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Sharma, Chanchal Kumar

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## **The Federal Approach to Fiscal Decentralisation: Conceptual Contours for Policy Makers**

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Chanchal Kumar Sharma, Department of Political Science, Maharaja Agrasen College (H. No-61 0 Sector-1? HUDA, Jagadhri-13500, Haryana India. (email: [siddhantchanchal@rediffmail.com](mailto:siddhantchanchal@rediffmail.com)). in his paper demonstrates that in order for fiscal decentralisation to be effective, it must be approached federally. A federal approach is not a decentralised approach but a dynamically balanced approach; one that constantly keeps on adjusting the contrasting forces of centralisation and decentralisation to create a system that can ensure good governance in accordance with the rapidly changing global and local scenario. According to the author, the good governance of the present time has to be federally flexible and dynamically decentralised and institutions of fiscal federalism are crucial for achieving such a dynamic equilibrium. Fiscal decentralisation cannot be detached from the broader principles of fiscal federalism if it is to be successful, irrespective of the fact of whether it is being carried out in a federal or non-federal country. He argues that too much decentralisation or an overly strong central federal government precludes the survival of a constitutional federal state.

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### **INTRODUCTION**

Beginning in the 1990s, decentralisation and local government reform have become amongst the most widespread trends in development (World Bank, 2000) which Shah (2004:3) calls a "silent revolution sweeping the globe." Central governments around the world are decentralising fiscal, political and administrative responsibilities to lower level governments and to the private sector (Dillinger, 1994). This trend, according to Ter-Minassian (1997), is evident not only in federal countries but also in many unitary countries including some that have a long tradition of centralist government. According to Shah (2004:3), "the vision of a governance structure that is slowly taking hold through this silent revolution is the one that indicates a gradual shift from unitary constitutional structures to federal or confederal forms of governance for a majority of people." Thus the federal structure of governance has

come under sharp focus. This paper seeks to deal with the conceptual questions of centralisation and decentralisation within a federal form of government. It suggests that for fiscal decentralisation to be successful it must be approached federally (even if the country in question is not an officially declared federal state). The federal approach means 'a balanced approach between the contrasting forces of centralisation and decentralisation.

But there is a lack of clear understanding regarding the 'overlapping' concepts of federalism and decentralisation. Some see little difference between 'federalism and decentralisation' or 'federalism and devolution.' Although there are similarities between these concepts, they should be defined precisely and should not be confused with one another as there are dangers inherent in poorly defined concepts.' Schneider (2003:7) states, "Two problems tend to arise with concepts given varied meanings. The concept can be associated with too many meanings (over specified) or too few (underspecified). Either extreme produces conceptual muddle and causal uncertainty, as observers can approach the concept by delimiting the meanings and indicators that match their belief system" (p.7). Thus it is important to clarify the conceptual contours.

This paper is structured as follows: Section I looks into the perceived advantages of federal structure that have traditionally lent it much theoretical strength. In recent times, when central governments are trying to reduce their role in managing development and relying more on local governments, academics have been led to reconsider if new solutions are to be developed in policy areas concerned with long term change and stepwise internalisation of externalities. Section II deals with the overlapping concepts of federalism and decentralisation in order to demystify conceptual confusion surrounding the difference in meaning and scope of these terms. A clear understanding of the concept is one of the most critical prerequisite for translating decentralisation from theory to practice. Section III demonstrates this by taking the example of the European Union (EU) as to how centralising and decentralising forces interact in a federalizing system to strike a balance thus ensuring good governance. Section IV further extends the discussion by emphasizing that institutional arrangements related to fiscal federalism are crucial for striking such a balance, thus emphasizing that it is fiscal decentralisation that is the most salient federal institution. After stressing the significance of fiscal decentralisation, section V suggests that the attempt to implement fiscal decentralisation must take into account the broader principles of the political economy of fiscal federalism. Ignoring these principles can lead to decentralisation failure. Section VI examines one such principle i.e. 'a strong centre' in detail.

Section VII finally highlights how the strong centre of the 21st century will be different from the one that existed in the earlier paradigm of governance structure.

## I

### **THE FEDERAL APPROACH: COMBINING THE BEST OF UNITY AND AUTONOMY**

Alexis de Tocqueville wrote in *Democracy in America* that "the federal system was created with the intention of combining the different advantages which result from the magnitude and the littleness of nations" (Tocqueville, 1990: 163). Thus the federal system is concerned with combining the political and economic advantages of unity while preserving the valued identity of the sub national units.

The political advantage of unity is 'security.' This security can be of many kinds; "security against foreign danger; security against contentions and wars among the different States; guard against those violent and oppressive factions which embitter the blessings of liberty, and against those military establishments which must gradually poison its very fountain." (Madison, quoted in Cooke, 1961 :308)

The economic advantages of unity are those that result from 'operating within a common market' (that have become a serious concern in the context of globalisation and the market economy<sup>2</sup>). In addition to this the centralised provision of certain services (that can be provided less expensively on a larger scale or their benefits may spill over across districts) creates economies of scale and captures externalities (but at the cost of imposing a common policy on populations with varied preferences and priorities).

Similarly political advantages of sub-national flexibility are that it "fosters greater responsiveness of policy makers to the will of the citizenry and results in a closer congruence between public preferences and public policy. It promotes diversity in public choices. It enhances democratic values and provides the opportunity for people at the local level to define and debate the problems facing their area. It also protects democracy through assuring countervailing centres of power and influence in a plural society" (Wolman,1990:32).

Economic advantages of decentralisation are allocative and production efficiency. It has been argued that the role of local governments in allocation is substantial and thus allocative efficiency is maximised under highly decentralised political structures (Smoke, 1994:28).<sup>3</sup> Another economic advantage is that under the local people's scrutiny, production efficiency of local public goods and services such as water supply, solid waste collection, sewerage works, refuse disposal and public transport could be maximised (Wolman,

1990:30-1; Campbell *et al.*, 1991: 6). It is to be noted that there are trade-offs in uniting the two principles of central government control and local flexibility. On the one hand, to achieve the gains stemming from unity, autonomy is to be restrained and on the other hand, to realise the gains emerging from autonomy, central government control is to be relaxed in addition to granting independent financial powers to sub-national levels to enable them to fulfil their responsibilities and also to increase government's accountability. In fact the appeal of federalism lies in the fact that it provides enough opportunities to resolve this trade-off to arrive at the optimality.

In fact, the trade-off between autonomy and efficiency forms the basis of the federal approach to governance. Federalism is a system that strikes a balance between these two tendencies or trade-offs. According to Riker (1975:113-4), "federalism is an outcome of rational bargain among various constituents. The bargain may be for political or economic gains. In the political bargain, the constituents give up political autonomy for security from external threat. The economic bargain is to enable a common market and to ensure optimal provision of public services by reaping economies of scale and catering to diverse preferences." This kind of arrangement implies the existence of both forms of administration (centralised and decentralised). Thus the paradox at the heart of all federal systems is that federalism is designed, as the late Elazar (1966: 2) put it, for both "self rule and shared rule," In the words of Watts (1998:133), "...in the context of contemporary global scene, federal political systems, combining shared rule and self rule do provide a practical way of combining the benefits of unity and diversity through representative institutions... federal arrangements and the idea of federalism have shown that they can provide a means for reconciliation in the world. The challenge for scholars is to contribute, by critical, objective and comparative analysis, to a better understanding of how new federal systems may be established or existing ones made more effective. "

Coexistence of both forms of administration is a vindication of the consensus since the 1980s that excess of centralisation or absolute local autonomy, cannot only seriously compromise the principle of unity in diversity or that of combining shared rule with self rule but can also lead to inefficiencies. In the former case, the minimum winning coalition within a legislature will come to determine the provision of public goods and in the latter case sub-national governments will compete for scarce capital by lowering their capital taxes and public goods level below the efficient levels. The federal approach to governance seeks to derive conditions for resolving a trade-off between these two inefficiencies and the conditions under which both regional and central governments

should provide public goods. Oates (1972: 14) compares the alternatives of a centralised and decentralised government in terms of their ability to deliver the three tasks (stabilisation, redistribution and allocation) identified for the public sector by Musgrave (1959). He argues that both the options of centralised and decentralised government have relative advantages and disadvantages, so the optimal system would be one that combines the strengths of both while avoiding their weaknesses: "a federal organisation of government meets this need."

## II

### FEDERALISM AND DECENTRALISATION

Economists like Boucher and Migue (2002:2) have flatly stated, "federalism is decentralisation." Thus, to them supporters of devolution are real federalists. Similarly, Dafflon (1992) argues that in federalism, centralisation is seen basically as negative policy measure. Supporting this view is another economist, Lee (1994:75), who talks of *restoring* fiscal federalism in the US which in his opinion "can only be achieved by dramatic decentralisation in the power to tax." Thus follows his extreme proposal for reverse revenue sharing. Similarly, federalism has been regarded as "a critical theoretical component of decentralism" by Gerring *et al.* (2004), thus reinforcing the federal-decentralised vs unitary-centralised dichotomy.<sup>4</sup> On the other hand, in the conventional debate in Canada and Europe, federalism is associated with strengthening central government's powers, while the search for autonomy and decentralisation is linked to narrow secessionist movements and anti-European options.

But both the views ignore the fact that the subject matter of federalism is neither centralisation nor decentralisation. Federalism is concerned with striking the right balance between the two tendencies. Lijphart argues that decentralisation and federalism do not always mean the same thing.

Thus it is clear that a federal political system cannot be distinguished from a non-federal political system on the basis of the degree and extent of decentralisation. What distinguishes a federal political system from a decentralised non federal unitary system is not just the scope of decentralised responsibilities but the constitutional guarantee of autonomy for the constituent governments in the responsibilities they perform. Elazar (1981:34) has therefore preferred to describe federations as "noncentralised" on the grounds that decentralisation implies a hierarchy with power flowing from the top or centre, whereas non-centralisation suggests a constitutionally structured dispersion of power, better representing the essential character of

federations. Generally it is claimed that this broad characteristic distinguishes federations from unitary systems. This does not mean that all the federal systems on the one hand and the unitary system on the other are structurally similar. In fact there is considerable institutional, political and cultural diversity within these two types. As Nathan (1992) has pointed out, there is in practice enormous variation among federations in the extent of the powers, responsibilities and resources assigned to the different levels of government. Among multiple indices, not all of equal weight, to be considered are the distribution of legislative and administrative jurisdiction, the allocation of financial resources, decentralisation to non governmental agencies, constitutional limitations and degrees of participation by the constituent unit governments in federal decision making.

A federal political system thus is not always coterminous with a decentralised system and should be viewed as making continuous adjustments over the centralisation or decentralisation continuum due to their own 'endogenous' reasons. This strand views decentralisation as a complex process that is a product of many factors including cultural heritage and geography. Tocqueville (1990: 114) wrote "it is as impossible to determine beforehand, with any degree of accuracy, the share of authority which each of two governments to enjoy, as to foresee all incidents in the existence of a nation." While studying the centralisation-decentralisation tilt in federal systems, Watts (1998) argued that the interactions of social, political, economic and ethnic factors have shaped institutional structures and political processes in such a way as to produce trends towards centralisation in some federal systems and decentralisation in others. In fact, it is not entirely exceptional to find that in practice, some federations for their own reasons may decide to give more powers to the centre while others will attribute the majority of authority to their constituent units. Thus, due to some *endogenous reasons* some federations remain highly centralised while others remain much decentralised. Therefore an analogy between federal and decentralised nations could be erroneous, while "it is appropriate to view federalism as a process of unifying power within the cluster of states and decentralising power within the unified state" (Ariyo, 2003:2). Federalism thus is not a fixed allocation of spheres of central and provincial autonomy or a particular set of distribution of authority between governments. Rather, it is a process, structured by a set of institutions, through which authority is distributed and redistributed. In the words of Wheare (1963: 117), "there is and can be no final solution to the allocation of financial resources in a federal system. There can only be adjustments and reallocations in the light of changing conditions." Federations have

evolved as ongoing incomplete contracts (Hart, 1988; Seabright, 1996) and by their very nature are under constant renegotiation. Viewing federations as incomplete contracts does to some extent help in solving the puzzle as to why some mature federations like Australia, the US and Canada are evolving towards more centralisation when there is an increasing trend towards decentralisation in developing countries. The insight yielded by the new institutional economics (North, 1990) - that the motivations and incentives of economic agents, and the options available to them, are influenced in a fundamental sense by the incompleteness of contracts may throw considerable light on such evolution.

Thus in federal governance decentralisation is not considered as an alternative to centralisation. Both are considered necessary. The greatest challenge is to strike a balance. That is why the UNDP(1999:3) report on decentralisation says that use of the term "decentralised governance" is more appropriate rather than the term "decentralisation."

### III

#### **BALANCING CENTRALISATION AND DECENTRALISATION: FEDERAL DYNAMISM OR FEDERAL DILEMMA?**

The idea of balancing the contrasting forces of centralisation and decentralisation is central to the concept of federalism. These two movements are at work in the European Union. The notion of fiscal federalism as a predominantly centralising (unifying) force led to the emergence of an integrated European Union in November 1993. The Maastricht Treaty of November 1993 conferred important new powers on the European Parliament including co-decision making on legislation. This creation and evolution of a new top level of government in Europe in the context of European Monetary Integration has significant spatial consequences in which national factors are gradually losing relevance with the vanishing of old borders and redistribution of roles at national and regional levels. The biggest riddle according to Inman and Rubinfelds (1992:654) is "the future of the national governments of the member states." However, on the other hand, the 'subsidiarity principle' was also formally adopted as a quasi-constitutional rule through Article 3b of the Maastricht-Treaty-which stipulates that the powers of EU institutions be limited to those functions that cannot be adequately performed by member states. More recently, while the notion that monetary policy be centralised has gained acceptance among the Europeans, the idea to centralise fiscal policy in the European Union (EU) has generally been rejected. Thus there are contrasting forces of centralisation and decentralisation at work.

All this has generated a lot of rethinking on the implications of economic integration within the European Union for the fiscal structure of

the EU specifically and on the concept of fiscal federalism more generally. The contradictions emerging from the working of contrasting forces, some leading towards greater centralisation and others towards greater decentralisation which are at the heart of fiscal federalism have become more pronounced than ever in the context of new global economic order. This phenomenon is not restricted to the EU but is also to be seen in those countries which are moving towards a market economy after failure of centralised planning, in the context of 'globalisation.'

The dilemma of balancing the contrasting forces of centralisation and decentralisation that is inherent in the very dynamics of federalism, is more pronounced in the developing and transitional countries - the nations that are trying to stabilise their economies while"... trying to invest more decision making power in populations that have long been disenfranchised" (Bahl, 1995: 1) and thus ideally trying to "combine the advantages of magnitude and littleness of nations" (Tocqueville, 1990: 163). In consequence, they are confronted with the predicament of resolving the trade off between autonomy and efficiency signifying a movement towards decentralisation and centralisation respectively.

The foregoing discussion demonstrates that decentralisation should not be considered as an alternative to centralisation. Both are needed. The complementary roles of national and subnational actors should be determined by analysing the most effective ways and means of achieving a desired objective. For example, a national road system should be designed with both local input and national coordination. Foreign policy should be a national function based on the views of the citizenry. Solid waste management should primarily be dealt with through local mechanisms (UNDP, 1999).

Thus the right degree of decentralisation, according to Wildasin (1996), depends on what it is we are considering decentralising and on the particular economic, historical, political and other circumstances within which decentralisation is contemplated. The crucial issue, says Wildasin, is to identify which level of decentralisation is appropriate for each kind of activity. It just does not make much sense to hope for any sort of bottom-line presumption in favour of "more centralisation" or "more decentralisation." But it is regrettable, says Shah (2004:1) that the debate in development policy triggered by the rekindling of interest in fiscal rearrangements and re-examination of the respective roles of the levels of government "has focused on the straw men of centralisation vs decentralisation."

## IV

**FISCAL FEDERALISM:  
MAKING ADJUSTMENTS OVER THE CONTINUUM**

Given that the dynamics of the federal approach to governance lies in its ability to balance the contrasting forces of centralisation and decentralisation, it can further be argued that it is the fiscal side of the federalism (fiscal federalism) that is crucial for striking the right balance, for it is finance that is the life blood of the government. It is no surprise then that fiscal federalism literature is far away from the centralisation vs decentralisation focus and is particularly concerned with clarifying assignment of responsibilities among different levels of government in support of good governance.

In common parlance political and constitutional aspects (e.g. giving citizens or their elected representatives more power in political decision-making, establishment of subnational political entities for decision making and making them politically accountable to local electorates which often entails constitutional or statutory reforms like providing for representation of the member states, the strengthening of legislatures, creation of local political units along with the encouragement of effective public interest groups and pluralistic political parties) are considered crucial for federalism. Dillinger and Webb (1999)<sup>5</sup>, while giving more preference to political decentralisation (though without ignoring fiscal decentralisation), use political decentralisation as synonymous -to federalism. Yet Lane and Ersson (1997) in a striking study, conclude that it is fiscal decentralisation rather than the political one that is *the* most salient federal institution. In their opinion, even though a constitutionally recognised regional autonomy makes the theoretical case for federalism, in practice it has no sense in case regions lack financial resources. A few scholars (Azfar *et al.*, 1999:28) have raised the question regarding the relative importance of various factors contributing towards meaningful decentralisation. Others (Yilmaz and Ebel, 2002) recognise the importance of fiscal decentralisation which, according to them, is crucial for intergovernmental restructuring. But the step towards fiscal decentralisation has been a bit sketchy when compared to a great deal of political decentralisation in the 1990s. This can be largely explained by the fact that it takes time for systems to change from a long-lasting centralisation to decentralisation. While it is easier to achieve political decentralisation, building institutions for fiscal decentralisation takes time.

Gates describes fiscal federalism as a "general *normative* framework for the assignment of functions to different levels of government and

appropriate fiscal instruments for carrying out these functions.. It explores, both in normative and positive terms, the roles of the different levels of government and the ways in which they relate to one another through such instruments as intergovernmental grants" (Gates, 1999: 1120-1 ). This definition lends support to the idea that 'the balancing act' that is so crucial to federal organisation of government, is best performed by fiscal federal arrangement.

In fact, centralisation-decentralisation is a continuum, rather than a dichotomy and federalism is a special case. Fiscal federalism is concerned with making continuous adjustments over this continuum and exploring the respective roles of the different levels of the government and assigning responsibilities and fiscal instruments to the proper levels of government (of course not to be fixed once and for all). It is concerned with ensuring mutual interaction and coexistence of centralised and decentralised levels of government.

## V

### **SUCCESSFUL FISCAL DECENTRALISATION: BRINGING 'FISCAL FEDERALISM' BACK IN**

The above discussion shows that the institutions of fiscal federalism are crucial for maintaining centralisation-decentralisation equilibrium. It is to be realised that while 'fiscal federalism' is a guiding concept that helps in designing the structure of financial and broader relationships between central and subordinate levels of the government, 'fiscal decentralisation' is a process that alters such structure by devolving powers to the lower levels of the government. Thus fiscal decentralisation is one of the most significant principles of fiscal federalism. It however cannot be successfully implemented while disassociating it from other principles underlying fiscal federal theory.

The concept of fiscal federalism offers a wide variety of structural designs and one has to be clear as to what design one ultimately desires to achieve before setting out on the task of designing the contours of decentralisation process. Thus decentralising without the vision of a fiscal federal blueprint is like working without sight of the goal. As Gallagher (1998:2) observes, "before we can think about the nature of decentralisation we must consider the nature of the fiscal arrangements that are desired i.e., before setting on a path of decentralisation it is important to have a clear picture of the target structure of fiscal arrangements."

Thus there are perils inherent in over-stressing the idea of fiscal decentralisation "in general" while ignoring other dimensions of political economy of fiscal federalism<sup>6</sup> "in particular country-specific context." Brazil is an example where states and municipalities have won due to

overemphasis on fiscal decentralisation. They (states and municipalities) dominate the union and compete among themselves in a disorganised and predatory fashion. The experience of Argentina shows that perversely structured systems of intergovernmental finance can destabilise the public sector and economy as a whole. Another instance is Bosnia Herzegovina. The country adopted a federalist structure under the Dayton Peace Agreement. But the agreement seriously compromised some basic principles of "fiscal federalism" and powers of the centre with respect to subcentral units were highly curtailed. The state (centre) now faces the challenge of carrying out even its minimal responsibilities, since it relies on transfers from the entities.

Thus an improper attempt at fiscal decentralisation could be a disaster-prone strategy while the "proper" distribution of tax authority and expenditure responsibility is an extremely complex issue. The problem in many cases according to Prud'homme (1995) is not what to decentralise (or whether a service should be provided by a central, regional or local government) but, rather how to organise the joint production (shared rule) of the service by various levels. The riddle can be solved only if a comprehensive view of the political economy of fiscal federalism is considered instead of a narrow approach to fiscal decentralisation. Since success of decentralisation depends on its design, an overall improvement in the political, fiscal and administrative institutions of decentralisation is a precondition before embarking on the path of decentralisation. "But decentralisation is often implemented haphazardly. Decision makers do not always fully control the pace and genesis of the decentralisation process" (World Bank, 2000: 107). Thus what is required is that decentralisation as it is understood and pursued in recent times must not be detached from a broader and constantly expanding perspective on fiscal federalism, the intellectual lineage of which can only offer a framework for successful decentralisation.

The market-based decentralisation as it is understood today is a recent phenomenon and has its origin in the development ideology of the World Bank and the International Monetary Fund. The re-emergence of modern-day decentralisation can be traced back to 1961, when Cambridge University hosted a conference on decentralisation which was closely followed by the meeting of the United Nations Working Group on Decentralisation in the same year. These were probably the first formal attempts made by academicians and practitioners alike to discuss the conceptual and practical issues relating to the notion of decentralisation. However, after the passage of four decades, there still remains confusion surrounding what the concept actually stands for both in theory and practice.

The conceptual framework of fiscal decentralisation is well established in fiscal federalism literature, drawing largely on the contributions by Musgrave and Oates to the understanding of which is further expanding with the emerging second generation theory of fiscal federalism with important contributions from In man and Rubinfelds (1992, 1997), and Oian and Weingast (1996, 1997). The central logic is that the core issues of growth and poverty (the justification offered for economic reforms across the globe after failure of the earlier paradigms) cannot be addressed without addressing efficiency-supplying services up to the point at which, at the margin, the welfare benefit to society matches its cost.

Though the conceptual framework of fiscal decentralisation is well established in fiscal federalism literature there is no set of prescribed rules for fiscal decentralisation. Bahl (1999: i-ii), however, on the basis of best practices in fiscal federalism delineates 12 rules for fiscal decentralisation which are well grounded in the theory of fiscal federalism. These are:

1. Fiscal decentralisation should be viewed as a comprehensive system.
2. Finance follows function.
3. There must be a strong central ability to monitor and evaluate decentralisation.
4. One intergovernmental system does not fit the urban and rural sectors.
5. Fiscal decentralisation requires significant local government taxing powers.
6. Central government must keep the fiscal decentralisation rules that it makes.
7. Keep it simple.
8. The design of the intergovernmental transfer system must match the objectives of decentralisation reform.
9. Fiscal decentralisation should consider all the three levels of government.
10. Impose a hard budget constraint.
11. Recognise that intergovernmental systems are always in transition and plan for this.
12. There must be a champion for fiscal decentralisation (meaning that one must defeat very strong centralisation arguments).

To proceed with fiscal decentralisation while detaching it from federal dimensions and political economy considerations inherent in fiscal federalism is no doubt dangerous. At this point it needs to be asserted that while bringing about fiscal decentralisation in any country (whether unitary or federal, developing, transitional or industrialised); sight should not be

lost of the principles of the political economy of fiscal federalism. While drawing attention to this aspect Boex (2001 :3) stresses that "fiscal decentralisation is relevant to all countries, regardless of whether they are unitary countries, federal countries or confederations." Though the manner in which the principle will be applied will differ in each case as the unitary and federal governments provide different opportunities for fiscal decentralisation due to divergence in their respective political and legislative context. However, it must be reasserted that to regain the dynamic stability inherent in fiscal federalism, there is a need to "put federal back into fiscal federalism" (Keen, 1998:456) which is notable in decentralisation literature only by its absence and which has been identified as one cause behind 'decentralisation failure.'

## VI

### **STRONG CENTRE FOR EFFECTIVE FEDERALISM**

Most of the studies on the 'centralisation versus decentralisation issue' tilt heavily in favour of decentralisation. Because decentralisation, besides giving many other advantages may also avoid noted inefficiencies of centralised decision-making such as (a) central officials who lack detailed information about local tastes (Hayek, 1948), (b) decision-making by a centralised legislature may permit a narrow majority of regions to expropriate the others, or generate norms of reciprocity that result in overspending (Weingast, 1979; Besley and Coate, 2000), and (c) central government's ability to insure regions against exogenous shocks, increasing welfare, will create moral hazard for the regions (Persson and Tabellini, 1996). More recent literature suggests that decentralisation, unless carried out under the aegis of a reasonably strong centre, is doomed to fail. A weak centre is prone to get manipulated by the strong coalitions and interest groups. There is overwhelming consensus that most of the problems associated with decentralisation can be solved by central government intervention and regulatory powers entrusted in it (Cumberland, 1981; Gordon, 1983; Wildasin, 1989; Rivlin, 1992). While comparing a case of a strong centre with a weak one, Blanchard and Shleifer (2000), argue that fiscal decentralisation has been successful in China because the centre in China is strong enough to restrain destructive behaviour of local interests and withstand unhealthy local demands. On the other hand the process in Russia is, at best, just wavering, all because of the weak centre. They show in their study that decentralisation in developing and transitional countries can lead to the capture of local governments. In such cases the authors argue, strong administrative control of the local government by central authorities is important for efficient economic decentralisation. Thus for

federalism to be effective one of the conditions is that decentralisation must be balanced with the provision of a strong central government with ability and willingness to resist unhealthy demands from lower levels of the government. This argument endorses Riker's (1964) suggestion that centralisation does matter for federalism to be effective. To quote an even earlier source, Tocqueville writes, "From my perspective, I cannot imagine a nation that could survive and especially prosper without strong government centralisation" (1952: 87). In 1836 after living for several months in Switzerland he wrote "I have developed such an utter disdain for the federal constitution of Switzerland, that I would unequivocally term it a league and not a federation. A government of that nature is certainly the weakest, the most impotent, the clumsiest and the least capable of leading its people anywhere except to anarchy that one could imagine. I am also struck by the lack of any *vie politique* in its population. The Kingdom of England is a hundred times more republican than this republic" (Tocqueville, 1952: 70-1).

Various studies show that fiscal decentralisation may lead to allocative inefficiencies, as well as poor accountability and governance if expenditures and revenue mobilisation functions are not properly assigned across the different levels of the government (Hommes, 1995; Fukasaku and de Mello, 1999; World Bank, 1999). Hommes (1995:332) sees decentralisation as "essentially a political problem" representing, in Latin America for example, a stark departure from centuries of centralism. The success of decentralisation may depend upon the existence at the local level of a civic cultural tradition-informal civic institutions, such as solidarity and cooperatives. With a lack of local governmental experience and riddled with patronage, local governments in Latin America tend to be captive of the elites and political barons. Thus, for Hommes, an irony of fiscal decentralisation may be the need for more central government controls to protect against this danger. Hommes notes that the seeming paradox of decentralisation is that it demands of the central government more sophisticated political control. Some authors have argued that in the post Soviet context, greater centralisation is in fact required (Polishchuk, 2000, Stoner-Weiss, 2001). Ultimately effective decentralisation requires the relinquishing of some central control.

## VII

### **THE NEW 21<sup>ST</sup> CENTURY ROLE OF THE CENTRAL GOVERNMENT**

The emerging governance literature explores the kind of 'sophisticated control' that is being considered more relevant than ever in the current scenario. This new role of the centre is based on changing paradigms of governance structure (table-1).

**Table 1**  
**Governance Structure, the 20th Versus the 21st Century**

20th Century	21st Century
Unitary	Federal/Confederal
Centralised	Globalised and Localised
Centre manages	Centre leads
Bureaucratic	Participatory
Command and Control	Responsive and accountable
Input controls	Results matter
Top down accountability	Bottom up accountability
Internally dependent	Competitive
Closed and slow	Open and Quick
Intolerance of risk	Freedom to fail/succeed

Source: Shah, 2004, p 4

The centre's new role will not be identical to the older one where the central government played a strong-control and commanding role. As governments restructure, the role of the centre should be that of "stewardship." Peter Block argues that principles of stewardship bring a new understanding of accountability to each act of governance (1993: 27). In this concept, which is quite popular in the literature of management and organisation in United States, trust and service and accountability are emphasised. In the new role, the central government, enables the regional governments to exercise the newly devolved responsibilities, powers and authorities. In this process, national level institutions are strengthened to provide support to the regional levels.

In fact the changed global economic and political conditions are compelling central governments to look forward to more involvement of regional levels (some authors now prefer to use the word *engagement*) in the development of national economic development strategies and thus are attempting to build local capacity. In the emerging borderless world economy a newer federalism perspective will be called for, because in the times to come the functions such as "regulation of financial transactions, international trade, global environment and international migration, corporate taxation, stabilisation, international conflict resolution, surveillance of governance conditions, transnational production, investment and technology transfer suppression of money laundering, drug smuggling and terrorism will gradually pass upwards i.e. beyond nation states. The central level of government will perform tasks such as "oversight and technical assistance

to subnational governments, macroeconomic coordination, social safety nets, skill enhancement for international competitiveness, social and environmental policy through international agreements" (Shah, 2004: 11). The task ahead to ensure this is to strengthen national level institutions. A real test of the strength of the institution is the ability to successfully meld two goals: central authority and subcentral or decentralised engagement and empowerment to ensure good democratic governance.

New literature on the political economy of fiscal federalism goes far beyond the earlier issues. Now the case is for the centre to assume sophisticated styles of remaining 'in charge' (stewardship/ leadership) and constructing such support structures, processes and national institutions which create an enabling environment<sup>1</sup> (in which subnational autonomy is tolerated and treasured), build local capacity and provide appropriate incentives for the sub-national governments to behave responsibly while allowing the centre to perform its new role in changed political and economic conditions. The best design for decentralisation in the last analysis will vary according to circumstances and situations.

## NOTES

1. Cognitive linguists like Lakoff (1985) have elaborated on the dangers of poorly defined concepts.

2. In a two-day seminar on 'Federalism in a Globalising World' in New Delhi on 5 August 2003, under the joint auspices of the National Institute of Public Finance and Policy (NIPFP) and Forum of Federation, Ottawa, Canada, the former RBI Governor and a distinguished economist, Rangarajan noted in his presentation that in meeting the challenges of globalisation, the Indian federal structure must respond in such a way so as to create a large common market within the country (*The Hindu*, 6th August 2003).

3. This distribution of functions and collaboration in allocation between central and local government is named as the Tiebout-Musgrave layer cake model of the public sector in the literature. The traditional fiscal federalism paradigm makes use of Musgravian tripartite division (like a layer cake) according to which public services can be divided into three functions (a) stabilisation functions, (b) redistributive functions, and (c) allocative functions. Musgrave and Tiebout proposed that the distribution and stabilisation functions of government should be carried out at national level, while the allocation role should be performed by state and local governments. This has become known as the layer cake model of government. The argument for giving the allocation role to lower levels of government was based on the view that they are more efficient in the allocation of resources because they provide that mix of outputs which best reflects individual tastes. Opposed to this is the Marble Cake Model or Cooperative Federalism Model. In this model various levels of government have overlapping and shared responsibilities and all levels are treated as equal partners in federation.

4. It must be recalled that William Riker in 1969 critique of federalism literature complained that scholars place too much emphasis on differences between unitary and federal system and not enough on the institutional, political and cultural diversity within these two types.
5. William Dillinger and Stewen B.Webb (1999) write, “ it is difficult to imagine what the restoration of democracy would have been like without substantial political decentralization—federalism—and some concomitant form of fiscal decentralization”.
6. The political economy of a fiscal federation in which spending is decentralized and taxation is not (as in the Scottish case) is very different from one in which taxation is decentralized as well(as in the US). Further political economy of fiscal federalism in a developing country attempting to decentralize is different from a developed country on account of the unintended consequences that relatively less developed institutions of accountability, governance and capacity in developing countries might have on decentralization policies.
7. ‘Enabling environment’ means- institutions of citizen participation and accountability. Anwar Shah adds the notion of – “authorizing environment” which in his words, “represents the institutional mechanisms to translate constitutional mission to concrete objectives and actions. These include societal norms, formal and informal rules, procedures and organizations dealing with participation, consultation, policy making and accountability. Legislative coordination and oversight bodies are important elements of authorizing environment. These institutions ensure that public sector is solely focused on citizen aspirations.” (Shah, 2004, p6).

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