

Decentralization

The Institute's June 2007 Land Policy Conference focused on decentralization—the

degree to which local and provincial governments exercise power, make decisions about their revenues and expenditures, and are held accountable for outcomes. Because the services, regulatory constraints, and institutional environments provided by local governments are major factors in the location decisions of households and firms in urban areas, decentralization is a key determinant of policies that affect land and property taxation.

Advocates claim that decentralization will increase the efficiency and equity in the public sector because it allows customization of public services to local preferences, promotes scrutiny by citizens of expenditures, and facilitates innovation. Critics have concerns about a lack of local administrative capacity, the potential for local corruption, and the risk that local governments will be captured by local elites. The duality of these arguments provided the rationale for this conference.

The speakers addressed two main issues: to what extent has decentralization achieved its expected and related objectives; and what is the potential for and outcome of the interjurisdictional competition fostered by decentralization?

Achieving Objectives: Roy Bahl's keynote address reviewed the facts about, arguments for, and risks relating to decentralization in developing countries. He reported that the average share of general government expenditures has been virtually unchanged since 1970 for developed (33 percent) and developing (13 percent) countries, but that decentralization's costs are high and its positive impacts take a long time to be realized.

Ehtisham Ahmad, Giorgio Brosio, and Vito Tanzi reviewed the empirical evidence across countries on how well decentralization has delivered on its promises of improving efficiency, satisfying local preferences, and fostering economic growth. They found the evidence was inconclusive on all fronts. Paul Smoke similarly reviewed the empirical literature on the relationship between decentralization and local revenue performance, technical reform, governance, and capacity. He found mixed results, with stronger evidence on the linkages in studies of specific countries.



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Compelling evidence of an increase in decentralization in the United States was provided by Robert Nelson. He reported on the rapid growth of local service provision by private community associations, which encompassed about half of the new housing units built since 1980; their residents now number 57 million. Also using U.S. data, Daniel McMillen and Larry Singell demonstrated that constraining the options of local governments

seems to reduce their ability to customize local services: property tax limits and school finance reforms reduced the variation in per pupil expenditures across communities.

Decentralization can pose risks of undesirable outcomes. William Fischel provided evidence that fragmented metropolitan areas are likely to produce more exclusionary zoning than those with few local governments. Using cross-country data, Luiz de Mello found that local government indebtedness increased as transfers from the central government expanded. Jorge Martinez-Vazquez and Cristian Sepulveda found that increased decentralization was associated with greater income inequality across countries.

Interjurisdictional Competition: Sally Wallace's review of competition among jurisdictions for economic activity found that fiscal inducements had modest effects on location decisions that were dominated by other economic considerations. An examination of the environmental consequences of decentralization in papers by Hilary Sigman (using cross-country data) and Shelby Gerking (using U.S. data) found modest to nonexistent risks of an environmental "race to the bottom" driven by competition among local governments.

Building on his prior analytic work, Tom Nechyba explored the outcomes of competition between public and private schools in an urban area. Clifford Zinnes explored how competition can promote increased efficiency and effort among local governments. Both papers found that the outcomes were heavily dependent on the "rules of the game."

The empirical papers concluded that measures of decentralization are very weak, particularly across countries. This is an important research area for the Institute because improved understanding of how decentralization impacts local governments in different countries is necessary to formulate land policy and design local revenue and expenditure reforms. 