

Chapter 5. Making decentralisation work: A handbook for policy-makers

This chapter is the “handbook” component of this report. This chapter presents ten guidelines on selected key issues of decentralisation to aid the policy-makers to implement decentralisation reforms, as decentralisation outcomes depend very much on the way the process is designed and implemented. Each subsection follows the same structure: in the beginning, the issue in question is described and the key international trends and the rationale of the theme are discussed. The sections then present examples of good practices and pitfalls to avoid. The examples presented cover both unitary and federal countries. Finally, the key recommendations for policymakers are presented. A checklist to help identify the main aspects of the issue linked to the guideline in question is also provided in the end of every section.

Decentralisation is not an end in itself but should be part of a broader strategy of territorial development. Decentralisation outcomes depend very much on the way the process is designed and implemented, on adequate subnational capacity and on the quality of multi-level governance, including efficient co-ordination mechanisms across levels of government. Overall, it should be remembered that decentralisation reforms tend to take time and the assignment of responsibilities needs to be periodically reviewed.

A pragmatic approach to decentralisation should be adopted, based on an in-depth analysis of political, social and economic conditions of the country. The challenge of designing decentralisation has sometimes been compared to a soufflé where all ingredients must be present in the right amounts and prepared in the right way at the right time to achieve success (Sharma, 2018^[1]; Parker, 1995^[2]). But ingredients are not enough. The cooking is essential. Even if a decentralisation reform is well designed, it can face implementation challenges due to its complex and systemic nature. Decentralisation may produce unexpected perverse effects and undesired outcomes, making adjustments and fine-tuning necessary. The best-laid plans can fail due to implementation difficulties. There is a long and difficult path between theory and practice and between plans and experience in the field, made of “potholes, detours and road closures” (Shah and Thompson, 2004^[3]). Decentralisation as *a process* must receive the attention it deserves.

Making the most of decentralisation for regional development is particularly crucial in the current context of the growing “geography of discontent” and the increasing divides between places that have felt left behind by globalisation and technological change and those that have been able to seize the opportunities offered by these. Dysfunctional decentralisation systems are part of the story behind the current crisis of democracies: it is thus critical to find ways to make decentralisation systems work in a more effective way.

Subnational governments are particularly well placed to design and implement relevant regional and local development strategies by identifying local comparative advantages and responding to people’s needs. This implies that they enjoy some capacity and flexibility to act and identify local comparative advantages and relevant development projects, including adequate responsibilities and resources.

Ten guidelines to help make decentralisation work have been identified.¹ They are further broken down into detailed recommendations, with practical guidance, pitfalls to avoid, good practices and a checklist for action, tailored to both federal and unitary countries.

Guideline 1: Clarify the responsibilities assigned to different government levels

Definition

- Transparent division of powers means that the responsibilities of various levels of government have been codified in significant detail in legal and regulatory frameworks, and/or intergovernmental agreements, traditions, etc., and are widely disseminated. Such codification would clarify each sub-function, the role of various levels of government in policy, legislation, standards, oversight, financing, provision/administration, production, distribution, performance monitoring, evaluation, citizen complaints, feedback and redress mechanisms.
- Principled division of powers means that the following well-known assignment principles and related considerations are taken into account:

- *Fiscal equivalency principle.* Political jurisdiction and taxing (revenue) and benefit (spending) areas should overlap, i.e. local services should be self-financed by each local jurisdiction to ensure local autonomy, accountability and fair burden sharing while eliminating free rider problems.
- *Correspondence principle.* The jurisdiction that determines the level of public provision of each public good should include precisely the set of individuals who consume the good.
- *Decentralisation theorem.* Each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalise benefits and costs of such provision.
- *Subsidiarity principle.* Taxing, spending and regulatory authority for any service should be vested in the lowest order of government unless a convincing case can be made for higher order assignment. Developing a convincing case to override subsidiarity would require combining economic, political, administrative, social, cultural and historical considerations to decide on a specific assignment. Note that application of these principles to individual circumstances yields unique country-specific results.
- *Balanced decentralisation principle.* Local and regional economic development requires integrated multi-sectoral, system-wide approaches. Balance in decentralised responsibilities should ensure that subnational governments are not hampered in their pursuit of improving economic and social outcomes by an ill-conceived, unbalanced division of powers.
- *Recognition of economies of scale and scope and inter-jurisdictional spillovers.* The assignment of functions needs to pay due consideration to economies of scale and economies of scope (appropriate bundling of local public services to improve efficiency through information and co-ordination economies, e.g. fire and ambulance services are better provided jointly) and to inter-jurisdictional spillovers to limit the free rider problem.
- *Asymmetric decentralisation principle.* To make decentralisation work, it is desirable that functional responsibilities be tailored to the local preferences and needs, demographic and geographic character (area, population size, topography, urban vs. rural, small towns vs. metropolitan areas, plains vs. mountainous region, agricultural vs. industrial towns, etc.) and fiscal capacity of local jurisdiction.
- *Stable assignments but subject to a review on a need basis.* Globalisation, the information revolution and a changing internal and external environment call for a periodic review of the assignment issues and for adaptation of the division of powers to a changing world and domestic orders. Institutions of executive and legislative federalism must be in place and empowered to address these issues on a need basis.

What are the key trends/data?

- Over the past several decades, there has been a persistent global trend towards decentralisation, at both the regional and municipal levels (with a few exceptions).

- Most responsibilities are shared among levels of government. The extent of responsibility sharing also depends on the service in question. For example, responsibilities tend to be shared more often in public transport than in childcare or elderly care (OECD, 2016^[4]). In most countries, due to the complexity of interactions in shared rule, many ambiguities in the assignment of responsibilities still remain.
- Given the diversity of regional and local governments in a country, a major trend in recent decades has been to tailor responsibilities to be consistent with local capacities, local circumstances, local needs and local preferences. These considerations have contributed to an increasing emphasis on an asymmetric assignment of responsibilities (Allain-Dupré, 2018^[5]).
- Shared responsibilities and division of powers require clarity with stability but an opportunity for a joint review on a need basis. Many OECD countries have continuously strived to improve clarity as well as to adapt to changing circumstances.

Rationale and benefits

- A principled and transparent division of powers is crucial for governments to deliver on their mandates and be held accountable by citizens. This is especially desirable for shared rule, i.e. when a function is the joint responsibility of several levels of government as is often the case in the provision of education, health and social welfare due to their redistributive nature. For preference matching and tailoring of programmes to specific local needs these services are best provided locally, but higher-order legislative frameworks and financing may be required for equitable provision.
- A lack of clarity in the division of powers for concurrent/shared responsibilities contributes to government failures or inefficiency and inequity in public service provision.
- A lack of clarity in responsibilities contributes to critical infrastructure needs not being addressed in a timely manner.
- Balanced decentralisation – i.e. when the various policy functions are decentralised to a similar extent – is conducive to growth. Balanced decentralisation allows subnational governments to better co-ordinate policy and to reap economies of scale and scope across functions (OECD, 2016^[4]).
- Citizen-based government accountability can only work if the citizens are well-informed about who is responsible for what and whom to approach to address their concerns about service quality or service failure.
- Clarity in the division of spending powers is critical for tax assignment and the design of higher order transfers to ensure consistency of revenue means with expenditure needs and other national objectives.
- Clarity in the division of power is critical to building subnational government capacities as well as instituting mechanisms for intergovernmental as well as beyond government partnership and co-ordination.

What are examples of good practices?

Federal countries

- Reasonably clear division of powers exists in the newer federal constitutions of Canada, Germany and Switzerland, backed by appropriate legislative and legal frameworks and intergovernmental agreements.
- In Switzerland, reforms over the 2004-08 period clarified federal and canton competencies and provided incentives and the mechanism for the formalisation of inter-canton co-operation agreements. Since 2008, Switzerland has further clarified federal and cantonal roles in specific policy areas and developed a new framework for inter-cantonal collaboration in order to avoid fragmentation and unproductive competition for schools and higher education, culture, waste management, wastewater treatment and urban transport.
- Following the 2011 intergovernmental agreement, Belgium has devolved additional responsibilities in employment, healthcare, social assistance for the elderly and disabled and family support and justice to the regions and communities.
- During the past decade, Germany transferred responsibilities in staff management, economic functions, and trade and justice to the lander and clarified the division of powers for university education and the environment. It also reformed intergovernmental fiscal relations. The German Bundesrat passed legislation in 2017 to terminate the current inter-state horizontal equalisation programme upon expiry in 2020, and to shift the responsibility for equalisation to federal goods and services tax (GST) revenue sharing and specific purpose programmes (Shah, 2017^[6]).
- In 2013, Austria established a Commission on Tasks and Deregulation to develop further clarity in the respective roles of various orders of government (OECD, 2017^[7]).

Quasi-federal countries

- In 2013, Spain adopted a reform to clarify municipal competencies and prevent duplication under the principle of “One Administration, One Competence”. The reform aims at reducing competencies which are not attributed by law or delegated by other administrations without adequate resources (known as “improper competencies”). The Local Reform intends to improve the definition of local competencies. To do so, a list of core competencies was established. Competencies which are not included in this list are referred to as “non-core competencies”. In the event of any agreements delegating competencies from upper levels of government – usually, the Autonomous Communities – to lower levels of government, it is compulsory to provide corresponding resources earmarked for financing the services involved.

Unitary countries

- In recent years, Denmark, Japan and the Netherlands have introduced reforms to clarify competencies of central and local governments and areas of intergovernmental co-operation.
- Denmark reformed its subnational government in 2007. The reform reassigned the tasks among levels of government, merged municipalities and reduced the number of intermediate governments (counties). As a result of the reform, counties were granted responsibility for the most demanding healthcare services, including hospital services. Municipalities gained responsibilities for health promotion, social welfare and education. One of the aims of the structural reform was to reduce the degree of shared assignments and reduce incentives for cost shifting between government levels. In order to tackle the latter problem, the municipalities were obliged to co-finance the rehabilitation services and training facilities provided by the counties.
- In Japan, the 1999 decentralisation law eliminated opaque central decision-making on local responsibilities and clarified competencies more generally. Subsequent waves of reform have continued to develop the goals of greater municipal autonomy, clear delineation of responsibilities, and proper financing.
- In the Netherlands, the Dutch decentralisation reform of 2012-15 aimed to reallocate competencies between the different levels of government, in particular by re-enforcing provincial and municipal responsibilities and by establishing a simpler and clearer division of responsibilities among the different public actors, avoiding the overlapping of functions.

What are the pitfalls to avoid/risks?

- For concurrent powers, a legal framework must establish which order of government has legislative supremacy in the event of a conflict. If multiple orders of government have exclusive jurisdiction in sub-areas of a function, for example, environmental impact assessment, then inter-governmental agreements must specify the precise processes to reach an agreement and to resolve conflicts in allowing projects to proceed. In the absence of such clarity, critically important projects may be unduly delayed or even abandoned.
- The separation of operating and capital expenditure functions contributes to catastrophic service failures by not having proper upkeep of critical infrastructure facilities or building infrastructure for which there is no financing for upkeep, i.e. creating white elephants.

What are the recommendations?

- Develop a framework of representative assignment of responsibilities based on assignment principles (Kim and Dougherty, 2018^[8]; Boadway and Shah, 2009^[9]). Use this as a starting point for developing an inter-governmental consensus for clarity in responsibilities (including sub-functions and major tasks) that is tailored to local circumstances and mutually acceptable and

agreeable to all orders of government. Given the predominance of shared rule especially between provincial/regional and municipal levels, in practice “[...] the question is not of a clear-cut allocation of responsibilities, but rather of how to manage shared functions and responsibilities”.

- 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.
- Ensure balance in the way different responsibilities and functions are decentralised. Balanced decentralisation, that is, when the various responsibilities are decentralised to a similar extent, is important to local economic development and growth (OECD, 2016_[4]). OECD work has shown that “infrastructure investment alone has little impact on regional growth unless it is associated with human capital (investment) and innovation” (OECD, 2014_[10]).
- It is important to ensure balance in the way various policy functions are decentralised, to allow for complementarities across decentralised policies and integrated policy packages, for effective territorial development approaches (OECD, 2014_[10]). Balanced decentralisation – i.e. when the various policy functions are decentralised to a similar extent – is conducive to growth (OECD, 2016_[4]).
- An effective regional or local development strategy requires a balance in the way policy areas are decentralised. If decentralisation only takes place in two or three policy areas (like health or housing) in an unbalanced way vis-à-vis other policy areas, this will prevent subnational governments from designing integrated regional and local development strategies.
- Within each function, the responsibilities should be balanced. For example, it is not recommended for one level to have an exclusive focus on operating functions. Within functions, if a level of government is involved in financing, it is recommended to have a balanced focus on operating versus capital expenditure, rather than a focus only on operating expenditure.
- Reform is “eternal”. Conduct periodic (e.g. every 10 years) joint reviews of the working of the whole of government, especially performance in service delivery, to seek further improvements in the existing assignment.
- For social services, consider devolving service delivery and network co-ordination responsibilities to local governments, especially in the case of redistribution. Central and regional governments, however, should retain responsibility for financing and setting national minimum standards to ensure equitable provision. Also, network co-ordination (including horizontal inter-municipal co-ordination) should be encouraged and rewarded by higher order governments. This is done in Finland.

- Strengthen institutions of executive and legislative federalism (inter-legislative and inter-governmental consultation and co-ordination) and ensure their functioning on a regular, pre-determined, as well as emergency, basis.
- For natural disasters consider empowering subnational governments to assume the lead role in co-ordinating the response to all orders of government and beyond government entities.

| Guideline 1. Clarify the responsibilities assigned to different government levels | | | |
|--|-----|-----------|----|
| Checklist | Yes | Partially | No |
| Legislative powers of various orders are clearly demarcated by: <ul style="list-style-type: none"> • Constitution • National legislation • Other (executive orders, agreements) • All of the above? | | | |
| For shared functions, is there clarity in the division of powers: <ul style="list-style-type: none"> • Who sets the policy • Who decides on the standards • Who is responsible for oversight • Who is responsible for financing • Who is responsible for service provision • Who produces the service • Who monitors and evaluates service delivery • How do citizens provide feedback | | | |
| For each of the shared functions and sub-functions, are there institutional mechanisms in place for: <ul style="list-style-type: none"> • Consultation/co-ordination • Burden sharing • Conflict resolution | | | |
| Sub-functions within each function are decentralised to a similar extent | | | |
| Subnational governments are empowered to pursue integrated approaches to local economic development | | | |
| There is a separation of decision making for capital and operating expenditures | | | |
| The authority to hire, fire and set terms of reference and day-to-day management/supervision for own employees rests at the same level for each function | | | |
| There a separation of decision making among various levels on planning, policy, finance and provision for each function | | | |

Guideline 2: Ensure that all responsibilities are sufficiently funded

Definition

- Jurisdictional fiscal equity requires that responsibilities for spending (expenditure needs) must be consistent with revenue means (own revenues, shared taxes and transfers) for each order of government to discharge its public service responsibilities consistent with its mandate.

What are the key trends/data?

- The alignment of responsibilities and revenues remains an area of concern in most countries. In most countries, subnational expenditure far exceeds subnational tax revenues indicating a vertical fiscal gap that is filled by other sources of revenue, i.e. non-tax revenues and transfers.
- In almost all OECD countries, spending is more decentralised than revenue. This is partly because central governments need more finances than their direct expenditure requirements to ensure equity and balanced development.
- The decentralisation of taxes on mobile bases can distort the allocation of mobile factors of production and can induce wasteful tax competition across subnational governments. This mismatch should be managed by equalisation and output-based transfers and sufficient revenue autonomy for decentralised taxes. In the absence of these, the national government may be inclined to use its spending power too intrusively and may be too heavy-handed in influencing subnational government priorities. Also, any negative changes in the national government fiscal situation may have adverse consequences for basic regional/local services. This misalignment represents an unmet challenge in many OECD and most developing countries.
- A rough indicator of mismatch of own revenues with expenditure needs is given by the vertical fiscal gap. A vertical fiscal gap refers to the fiscal deficiency arising from differences in expenditure needs and revenue means of local government. These deficiencies are partially or fully overcome by higher-level financing. Therefore, a vertical fiscal gap is a measure of fiscal dependence of local government on higher-level financing.
- The design and nature of higher-level financing have implications for the fiscal autonomy of local governments. It must be recognised that a vertical fiscal gap, while being a useful concept, cannot be considered in isolation. Also, other related indicators should be used in order to reach better judgement on local fiscal autonomy. In all regions, there are subnational governments with a high share of expenditures and high reliance on financing from above (e.g. Brazil, Ireland and Turkey).

Rationale and benefits

- Consistency between revenue-generating means with expenditure needs is conducive to political accountability and responsiveness to local preferences. This is especially so when revenue means are dominated by own or concurrent tax revenues.

- Shared taxes and unconditional and equalisation transfers are also helpful if they are stable and predictable.
- Conditional grants with input conditionality weaken incentives for local accountability and responsiveness to local preferences. The risk is somewhat reduced if most transfers are unconditional formula-based grants. Nevertheless, there are some cases where earmarked grants, especially output-based grants, can be used in an efficient way.

What are examples of good practices?

Federal countries

- In Canada, subnational governments have access to all the revenue sources, except customs duties. To encourage harmonisation of concurrent tax bases, the Federal Government of Canada has, in the past, offered tax abatement (reduction of federal rate to allow more room for provincial tax rates) and tax-base sharing (levying a supplementary rate on a uniform federal base) options to provincial governments while waiving cost of federal collection of the provincial share. More recently, it offered provinces and the private sector representation on the board of the autonomous tax collection agency.

Unitary countries

- In Sweden, the subnational financing system is mostly based on own-source revenues and the system provides a sound base of funding for all subnational governments, while also enabling autonomy in subnational decision-making (OECD, 2017^[11]).
- In Poland, the 2004 Act on Local Government Revenue modified the financing of subnational governments. They gained more financial autonomy with a decrease in the share of central transfers. The use of earmarked grants especially was reduced. At the same time, tax sharing on personal income tax (PIT) and corporate tax revenues was introduced (OECD, 2008^[12]; Regulski and Drozda, 2015^[13]).

What are the pitfalls to avoid/risks?

- Unfunded and underfunded higher-level mandates undermine local accountability and can endanger service provision.
- Conditional (earmarked) input-based transfers should be avoided because they weaken incentives for local accountability and responsiveness to local preferences.
- Fiscal equity may be undermined by significant tax decentralisation unless accompanied by fiscal equalisation transfers.
- Lack of clarity in responsibilities is a major contributing factor to misalignment of revenue means with expenditure needs.
- Redistribution should not be solely based on local financing because of the externalities involved.

- Business should be taxed only for services to business and not for redistributive services.
- Profit, output, sales and movable asset taxes may drive business out of the local jurisdiction. Therefore, business services should be mainly financed through onsite/land value taxes and user charges.
- Resource rent taxes should either be centralised and redistributed through a national fiscal equalisation system, or alternatively, if such taxes are decentralised then they should be accompanied by an inter-state (net) equalisation programme.

What are the recommendations?

- Access to finance should be consistent with functional responsibilities. The division of financing responsibilities should ensure that there are no unfunded or under-funded assignments or mandates.
- Higher-level mandates must be fully financed by the higher-order government.
- Taxes on immobile bases, resource royalties, conservation charges, payroll taxes, single stage sales taxes, sin taxes, taxes on “bads”, motor vehicle registration taxes, business taxes, excise taxes, land and property taxes, frontage charges, poll taxes and user charges are all suitable for subnational assignment (Table 5.1).
- In addition, subnational governments may be allowed to piggyback on national taxes on (residence-based) personal income, wealth and carbon taxes. Table 5.1 presents a representative view of tax assignment. However, this view requires adaptation to suit local circumstances, for instance, the extent of assigned responsibilities.
- The decentralisation of revenue-raising responsibilities should be accompanied by a system of equalisation of revenue-raising capacities designed to ensure that different subnational governments have the potential to finance a comparable level of public services at comparable tax rates (see Guideline 10).
- Specific purpose transfers should embody output-based conditionality.
- The formulae for determining central government transfers, grants and earmarked funds from the centre to lower levels of government should be transparent and non-discretionary.

Table 5.1. Representative tax assignment

| National | National/provincial | State/provincial | Local | All levels |
|------------------------|--------------------------------|-----------------------------|----------------------------------|--|
| Customs | Personal income | Single stage sales | Property | Sin taxes |
| Value-added tax | Taxes (residence-based) | taxes | Land | Taxation of "bads" (environmental pollution) |
| Corporate income tax | Payroll | Motor vehicle registrations | Betterment/frontage charges | Poll |
| Resource rents/profits | Excises on alcohol and tobacco | Business | Surcharge on personal income tax | User charges |
| Wealth/Inheritance | | Royalties | | |
| Carbon | | Conservation charges | Parking | |

Guideline 2. Ensure that all responsibilities are sufficiently funded

| Checklist | Yes | Partially | No |
|---|-----|-----------|----|
| There are no unfunded mandates <ul style="list-style-type: none"> • At the provincial/regional levels • At the local levels | | | |
| Some subnational governments do not fail to reach service standards | | | |
| There is a large variation in tax bases between subnational governments | | | |
| Equalisation transfers are in place <ul style="list-style-type: none"> • For cost equalisation • For revenue base equalisation | | | |
| The formulae for determining central government transfers, grants and earmarked funds from the centre to lower levels of government are transparent | | | |
| There are tax base sharing options available for residence base personal income taxes and carbon taxes <ul style="list-style-type: none"> • To provincial/regional governments • To local governments | | | |

Guideline 3: Strengthen subnational fiscal autonomy to enhance accountability

Definition

- *Fiscal autonomy* refers to the ability of a subnational government to undertake fiscal tasks (taxing, spending, debt raising and financing) without seeking approval/clearance/authorisation from another order of government. For taxing powers, it implies that the subnational government has the constitutional/legal/administrative authority to determine the rate and base of local revenue sources both for tax collection and administration and also for some higher-level revenues it is empowered to levy supplementary rates on a higher-level tax base.
- *Revenue autonomy* would be strong if own revenues more or less matched responsibilities, i.e. finance majority of own expenditures, and also if higher order transfers are predominantly formula-based and unconditional. In addition, subnational governments have the unconstrained opportunity to access the capital market to finance long-lived investments by issuing bonds or through borrowing.
- *Expenditure (spending) autonomy* refers to the independence of the subnational government in making sectoral allocation choices, deciding on the level and composition of spending on specific areas within their own responsibility, setting service standards, determining modes of production, distribution/delivery, local planning and procurement without making any reference to a higher order government.
- Subnational accountability refers to the subnational government being accountable primarily to own electorate for its decision making.
- The term “tax autonomy” captures various aspects of the freedom subnational governments have over their taxes. It encompasses features such as the subnational government’s right to introduce or to abolish a tax, to set tax rates, to define the tax base or to grant tax allowances or reliefs to individuals and firms (Table 5.2). In a number of countries, taxes are not assigned to one specific government level but shared between the central and subnational governments. Such tax sharing arrangements deny a single subnational government control on tax rates and bases, but collectively subnational governments may negotiate the sharing formula with the central government.

Table 5.2. OECD Rating Methodology for Taxing Power

| | |
|-----|--|
| a.1 | The recipient subnational government sets the tax rate and any tax reliefs without needing to consult a higher-level government. |
| a.2 | The recipient subnational government sets the rate and any reliefs after consulting a higher-level government. |
| b.1 | The recipient subnational government sets the tax rate, and a higher-level government does not set upper or lower limits on the rate chosen. |
| b.2 | The recipient subnational government sets the tax rate, and a higher-level government does set upper and/or lower limits on the rate chosen. |
| c.1 | The recipient subnational government sets tax reliefs – but it sets tax allowances only. |
| c.2 | The recipient subnational government sets tax reliefs – but it sets tax credits only. |
| c.3 | The recipient subnational government sets tax reliefs – and it sets both tax allowances and tax credits. |

| | |
|-----|--|
| d.1 | There is a tax-sharing arrangement in which the subnational governments (SNGs) determine the revenue split. |
| d.2 | There is a tax-sharing arrangement in which the revenue split can be changed only with the consent of SNGs. |
| d.3 | There is a tax-sharing arrangement in which the revenue split is determined in legislation, and where it may be changed unilaterally by a higher-level government, but less frequently than once a year. |
| d.4 | There is a tax-sharing arrangement in which the revenue split is determined annually by a higher-level government. |
| e | Other cases in which the central government sets the rate and base of the subnational government tax. |
| f | None of the above categories a, b, c, d or e applies. |

Note: This is the classification used in the data collection exercise but there may be a need for clarification in the future. For example, the sub-division of the “c” category cannot be applied to sales taxes (including VAT) where the concepts of allowances and credits (in the sense that they are used in income taxes) do not exist. Also, it may be more appropriate to qualify the definition of the “d.3” category by saying that the change is normally less frequent than once a year, as specific legal restrictions on frequency may not exist.

Source: OECD (n.d._[14]), *OECD Fiscal Decentralisation Database - OECD Network on Fiscal Relations across Levels of Government*, <http://www.oecd.org/media/oecdorg/directorates/centrefortaxpolicya ndadministration/A%20taxonomy%20of%20tax%20autonomy.doc>.

What are the key trends/data?

- Tax autonomy has increased slightly in OECD countries in recent decades. Since 1995, tax autonomy has increased, at the expense of tax-sharing systems (Blöchliger and Kim, 2016_[15]).
- The structure of subnational government revenue varies greatly across countries. Countries with the highest level of taxes (excluding social contributions) in their subnational revenues include Canada, Denmark, Finland, Germany, Iceland, Japan, Switzerland, Spain, Sweden and the United States. The share of tax revenue is not an indication of tax autonomy, which depends on many factors, such as the right to introduce or to abolish a tax, to set tax rates, to define the tax base or to grant tax allowances or relief to individuals and firms
- In OECD countries, local fiscal autonomy is fairly high, whereas such autonomy is lacking in most developing countries, especially in Africa and the Middle East regions.

Rationale and benefits

- Subnational governments work best when local residents self-finance local services through local taxes and charges (Geys, Heinemann and Kalb, 2010_[16]; Blöchliger and Kim, 2016_[15]). This enhances the efficiency and accountability of local service provision by encouraging local residents to evaluate the costs and benefits of local service provision, and benchmark local government performance against itself as well as with neighbouring jurisdictions. Such performance evaluation enhances voice and exit options for residents and facilitates both voting by ballot as well as voting with feet behaviours.
- This also facilitates yardstick competition, which encourages local politicians to maximise the welfare of local residents instead of promoting their own self-interested goals. An empirical study by Geys, Heinemann and Kalb using a broad panel of German municipalities demonstrates that local fiscal autonomy has a positive, significant effect on voter involvement which in turn has a positive significant impact on cost efficiency (2010_[16]).

*What are examples of good practices?**Federal countries*

- Canada, Switzerland and the US have a high degree of fiscal autonomy at the state and local levels. The Canadian Federal Government provides police services to smaller municipalities on a fee-based basis². Tax collection services are offered by Revenue Canada to provinces without fee if they agree to harmonise their tax base with the federal government, and provincial and private sector representatives serve on its governing board.

Unitary countries

- Denmark, Finland, Iceland, New Zealand and Sweden have a high degree of local fiscal autonomy. Examples of countries that have fairly recently enhanced subnational fiscal autonomy include the Netherlands, Poland and the UK (in a more modest sense).

What are the pitfalls to avoid/risks?

- Financing systems with a minor share of own-source funding should be avoided especially in the case of local public services. Self-financing and full fiscal autonomy is most desirable to finance municipal and economic services.
- Fiscal transparency is critical for local accountability. Local accountability works best in the presence of democratic political governance and citizen-voter activism but this requires that voters are fully informed about the government operations. Unclear systems with vague information should be avoided.
- For redistribution, a full or major share of local funding is not ideal without further measures because in these cases subnational governments do not necessarily take the externalities into account. Therefore, in the case of social services, subnational governments should be given autonomy in local design and delivery of services, but financing and minimum standard setting by higher levels would be desirable in the interest of equity in service provision due to varying fiscal capacities of subnational governments.
- Very loose fiscal rules can be problematic especially if central government transfers form a major share of funding for subnational governments. Therefore, for subnational government borrowing, a higher-order regulatory framework to deal with bankruptcy and insolvency issues, as well fiscal rules for fiscal discipline, is desirable to minimise fiscal risks and to restrain imprudent fiscal behaviours.

What are the recommendations?

- 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.
- It is important for subnational governments to have a balanced system based on a basket of revenues. Subnational governments should have a diversified

funding system based on grants (for delegated functions), tax revenues, tariffs and fees, and property income. Tax revenues should be a mix of shared and own-source taxes, including a minimum level of own-source taxes in particular to finance exclusive responsibilities. A higher own-tax share may contribute to making subnational governments more efficient and accountable and help mobilise resources at the state/regional and local levels.

- Subnational governments should be able to co-ordinate services provided by all orders of government in their jurisdiction and private and non-profit interest-based networks in the local area.
- Central government should retain control at least over major tax bases such as personal and corporate income tax (PIT and CIT). Since the central government is responsible for economic stability and for redistribution, the central government should be able to co-ordinate tax policy.
- Subnational governments should be encouraged to enter into partnership arrangements for service delivery to reap economies of scale and scope with other governments and beyond government providers. Subnational governments should be empowered to contract out some services for a fee to other governments and beyond government providers.

Guideline 3. Strengthen subnational fiscal autonomy to enhance accountability

| Checklist | Yes | Partially | No |
|---|-----|-----------|----|
| On tax bases assigned to them, subnational governments have autonomy to: <ul style="list-style-type: none"> • Set revenue bases • Set tax rate • Be responsible for tax collection • Set supplementary rates on higher order bases • Set user charges/fees for own services | | | |
| Subnational government own revenues finance a large share of their expenditures | | | |
| Higher order transfers are mostly: <ul style="list-style-type: none"> • Formula based • Unconditional • Stable • Predictable | | | |
| Subnational governments have the freedom to access capital market finance: <ul style="list-style-type: none"> • Borrowing for long term infrastructure projects • Issue bonds | | | |
| Subnational governments have the autonomy: <ul style="list-style-type: none"> • To decide on sectoral allocations • To decide on level and composition of spending on any category of own service • To set service standards depending on service • To choose modes of production (outsourcing, own production, co-production) • To decide on procurement within limits set by central governments • To decide on local planning taking into account regional and national planning strategies • To enter into co-operation agreements with governments and beyond governments | | | |

Guideline 4: Support subnational capacity building

Definition

- A subnational government's capacity refers to its ability to perform its mandatory functions effectively, efficiently and sustainably. It refers to a subnational government's constitutional/legal/traditional empowerment, resources, competencies, skills and organisation as a whole, its ability to undertake collective action and create and sustain public value.
- Administrative capacity refers to the ability of a subnational government to deliver its mission/mandate in an efficient, fair, accountable, incorruptible and responsive manner. It entails the subnational government having the: i) ability to deliver high quality services in an efficient and equitable manner; ii) ability to hire, fire and set terms of employment of own employees; iii) capacity to co-ordinate or co-deliver policies and programmes with other governments (horizontally and vertically) and beyond government stakeholders; iv) wherewithal to carry out prudent fiscal and financial management with a high degree of transparency; and v) ability to audit and evaluate own services.
- Institutional capacity refers to having an effective legislative, executive, intergovernmental and beyond-government partnership and co-ordination, audit, evaluation and citizen feedback institutions in place.
- Strategic capacity refers to the ability to set strategic goals for social, political and economic outcomes and having the administrative and institutional capacity to realise those goals within the stated time frame.
- Financial management capacity refers to the ability of subnational governments to ensure the effective use of internal and external resources with integrity. This includes cash management, transparent procurement processes to mitigate corruption, ability to decide on how and when to use debt, how to assess debt affordability, what debt to use, how to issue and how to manage debt, how to use internal controls and internal and external audits to ensure efficiency and integrity.

What are the key trends/data?

- Decentralisation reforms have enhanced the relative importance of subnational governments in the finance and delivery of public sector programmes. To perform the newly assigned tasks more efficiently, there is increasing emphasis placed on enhancing subnational government capacity to meet newer challenges. While subnational governments strive to meet these challenges, they face formidable obstacles in view of resource constraints or deficient capacity more generally.
- A survey conducted by the OECD and the EU Committee of the Regions in 2015 indicates that subnational government capacities vary enormously within countries in all countries surveyed and are not consistent with their responsibilities. Smaller municipalities are hampered by having an inadequate pool of managerial and technical talent and service providers. Larger municipalities, on the other hand, face complex transport, urban

planning and infrastructure tasks and do not have the workforce skills to address these tasks effectively.

Rationale and benefits

- Administrative, institutional and strategic capacity is critical to the working of a (subnational) government. This is especially critical for regional development strategies that require substantial citizen input and co-ordination across and beyond governments.
- Uniform service delivery requirements by all local governments pose additional bottlenecks if some local governments do not have the capacity or local priority to meet these requirements. In the presence of heterogeneous capacities, competitive grants, capital market finance and Public Private Partnerships (PPPs) compound the difficulties for deficient capacity in local governments, especially among rural local governments, and can contribute to wider local inequalities.

What are the examples of good practices?

Federal countries

- In US, the National League of Cities (NLC), a voluntary organisation of municipalities, has established an NLC University to impart online and face-to-face training in municipal governance. It also produces toolkits and other training materials of use to municipal leaders and officials. In Canada, the Federation of Canadian Municipalities (FCM) plays a similar capacity development role.
- In Switzerland, Regiosuisse is the network unit for regional development. It was launched in 2008 by the State Secretariat for Economic Affairs (SECO) as an accompanying measure for the implementation of the New Regional Policy (NRP), and it supports SECO in the policy's implementation at the state, cantonal and regional levels. This is done by providing systematic knowledge management, opportunities for networking and further education. The main task of Regiosuisse is to build up knowledge management for the NRP and regional development in general. Regiosuisse maintains and continuously develops a set of interrelated tools for knowledge management.

Unitary countries

- In 2007, Chile created the *Academia de Capacitación Municipal y Regional* to strengthen subnational capacities. It aims to be a technical reference for subnational staff and to strengthen human resources in municipal and regional governments to support a broad spectrum of knowledge of use in various territorial situations. It provides free training, in-person and online training for public servants. In addition, a Fund for the Training of Municipal Public Servants was created in 2014, financing technical and professional studies for municipal personnel (OECD, 2017^[7]).
- In Colombia, KiTerritorial is a toolkit developed by the Department of National Planning (DNP) that offers specific instruments to support local leaders in the formulation of their territorial development plans (PDT). The

toolkit is organised around four pillars of operation that local governments should follow when developing their PDTs: i) diagnosis; ii) strategy; iii) investment plan; iv) monitoring and evaluation. The DNP has also developed an index of institutional capacity in municipalities, which permits measuring municipal performance along four dimensions: effectiveness, efficiency, compliance with legal requirements and management. Indices are published annually, contributing to the enhancement of accountability to citizens (OECD, 2016_[17]).

- The European Union has strengthened its focus on administrative capacity for the use of funds for 2014-20. EU countries are required to set performance criteria, clearly define responsibility, separate managing and auditing functions, and ensure stability and qualifications of staff. Almost EUR 4.3 billion will be allocated to building additional institutional capacity for public authorities and increasing the efficiency of public administration and services (an increase of 72% compared to 2007-13). For the post-2020 financial period, the European Commission is proposing that member countries be required to develop roadmaps of actions planned to reinforce administrative capacities for the management of EU funds, notably targeting subnational governments.

What are the pitfalls to avoid/risks?

- One size does not fit all. Capacity development programmes must be tailored to the needs of individual local government units based upon a careful assessment of local needs.
- Capacity should not be seen as a constraint to get the government right, i.e. having a principled and transparent division of powers across governments. Bottlenecks in capacity can be overcome with time whereas in the short run such capacity gaps could be filled through borrowing/contracting capacity from associations of subnational governments, higher orders of government or the private sector, for example.
- Capacity-building programmes often lack a long-term dimension. Building and strengthening subnational capacities is a long-term commitment which requires sustained resources and political commitment from both subnational and central/federal government levels.
- Capacity building programmes are often too narrow, focusing on training and technical assistance, without a comprehensive diagnosis of the different dimensions involved.

What are the recommendations?

- Governments should seek to reinforce the capacities of public officials and institutions with a systemic approach, rather than adopting a narrow focus on technical assistance only.
- Central government should assess capacity challenges in the different regions on a regular basis and adapt policies to strengthen capacities to deal with the various needs of territories.

- Staff training should be established that covers local public financial management and it should be mandatory that relevant staff pass this training. Institute mandatory training for budgeting department staff in budget methods, budget formulation, budget execution, revenue analysis, as well as strategic planning.
- Distribute formal/standardised guidance documents in areas such as planning, project appraisal, procurement, or monitoring and evaluation is very cost-effective.
- Promote open, competitive hiring and merit-based promotion as well as policies, such as special pay scales for areas of needed technical expertise.
- Creating special public agencies accessible to multiple jurisdictions in areas of needed expertise helps support subnational capacities (e.g. PPP units, regional development agencies).

Guideline 4. Support Subnational Capacity-building

| Checklist | Yes | Partially | No |
|--|-----|-----------|----|
| Subnational governments have the administrative capacity to: <ul style="list-style-type: none"> • Prepare physical and financial plans and to evaluate alternative plans • Develop and implement appropriate policies • Develop regulatory and legal frameworks • Develop and manage partnerships • Co-ordinate the activities of multiple stakeholders • Prepare own budgets • Determine revenue requirements for budgetary balance and raise any additional revenues • Determine own capital financing needs • Access capital market finance on a need basis • Determine staffing needs • Develop a human resource management framework • Facilitate alternative service delivery mechanisms • Carry out internal controls and internal audits • Ensure integrity and transparency of procurement processes • Carry out periodic evaluation of own programs | | | |
| Subnational governments have the strategic capacity to: <ul style="list-style-type: none"> • Develop strategic plans for local and regional economic development • Set realistic objectives and goals | | | |
| Subnational governments have the financial management capacity to: <ul style="list-style-type: none"> • Decide on better practices for financial accounting and reporting • Issuing and managing debt | | | |

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

Definition

- To make multi-level governance work, a dense network of national/regional/local political and bureaucratic interactions, especially for shared rule, becomes a necessity. This requires developing formal and informal, vertical and horizontal mechanisms and processes of inter-governmental consultation, co-ordination, co-operation and joint decision-making. This should also involve senior policymakers and officials, i.e. the so-called inter-governmental fora and legislative consultation through inter-legislative fora. The interactions through these fora can be co-operative and consultative, or in some cases coercive, depending upon the power relations among the various orders of government in a country.

What are the key trends/data?

- Although challenges remain numerous, a number of OECD countries – in particular, federal countries and Nordic countries – have made progress toward better vertical co-ordination among levels of government (OECD, 2019 forthcoming^[18]).
- Platforms for vertical co-ordination have been established in several OECD member states, in particular, federal countries. Eleven OECD countries have put co-ordination structures in place. These are often related to environment, infrastructure, transport, technology and development. In 14 countries, the national government needs to consult subnational governments prior to issuing new regulations (OECD, 2017^[19]).
- The 2007-08 financial crisis spurred investment in both ad hoc and permanent bodies for horizontal and vertical co-ordination in several countries, though in some cases only at the intermediate level. Fiscal councils and internal stability pacts have been used since the crisis to strengthen multi-level fiscal co-ordination in macroeconomic management. Austria, Belgium, Brazil, Germany, Italy, Portugal and Spain, have all strengthened or expanded these institutions in recent years (OECD, 2017^[19]).
- Standing commissions and intergovernmental consultation boards that create a permanent conduit for co-operation and communication across parties and levels of government can facilitate reform when the time comes, despite their expense and the time needed to establish them. Creating a culture of co-operation and regular communication is crucial for effective multi-level governance and long-term reform success.
- Among 15 dimensions of institutional quality for efficient public investment management, central-local co-ordination is the dimension where advanced economies tend to fare the worst (IMF, 2015^[20]).

Rationale and benefits

- Multi-level governance implies managing mutual dependence among levels of government, and a series of gaps or co-ordination failures that may occur among them (OECD, 2014^[10]; 2013^[21]; Charbit and Michalun, 2009^[22]). Such

co-ordination failures may be overcome by governance tools such as dialogue platforms, partnerships/contracts across levels of government, co-financing arrangements, etc.

- Inter-governmental fora hold the potential to improve the working of multi-order systems with relatively low transaction costs by reaching executive/legislative agreements. However, to ensure the durability and wider political acceptance of such compacts, especially those on issues of constitutional significance, such compacts must be subjected to ratification by concerned legislatures and also be open to review.
- Some mutually dependent conditions can facilitate an effective dialogue among levels of government: simplicity of information and feedback, transparency of rules; transversal engagement, credibility, ownership.
- Countries with well-developed co-ordination arrangements, such as inter-governmental committees and regular formal meetings, have a comparative advantage for the introduction and implementation of reforms (OECD, 2017^[19]; 2013^[21]).

What are examples of good practices?

Federal countries

- In Australia, the Council of Australian Governments (COAG), established in 1992, is the peak intergovernmental forum with representation from all orders of government. The role of COAG is to initiate, develop and monitor the implementation of policy reforms that are of national significance and which require co-operative action by Australian governments (for example, health, education and training, Indigenous reform, early childhood development, housing, microeconomic reform, climate change and energy, water reform and natural disaster arrangements). Issues may arise from: ministerial council deliberations; international treaties, which affect the states and territories; or major initiatives of one government (particularly the Australian Government) that affect or require the co-operation of other governments. COAG meets on a needs basis but usually once every quarter. The outcomes of COAG meetings are contained in memoranda released at the end of each meeting. When formal agreements are reached, these may be embodied in intergovernmental agreements.
- In 1971, Austria's Federal Chancellery and the *länder* established the Austrian Conference on Spatial Planning (*Österreichische Raumordnungsconferenz*, ÖROK) as a common platform of spatial planning co-ordination involving all federal ministries, the *länder*, and the umbrella associations of municipalities and social partners. Today, the ÖROK operates as a central network interface for regional policies and the EU's Structural Funds programmes in Austria. Its executive body is chaired by the federal chancellor and includes all federal ministers and state governors, the presidents of the Austrian Union of Towns and the Austrian Union of Communities and the presidents of the social and economic partners as advisors. Decisions are consensus-based. Thematic committees and working groups, formed by senior officials of the territorial authorities and social and

economic partners, were set up at the administrative level to carry out ÖROK's tasks and projects.

- In Germany, an integrated or co-operative model of federalism has been adopted where the federal government has pre-eminence in legislation³ and policymaking, and *länder* governments, in collaboration with local governments, have the responsibility to implement these policies. Executive federalism is therefore of absolute necessity in making federalism work in Germany. Recognising this, Germany has developed a dense inter-governmental network. The chancellor and the leaders of the 16 *lander* governments, *Ministerpräsidenten*, meet periodically to agree on major issues, such as tax sharing and fiscal equalisation, and the implementation of federal laws. These meetings are supported by the Conferences of the Ministers of Economics and ministers in all functional areas and Meetings of High Officials of relevant ministries. Originally, these meetings were part of the constitutionally mandated process of “joint tasks (ventures)”. The 2006 constitutional reforms eliminated this requirement, but the dense network of formal and informal federal-lander contacts continues to grow due to the integrated nature of German federalism (Lhotta and von Blumental, 2010_[23]).

Unitary countries

- In France, territorial strategies are formalised as contractual arrangements across levels of government through state-region planning contracts (*contrat de plan État-région*) that stipulate co-decision and co-financing of interventions.
- In Italy, three separate conferences – state-regions, state and local governments, and state-regions-local governments – serve as the inter-governmental fora.
- Denmark, Finland, Norway and Sweden have regular meetings of central and local governments (through their associations of local governments) to discuss policy and implementation issues. Finland offers financial incentives for inter-municipal co-operation for service delivery.
- In 2015, Portugal established the Council for Territorial Dialogue chaired by the prime minister, and with the representation of central and local governments, in order to facilitate continuing dialogue on important policy and programme issues. Beyond permanent fora of inter-governmental consultation, ad hoc committees and commissions also serve to facilitate intergovernmental and civil society dialogue on some intractable issues.
- The Local Government Commission in New Zealand is an independent, permanent body for inquiry into local reform created by the Local Government Act in 2002 specifically with the aim of building a relationship across party lines in the context of multi-level governance needs (OECD, 2017_[19]).

What are the pitfalls to avoid?

- It is important to avoid multiplying co-ordination mechanisms with no clear role in the decision-making process and with important transaction/opportunity costs.
- An open and transparent system of inter-governmental co-ordination with broad legislative and civil society participation is likely to be expensive, time-consuming and may result in gridlock and/or a “joint decision trap”, while increasing transaction costs for principals (citizens).
- In countries where the upper house of the parliament sees itself as a prime institution of inter-governmental co-ordination (e.g. France and Germany), there may be some political resistance to inter-governmental fora.

What are the recommendations?

- Since most responsibilities are shared, it is crucial to establish governance mechanisms to manage those joint responsibilities. Creating a culture of co-operation and regular communication is crucial for effective multi-level governance and long-term reform success. Such tools for vertical co-ordination include dialogue platforms, fiscal councils, contractual arrangements, standing commissions and inter-governmental consultation boards.
- Formal instruments (e.g. contracts for regional development) are helpful to build trust between parties and provide a long-term perspective.
- It is important to avoid unilateral decisions without consultation as this undermines trust and to find the right balance between top-down and bottom-up approaches.
- Intergovernmental fora (IGF/ILF) have the potential to help clarify, co-ordinate, and develop reform options, joint provision or partnership arrangements for tax, expenditure, revenue sharing and transfers, public services delivery and regulatory policies.
- Inter-governmental fora can be used to facilitate: i) clearer division of powers among various orders of government so that there could be more complete contracts of citizens with each order of government; ii) facilitate greater access to information by citizens, interested sectors of civil society and legislators, enabling them to better hold those agents to account; iii) minimise transaction costs associated with participation, monitoring and decision making, agency costs (i.e. costs incurred by principals and other agents to ensure that agents involved act faithfully in serving their mandates), and uncertainty costs; and iv) create an incentive structure for both the legislative and administrative agents to comply with their compact with the citizens (principals).

| Guideline 5. Build adequate co-ordination mechanisms across levels of government | | | |
|--|-----|-----------|----|
| Checklist | Yes | Partially | No |
| <p>There are formal institutions of vertical co-ordination among national, regional and local governments. If yes, are these mandated by the:</p> <ul style="list-style-type: none"> ● Constitution ● National legislation ● Executive order? | | | |
| <p>The mandates of these institutions are:</p> <ul style="list-style-type: none"> ● Specifically stated ● Broadly specified in terms of objectives <p>There are separate institutions of vertical co-ordination for central and line/sectoral ministries? If yes:</p> <ul style="list-style-type: none"> ● Are there mechanisms for feedback of sectoral ministries into central agency decision making and vice versa? <p>Are these institutions mandated to meet?</p> <ul style="list-style-type: none"> ● On a regular basis ● On a need basis only <p>Are agreements reached at these meeting?</p> <ul style="list-style-type: none"> ● Disseminated to the public ● Monitored for implementation compliance <p>Are the following tools used for facilitating vertical co-ordination?</p> <ul style="list-style-type: none"> ● Conditional transfers ● Partnership agreements ● Formal contracts ● National and regional directives ● Monitoring using indicators for service outcomes ● <i>Ex ante</i> and <i>ex post</i> analysis | | | |
| Does central government have the capacity to set guidelines, monitor the outcomes and alter policies if problems occur? | | | |
| Is higher-level government actively engaged in the co-ordination institutions? | | | |

Guideline 6: Support cross-jurisdictional co-operation

Definition

- Cross-jurisdictional co-ordination can take a variety of forms, with the appropriate approach depending on the characteristics of the locality or region as well as the policy objectives and investment(s) being considered. At one end of the spectrum are integration arrangements, such as municipal or regional mergers, which can include the creation of a metropolitan government by merging multiple municipalities. However, economies of scale and thus “optimal size” can vary by investment, such as in transport, education and sanitation. Decisions to merge should be based on a comprehensive assessment of a variety of factors, not only particular investments.
- More flexible co-ordination arrangements may be best suited to achieving policy goals or to making the most of particular investments. These include establishing joint authorities, co-ordinated investment strategies, polycentric co-operation in urban areas, rural-urban partnerships, trans-border co-operation and platforms for cross-jurisdictional dialogue and co-operation
- It is essential to encourage subnational horizontal co-ordination for effective public service delivery and investment in the presence of positive spillovers, to increase efficiency through economies of scale, and to enhance synergies among policies of neighbouring (or otherwise linked) jurisdictions.
- Co-operation is important for physical infrastructure provision where the efficient scale often exceeds the boundaries of individual regions or localities, and for investments in human capital development and innovation where administrative and functional boundaries may not coincide. Horizontal co-operation is important also for subnational public service delivery, especially in the case of small subnational governments with limited resources.
- The central government has an important role in making sure that major externalities are internalised, and that services are provided at an adequate scale. The central government can encourage voluntary horizontal co-operation with a transfer system or it can simply target matching grants to specific projects to ensure efficient scale of local public investments or service provision. Subnational governments may also have an incentive to co-operate without central government intervention, especially if subnational governments fund a major share of service provision from own source revenues and if services are steered with strong normative regulations. To keep costs in control, subnational governments can actively seek co-operative arrangements.
- Rural-urban partnerships are a form of co-operation in functional areas. The partnerships cover a territory with rural and urban areas connected by one or more functional linkages (e.g. value chains, commuting, natural resources, etc.). These linkages form the basis for a co-operative partnership, which in turn manages these linkages for different possible purposes (e.g. supply chains, territorial branding, service delivery, environment protection, etc.). Benefits include the production of public goods, accounting for negative

externalities, achieving greater economies of scale, overcoming co-ordination failures and strengthening capacity.

What are the key trends/data?

- As a result of merger reforms, the number of municipalities and regions has been declining in many countries. Merger reforms usually also decrease inter-municipal or inter-regional co-operation because the size of subnational government units is increasing and so the need for co-operation is decreasing. During the past decades, municipal merger reforms have been carried out, for instance, in Denmark, Finland, Ireland, Japan, the Netherlands and Sweden.
- In parallel, reforms enhancing co-operation between subnational government units are increasingly popular in many countries, including Italy, Poland and the United Kingdom. The reforms apply not only to municipal levels but also to intermediate levels, such as in Italy.
- The number of metropolitan governance authorities has increased during the past decades. Often, the aim has been to find governance solutions that would better take into account the evolved functional areas in metropolitan regions, i.e. the mismatch between existing administrative borders and current activities in the metropolitan areas.
- Yet another trend is regionalisation, resulting in the creation (or strengthening) of an autonomous regional level and up-scaling of existing regions and/or their institutional reinforcement. Regionalisation reforms have been carried out for instance in France, Greece, the Netherlands, Spain, Sweden and the UK.

Rationale and benefits

- Inter-municipal co-operation allows municipalities to internalise externalities in the management of the services and to benefit from economies of scale for utility services (e.g. water, waste, energy), transport infrastructure and telecommunication. Services may be shared as well: back office and administrative functions (e.g. payroll, finance, compliance and control activities, etc.), telecommunications and information technology, environmental services and parks maintenance, joint procurement, frontline services such as customer services, etc.
- At the same time, inter-municipal co-operation allows municipalities to retain their identity and those functions that either do not require a larger scale of production or do not affect neighbouring municipalities.
- One important motivation behind the abovementioned reforms has been the financial crisis, which has put pressure on governments to find ways to improve territorial structure and to find efficiency gains through economy of scales. The reforms also target reducing municipal fragmentation.
- Inter-municipal co-operation allows local governments to invest at the right scale, leads to better and more diverse local services and improved processing times, supports the adoption of innovative, high-tech and specialised services (e.g. through the application of shared technologies) and finally leads to improvements in staff performance and access to expertise,

especially in remote locations that experience skills shortages. Shared services arrangements are well-developed in countries such as Australia, Ireland, New Zealand and the United Kingdom. France is the only OECD country that has given own-source taxing power to inter-municipal entities.

What are examples of good practices?

- Inter-municipal co-operation arrangements are well developed in the OECD and also extremely diverse, varying in the degree of co-operation, from the softest (single or multi-purpose co-operative agreements) to the strongest form of integration (supra-municipal authorities with delegated functions and even taxing powers). Other shared services arrangements are common in countries such as Australia, Ireland, New Zealand and the United Kingdom.
- In addition, it often happens that one municipality adheres to several inter-municipal groupings, and the size of these groupings may vary from two to dozens of municipalities, covering regional scales.

Federal countries

- Institutions of horizontal co-ordination serve as a check on federal powers and are fast becoming an important institution of horizontal co-operation in most federal countries.
- In 2006, the Australian States established the Council of the Australian Federation (COAF) for horizontal co-ordination among states, harmonisation of policies and influencing national policies (Philimore, 2010^[24]).
- In Canada, the Council of the Federation comprising provincial and territorial premiers was established in 2003. It formalised the Annual Premiers Conferences (APC) that had previously served as an informal venue for horizontal co-ordination. The APC aims to develop and present common Provincial/Territorial positions in their dealings with the federal government, and to facilitate collaboration between Provinces and Territories in their own areas of jurisdiction.
- Germany has a long tradition of inter-*länder* co-ordination to achieve “uniform” (now “equivalent”) living conditions in areas of exclusive *länder* competency and to have *länder* inputs in European Union policymaking. These consultations take place through the Conferences of Lander Ministers, which are held regularly and also attended by federal ministers as observers. There are regular meetings of officials and experts to learn from each other’s experiences.

Unitary countries

- Several countries use grants and other financial incentives to encourage horizontal partnership in service delivery. In France, inter-municipal co-operative units can also have their own sources of tax revenue. Local government co-operation and issue/task specific committees serve important channels of horizontal co-ordination.
- In Finland, the single-tier subnational government level is formed by 320 municipalities. Finnish municipalities are often too small to provide

health, secondary education or social services by themselves. Therefore, voluntary inter-municipal co-operation is very common. The most common way to organise co-operation is the joint municipal authority, which is a legal entity, financed by member municipalities and led by a board assigned by member municipalities. Joint municipal authorities are not subject to central government transfers. While in general inter-municipal co-operation is voluntary, municipalities are obliged to form a joint municipal authority for specialised healthcare (hospitals) and regional planning. Although in recent years there have been voluntary municipal merger reforms, inter-municipal co-operation is still common as it has enabled utilising economies of scale especially in rural and sparsely populated areas. Inter-municipal co-operation has allowed municipalities to focus on tasks that best suit their capacities. In recent years, the trend has been to form even larger co-operative units, which are able to integrate all health and social services in order to utilise both economies of scale and scope. Some municipalities have also outsourced health and social service production to private companies with long-term contracts.

What are the pitfalls to avoid/risks?

- Co-ordination does not come without costs. Encouraging inter-municipal or inter-regional co-operation and municipal mergers with cash transfers or other financial incentives can be expensive and lead to inefficient structures without thoughtful planning of measures.
- Inter-municipal or inter-regional co-operation may lead to a democratic deficit if the decision-makers of co-operative organisations are nominated by the member organisations instead of elected by the local resident. Such governance models can be unclear for citizens and lead to accountability problems especially if the decision-makers are self-interested.
- Comprehensive metropolitan governance models can be politically and administratively hard to achieve. As a result, metropolitan governance may be limited to certain core competencies. This can lead to organisational and administrative silos, which can be hard to govern efficiently.

What are the recommendations?

- Horizontal co-ordination can be carried out using specific matching grants, with inter-municipal and inter-regional co-operation, or mergers of subnational government units. The legal system should allow such tools.
- Co-ordination measures should be based on high-quality information on externalities, economies of scale, local democracy aspects and efficiency differences in service delivery. Information used in decision-making should be based on research and databases that describe subnational government service production from coverage, quality and efficiency aspects.
- Voluntary co-operation and mergers could be encouraged with temporary grants that cover part of the cost for setting up such arrangements. The main incentive for co-operation and mergers should be the expected efficiency improvement and better quality of services, not the financial support from the higher level of government.

- If a forced merger or co-operation reforms are adopted, decisions should be based on a national reform plan of subnational government structure. The resulting multi-level structure should support the overall fiscal policy targets.
- Matching rates should be based on the size of externalities. Too high a matching rate can easily lead to overspending. Low matching rates will benefit only the wealthiest subnational governments, especially if the revenue equalisation system is weak or non-existent.
- In all cases, formal and informal negotiation frameworks should be established for continuous dialogue between subnational and central government representatives. The dialogue should be arranged periodically to discuss the service level and quality targets, subnational government financing, and current and planned reforms. Systematic negotiations between the central government and subnational governments help promote co-operative arrangements and enable more co-ordinated actions.
- 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 6. Support cross-jurisdictional co-operation | | | |
|--|-----|-----------|----|
| Checklist | Yes | Partially | No |
| There are formal institutions of horizontal co-ordination: <ul style="list-style-type: none"> • Among regions • Among local/municipal governments There are formal mechanisms or incentives to encourage co-ordinated response. If so, by: <ul style="list-style-type: none"> • Regions • Municipalities • Municipality and its stakeholders (private for profit, non-profit, etc.) | | | |
| The legal system allows co-operation and mergers between subnational governments | | | |
| There is readily available information of externalities and economies of scale in subnational government service provision and investments | | | |
| There is a national reform plan of optimal subnational government structure, and horizontal co-ordination is based on such plan | | | |
| Functional regions are identified and used in investment policy | | | |
| There are publicly available indicators on public service production, service coverage, needs, quality and efficiency | | | |
| There is a nationwide plan for metropolitan policy, based on functional areas | | | |
| There are regional and national dialogue frameworks in place for metropolitan area development | | | |
| Urban-rural partnerships are enabled | | | |
| Financial support and incentives are established for planning and executing reforms on metropolitan governance | | | |
| Systems are transparent and rules are clearly communicated to citizens | | | |
| Co-operative bodies are led by decision-makers who are elected by local residents or they are otherwise made responsible to residents they serve | | | |
| Efficiency benchmarking is carried out periodically and data of such analysis is openly available | | | |

Guideline 7: Strengthen innovative and experimental governance, and promote citizen engagement

Definition

- Participatory governance (at the subnational level) refers to approaches to local public governance that facilitate the participation and engagement of private citizens and other stakeholders (e.g. private for-profit, private non-profit, interest-based or hope/faith-based networks, self-help groups, etc.) in deliberations on public policy choices and the delivery of local public services in partnership or in competition with the formal public sector.
- There is a diverse range of approaches to building participatory governance. These include a focus on transparency, for example using open government methods such as open and competitive procurement, performance budgeting, maximum disclosure, citizens right to know, and citizen-centric or participatory governance, using such tools as participatory planning and budgeting, civil society performance monitoring, social audits, direct democracy provisions (e.g. referenda on major initiatives/projects, recall of officials for dereliction of duty). Innovations in accountable and responsive governance is another mechanism and can promote local government as a facilitator of network governance to improve economic and social outcomes. Client/citizen charters and new public management approaches are another means to support participation through result-based management to government accountability, e-government/ information and communications technology (ICT) innovations, and pilot projects with a potential for regional or nationwide replication to improve service delivery.

What are the key trends/data?

- Overall, local governments around the world are often the leaders in innovations that aim to ensure government works better, costs less and is more responsive and accountable to local residents.
- Subnational governments strive to introduce experiments that aim to inform and engage citizens, such as performance budgeting and open government initiatives. These are undertaken by some US local governments. Participatory planning and budgeting, initially as introduced by local governments in Brazil and a few other Latin American countries as well as the Republic of South Africa, have now extended to many other parts of the world. Other examples include social audits and citizen scorecards as used in India, direct democracy provisions as practised in Switzerland and the United States, innovations in internal and external government accountability such as the results-based management and competitive provision of local public services in New Zealand, and local government as a facilitator of network governance as practised in Vancouver, British Columbia, Canada.
- Empirical evidence on the impact of citizen engagement on local governance is scant. Broader citizen engagement in local government affairs remains an unmet challenge even in OECD countries.
- Recent innovations in local public governance aim to engage residents in all aspects and phases of local government operations from ideas to policy to

implementation. By doing so, they are building people's trust in local government while improving integrity, efficiency and equity of local government operations. This enhanced trust contributes to greater public support and improved finances for local government core business as well as for new initiatives. These innovations also broaden citizen voice, choice and exit options and thereby introduce strong incentives for local governments to strive for better performance in service delivery.

- Participatory planning and budgeting offer citizens at large an opportunity to learn about government operations and to deliberate, debate, and influence the allocation of public resources. It is a tool for educating, engaging and empowering citizens and strengthening demand for good governance. Participatory budgeting has the potential to strengthen inclusive governance by giving marginalised and excluded groups the opportunity to have their voices heard and to influence public decision-making vital to their interests. Done right, it has the potential to make governments more responsive to citizen needs and preferences and more accountable to them for performance in resource allocation and service delivery.
- The use of data that accumulates from public services provided by subnational governments is currently a hot topic in many countries. As a result of the rapid digitalisation of public services, the need to solve issues of data sharing, analysis, and privacy protection in public services is urgent. Solutions that help abolish vertical silos in public administrations and enhance co-operation among jurisdictions and levels of government are currently being sought. These solutions include facilitating the use of linked data and creating a shared view of data and information, including open data, within and across levels of governments (OECD, 2017_[25]). All of this should help governments prioritise the adoption of an overall sharing strategy to co-ordinate efforts. Open data also enables public access to information and can promote more direct involvement in decision-making.

What are examples of good practices?

Federal countries

- Australian local governments collaborate on using common smart forms for local applications, common ICT platforms for tracking enquiries/transactions, measuring service delivery response times and surveying customers, set benchmarks for performance and measuring and reporting results (ALGA, 2010_[26]). Australia's "Value Creation Workshops" are valuable resources for strengthening local government officials' capacity to engage citizens through training and access to relevant expertise.
- In Brazil, the experiment carried out in the city of Porto Alegre represents one of the earliest and most successful trials in participatory planning and budgeting. This experiment is widely recognised for its positive impact on citizen engagement and improved service delivery, especially to the poor.
- In Canada, in the 1990s, Metropolitan Vancouver government took the lead in facilitating network governance by bringing together all relevant stakeholders (i.e. private sector, civil society organisations, provincial and

federal governments) to form a partnership to overcome urban blight and to combat drug use and other crimes in the inner city. The metropolitan government co-ordinated and supervised the activities of all partners and successfully transformed the inner city into a safe, clean and a thriving work and residential environment. Several cities in Canada produce annual performance reports on their fiscal, financial and service delivery performance. A number of Canadian (and Finnish) municipalities also measure residents' expectations, priorities and degrees of satisfaction with local services in order to improve service delivery (OECD, 2017^[7]).

- Switzerland is the ultimate champion of citizen empowerment through direct democracy provisions in the constitution. Citizens with appropriate majorities in referenda can overturn legislation and have the right to be consulted through referenda on major projects, deficits and debt levels, and significant changes in tax burdens.
- In the United States, the concept of performance budgeting owes its origins to US local government innovations to enhance the transparency of their operations and showcase (benchmark) their performance as a means to demonstrate that local tax dollars advancing the local public interest. Direct democracy provisions on citizen-based initiatives concerning local taxing, spending and borrowing and the recall of local public officials also help in enhancing local government accountability to local residents. Local governments in Canada and the US have also adopted the single phone number 311 as a one-stop access point for all local services.

Unitary countries

- In recent years, Chile has followed a multi-faceted approach to promote transparency and citizen engagement in public processes. These include strengthening institutional frameworks for the citizens right to know. It has also promoted civic participation with mandatory requirements for establishing a municipal advisory council of civil society organisations (*Consejo Comunal de Organizaciones de la Sociedad Civil*, COSOC) for citizen engagement and to provide civic education.
- Finland's local governments engage citizens through a variety of fora to seek inputs on service delivery improvements.
- New Zealand pioneered results-based accountability of government through contract-based public employment and management. Public managers have full flexibility in input choices and delivery mechanisms but are held accountable for performance against contract expectations.
- The UK innovation foundation, NESTA, is one of the most prominent pioneers of public and social labs as a means of addressing societal challenges through evidence-based local experiments.

What are the pitfalls to avoid/risks?

- Participatory processes also come with risks. They can mask the undemocratic, exclusive or elite nature of public decision making, giving the

appearance of broader participation and inclusive governance while using public funds to advance the interests of powerful local elites.

- Participatory budgeting can be abused to facilitate an illegitimate and unjust exercise of power. To prevent these abuses, the participatory process must fully recognise local politics and formal and informal power relations, so that the processes yield outcomes desired by the median voter.
- Another risk is “fatigue” on the part of the citizen, especially when they are consulted or when they are engaged but do not see related or associated results or outputs, or when their input has not been fully taken into consideration. This is more likely to happen when participatory approaches become box-ticking exercises rather than undertaken as a strategic input to decision making. There is a balance that needs to be struck.
- Participatory approaches at the local level must be guided by local councils. As elected bodies, local councils voice citizen choices and preferences and provide oversight on behalf of the voters. Approaches that by-pass local councils may risk weakening democratic governance and accountability at the local level.

What are the recommendations?

- Citizens should be empowered through the right to know and benefit from direct democracy provisions. Care must be taken if imposing participation requirements through legal and regulatory frameworks as such requirements could impose significant costs but may elicit pro forma responses by local governments and citizens.
- Ensure that elected local councils have the ownership and control of citizen participation and engagement initiatives.
- Complement transparency provisions with governmental systems that create incentives for citizens-based accountability, e.g. output based grants for merit services where citizen voice, choice and exit options have a direct impact on the grant amount received by a provider.
- Higher-order government should consider encouraging citizen engagement and innovative and competitive service delivery through tournament-based output grants and recognition awards.
- Use ICT/e-government tools for better service delivery. ICT tools can help government to better understand who the service users are and to learn about their needs. Integrate ICT infrastructure, skills and services and systems and processes to create a connected government for efficient and effective service delivery. Pick pilot projects that can show quick results. Choose the right services to transform using ICT and the best delivery channels. Collaborate with other governments and delivery partners. Use ICT to measure, monitor and disseminate own performance.

| Guideline 7. Strengthen innovative and experimental governance, and promote citizens' engagement | | | |
|--|-----|-----------|----|
| Checklist | Yes | Partially | No |
| Some subnational governments practice participatory budgeting If yes, the process impacts budget priorities and allocation | | | |
| The subnational government uses ICT/e-government tools for: <ul style="list-style-type: none"> ● Measuring and monitoring performance ● Reporting on performance ● Improving access, efficiency and quality of public services ● Enhancing citizens engagement | | | |
| The subnational government strengthens citizen voice, choice and exit options through: <ul style="list-style-type: none"> ● Citizens' charter ● Service standards ● Annual performance report ● External performance audits ● All decisions including procurement, costs of concessions posted on the web ● Citizens friendly output budgets and service delivery performance report ● Open public hearing | | | |
| Subnational governments engage citizens for: <ul style="list-style-type: none"> ● Consensus building dialogues and conferences ● Deliberative mapping of policy and program options ● Deliberative polling on issues ● Deliberative (focus groups) meetings on public policy issues ● Uses electronic/digital media for engagement ● Meetings on vision for the future or to discuss a specific theme ● Participatory appraisal ● Participatory strategic planning ● Service users' panels for service evaluations ● Youth empowerment ● Convene a citizens' jury/panel to consult or to pass judgement on local services ● Form and convene networks of local beyond government service providers | | | |

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

Definition

- Asymmetric decentralisation refers to the fact that the political, administrative and fiscal arrangements across jurisdictions (i.e. at the same government level) may differ. It can apply to both federal and unitary countries. Political asymmetric decentralisation refers to situations where some subnational governments are given political self-rule that deviates from the norm or average assignment. In administrative terms, asymmetric decentralisation means that the devolved responsibilities might differ across jurisdictions. In fiscal terms, asymmetric federalism or decentralisation means that subnational government units at the same level have different revenue powers. Asymmetric decentralisation might occur at the regional level (state, province, *länder*), the metropolitan level and the local level.

What are the key trends/data?

- Territorial disparities are high and persistent within OECD countries and have been rising across urban and rural areas in a number of countries. Such disparities tend to be higher in developing countries.
- Trends in asymmetric decentralisation are changing: whereas between the 1950s and the 1970s asymmetric arrangements mostly occurred at a regional level, the present trend seems to apply asymmetric decentralisation in major urban areas. Capital city districts, in particular, have experienced a growth in asymmetric decentralisation arrangements, perhaps because the benefits of urbanisation and agglomeration economies have become more widely understood and accepted. As a result, the number of metropolitan governance authorities has increased during the past decades. Currently, around two-thirds of the metropolitan areas in the OECD have a metropolitan governance body.
- In 1950, around half of the 81 countries covered by the Regional Authority Index (RAI) had some kind of differentiated governance at the regional level. In 2010, almost two-thirds of the countries in the RAI had implemented asymmetric arrangements in some form.
- Asymmetry is often a basic characteristic of the federal countries. There are, however, different gradients of asymmetry: some federal countries are quite asymmetric (Canada and Spain, for example) whereas others are more symmetric (Australia, Austria, Germany, Switzerland and the United States). However, even the most “symmetric federations” have elements of asymmetry.
- Asymmetric decentralisation is increasing in unitary countries. There is thus a greater convergence between unitary and federal countries in the trend toward greater differentiated governance at the subnational level.

Rationale and benefits

- Subnational governments vary greatly in scale and capacities within countries. Subnational governments with low population levels may suffer from inadequate economies of scale, depending on their ability to co-operate and outsource; and sometimes on limited fiscal and administrative capacities.
- Given the important differences across subnational governments in fiscal, institutional and human resource capacities, a “one size fits all” approach is not necessarily the most appropriate way to organise decentralisation policies and multi-level governance systems.
- The age structure and service needs of the population may vary greatly between regions within a country. In some cases, there are important ethnic or political differences between regions. These are just a few examples of circumstances that challenge the ability of governments to maintain the unity and balanced development of the state.
- Asymmetric decentralisation may be politically motivated. There may be historic, cultural and/or ethnic reasons for the special treatment of some regions or subnational governments. The aim can be to safeguard the unity of a nation-state. It may also be motivated by economic issues, or to address efficiency considerations. In addition, the motive can be to address heterogeneity in the capacity levels of subnational governments. The economic motives for asymmetry are usually linked with efficiency considerations.

What are examples of good practices?

Federal countries

- In Canada, asymmetric decentralisation is mostly based on “menu federalism”, where the “opt in” or “opt out” choices are made available to all provinces. The province of Quebec has been using this option more frequently than the other provinces.

Quasi-federal countries

- In South Africa, several classifications are used to group the 278 municipalities. The different classification methodologies recognise that municipalities need differentiated approaches that take into consideration their different characteristics and needs. However, the South African Financial and Fiscal Commission has argued that differentiation approach is not always clear, and some classifications are not always useful for making decisions or allocating resources (Financial and Fiscal Commission of South Africa, 2012^[27])

Unitary countries

- In the Czech Republic, in the process of decentralisation, the responsibilities of the 76 abolished state “districts” were largely passed on to 205 “municipalities with extended powers” in 2003. These municipalities perform central government delegated functions such as child protection and issuing

passports on behalf of smaller surrounding municipalities. These functions are associated with additional funding. Smaller municipalities can also delegate additional functions to the municipalities with extended powers (ORP) that they do not want to provide, or cannot provide because of their lack of capacities (OECD, 2017_[7]).

- In Denmark, between 2012 and 2015, nine local municipalities were granted exemptions from government rules and documentation requirements in order to test new ways of carrying out their tasks, in a policy experiment known as the “Free Municipality” initiative. The main focus has been on simplification, innovation, quality and a more inclusive approach to the individual citizen, with many of the experiments focusing on employment. The Free Municipality experiment is being evaluated, in order to form the basis for potential future legislation on de-bureaucratisation for all municipalities. The concept of Free Municipalities continues in an adjusted form until 2019 and is being extended to more municipalities (OECD, 2017_[19]).
- In Italy, a 2014 reform ended two decades of gridlock over metropolitan governance reform and created the legal structure for the introduction of differentiated governance in ten major metropolitan areas – Bari, Bologna, Florence, Genoa, Milan, Naples, Reggio Calabria, Rome, Turin and Venice – and four additional cities in special regions: Catania, Messina and Palermo in Sicily, as well as Cagliari in Sardinia.
- In Sweden, the counties themselves gradually and voluntarily implemented regional reform since 1990s. This resulted in asymmetric and bottom-up regionalisation as a gradual and experimental process (a laboratory of regionalisation). The voluntary reform eventually led into decision to extend the reform to cover all Swedish counties since beginning of 2019. The underlying idea is that decentralised policymaking leads to more innovation in governance.

What are the pitfalls to avoid/risks?

- Putting in place a very complex differentiated system, which is not transparent and clear for citizens, can risk blurring accountability lines and raising the co-ordination costs of multi-level governance.
- Increasing disparities in capacity across regions, if adequate equalisation systems and capacity-building policies are not put in place.
- Not reaching national goals for universal service levels and quality standards in a very heterogeneous service provision system.
- Not monitoring the outcomes of asymmetric decentralisation, thus not allowing adjustments in the system.
- Questioning national unity.

What are the recommendations?

- Asymmetric decentralisation should be part of a broader strategy of multi-level governance and territorial development. Asymmetric decentralisation is not an end in itself, it is a means to achieve multi-level governance goals.

- Asymmetric decentralisation should be supported by effective vertical and horizontal co-ordination mechanisms.
- Asymmetric decentralisation needs to go hand in hand with an effective equalisation system.
- The type of asymmetric decentralisation should be well defined (political, administrative/management or/and fiscal) and have a clear rationale as the objectives and instruments will differ in each case.
- The scale and scope should be clear (large part of the territory vs. restricted, regional, metropolitan, local levels; permanent vs. transitory, timing, pilot/experimental).
- The way asymmetric responsibilities are allocated should be explicit, mutually understood and clear for all actors.
- An asymmetric decentralisation approach should be based on dialogue, transparency and agreements between all main stakeholders.
- To the extent possible, participation in an asymmetric arrangement should remain voluntary. The central government or a higher level of subnational government can take responsibility for service provision in non-participant areas.
- A variety of incentives (not just financial) should be used to foster participation in voluntary schemes or pilot experiences.
- A well-defined and transparent approval system for prospective participating subnational governments should be in place.
- The effects of asymmetric decentralisation should be carefully monitored on a regular basis and the results of such evaluations should be used to revise the plans if needed (including the effects on equity and national cohesion).
- A system for communicating good practices and lessons learned from the asymmetric arrangements should be organised.
- It is important to keep a rational number of asymmetric arrangements within the same country to limit co-ordination costs and complexity.

| Guideline 8. Allow and make the most of asymmetric decentralisation arrangements | | | |
|--|-----|-----------|----|
| Checklist | Yes | Partially | No |
| The type of asymmetric decentralisation is well defined (administrative, fiscal, political) | | | |
| The scale of asymmetric decentralisation is clear (regional, metropolitan, local levels) | | | |
| The number and types of asymmetric arrangements/instruments remain limited | | | |
| The way delegated responsibilities are allocated to specific subnational governments is clear and explicit | | | |
| There are vertical co-ordination mechanisms in place | | | |
| There are horizontal co-ordination mechanisms in place | | | |
| An equalisation system is in place | | | |
| There are incentives to foster the participation subnational governments (SNGs) in asymmetric arrangements schemes | | | |
| The participation of SNGs in asymmetric arrangements schemes remains voluntary | | | |
| There is a well-defined and transparent approval system for prospective subnational governments | | | |

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

Definition

- Transparency can be defined as openness to the general public with respect to a comprehensive and detailed view of government structures, processes, finances, operations, net worth and results. It involves ready public access to reliable, timely and easily comprehensible information that could be used to evaluate openness and inclusivity of government processes of decision-making. Moreover, freely available information enables performance measurements and benchmarking between governments and their agencies and entities.
- Data collection refers to the capacity of government entities to collect and disseminate information on their operations.
- Performance monitoring refers to the ability of citizens, higher-order governments, private sector and other interested parties to know what government entities are doing and how well they are performing their tasks.

What are the key trends/data?

- Government transparency in general, and fiscal transparency in particular has been on the rise due to the impact of the information revolution and globalisation.
- Subnational government transparency is also on the rise. This is because local governments are increasingly aiming for greater transparency by introducing performance-based budgeting and participatory budgeting techniques and making pro-active efforts to engage citizens in local government policymaking. Budgeting transparency throughout the investment cycle provides visibility to investments, clarifies recurrent budgetary implications and strengthens public accountability.
- Other recent initiatives to strengthen transparency include the Transparency and Accountability Initiative (TAI), which offers a forum for sharing information on innovative initiatives to improve transparency and accountability. Meanwhile, Publish What You Pay (PWUP) advocates the disclosure of contracts, revenue payments and receipts for extractive industries.

Rationale and benefits

- Transparency is critical to building trust in public policies as well as among citizens. Empirical evidence further suggests that transparency contributes to improved social and economic outcomes and reduced corruption (Ortiz-Ospina and Roser, 2017^[28]; Acosta, 2013^[29]; Hameed, 2005^[30]). A survey of the past 25 years of empirical evidence suggests that transparency has a positive impact on legitimacy, citizen participation, trust in government, citizen satisfaction, government accountability, and can result in less corruption, better performance and better public financial management (Cucciniello, Porumbescu and Grimmeliikhuijsen, 2016^[31]). Greater fiscal

transparency is also shown to improve sovereign credit ratings and lower borrowing costs. It contributes to citizen empowerment and leads to efficient and equitable use of government resources due to heightened citizens-based accountability. Transparency enhances voice and exit options for citizens.

What are examples of good practices?

Federal countries

- Australia is well recognised for how it disseminates timely, reliable, accurate, meaningful and understandable, comprehensive information on public decision-making processes and procedures, as well as government performance, including on its impact and outcomes.
- Canadian subnational governments pro-actively seek citizen participation and engagement in their policymaking and operations.
- Brazil's landmark Fiscal Responsibility Law 2000 further strengthened the fiscal transparency and accountability of Brazilian governments by introducing hard fiscal rules and empowering citizens to sue governments for any observed breach of the provisions of this law.
- In the United States, local governments pioneered approaches to open government and performance budgeting to earn the trust of the people.

Unitary countries

- Italy has always placed great attention on the construction and use of indicator systems, to monitor programme implementation (financial and output indicators), to support policymaking processes and to analyse policy results (statistical indicators). Throughout the programming cycle, significant financial and organisational resources have been devoted, on the one hand, to the construction and updating of a national monitoring system (using an open data approach <https://opencoesione.gov.it/en/>) and, on the other, to the availability of timely and territorial disaggregated statistical data for all policy areas relevant for regional development (available on the national statistical office website <https://www.istat.it/it/archivio/16777>).
- New Zealand is a good example of transparency in governance and government accountability for results in view of the results-based management framework it adopted in the 1980s for internal and external accountability of government. It outperforms all countries in the public access to information on government decision-making processes and makes available detailed information on a results-based chain (programme objectives, programmes, activities, inputs, outputs, outcomes, impact and the reach) of all government operations.
- Norway has implemented KOSTRA, a comprehensive system in monitoring and disseminating information on government operations and performance. KOSTRA system is considered a leading good practice in government transparency.

What are the pitfalls to avoid/risks?

- It is essential to avoid a complex information dump. The reporting of information must be user-friendly, otherwise, it will not advance public access to information.
- Time is of the essence. Information that is made available after long delays would not be useful in reviewing current operations.
- Information must be comprehensive and give a complete and accurate picture of government operations. Typically, such comprehensive information is not available in most developing countries. Information gaps often include development assistance, the local government sector as a whole, state-owned enterprises, tax expenditures, contingent liabilities, quasi and extra-budgetary operations, natural resource revenue management.
- Information must be contextual (linked to policy and outcomes), hierarchical (organised by orders of government and hierarchy in each order), and easily related to governmental units. Information that does not relate to governmental units is not valuable for oversight and accountability.
- The integrity of the information must be assured. Lack of integrity contributes to citizen mistrust in government.
- For local governments, complex ad hoc and add-on self-standing monitoring and evaluation systems are costlier and less useful than built-in tools and mechanisms for government transparency, self-evaluation and citizen-based accountability, such as local government output budgeting and output based fiscal transfers to finance local services.

What are the recommendations?

- National governments should develop performance-monitoring systems to monitor decentralisation and regional development policies. These systems need to remain simple with a reasonable number of requirements/indicators.
- Subnational governments need to be subjected to higher-level regulations and fiscal rules to ensure fiscal discipline and fiscal sustainability. These typically include compliance with the laws and reporting requirements for financial flows, assets and liabilities.
- Higher-level governments may impose a reporting requirement for service delivery performance in critical services. Higher order governments must also regularly monitor subnational government performance in critical service areas based on a minimum set of standardised indicators, provide timely feedback, and benchmark local performance in service delivery, allowing for comparison and learning.
- Higher-order governments must regularly monitor and provide timely feedback on the fiscal health of subnational governments.
- Higher-order government oversight must be based on normal subnational government systems (e.g. fiscal transparency requirements, quarterly audited, financial statements, output based budgeting, output based transfers, etc.) rather than imposing formal add-on and ad hoc monitoring systems.

- Subnational governments need to be encouraged to adopt pro-active policies for information disclosure, and to seek citizen engagement for all operations.
- Setting up independent evaluation institutions can be beneficial for policy credibility, trust and enforcement, and may help increase the uptake of monitoring and evaluation results.

| Guideline 9. Consistently improve transparency, enhance data collection and strengthen performance monitoring | | | |
|--|-----|-----------|----|
| Checklist | Yes | Partially | No |
| Subnational governments publish timely data on key performance indicators for its major public services | | | |
| Subnational governments maintain an open website to register complaints | | | |
| Subnational governments pro-actively disseminate performance information and seeks citizens' feedback | | | |
| The freedom of information legislation is guided by the principle of maximum disclosure – all information is accessible subject only to a narrow set of exceptions | | | |
| The principle of maximum disclosure takes precedence in the event of conflict with other legislation | | | |
| Exceptions are clearly and narrowly defined | | | |
| Public entities are required to publish key information needed to assess integrity, efficiency and equity of their operations | | | |
| Requests for information are processed rapidly within defined time frame | | | |
| The costs of requesting information are reasonable and affordable by an average citizen | | | |
| Meetings of government entities are open to public and media | | | |
| Individuals who release information on abuse of public office or other malfeasance are protected | | | |
| Subnational government performance indicators are used | | | |
| Subnational governments work through competitive provision, results-based management and benchmarking | | | |

Guideline 10: Strengthen national regional development policies and equalisation systems

Definition

- National regional development policies are essential to reduce territorial disparities and strengthen urban-rural linkages, as mega-trends have an asymmetric impact on regions and cities within countries, and tend to increase disparities.
- In most countries, regional governments have varying fiscal capacities and varying fiscal needs and therefore varying ability to provide local public services.
- Equalisation transfers are used to reduce fiscal disparities between central government and subnational government (a vertical fiscal gap) and between subnational governments (a horizontal fiscal gap). The purpose of fiscal equalisation is to enable subnational levels of government to provide approximately comparable levels of public services at comparable tax burdens.
- Regional and local fiscal equalisation could be administered through vertical federal and/or state programmes (in federal countries) or a central programme (in unitary countries). It can also be administered through two types of horizontal programmes (inter-regional or inter-local equalisation) where wealthy regional/local governments contribute to the pool and fiscally poor regional/local governments receive a subsidy from this pool according to a defined equalisation standard.
- Under a “Robin Hood” horizontal equalisation programme, the state or the central government collects these monies from richer jurisdictions and distributes to the poorer jurisdictions. Under a solidarity programme, the equalisation programme is administered by regional governments themselves.

What are the key trends/data?

- Most OECD countries have national regional development policies in place to support place-based policies, address urban-rural linkages and reduce territorial disparities. Nineteen out of 27 OECD countries surveyed in 2018 report having a national public investment strategy with a territorial dimension (OECD, 2019 forthcoming^[32]).
- Fiscal equalisation is in vogue in most countries, using various mechanisms and yardsticks. Only in a handful of countries does an explicit equalisation standard determine both the pool and individual allocations. Most countries use arbitrary pool and ad hoc fiscal capacity and need factors in determining allocations. Fiscal need calculations are data intensive and especially difficult to do. Countries have adopted second-best approaches to expenditure need determination that vary from cherry picking a few need factors to choose sophisticated quantitative methods to determine significant factors and constructing relative needs/cost disability indexes for various jurisdictions. Experience has shown that complexity in the methodology does not necessarily result in greater fiscal equity.

- Vertical fiscal equalisation programmes have grown in popularity in recent decades and are now practised in a large number of countries. Horizontal fiscal equalisation is in vogue in only a handful of OECD countries, most notably in Germany, the Nordic countries and Poland. The German interstate solidarity (horizontal) equalisation programme is, however, being allowed to expire in 2019.

Rationale and benefits

- Fiscal equalisation transfers are advocated to deal with regional fiscal equity and fiscal efficiency concerns. These transfers are justified on political and economic considerations.
- Large regional/local fiscal disparities can be politically divisive. Equalisation transfers support national/state objectives in creating a common economic and social union. They strengthen a sense of national citizenship among residents of diverse localities. They facilitate decentralised public decision making and local autonomy and enable local governments to deliver a menu of public services consistent with local preferences. Overall, these transfers are seen as a glue that holds the region/state and the country together.
- Public sector interventions that impede the free flow of factors of production within the nation have adverse consequences for the efficiency of the national economy. Most equalisation programmes in vogue are intended to promote such mobility of factors by ensuring reasonably comparable levels of public services at comparable burdens of taxation. Such a level playing field facilitates movement of factors in response to economic stimuli but retards their movements in response to fiscal considerations alone.
- Therefore, such programmes, if properly designed, may enhance fiscal equity (citizens are treated equally by the public sector regardless of their place of residence) and fiscal efficiency (by discouraging fiscally induced migration – mobility of factors in response to differential net fiscal benefits across the nation).
- They can potentially play a positive role in strengthening an internal common market and common economic, social and political union. For these reasons, equalisation is often seen as “the glue that holds a federation together”.
- Care must be exercised in the design of such programmes so that they do not inadvertently contribute perverse incentives that may lead to a misallocation of resources, thereby retarding regional and national economic growth.

What are examples of good practices?

- Better practices in equalisation suggest that for the sustainability of the programme, there must be broad political and societal consensus on the degree of equalisation and the means to finance such transfers. Simplicity, transparency, objectivity and predictability of design should take precedence over precision and sophistication or academic excellence. Furthermore, an explicit equalisation standard must determine both the total pool of funds allocated and the allocation of transfers. For example, the pool and allocation

can be defined using a formula. An arbitrary pool given by a revenue sharing programme is not desirable.

Federal countries

- Equalisation methods differ among countries. For instance, Canada and Germany primarily equalise fiscal capacity with Germany providing an adjustment for population size, density, and whether a city is a harbour. Switzerland devotes 19% of the equalisation pool to cost equalisation, and compensates for infrastructure deficiencies through a supplementary cohesion fund. Australia takes a comprehensive view of both fiscal capacity and expenditure/cost equalisation. In addition, the Australian programme is the only one among mature federations that also equalises for capital expenditure needs and associated capital financing.

Unitary countries

- In Nordic countries, the role of the intermediate order of government is either very limited (i.e. in Denmark, Finland and Norway) or highly constrained (i.e. Sweden). Local governments are mostly self-financing but do receive central assistance for health, education, social welfare and local fiscal equalisation. In general, specific purpose transfers relate directly to demand factors for local public service. Local fiscal capacity equalisation programmes use an explicit standard of equalisation that determines total pool and allocation among local governments. The programme is administered based on either solidarity principles (fiscally wealthy municipalities contribute to the pool and fiscally poorer municipalities receive from the pool in a horizontal equalisation programme). In Denmark, Finland and Sweden, a mixed programme using a central component and Robin Hood components (central government taxes wealthier jurisdictions and transfers these funds to poorer jurisdictions in a vertical equalisation programme) are in place. Norway uses the Robin Hood principle in the financing and allocation of these transfers. Expenditure need equalisation is organised on solidarity principles in Denmark, and Norway uses a solidarity programme plus central grants for smaller local governments, northern counties and faster growing local governments. Finland and Sweden use a central programme of cost equalisation for selected services such as health, education and social services.

What are the pitfalls to avoid/risks?

- Avoid very generous equalisation schemes. Equalisation transfers that are too open-handed may create disincentives for local economic development.
- Equalisation transfers may create incentives for lobbying, inefficiencies and disincentives for improving tax base and amalgamation. They can also create false prices for local public goods. At worst, fiscal equalisation can open a development trap for poorer jurisdictions and even increase long-term disparities.
- Equalisation systems that weaken incentives for inter-regional migration may induce inefficiency in the inter-regional allocation of resources. This happens

if the grants discourage the outmigration of labour to high-income regions where it would be more productive.

- Avoid situations where the transfer system distorts the dependence of own revenues and spending. If the transfer system is allowed to separate taxing and spending decisions, it may also undermine local government accountability to residents.
- Avoid overly complex transfer systems. Complex equalisation systems may have unintended negative consequences through implicitly perverse incentives (e.g. the use of need factors for government employment, incidence of crime, etc.), which may contribute to higher public employment and a reluctance to initiate policies to curb crime, etc.

What are the recommendations

- Fiscal equalisation policies need to be accompanied by pro-active regional development policies to offset the potentially negative incentives of such systems.
- Equalisation arrangements need to be carefully designed to promote the tax and development efforts of subnational governments (OECD, 2007_[33]).
- Policymakers should strive to respect the following principles in designing and implementing intergovernmental transfers:
 - Keep it simple. In the design of fiscal equalisation transfers, rough justice is better than precise or full justice if it achieves wider acceptability and sustainability.
 - Focus on a single objective (equalisation for equalisation transfers) in a grant programme and make the design consistent with that objective. Setting multiple objectives in a single grant programme runs the risk of failing to achieve any of them.
 - Introduce ceilings on equalisation grant funds. Such limits could be linked with macro indicators and floors to ensure stability and predictability of transfer funding.
 - Introduce sunset and stability clauses. It is desirable to have the equalisation grant programme reviewed periodically – say, every five years – and renewed (if appropriate). In the intervening years, no changes to the programme should be made, in order to provide certainty in budgetary programming for all governments.
 - Determine both the total pool of resources used for transfers and allocations in the equalisation formula. Solidarity-based systems are more likely to strike the right balance on an equalisation standard. Paternal and Robin Hood programmes lack internal discipline and could lead to too much or too little redistribution.
 - Equalise per capita fiscal capacity to a specified standard in order to achieve fiscal equalisation separately among various local governments grouped together by size/class and urban/rural distinctions. Such a standard would determine the total pool and allocations among recipient units. Calculations required for fiscal capacity equalisation using a representative tax system for

major tax bases are doable for most countries. Fiscal need equalisation is best achieved through a demand for services approach that allocates funds by service population, e.g. school-age population for school finance. Alternately, fiscal need equalisation can be achieved through output-based sectoral grants that also enhance results-based accountability.

- A national consensus on the standard of equalisation is crucial for the sustainability of any equalisation programme. The equalisation programme must not be looked at in isolation from the broader fiscal system, especially conditional transfers.
- Recognise population size, the area served and the urban/rural nature of services in making grants to local governments. Establish separate formula allocations for each type of municipal or local government.
- Establish “hold harmless” or grandfathering provisions that ensure that all recipient governments receive at least what they received as general-purpose transfers in the pre-reform period. Over time, as the economy grows, such a provision would not delay the phase-in of the full package of reforms.
- Make sure that all stakeholders are heard, and that an appropriate political compact on equalisation principles and the standard of equalisation is struck.

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

| Checklist | Yes | Partially | No |
|---|-----|-----------|----|
| Active regional development policies are in place to support the development of lagging regions as a complement to equalisation policies | | | |
| The objectives and fundamental principles of fiscal equalisation are clearly defined. If so, by: <ul style="list-style-type: none"> ● Constitution ● National law ● Executive order/regulations | | | |
| The legislation defines the type of programme | | | |
| The programme is intended to be: <ul style="list-style-type: none"> ● Gross equalisation (national transfers to have-not jurisdiction but no explicit equalisation tax on richer jurisdictions) ● Net equalisation (fiscal capacity of poorer jurisdictions is upgraded while richer jurisdictions are downgraded) ● Mixed | | | |
| Total pool of transfer funds is determined <ul style="list-style-type: none"> ● By equalisation standard ● Arbitrary | | | |
| Fiscal capacity is equalised <ul style="list-style-type: none"> ● Potential per capita revenue from each base ● Actual per capita revenues ● By macro indicators | | | |
| Fiscal need is determined <ul style="list-style-type: none"> ● Considered as equal per capita ● Ad hoc determination ● Regression based approaches | | | |
| The overall complexity of the programme is perceived as: <ul style="list-style-type: none"> ● High complexity ● Medium complexity ● Low complexity | | | |
| There is a sunset clause | | | |
| There is a stability clause | | | |

| | | | |
|--|--|--|--|
| There are ceilings and floors to circumvent large yearly fluctuations in entitlements | | | |
| Who recommends the formula? <ul style="list-style-type: none"> • Independent grant commission or similar body • Ministry in charge | | | |

Notes

¹ See also Allain-Dupré (2018_[5]).

² In many cases, there is also a provincial police force and the municipalities in those cases will have their policing needs provided by that provincial police force rather than the RCMP. For example, in Ontario, major cities have their own police forces (Toronto Police, Ottawa Police, etc.) and outside of these major cities, there is the Ontario Provincial Police (OPP), which provides services in rural areas and small municipalities. British Columbia on the other hand does not have a provincial police force, and so in that case it is the federal RCMP that provides the police services in small municipalities there.

³ The *länder* governments are directly represented at the Bundesrat, the upper house of the parliament with veto power over issues affecting *länder* interests, to incorporate regional interests in federal legislation.

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From:
Making Decentralisation Work
A Handbook for Policy-Makers

Access the complete publication at:
<https://doi.org/10.1787/g2g9faa7-en>

Please cite this chapter as:

OECD (2019), “Making decentralisation work: A handbook for policy-makers”, in *Making Decentralisation Work: A Handbook for Policy-Makers*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/dd49116c-en>

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