

THE IMPACT OF DECENTRALIZATION ON INFRASTRUCTURE PROVISION

H.SHOJI

Development Assistance Strategy Department, Japan Bank for International Cooperation,
Japan

h-shoji@jbic.go.jp

ABSTRACT

East Asian countries, which have adopted a central regime for their economic development, now implement decentralization with rather radical examples found in Indonesia and the Philippines. While decentralization is generally considered desirable in reflecting local needs, it affects infrastructure negatively in terms of diminished economies of scale and externality, expansion of regional inequality, weak human capacity, financial shortfalls in local government, and rent-seeking of local power elites. In order to overcome these negative impacts, it is necessary to choose a technically appropriate and practically workable solution of infrastructure according to the level of government in order to enhance capacity, to overcome financial constraints and to reinforce the accountability of the local government.

1. DECENTRALIZATION IN EAST ASIAN COUNTRIES

Since the 1980s, decentralization has been discussed within the context of the economic development of developing countries. However, the East Asia region lagged behind the rest of the world, and until recently, countries in that region have been adopting a highly centralized regime, known as “development dictatorship”. That regime was successful in bringing about economic development in those countries, which came to be known as “East Asian Miracles”, while economic difficulties in the late 1990s brought about serious blows, and thereafter, those countries started to adopt a “decentralized” regime. In some countries, these movements towards decentralization have been quite impressive. This presentation will attempt to present the impact and issues of decentralization on infrastructure provision under decentralized regimes as well as the measures for dealing with those issues, mainly using examples in Indonesia and the Philippines.

Since the degree, type and progress of decentralization vary considerably among East Asian countries, it is useful to adopt the following framework; (i) deconcentration, (ii) delegation and (iii) devolution. Deconcentration means transferring the administrative workload from central government officials to sub-national government staff. Deconcentration may be considered as the first step toward decentralization. Delegation requests the central government to entrust organizations, which are legally detached from the central government, to plan and conduct specific tasks which are part of central

government services, and Devolution gives autonomy to the local governments.

Focusing on the functions of government, the following three aspects describe a different angle of decentralization, namely, political, administrative and financial aspects. Political decentralization suggests bringing decision-making closer to the people, as represented by local parliament. Administrative decentralization implies the transfer of administrative operations and authorities from central to local governments while financial decentralization implies local revenue raising by the local government. When looking at East Asian countries, Indonesia and the Philippines are pursuing particularly drastic reforms since autonomy and the decision-making power on political and administrative matters have largely shifted to the local level. Although the share of local revenue is still low, it has been considerably increased compared to that during the pre-decentralization period. Progress in Thailand is slow despite ambitious goals set under the Decentralization Act of 1999, while China and Vietnam have pursued decentralization within the context of administrative reform with decision-making power over all important administrative matters still being retained by the central party or government. Cambodia has just started the decentralization process, while Laos is facing severe constraints in terms of human resources at local level.

2. THE IMPACT OF DECENTRALIZATION ON INFRASTRUCTURE PROVISION

In countries where decentralization has been drastically and hastily pursued, there have been widespread fears that those countries would fall apart and that service delivery would deteriorate as a result of this. In the Philippines and Indonesia, the degree of maneuver for local governments has certainly increased and they strongly demand autonomy from their central governments. Since it can reflect more precise needs of the people residing in the administrative area, decentralization is generally considered to be desirable in terms of development, but it poses critical issues in infrastructure provision particularly with regard to the following issues; (a) diminished economies of scale and externalities; (b) widening of regional inequalities; (c) weak human capacity of local governments; (d) financial shortfall of local governments, and (e) excessive intervention of local elites and bosses.

2.1 Diminished economies of scale and externalities

Infrastructure services presume that the construction of networks, which require large fixed costs, imply economies of scale. Decentralization adversely affects economies of scale in the following way: first of all, it limits the scope of development strategies and consequently infrastructure construction within its jurisdiction, and secondly, it deprives the economies of scale materialized, based on the scope of the network, cutting across the administrative boundaries of local governments. Focusing the benefit only within its jurisdiction diminishes the positive spillover effect derived from a larger network.

The number and size of the lowest level of autonomous administrative body in the Philippines and Indonesia are, by far, more numerous than the upper level of administrative bodies. In addition, its number tends to increase further. Even though the number of local governments is large and their sizes are small, economies of scale can be achieved if the network of infrastructure assets covers a large number of small local administrative areas and where the services are provided through such an across-the-border network. However, those local governments tend to be inward-looking in their administrative areas and manifest a preference to provide infrastructure and services by themselves. Under such circumstances, the connection of infrastructure assets and services among neighboring local governments is neglected. Given the fact that local governments are small and numerous, this problem becomes serious. The middle tier of governments, such as provinces and states, are expected to address these problems by coordinating local governments within judicial territories, but the capacity of such middle tier governments is weak in East Asian Countries, and as a consequence, coordination does not function. In countries such as Indonesia, the law even stipulates no hierarchical relation between provincial and local government, making the former difficult to facilitate coordination and cooperation with its lower level local governments. Meanwhile, certain efforts to form such middle tier governments and to coordinate local governments may be found even in those countries. Examples of these are the efforts to formulate a regional development strategy by the Yogyakarta provincial government in Indonesia, and the provision of interjurisdictional urban services as shown by the Metro Manila Development Authority in the Philippines.

One example of the failure to achieve economies of scale is found in the Cavite and Laguna (CALA) provinces region in the Philippines. The North-South corridor project spanning three municipalities of the CALA area failed to be completed on schedule since one of the three mayors in the municipalities concerned was hesitant about bearing the financial burden. Because of decentralization, municipalities are supposed to bear 50% of the land acquisition cost within its jurisdiction, whereas prior to decentralization, the central government contributed the entire cost of the said project. Such an increase in the financial burden provides a negative incentive for the promotion of large-scale infrastructure connecting neighboring local governments.

2.2 Widening regional inequalities

While measures to mitigate inequality within national territory are built into the budget allocation in the centralized administrative system, under decentralization, local governments must depend on their own financial resources. Fiscal decentralization thus creates inequality among local governments since the individual local government's capacity to raise revenue depends upon the economic development of the areas of jurisdiction. Therefore, an income-redistribution mechanism must be constructed even

under decentralization. While local governments in the Philippines and Indonesia depend on the transfer from the central government, such transfers are not designed in a way that will narrow regional inequality. In the Philippines, the criteria for distributing Internal Revenue Allotments do not take into consideration factors such as poverty incidence, resulting in a more favorable allocation to urban areas, while in Indonesia, the amount of grants for local governments before decentralization is used as the base amount, which is called a “hold harmless” policy, and the redistribution formula for grant subsidies does not take into consideration the revenue share from the natural resources of resource-rich regions. These measures, therefore, work against narrowing regional inequality.

2.3 Weak Human Capacity

While decentralization requires local government officials to be more accountable and proactive vis-à-vis their constituency in the provision of infrastructure services, they have no experience and skills for providing such services. This is because under the centralized system, tasks such as planning, budgeting and executing infrastructure projects, were conducted by the regional offices of central government ministries. Since infrastructure requires a high level of expertise and capacity in planning, designing, financing, implementation, operation and maintenance, local governments remain constrained in terms of human capacity. In order to compensate for such a capability gap, central governments in the Philippines and Thailand attempted to displace central government officials to the local government, but failed due to the difference in salary scale and the lack of incentives and motivation among central and local governments and public sector employees.

2.4 Financial shortfall of local governments

While the increase in the amount of local government revenue and its share in national revenue was observed after decentralization in East Asian countries, many local governments, especially those in the Philippines and Indonesia, are still suffering from the mismatch between functions and revenue devolved. In those countries, central governments need to reconstruct their fiscal positions. Consequently, this reinforces the central government’s preference to retain its fiscal resources instead of devolving them to the local governments, in addition to the resistance to devolution in general. Such reluctance is considered to be a loophole in the decentralization code in the Philippines, admitting that the central government intervenes in the devolved activities or as a retention in the kinds of taxes which were supposed to be transferred to the local government in Indonesia. In addition, local governments’ ability to raise its own revenue is constrained by stipulations limiting the local government’s room for maneuver in the local government code in the Philippines. Local governments are even reluctant to impose direct taxes on their constituencies for fear of a backlash from the latter at election time. In viewing local government budget expenditure, its priorities are normally given to recurrent expenditure,

which severely constrains the implementation of such a strategic investment as improving connectivity to the infrastructure of national interest and promoting local socio-economic development.

3.5 Rent-seeking

While political decentralization promotes citizens' participation in choosing their leaders as well as public meetings during the planning process, observations reveal that in the Philippines, the participation of a wider range of stakeholders, including the private sector in infrastructure development, is still limited and that not all mayors and leaders are willing to listen to the voices of the people and communities. In Indonesia, weak planning and a participatory mechanism leave room for the local elite to intervene during the administrative process of infrastructure development. Since the personal connection is deep and solid at the grassroots level in Asian countries, the intervention of the local elite or bosses works like rent-seeking and results in high project cost, corrupt procurement practices and the reduced benefits and effectiveness of the projects.

3. THE WAY FORWARD

3.1 Making the functions of governments technically appropriate and practically workable

In order to avoid the adverse effect of decentralization in infrastructure provision and services, much remains to be done in terms of government functioning, reinforcing financial and human resources capacity and reinforcing the accountability of the local government. The keys to successful decentralization include the intergovernmental arrangement on functions, authorities, responsibilities and financial resources, the optimal choices of which are highly country and sector specific. In this context, it is useful to classify characteristics of infrastructure by sector and highlight dimensions affecting infrastructure provision in order to decide on the most appropriate form of services provision within the government hierarchy. After such classification, appropriate functions may be assigned to the corresponding level of government. Providing incentives to them is also important in order for them to be able to play their anticipated roles, so that qualified and reliable infrastructure services - covering the areas with which to enable economies of scale - can be provided. Central government dominance over local government in many aspects of infrastructure development, weak capacity and the lack of financial resources of local governments run the risk of local government becoming a simple agent for implementing centrally decided projects. Therefore, certain safeguard measures must be integrated into the decentralization program. In addition, interventions and influence by politicians should not be undermined since such forces may block technocratic solutions.

3.2 Enhancing local government capacity

There is a universal need to strengthen the weak capacity of local government staff. In order to do so, it is important to give local authorities an autonomous financial and administrative status in order to hire and promote experts. In this context, the budgeting problem, in terms of lower salaries for local officers, is a bottleneck for attracting a highly skilled labour force. Since the central government has advantages in many aspects, its assistance to the local government is also essential. Strong and continual support from the heads of local government is also indispensable, while local officers' efforts to enhance accountability provide the key opportunity to build their capacity. In building capacity, the local government needs to respond to the immediate needs of infrastructure provisions. Measures such as sharing professionals with other local governments and using out-of-town professionals are the solutions to such requirements.

3.3 Overcoming financial constraints

Local governments face imbalances between the resources transferred and the expenditure needed to perform devolved responsibilities. Under such a situation, local governments should either save or raise money. For saving money, the use of community contributions in village infrastructure construction projects, either in the form of labor, materials, crops and land, may reduce the infrastructure investment cost considerably, while the labor contribution of the people to rural road maintenance shows the same effect. The latter also contributes to the accumulation of local technical skills and income generation. The use of locally procured materials, consultants and contractors with the choice of technologies appropriate to the local context will also reduce the investment cost. In order to increase local government revenues, central government support is essential since in devolving more taxing power to local government, it cannot materialize without it. In addition to increasing the types of local taxes, increasing the power of local government with regard to tax and measures for balancing regional disparities within a country must be taken into consideration, while the local borrowing possibility should also be explored within the limits of securing macroeconomic stability.

3.4 Reinforcing local accountability

Accountability is pivotal to the economic rationale for decentralization since it is believed that decision-making with regard to public expenditure by the local constituency tends to reflect local demand. While fair elections remain the main driver for enhancing accountability, measures for providing incentives, such as enhancing transparency and community participation, should also be taken into consideration. Such incentives can also be provided by the upper levels of government by utilizing local accountability as an instrument with which to administer the regulatory framework.

REFERENCE

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