital expenditure like small infrastructure projects because of the restrictions in their budget that require them to use their funds mainly for capital expenditure. Second it addresses LG revenue sources. The main challenges include improving the revenue assignment structure to reduce vertical imbalance, redefining and making clear arrangements for tax sharing, and the linking of accountability for tax collection with service provision. Third the issues related to inter-governmental transfers are highlighted: (i) the transfer system is unpredictable as it is ad hoc and determined yearly by parliamentary allocations, and (ii) the current transfer system affects local revenue generation. Finally, the budgeting and monitoring process of LG is currently not well coordinated and does not allow autonomous decision-making at the local levels.

The chief recommendations provided in the paper are as follows: (i) there should be a clear assignment of expenditure responsibilities at all levels of government, (ii) there needs to be a strengthening of local governments' ability to implement expenditure responsibilities through provision of adequate funding and co-delivery of services with private or civil society groups, (iii) LG must be provided with devolved and autonomous revenue assignments, (iv) the objectives of the fiscal transfers in addressing the aims of decentralisation reforms must be specified, (v) a system must be designed to stimulate local revenue generation, (vi)

budgetary autonomy, accountability and transparency should be increased, and (vii) the oversight and the audit of the LG must be strengthened.

36. Smoke, Paul. 2001. *Fiscal Decentralisation in Developing Countries: A review of current concepts and practice*. Democracy, Governance and Human Rights Programme Paper No. 2. Geneva: UNRISD.

This paper examines the origins, conceptual foundations and practice of fiscal decentralisation in developing countries. First, it considers why fiscal decentralisation has been so prominent historically in developing countries, and why this trend has been reversing. Second, it summarises conventional fiscal decentralisation theory and considers its relevance for developing countries. Third, it reviews some popular claims made for and against fiscal decentralisation, and considers the available empirical evidence. Fourth, it outlines some key elements of fiscal decentralisation as it is being promoted in selected countries, including some of the problems being faced and successes being realised. The paper concludes with some observations on how to think about designing more appropriate and effective fiscal decentralisation in developing countries. (Author's summary)

37. Smoke, Paul and Roy Bahl. (eds). 2003. *Restructuring Local Government Finance in Developing Countries: Lessons from South Africa*. Cheltenham: Edward Elgar.

This compilation book provides a discussion of the status of fiscal decentralisation in South Africa. South Africa is one of the leading countries in implementing fiscal decentralisation with its sub-national expenditure of 29 percent compared to 14 percent in other developing countries for the period of 1992-97.

The rest of the book covers issues regarding 1) local government powers and functions; 2) local government revenue systems; 3) issues regarding property taxes; 4) the regional service council levy, 5) inter-governmental transfer systems; and 6) integrating fiscal

reforms and the challenges of implementation. Most of the concepts and discussion have been drawn from the authors' international experience and its relevant lessons for other developing countries.

38. Vergara, Victor. 1996. *Local Integrity Systems and Fiscal, Political and Functional Decentralisation: An overview to making local government credible and effective*. Washington DC: World Bank, Municipal Technical Assistance Programme.

This paper presents key issues regarding local government integrity; it provides an overview of the issues that affect and define local integrity and the need to build in local integrity initiatives as part of decentralisation policies. Furthermore, the paper introduces several tools that can be used to build local integrity systems including inter-governmental fiscal transfers, information systems focusing on public revenue and expenditure, and participatory techniques for monitoring and developing local budgets. (Author's summary)

39. Wescott, Clay, and Doug Porter. 2002. *Fiscal Decentralisation and Citizen Participation In East Asia*. Manila: Asian Development Bank.

This is a comparative study on the impact of fiscal decentralisation on reforms of five countries in East Asia, which have been and are currently embarking on a decentralisation process. The article sets the stage by looking at the economic growth trend and conceptualisation of decentralisation in the region as a whole. It then provides a country-by-country analysis on: i) background of the reform and how reform initiatives come about; ii) challenges and issues of the current structure and system, and of fiscal decentralisation reform; iii) analysis of public finance management reform; iv) achievement and progress of reform so far. Cambodia, for example, has no regulation yet on what and how the commune can collect fees/charges and levy local taxes.

The article concludes with major experiences of the decentralisation process in East Asia including the process of democratisation, local

governance, efficiency and effectiveness of service delivery and the link/interaction between economic growth and decentralisation. Some interesting questions for further research study are suggested.

40. Yilmaz, Serdar. 2002. *Concept of Fiscal Decentralisation and Worldwide Overview*. World Bank Online Course on Fiscal Decentralisation.

The purpose of this introductory paper is two-fold: to provide an overview and address the emerging challenges in the process of fiscal decentralisation. It begins with a discussion of the concept (e.g., distinguishing fiscal from other forms of decentralisation and pointing out the variants this may take), and then proceeds to ask several critical questions: Why/why not decentralise? What are the benefits and risks? How does one measure and monitor? And, what are the basic approaches and instruments of a fiscal decentralisation and local financial management policy?