

Chapter 1. Key findings

This chapter provides a summary of the key findings from the report. It highlights that decentralisation is among the most important reforms of the past 50 years, and has profound implications due to its complex and systemic nature. The question is not whether decentralisation is good or bad in itself, but that decentralisation outcomes – in terms of democracy, efficiency, accountability, regional and local development – depend greatly on the way decentralisation is designed and implemented. The report identifies ten guidelines for decentralisation to work and be conducive to regional development.

Sometimes called a “silent” or a “quiet” revolution, decentralisation is among the most important reforms of the past 50 years. It is implemented to varying degrees in a majority of developing and developed countries and has profound implications due to its complex and systemic nature. Engaging in a decentralisation process affects all spheres of society, from the nature and the quality of governance to national wealth and economic growth and, more broadly, to citizen well-being.

This report focuses on current trends in the decentralisation policies of OECD countries and beyond, and on ways to make decentralisation work. It argues that the question should not be whether decentralisation is good or bad in itself, but that decentralisation outcomes – in terms of democracy, efficiency, accountability, regional and local development – depend greatly on the way decentralisation is designed and implemented. Decentralisation should not be considered a panacea for any type of problem a country may face, nor should it be seen as an objective in and of itself. Rather it is a means to achieve certain goals. Empirical research and a number of country examples show that decentralisation can be conducive to public sector efficiency, democratisation and political stability. There are also examples of failures with decentralisation, when the reforms were not properly designed and implemented, and when the multi-faceted dimension of the concept was not well understood.

Making the most of decentralisation for regional development is particularly crucial in the current context of a “geography of discontent” and growing divides between places that feel left behind by globalisation and technological change and those that may benefit from the opportunities offered by megatrends. Dysfunctional decentralisation systems are part of the story behind the crisis of democracies: it is thus critical to find ways to make decentralisation systems more effective.

The report identifies ten guidelines for decentralisation to work and be conducive to regional development. Beyond the guidelines, the report proposes concrete tools for policy-makers, including detailed sets of recommendations, checklists, pitfalls to avoid and examples of good practices, both in unitary and federal countries.

What is decentralisation?

Although widespread and extensively analysed, decentralisation is often understood in different ways and applied in different scopes. Decentralisation refers to the transfer of powers and responsibilities from the central government level to elected authorities at the subnational level (regional governments, municipalities, etc.), having some degree of autonomy. Decentralisation is also about reconfiguring the relationships between the central government and subnational governments towards a more co-operative and strategic role for national/federal governments. It is also a multi-dimensional concept, as decentralisation covers three distinct but interrelated dimensions: political, administrative and fiscal.

The forms and extent of decentralisation vary greatly from one country to another. Depending on the country, there are also varying degrees of upward and downward accountability and varying ranges of central government control.

At the global level, the OECD-UCLG World Observatory on Subnational Government Finance and Investment has identified that subnational expenditure amounted to 9% of gross domestic product (GDP), 24% of public expenditure and 40% of public investment (OECD-UCLG, 2016^[1]).

In OECD countries, subnational governments represent a larger share of public spending, accounting in 2016 for 16.2% of GDP, 40.4% of public spending and 56.9% of public investment. Education represents the largest spending areas (25% of subnational expenditure), followed by health (18%), general public services (administration), social protection and economic affairs/transport).

Rather than a clear-cut separation of responsibilities, most responsibilities are shared among levels of government, and the trend toward shared responsibilities has increased over the past decades. The need to share responsibilities may arise for functional reasons – as is common between municipal and regional tiers around issues of transport and infrastructure, environment and water, culture and tourism, communication, or economic development. It may also arise for financing reasons such as for social services. Overall, there is greater variation across countries in the distribution of competencies at the regional level, and less variation at the local level.

The financing systems for subnational governments vary significantly. Countries can be grouped into four families based on both their degree of subnational spending and their tax level characteristics, which cut across federal versus unitary distinctions. In 2016, taxes represented the number one source of revenues for subnational governments in the OECD on a weighted average (45%), followed by grants and subsidies (37%). The degree of tax revenue is not necessarily an indication of tax autonomy, as some taxes are also shared with the central government. Tax autonomy depends on many factors, including the ability to set or modify tax rates and bases. The same is true for the degree of spending power, as often spending covers delegated functions which are highly constrained by central government regulations and fiscal discipline rules.

Measuring decentralisation is complex. Fiscal indicators are useful for providing a macroeconomic view of decentralisation but remain partial – only focusing on fiscal aspects – and may also lead to a distorted interpretation of the reality, over-estimating the real spending and taxing power of subnational governments. They must be completed by complementary approaches and institutional indicators to better understand the fiscal power of subnational governments. In particular, OECD subnational spending power indicators show that spending authority is quite low in a number of countries, and is lower in health than in housing, transport and education.

Current trends in decentralisation

Although the measurement of decentralisation is complex, fiscal and institutional indicators converge on the fact that the overall trend has been towards decentralisation, despite some exceptions.

Decentralisation reforms are and have been implemented for a wide variety of political, historical, and economic reasons that vary greatly across countries. Several moves towards decentralisation have been mainly motivated by the quest for more local democratic control, as well as by greater efficiency in public service delivery and accountability for regional and local development policies. Mega-trends such as information revolution, digitalisation, the globalisation of economic activity and urbanisation, also contribute to the stronger role played by subnational governments.

Paths to decentralisation vary considerably across countries, from “big bang” approaches to incremental approaches or “waves” of reform. Engaging in a decentralising reform is ultimately a political issue and thus should be conceived and pursued as part of a broader strategy of territorial development and broader public

governance reforms. Decentralisation should also be viewed in a more comprehensive way, including interactions between public entities and private stakeholders, in particular citizens, businesses and non-governmental organisations. Decentralisation reforms are often accompanied by other types of multi-level governance reforms, notably territorial and public management reforms. In all cases, decentralisation systems require regular review and adjustment.

Several complementary trends in decentralisation stand out:

1. **Increased subnational spending and revenues:** In two thirds of OECD countries, decentralisation processes have resulted in an increase of economic importance of subnational government, measured both as a spending share of GDP and share of total public spending between 1995 and 2016.

On the revenue side, tax revenues have slightly increased both as a share of GDP and in total public tax revenues. Subnational spending and revenue have increased – and this was amplified in some countries by the global financial crisis. Although the real spending power of subnational governments is more limited than what financial indicators show, more comprehensive indicators, such as the Regional Authority Index and the Local Autonomy Index, also indicate an increase in the degree of authority of regions and municipalities over the past decades.

2. **Upscale in subnational governance** through municipal co-operation, metropolitan governance and the strengthening of regions (regionalisation):
 - **Municipal fragmentation** has been the driver of policies encouraging or imposing amalgamations. It has also motivated policies fostering inter-municipal co-operation as a way of generating economies of scale, efficiency gains and cost savings. Today, inter-municipal co-operation is widespread in the OECD, benefiting rural and metropolitan alike.
 - The number of metropolitan governance authorities of all types created has increased, in particular since the 1990s. Currently, around two-thirds of the metropolitan areas in the OECD have a metropolitan governance body.
 - The rising role of regions: of the 81 countries covered by the Regional Authority Index, 52 experienced a net increase in the degree of regional authority and only 9 experienced a net decline. The main objectives are to generate economies of scale in public service provision, for example in the health sector, and public transport sectors. The objectives are also to design and implement integrated regional development strategies that take into account urban-rural linkages. Regionalisation trends increase the need for co-ordination across government tiers and the need for clarification in the assignment of responsibilities, to avoid overlap.
3. **Increased asymmetric decentralisation**, i.e. the fact that governments at the same subnational government level have different political, administrative or fiscal powers. Whereas between the 1950s and the 1970s asymmetric arrangements happened mostly at a regional level, the present trend seems to apply asymmetric decentralisation in major urban areas. While asymmetric decentralisation appears more “natural” in federations, it is increasing in unitary countries, based on new motives. There is thus a greater convergence between unitary and federal countries in differentiated governance at the subnational level.

Observed experience indicates that once adopted, asymmetric arrangements are kept on a long-term basis.

In parallel to these trends affecting subnational governments, the role of central governments has evolved. Decentralisation implies a renewed role for central governments. Being more strategic, this role is focused on setting the conditions for proper co-ordination and alignment of policy objectives, monitoring the performance of regions and cities, and ensuring balanced development of all parts of the national territory, through active regional development policies. Given that most responsibilities are shared, decentralisation policies are about managing mutual dependence to achieve common objectives. Decentralisation reforms involve a shift from a direct role in service delivery to one of enabling, advising and assisting, ensuring consistency and facilitating the work of subnational governments. This requires building new capacity at the central government level, able to cope with these new functions, which cover a large area of sectors.

The impact of decentralisation on the central government is often underestimated. Failing to take the full measure of this issue may be detrimental to the reforms, slowing down or modifying the reform process.

Making the most of decentralisation's benefits

The way decentralisation is designed and implemented has a major impact on its associated outcomes. The benefits depend on the system as a whole, including the adequate capacity of subnational governments, accountability of local public decision-making and sound framework conditions.

The benefits and challenges of decentralisation can be direct or indirect. Direct effects result from enhanced allocative efficiency and may include improvements in service levels, quality and efficiency of public services. Indirect effects of decentralisation, such as faster economic growth or better stability of the society, result from direct outcomes of decentralisation such as better education or higher participation in political decision-making. Since the indirect effects of decentralisation are affected by a variety of factors, the role of decentralisation is, of course, harder to separate from other trends and policies.

While country statistics and correlations do not allow for causal conclusions, subnational fiscal power is positively associated with economic activity. In particular, measures such as GDP, public investments made in physical and human capital and education outcomes show a positive correlation with decentralisation. Revenue decentralisation appears to be more strongly associated with income gains than spending decentralisation. In addition, country examples and empirical research results show that decentralisation can be conducive to public sector efficiency, democratisation and political stability. Decentralisation has the potential to support and expand citizen participation by bringing government closer to citizens and by making government more easily accessible. In certain cases, decentralisation can be a “glue” that holds countries together.

Recent empirical evidence indicates that revenue decentralisation could be associated with smaller regional economic disparities. This could be because own-source revenue may spur growth especially in poorer regions and enhance the convergence process towards the best performing regions. Another potential benefit of decentralisation is the ability to carry out more effective regional development policies, as

local and regional actors are better able to design regional policies that respond to local needs. Institutional quality seems to explain part of the story: decentralisation appears to foster convergence when institutional quality is high, while it tends to exacerbate territorial disparities in environments with low institutional quality.

Decentralisation may also diminish opportunities for rent-seeking and corruption in public administration. For instance, a larger subnational share of public expenditures has been found to correlate with lower corruption. Again, these results depend on the way decentralisation is designed and implemented. For example, very complicated multilevel governance models with unclear assignments have been found to be more prone to corruption.

Finally, decentralisation may provide a useful way for experimenting with public policies. At best, “learning by doing” processes of decentralised policy innovation can result in important information spillovers from good practices. The “information externalities” created by decentralisation can benefit not just subnational governments themselves but also central government.

Anticipating and minimising the risks

Central/federal governments are responsible for the framework conditions that will determine how decentralisation systems operate. There are some challenges associated with both the design and implementation of decentralisation that need to be carefully addressed.

From a general aspect, decentralisation presents a challenge to subnational governments because it requires certain economic, political and administrative capacities. The lack of sufficient administrative, technical or strategic capacities is probably one of the bigger challenges in the field of decentralisation. Building capacities, including “learning-by-doing”, should be a priority. This takes time and therefore needs a long-term commitment from central and subnational government levels. There are a number of ways to strengthen government capacities at all levels, and the capacity building policies need to be tailored to the various needs of regions. Such policies require the right framework conditions for decentralisation to be in place.

The fiscal dimension is very often the weak or even missing link of decentralisation. One of the most frequent challenges, particularly in developing countries or countries at an early stage of decentralisation, but also in developed countries, is the misalignment between responsibilities allocated to subnational governments and the resources available to them. Unfunded or under-funded mandates – where subnational governments are responsible for providing services or managing policies but without the requisite resources – are common.

A high reliance on central government transfers may also reduce subnational government incentives for responsible fiscal behaviour. Subnational governments need own-source revenues because this contributes to accountability and efficiency of local public service provision. While a general rule for the optimal degree of tax autonomy is difficult to define, local authorities should rely on their own revenues for financing their services at the margin.

Another important challenge of decentralisation is formed by overlapping assignments between levels of government. Lack of clarity in the assignment of responsibilities makes service provision and policymaking costlier; it also contributes to a

democratic deficit by creating confusion among citizens regarding which agency or level of government is responsible. Unbalanced decentralisation, where the various policy areas are decentralised in different ways, can also weaken regional development policies.

Decentralisation may result in loss of certain economies of scale and fragmentation of public policies. This could happen especially if subnational governments are unable to co-operate with each other. Determining optimal subnational unit size is a context-specific task; it varies not only by region or country but by policy area, as well. National governments have an important role in establishing legal, regulatory arrangements and incentives to foster co-operation across jurisdictions, in particular within functional regions.

Ten guidelines for effective decentralisation conducive to regional development

The question is not whether decentralisation is good or bad in itself, rather it is a question of the conditions under which decentralisation can promote local democracy, efficient public service delivery and regional development. The policy experiences and research results that have accumulated over the past decades can help policymakers to implement decentralisation reforms in a way that avoids the major pitfalls. When it is properly designed and implemented, there is evidence that decentralisation policies have a number of benefits, from improved subnational public service delivery and greater citizen engagement to reduced corruption and a positive impact on growth.

To support countries in identifying the conditions that help make decentralisation work, the OECD has developed ten guidelines for implementing decentralisation. The guidelines are more than just recommendations. Each section covers the rationale of each guideline, practical guidance, pitfalls to avoid, good practices and a checklist for action, tailored to both federal and unitary countries. They are presented in a summarised version below:

Guideline 1: Clarify the responsibilities assigned to different government levels

- The way responsibilities are shared should be explicit, mutually understood and clear for all actors. Equally important is clarity in the different functions that are assigned within policy areas – financing, regulating, implementing or monitoring. Since multi-level governance systems are constantly evolving, a periodic review of jurisdictional assignments should be made to ensure flexibility in the system.
- Clear assignment is critical for accountability, monitoring and effectiveness of investment and service delivery policies. The more a responsibility area is shared across different government levels, the greater clarity is needed to reduce duplication and overlaps.
- Clarity does not mean that shared responsibilities should be avoided, as this is by definition impossible. It means that the way responsibilities are shared should be explicit, mutually understood and clear for all actors, including citizens
- The way different responsibilities across policy areas are decentralised should be balanced.

Guideline 2: Ensure that all responsibilities are sufficiently funded

- Access to finance should be consistent with functional responsibilities. Division of financing responsibilities should ensure that there are no unfunded or under-funded assignments or mandates.

Guideline 3: Strengthen subnational fiscal autonomy to enhance accountability

- Subnational governments should have a certain degree of autonomy in the design and delivery of their public service responsibilities within the limits set by normative regulations, such as minimum service standards.
- Subnational governments need own-source revenues beyond grants and shared tax revenues – and they need to develop other sources of revenue to have a balanced basket of revenues.

Guideline 4: Support subnational capacity building

- Central government should assess capacity challenges in the different regions on a regular basis. Policies to strengthen capacities should be adapted to the various needs of territories. Governments should seek to reinforce the capacities of public officials and institutions in a systemic approach, rather than adopting a narrow focus on technical assistance.
- Staff training in the basics of local public financial management should be established. Open, competitive hiring and merit-based promotion should be ensured.
- Special public agencies accessible to multiple jurisdictions should be encouraged in areas of needed expertise (e.g. regional development agencies, PPP units).

Guideline 5: Build adequate co-ordination mechanisms across levels of government

- Since most responsibilities are shared, it is crucial to establish governance mechanisms to manage joint responsibilities. Creating a culture of co-operation and regular communication is essential for effective multilevel governance and successful long-term reform. Tools for vertical co-ordination include for example dialogue platforms, fiscal councils, standing commissions and intergovernmental consultation boards, and contractual arrangements.
- It is important to avoid multiplying co-ordination mechanisms with no clear role in the decision-making process.

Guideline 6: Support cross-jurisdictional co-operation

- Horizontal co-ordination can be carried out using specific matching grants, and by promoting inter-municipal and interregional co-operation. Metropolitan governance should be promoted as well. The legal system at the national level should allow such tools.
- Rural-urban partnerships should be promoted as a form of cross-jurisdiction collaboration to enhance inclusive growth by bringing multiple benefits, such as expanding the benefits of agglomeration economies, to overcome co-ordination failures and strengthen capacity.

Guideline 7: Strengthen innovative and experimental governance, and promote citizens' engagement

- Citizens should be empowered through access to information. Ensure that elected local councils have the ownership and control of citizen participation and engagement initiatives.
- Participatory budgeting has the potential to strengthen inclusive governance.

Guideline 8: Allow and make the most of asymmetric decentralisation arrangements

- Asymmetric decentralisation should be supported by effective vertical and horizontal co-ordination mechanisms and needs to go hand in hand with an effective equalisation system. An asymmetric decentralisation approach should be based on dialogue, transparency and agreements between all main stakeholders, and be part of a broader strategy of territorial development.
- The way asymmetric responsibilities are allocated should be explicit, mutually understood and clear for all actors. To the greatest extent possible, participation in an asymmetric arrangement should remain voluntary.

Guideline 9: Consistently improve transparency, enhance data collection and strengthen performance monitoring

- National governments should develop performance-monitoring systems to monitor decentralisation and regional development policies: they need to remain simple with a reasonable number of requirements/indicators.
- Higher level governments need to monitor subnational performance in critical service areas based upon a minimum set of standardised indicators and provide timely feedback, as well as benchmark inter-local performance in service delivery.
- Subnational governments need to be subject to higher-level regulations and fiscal rules to ensure fiscal discipline and fiscal sustainability.

Guideline 10: Strengthen national regional development policies and equalisation systems and reduce territorial disparities

- The equalisation programme must not be looked at in isolation from the broader fiscal system, especially conditional transfers. Equalisation arrangements need to be carefully designed to promote the tax and development efforts of subnational governments. Fiscal equalisation policies need in particular to be accompanied by pro-active regional development policies to offset the potential negative incentives of such systems.

Reference

OECD-UCLG (2016), *Subnational Governments Around the World: Structure and Finance*, <http://www.oecd.org/regional/regional-policy/sngs-around-the-world.htm>.

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