12 The Structure of Urban Governance

IN INDUSTRIAL and developing countries alike, there is much disagreement about the proper way to organize the public sector to finance and deliver services. The debate centers on questions about which level of government should provide which services, how much managerial and fiscal autonomy the local governments should have, whether the revenue base given to local governments is commensurate with their expenditure responsibilities, and how much fragmentation in the structure of local government within urban areas should be allowed. This chapter seeks to develop a framework for answering such questions in the context of developing countries.

The questions we raise here by no means exhaust the list of important concerns. Among the important issues not discussed in any detail are mandated expenditure requirements by higher levels of government, the legal limits on interactions among governments, the elective process, the relation between the national and local civil services, and a host of very important management and administrative topics.' Perhaps the most important omission is a direct discussion of the influence of politics on the choice of structure for local government. As in earlier chapters, we are concerned both with what theory tells us about how the intergovernmental system should be structured and with current practices.

Fiscal Decentralization

The current structure of local government in developing countries—and that which will emerge in the future—reflects the commitment of central governments to decentralization.' Indeed, the rhetoric on this issue is strong: the decentralization of population and economic activity is a common goal for developing-country governments and the international agencies which advise them. A development strategy of decentralization, however, does not necessarily mean that local governments will finance and deliver more services. Some countries limit their concern to population, that is, to seeking a better balance in size and economic well-being between rural and urban areas or between large and small towns. Others want to decentralize government operations, for example to pass decisionmaking authority to the regional branches of central government ministries. Still others may view the lowest levels of subnational government (municipalities and counties) as inconsequential to decentralization and go no further than to consider central-provincial relations. Bird and DeMello give us two good statements of this view:

> One of the most interesting features of the governmental structure in Papua New Guinea is that by far the largest city in the country, with a population greater than that of most provinces and a budget and public service establishment which is also much larger than that in most provinces, has apparently never been taken explicitly into account in any of the interminable discussions over the last decade about the relationship between national and provincial governments [Bird 1983: 561.
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> As a rule, national development plans in Latin America do not explicitly include local governments as part of their strategies . . . no Latin American development plan has come down, for example, to the establishment of a national system of cities or to a blueprint for the redistribution of functions among the several levels of government, as a means to enhance economic and social development [De Mello 1977: 28-371.

Conversely, many countries have come to realize that strengthening local governments by granting them some fiscal autonomy is an important component of decentralization. The evidence for this concern is a rash of government commissions on allocating fiscal responsibilities to local governments, restructuring intergovernmental grant systems, and solving the special fiscal problems of large cities. The role of local governments in the development process is in general less often spelled out in national plans than included in administrative and legislative actions that become part of the planning process.

Three general arguments might be given in support of fiscal decentralization:

- If the expenditure mix and tax rates are determined closer to the people, local public services will improve and local residents will be more satisfied with government services.
- Stronger local governments will contribute to nation-building because people can identify more closely with local than central government.
- Overall resource mobilization will be increased because local governments can tax the fast-growing parts of their economic base more easily than can the central government.

The third argument is particularly important and ultimately may make the strongest case for fiscal decentralization. As the economies of rural areas and secondary cities develop, their taxable capacity and willingness to purchase public services will also develop. It will be very difficult for central governments to capture much of this fiscal surplus because neither central government income nor consumption taxes typically reach small firms, workers in smaller firms or outside the larger cities, or marketing activities; local government business and occupation licenses, sales taxes, permits, and property taxes have a much better chance.

With this set of general arguments for fiscal decentralization as backdrop, and because decentralization policies are followed by many developing countries, we turn now to a more systematic inquiry into the merits and demerits of the practice. Several questions call for answers:

- What does the theory of public finance suggest about the optimal assignment of functions among levels of government?
- How can fiscal decentralization be measured?
- How far have developing countries gone in decentralizing their fiscal activities?
- What population and economic characteristics make some developing countries stronger candidates for fiscal decentralization than others?
- What policy changes are likely to lead to more fiscal decentralization?

The Theory of Fiscal Assignment

Economic theory cannot lead to firm conclusions about the best division of fiscal responsibilities between central, state, and local governments, that is, about optimal fiscal decentralization. It can only suggest the considerations relevant in making the best fiscal assignments. "Best" of course varies from country to country and depends on the institutional setting, history, and most of all politics.

Musgrave's view that the purposes of government budgets are to stabilize growth, redistribute income, and allocate fiscal resources has long been the starting point for discussing the division of taxing powers and responsibility for expenditure.[3] The stimulation of stable economic growth and the distribution of income, he argues, are appropriate budget objectives of the central government. The mobility of capital and labor rules out local government success with policies in either area. This leaves allocation as the main role for local governments, that is, the decisions about how much to spend for each service and how to finance these expenditures. Subnational governments, it is said, are closest to voter-consumers and are in the best position to read local preferences for public services and for various kinds of taxes and user charges. The proper degree of decentralization, then, will depend on how the efficiency gains achieved by getting government closer to the people compare with the advantages which result from giving central governments more discretion to pursue fiscal policy.

THE CASE FOR CENTRALIZATION. The arguments for fiscal centralization are stronger in developing than in industrial countries. Because low-income economies are less diversified and therefore more exposed to international fluctuations in commodity prices, natural disasters, wars, worldwide recession, and so forth, stabilization is especially important for them. This argues for central government control of the main tax and borrowing instruments. In developing nations, a policy for economic growth is also an argument for fiscal centralization because investment capital is scarce and must be controlled by the central government to maximize returns. If local governments are given access to major tax bases, they may compete with the central government and therefore limit the amount available for the central tax. As a corollary, centralization allows the national government to allocate fiscal resources to goods and services with national benefits, whereas local autonomy would inevitably lead to greater expenditures on those services that have more local benefits.

Several arguments for income distribution also support fiscal centralization. The most important is that regional (and rural-urban) disparities in income and wealth may be accentuated by fiscal decentralization because wealthier urban governments will benefit most from greater taxing powers. Centralization allows the national government more discretion in shaping regional differences in levels of public service and taxation, which is an especially important consideration for governments that intend to use tax and subsidy policy to shape the spatial distribution of economic development.

The final argument is that central governments have superior abilities to administer taxes and manage the delivery of public services. Local governments in almost every country have very weak administrative practices, and less local autonomy means less chance for local governments to mismanage finances. A corollary to this argument is that skilled fiscal managers—analysts, accountants, valuers, and collectors—are too scarce in developing countries to be shared between the central and local governments.

THE CASE FOR DECENTRALIZATION. One might counter the above justifications of centralization with these good arguments for decentralization:

- Cities could levy higher taxes and could thereby charge residents the full marginal cost of urbanization. A more efficient size distribution of cities could result.
- Local governments could adjust budgets to local preferences, and a more efficient distribution of local public services could result.
- Local governments might be able to tax some sectors of the urban economy more easily than could the central government. A higher rate of national resource mobilization could thus occur.

Are these arguments really valid? Can local governments actually respond to citizens' preferences for more or fewer local services, or to a willingness to pay more tax to receive local services? In fact, the efficiency case for fiscal decentralization is much stronger in industrial than developing countries. Consider first the notion that moving service provision closer to the people can lead to gains in the welfare of consumer-voters. Because the theory of fiscal assignment was developed in industrial countries, it was heavily influenced by democratic processes of budgetmaking, for example, the median voter theories of public expenditure determination. In this model, the level of tax effort and the expenditure mix in local areas are responsive to changes in relative prices and income, and the potential losses in efficiency caused by interference from a higher level of government can be substantial (as can the potential efficiency gains from the greater fiscal autonomy of local government). Although the model is based on a number of questionable assumptions, empirical research has shown that the behavior of U.S. state and local governments more or less squares with it.[4]

The model does not so easily fit developing countries, however, and the efficiency gains from decentralization therefore may not be so great in developing countries. This is partly because voter preferences are not as readily translated into budget outcomes as in industrial countries. Local councils are often not elected, chief officials are often not locally appointed, and adjustments in the allocation of local resources are often severely constrained by central government controls. These controls include approval of the budget, central appointment of chief local government officers, central government regulation of tax administration, mandates as to salary levels of local government employees, and the general absence of a mechanism by which local voters could reveal their preferences for a larger or smaller government. In this setting—where the devolution of revenue authority and expenditure responsibility is not accompanied by a relaxation of central government control over local fiscal decisionmaking—there is less to be gained from decentralization of taxes and expenditure than would be the case in industrial countries. (The standard constrained maximization approach, adapted to developing countries, is presented in the appendix to this chapter.)

Given this state of affairs, the situation in a developing country which could give maximum gains from a more decentralized local government structure would include: (a) enough skilled labor, access to materials, and plant capital to expand public service delivery when desired, (b) an efficient tax administration, (c) a taxing power able to capture significant portions of community income increments, (d) an income-elastic demand for public services, (e) popularly elected local officials, and (f) some local discretion in shaping the budget and setting the tax rate. These conditions are most likely to exist—or are likely to exist to the greatest degree—in large cities in developing countries. This important point is not likely to excite those who see decentralization as a strategy for improving the relative well-being of small municipalities and rural local governments.

Measurement

To what extent is the theory of fiscal assignment predictive? Is fiscal decentralization more prevalent in industrial countries, and have some types of developing countries chosen more decentralization? A first step toward answering such questions is to devise an index of fiscal decentralization, an exercise fraught with conceptual as well as empirical problems.' First, there is the issue of what dimension of fiscal decentralization one wants to measure and then the problem of constructing the index. As always, the difficulties are best resolved by a careful thinking through of the questions being asked, and by accepting at the outset that some degree of subjectivity will be involved. All measures of decentralization will be flawed in some ways, and the "best" choice will depend ultimately on which questions are the most important.

The fiscal importance of subnational government might be measured in terms of the share of revenues generated or the share of expenditures made. The revenue measure would help determine the extent to which local governments are mobilizing public resources through their systems of taxes and user charges and could indicate the relative claim of local governments on total national income. This measure, however, would understate the total involvement of local governments in public activities because it would ignore the possibly greater final responsibility of local governments for the delivery of expenditure and services. The alternative is to measure the share of expenditures made by subnational levels of government and ignore the question of the level of government at which the funds are raised.' Indeed, a larger share of expenditure at subnational levels might indicate increasing fiscal decentralization, even though revenue-raising authority remains highly concentrated at the central level. Such a result could occur if there were substantial intergovernmental grants.

We have chosen the share of total government expenditure made by subnational government as the index of fiscal decentralization. This index has three limitations as a comparative measure. First, even though a subnational government is responsible for a particular expenditure, it may or may not be fiscally autonomous. Musgrave has pointed out that local governments which act as spending agents of the central government do not reflect true decentralization of expenditure, just as centrally collected but shared taxes do not constitute true revenue decentralization (Musgrave 1959: 342). The measure of expenditure decentralization used here does not allow one to determine whether a high subnational government share of expenditure is a result of the constitutional assignment of functions, a statutory delegation of expenditure powers, or a division of fiscal functions "just for the sake of administrative convenience."

A second problem that reduces the comparability of the index across countries is that two countries may have the same share of subnational expenditure but a different number of participating local governments. More governments, all other things being equal, imply more fiscal decentralization. Moreover, the index will not pick up the difference between a subnational government share of expenditure concentrated in one or a few cities and an even distribution across all cities. A third problem is that the inclusion of defense expenditures in the denominator of the measure may artificially overstate the degree of centralization. Countries at war, or close to it, are more centralized. Bahl and Nath (1986) have estimated a significant negative relation between decentralization of expenditure and the share of defense in the central budget.

Determinants

Why does fiscal decentralization occur in developing countries, and to what extent does it occur? The voices in many countries calling for more fiscal autonomy for subnational government suggest the overwhelming importance of political considerations. These voices state the needs for more participation in the governmental process, for larger incentives to finance local public services, for recognition of regional diversity, and for an untying of the red tape that seems to characterize big government. One would not have to stretch too far to understand why politicians and even higher-income urban residents would be sympathetic to these needs: the majority of the voting age population lives outside the largest city in most countries, greater involvement in government might mean less opposition to government, better local government services might slow the rate of migration to big cities, and many politicians have their roots if not their constituencies outside large urban areas.

The political advocates of centralization are less vocal but possibly more persuasive. Centralists see decentralization as creating a power base for political rivals and as promoting factionalism. Bureaucrats also want to limit decentralization because stronger local government would drain away some of their budgetary control. As Bird has noted, though perhaps too strongly, "to sum up this discussion of political objectives, no clear conclusion emerges: there are political reasons why centralization may be desirable and equally good reasons for decentralization. On the whole, however, it seems likely that the main political objective in most countries—national unity—is centralizing in nature and that the theoretical merits of decentralization receive little weight in practice" (Bird 1978: 46).

Economic and managerial considerations also seem stacked against decentralization. Indeed, the review of the merits of decentralization above suggests significantly less decentralization in developing countries than in industrial countries. Decentralization more likely comes with the achievement of a higher stage of economic development. This is because per capita income growth is usually accompanied by an increase both in urbanization and in the local government tax capacity implied by urbanization; by a greater degree of local administrative capacity, improvements in the implementation skills of local governments; and perhaps by the desire to eliminate gross regional disparities in the quality of public services.

This hypothesis appears to be borne out by an analysis of 1973 U.N., World Bank, and IMF data conducted by Bahl and Nath. Using a sample of twenty-three industrial and thirty-four developing countries and the share of expenditure of subnational governments as the measure of fiscal decentralization, they found clear evidence of the greater dominance of central governments in developing countries. On average, subnational governments in industrial countries accounted for 32.2 percent of all government expenditures, compared with 14.9 percent in developing ones. Moreover, only four developing countries (all in Latin America) had a ratio of fiscal decentralization above the average for industrial countries. Further, they find that this pattern did not change during the 1960s and early 1970s. In fact, between 1960 and 1973, the subnational government share of total government expenditures increased more in the industrial than in the developing countries. A more recent analysis using 1980 data finds little change in this measure since 1973 for either developing or developed countries (Wasylenko 1987).

The question of what types of countries are most likely to decentralize fiscal activity has been subject to empirical testing using econometric models. This literature suggests three main determinants of the decentralization of expenditure. Cross-sectional studies have shown that the stage of development, measured as per capita GNP or urbanization, is associated with a significantly greater subnational share of expenditure.' A second influence on fiscal decentralization is country size: the larger the country, the more decentralization. In some cases, the size effect has led to the choice of a federal system of governance, whereas in others it has led to the delegation of more fiscal responsibility to subnational governments.' Fiscal management in very large countries becomes unwieldy and, all other things being equal, leads to a much stronger role for subnational government. This is not to say that smaller countries do not struggle with the question of the optimal degree of decentralization; for example, the question has very recently come under government study in Papua New Guinea (Bird 1983), Ecuador (Greytak and Mendez 1986), and Burkina Faso (Miner and Hall 1983).

Finally, there is the "crisis effect," that is, a propensity to give less discretionary powers to local governments in countries where there is a continuing threat of social upheaval. This possibility was raised in Peacock and Wiseman's displacement theory of the growth of government expenditure (1961). It has been supported by at least one cross-section study of developing countries which shows a negative association between fiscal decentralization and the central government share of expenditure devoted to defense (Bahl and Nath 1986). There are many examples of this effect. In the aftermath of civil war, Zaire considered complete abolition of local government (Prud'homme 1973), and Bolivia and Honduras abolished their municipal councils in the late 1970s, as did Jamaica (Kingston's) during the economic crisis of the early 1980s. Fiscal centralization may also be stimulated by a revenue "bonanza effect." One example is the growth of the Nigerian public sector during the period of increase in the price of oil. The revenues did not pass through—the state government share of total federal revenues fell from 40 percent in 1970 to 15 percent by 1973.

Conclusions and Implications

Theory and empirical analysis point to three reasons why subnational governments in developing countries receive varying amounts of public expenditure. First, there appears to be a direct relation between level of expenditure and level of economic development. Development stimulates demand for services provided by local governments in addition to increasing the local tax base. Second, countries with larger populations are more decentralized, perhaps because central provision of many government services becomes all but impossible. Third, countries whose budgets carry less of a defense burden and that have not faced social upheavals are more able to decentralize.

These results suggest three hypotheses about how government policy can strengthen the local fisc. First, fiscal decentralization may well accompany economic development, but the threshold level of economic development—beyond which countries decentralize government as per capita income rises—appears to be quite high. The implication of this observation is that government policies to promote fiscal decentralization are more likely to be effective for middle- and high-income countries. For the lowest-income countries, decentralization may be limited to rhetoric.

The second implication for policy is that the benefits of fiscal decentralization are most likely to be received by devolving fiscal authority to large cities. The primary gains from decentralization are thought to be gains in efficiency from allowing locals to choose their own levels of taxes and expenditure and the greater revenue mobilization that will result from letting local governments "get at" their growing tax bases. Large cities are more likely to capitalize on these potential benefits.

Third, as central governments raise more money, the subnational government share of expenditures falls—taxes stick where they hit. The implication of this "flypaper effect" is that the best route to decentralization of expenditure is to assign local governments particular revenue bases or to guarantee them shares of particular central taxes. Otherwise, larger central tax revenues will not be shared proportionately with subnational governments and more fiscal centralization will result.

The National Structure of Urban Government

The theoretical extremes in the national structure of urban government are complete centralization—a single central government—and complete decentralization—no central government. There appear to be no examples of complete decentralization, whereas Singapore and some West Indian nations come close to approximating the former. Most countries lie between these extremes with varying degrees of decentralization in revenue raising authority, expenditure responsibility, and local autonomy in deciding on the mix and level of services to be produced.' As noted above, we would expect developing countries to tend toward centralization.

The actual amount of fiscal decentralization in a country is not a straightforward, one-dimensional characteristic. Some local governments may be given more responsibility for expenditure than others, taxing powers may be broad or limited, borrowing may be permitted or prohibited, and so forth. To try to develop a reasonable taxonomy of local autonomy or local self-governance, we might think of a country's "intergovernmental arrangement"; this would include the delineation of levels of government, a definition of the formal relations these levels may have with each other in a national setting, and the degree of autonomy given to each subnational level of government. In short, what is the place of local governments in the national setting?

Typically, the structure of government in a developing country provides three degrees of autonomy for its local governments. Small, rural local governments are thought to have less wherewithal to plan and manage their fiscal affairs, and they have the least fiscal autonomy. Therefore the rural system of local government is often managed directly by the central government (in Kenya) or through provincial governments (in the Philippines). Municipalities—large urban governments—are given more autonomy and a broader range of revenue-raising powers and fiscal discretion. These *governments* often have the status of both municipal and provincial governments (in the Philippines and in China). The largest cities are treated differently from other municipalities and are usually given even more fiscal discretion. In short, the degree of autonomy given local governments varies within a country and depends largely on the size of the local government.'

Although this general pattern holds true in most developing countries, there is still a great deal of variation. Is one structure of local government and set of intergovernmental arrangements somehow best? Theory will not give us an answer. There are tradeoffs in choosing more or less autonomy for local governments and political considerations will weigh heavily in the choices eventually made. This leads us to turn to a more positive analysis, that is, consideration of the choices regarding local government structure which governments of developing countries have actually made. If there is some rationality in these choices, we might be able to identify those factors which appear to lead to the granting of more or less fiscal autonomy to local governments.

How do the varying degrees of local fiscal autonomy come about? One possibility, suggested by empirical research, is that a federal structure tends to be associated with a strong subnational government. Accordingly, knowledge of why some countries have a federal and others a unitary system is a useful starting point. A second possibility is that central versus subnational control of government fiscal affairs, rather than constitutional versus statutory provision of subnational fiscal powers, most delimits local fiscal autonomy. These two possibilities are taken up below.

Alternative Systems

Two common models of intergovernmental arrangements have emerged in developing countries. Under a unitary system, state (or provincial) and local governments are statutory bodies defined by the central government; their fiscal powers are a matter of central policy and are not guaranteed by any constitutional provision.' Under a federal system, the powers, duties, and responsibilities of state governments are defined in the constitution, and local governments usually are creations of the state government. Their fiscal powers may be changed often by the state, or they may be given residual fiscal powers. Therefore in a federal system, central-state relations normally are defined by the constitution, whereas state-local relations are organized as in a unitary state. This is the situation in India. Another version is for local governments to be full partners in the federal system with their financial powers and responsibilities provided for in the constitution. This is the case in Brazil and Nigeria.

The struggles for more autonomy between national and state governments and that between state and local governments are very different, especially in countries with strong intermediate governments or at least strong regional differences. The central-state struggle is usually over political autonomy and grows out of historic regional power bases; movements for independence; and ethnic, linguistic, and cultural differences (for example, the ongoing debates in Colombia, India, Indonesia, Mexico, and Nigeria). The central government resists too much subnational independence in the name of retaining the cohesion of the country or resisting dominance by a particular region, state, elite, or culture. By contrast, the central-local and state-local government struggle tends to center on the allocation of fiscal resources and the desire of local governments for autonomy in providing services. This relatively new conflict has arisen primarily because of the population growth of large cities. Of course, there is overlap: central-state relations also involve purely fiscal aspects, and central-local relations can also involve issues of independence, political power, and culture.

FEDERAL SYSTEMS. Many developing countries have chosen a federal system to structure the relation between central and subnational governments, for example, Brazil, India, Malaysia, Pakistan, and Nigeria.' This system, typically but not always, transfers control of city finances from the central to an intermediate level of government.' There are strong arguments for and against an intermediate level government with substantial budgetary control. In populous, large countries where preferences are likely to vary widely, for example Brazil and India, it enables the central government to avoid direct dealings with a large number of diverse urban governments. For example, the central government can use grant formulas to recognize broad differences in needs and preferences without having to take into account the needs of individual cities, or it can simply assign responsibility for local finances to the state government. Imagine the problems a country such as India would have in attempting to allocate grant funds or approve tax rate increases on a city by city basis.

Advantages and disadvantages aside, urban governments in a federal system generally depend on the state government to provide some services directly, pass through central grants, approve borrowing plans and increases in tax rates, appoint chief government officers, and assign expenditure responsibility and taxing power." Under this system, the central government essentially gives the responsibility for local finance to state governments. The degree of local autonomy that results depends on how state governments interpret their powers.

There are disadvantages to this approach. The federal structure creates an intermediate level of decisionmaking that complicates the implementation of any national urban plan; that is, it is necessary to rely on state governments to pass central funds through to targeted urban and rural governments. If state governments are relatively autonomous in their fiscal and economic planning, the resulting allocation may not match central goals. For example, in the 1960s and 197 Os the U.S. government watched states follow policies that increased the fiscal disparities between low-income central city governments and high-income suburban governments.' This inequitable attitude is not restricted to state governments in industrial countries. Adamolekun, Osemwata, and Olowu (1980: 98) report that in Nigeria, "the overall attitude of the state governments was to take whatever financial allocations the Federal government made to local governments and disburse same on their own terms, with little or no regard for what the Federal government requested them to do with such allocations."

To counter such disadvantages, some federal countries have taken the position that a viable system of local government requires direct central-local relations. Direct federal-local relations have become more important in Brazil and Mexico (De Mello 1977: 28-37), and in Nigeria the new constitution in 1979 recognized "the existence of local governments as a distinct third level of government within the national federal governmental system" (Adamolekun, Osemwata, and Olowu 1980: 97).

Are local governments given more or less fiscal latitude in a federal structure? The answer is by no means clear. Data on expenditure responsibility and revenue mix are reported for a number of developing-country cities in chapter 2 (tables 2-7, 2-10, and 2-11). Although the fiscal responsibility and importance of these local governments is far greater than has been generally supposed, there is a wide variation in their importance, and a pattern is not easily found. In one test, the cities were grouped according to their location in federalist and unitary countries and average values were calculated for the share of property taxes, grants, and borrowing in total revenues. There was little difference in any of these measures between the two groups. By the same procedure, there was little pattern in the distribution of responsibilities for expenditure. Some local governments do very little (Kingston), whereas others have a broad range of responsibilities (Seoul). Whether there is a federal or nonfederal structure does not appear to be the key to understanding this variation.

UNITARY SYSTEMS. A second form of intergovernmental arrangement links larger local governments directly to the center. Because local governments are statutory bodies, they are subject to direct control by the central government and may be abolished at its pleasure.

An intermediate level of government may still lie between the central and local governments under a unitary system. This is the case in Korea and the Philippines, where provincial governments act as the agent of the central government in regulating the finances of the smaller local units. In the case of urban governments, these provinces do not exert regulatory control or lend financial assistance.'

There are advantages to the unitary system. The central government can target aid flows more easily to particular local governments, and local governments can be made more accountable for their fiscal actions. Substantial national variation in the size and structure of local government budgets is also allowed. A major disadvantage is that it is administratively difficult for the central government to deal directly with a great number of local governments which may vary widely in service needs, fiscal base, and capacity to provide services. But as Henderson (1980) has shown, the unitary developing countries tend to have fewer large cities.

Central Regulation and Fiscal Autonomy

Local governments appear to spend relatively more under federal than unitary systems, but this may occur mostly because federal countries are larger. But there may not be any more urban fiscal autonomy under federal than unitary systems.

The important issue here is fiscal autonomy, the control over sufficient resources to plan and manage the provision of local public services without continuous interference from higher authorities.'[7] In trying to understand whether a federal system somehow gives large city governments more fiscal autonomy than does a unitary system, we might raise the following questions about the differences between the two systems:

- **Do** structures of revenue and responsibility for expenditure differ?
- Is there more latitude in revising tax rates under one system than the other?
- Are borrowing powers equally circumscribed?
- Does the degree of budgetary monitoring differ?
- Does the process of selecting the council and chief officers vary?

Because comparable information on the above measures is not readily available, it is not possible here to compare and contrast all cities in the world. What we can do is piece together the fragmentary evidence on fiscal performance presented in chapter 2, the information on government structure provided in the case studies which underlie this book, and other available data on the practice. These materials do not yield a random sample for econometric testing; they only lead to many examples and anecdotes. But they do give some sense of the relation between local fiscal autonomy and intergovernmental arrangement. Two overriding conclusions may be drawn: the fiscal activities of local government are very tightly controlled, and there is as much variation in fiscal autonomy and practice within the unitary and federal groups of cities as between them.

FISCAL DISCRETION. Two city governments may raise or spend the same amount but have very different degrees of autonomy in their fiscal actions. The central question here is not the size of the budget but the discretion which the local government has in the disposition of the budget.' In fact, the authority of local government to adjust tax rates and to enact new taxes is limited in virtually every developing country. National or state law normally prescribes the tax bases available (or unavailable) to local governments and sets maximum rates within which they must operate. These restrictions usually hold even for large cities. When the rate ceilings are binding, as is often the case, local governments have little discretion and must depend on the center to approve every revenue proposal. A similar arrangement holds for increases in user charges for most primary services, for example, water rates, bus fares, and rents. The issue then becomes whether the central or state government will approve the requested increases. Practice varies, but some countries have consistently refused requests for local increases; for example, cities in Bangladesh were held at 1960 property tax rates despite repeated requests for incremental increases (Schroeder 1985a: 33, 55). All countries, however, are not subject to such stringent controls. In

Brazil and Venezuela municipal laws are not subject to approval by higher levels of government, though some tax changes do require approval by a central agency (De Mello 1977: 6-16).

In developing countries most central or state governments have approval powers over local government budgets. The extent to which this process reduces local fiscal autonomy depends on the tightness of the review process. The experience in this regard varies widely. Nairobi has faced a line-by-line review of expenditures by the Kenyan Ministry of Local Government, but the Ministry of the Interior in Indonesia generally accepts the proposal of a metropolitan council.' The budget autonomy of local government may also be hampered by central government mandates. For example, nearly 50 percent of the budgets of Philippine municipal governments are earmarked for specific purposes, giving them only a very limited latitude to adjust the budget to respond to local demands (Bahl and Schroeder 1983c: chap. 2). Less permanent but unexpected central government mandates may also have dramatic and direct effects on the level of local government spending. For example, in the 1970s the Kenyan central government mandated an increase in local government employee emoluments, ordered the provision of free drugs and dressings by local authorities, and abolished local school fees. A common form of mandate which local governments in developing countries face is a hiring freeze, a reaction by the central government to what it sees as irresponsible management.

The borrowing powers of local governments are quite limited in most developing countries. Though credit is made available to local governments under a variety of schemes (see chapter 13), most local governments are given little discretion over the amount or purpose of the loan, the source of the funds, or the terms of repayment. The issuance of debt is tightly controlled by central governments on the grounds that expansion of total domestic credit is an important stabilization issue and that the allocation of scarce credit among regions and purposes must conform closely to the national development plan. Still, some local governments have been given more autonomy than others in the planning and issuance of debt. For example, the Calcutta Metropolitan Development Authority may borrow in the open market (from banks and provident funds) subject to a limit tied to its tax revenues; the Nairobi City Council may sell bonds in the market, but Ministry of Finance approval is required; and local governments in many countries are allowed to engage in short-term borrowing from commercial banks.

LOCAL COUNCIL AND OFFICERS. Perhaps the most important issues of all in establishing local autonomy have to do with how local council and chief administrative officers of the city are selected, and with the definition of the powers of the council and the administration. For example, it may matter little that local governments have a broad range of fiscal powers if all local decisions about financing and governance rest in the hands of centrally appointed officials. Again, a broad range of practices is followed. At one extreme are very centralized systems (such as those in Bangkok, Seoul, and Tunis), in which the head of the city government is appointed by the president. At the other extreme the local council and mayor are elected (as in Brazilian cities and Colombo, Sri Lanka). In between are many shades of centralization and decentralization. For example:

- Under the presidency of Ferdinand Marcos, the mayors of the Manila region's cities and municipalities were elected, but the councils and the governor of the Metropolitan Manila Authority were appointed by the president.
- Malaysian local government councils are appointed by the state government.
- One-hundred-fifty members of the Karachi Metropolitan Corporation are elected, and the other sixteen are appointed by the state government.

If the political and managerial systems of a city are separate, there is the issue of the status and appointment of the local public administrators, that is, the municipal commissioner or town clerk, treasurer, assessor, and so forth. Again, there are many variations. Though local councils are popularly elected in the Indian federal system, the chief administrative officer is a state appointee; in Mexico City, which has state and city status, he is a federal appointee. Chief officers may be seconded from the federal or state service in Nigeria, and the local assessor and treasurer are actually central government employees in the Philippines. In many Latin American countries, the municipal chief executive also represents the central government in the municipality.

There is the provision, in most developing countries, for the central government to dissolve the local council. Again, however, what these provisions mean for local autonomy depends on the degree to which the government exercises its powers. For example, Kingston's local council is elected but may be abolished by the central government if the latter finds evidence of an abuse of power. In fact, the Kingston—Saint Andrews Council has been abolished four times since 1923; the latest occurrence was in 1984 because of "financial irresponsibility" and "gross mismanagement." Manila's local councils were abolished during martial law, Bangkok's experience is similar to Manila's, Karachi's council was abolished in 1971 but restored in 1979, and local councils in Bolivia and Honduras were abolished in the late 1970s.

The Special City

The position of the city in a national system of urban governance may be modified to take account of special problems, needs, or national goals.

In almost every country, the capital city is afforded special status, and more often than not it is given more fiscal autonomy than other cities in the nation. Several factors have led to this special treatment. First, the machinery of government, and therefore a disproportionate amount of tax-exempt property, is in the capital. Second, because both the services provided and the local administration are highly visible, local government finance is inevitably a national political issue. Third, and perhaps most important, the capital city tends to be the primate city. As such, it usually offers a wider range of public services than other local governments in the country. Moreover, because it offers more employment opportunities and induces a greater rate of immigration, there are great pressures of urbanization and congestion on public services.

Nearly all countries have responded to these special needs by creating, by one name or another, a national capital district. For example, Bogota and Jakarta are national capital districts with both city and provincial powers, Nairobi was for many years the only chartered city in Kenya, Seoul is a special city under the office of the president and has both city and provincial status, and Kingston is an amalgamation of two parishes. Though in most cases the status of special city is reserved for the capital city, there are situations in which other large cities in the country are afforded similar treatment. Pusan is a special city in Korea, but under the Ministry of Interior; Rio de Janeiro is a special city; Chittagong and Mombasa have become the second municipal corporations in Bangladesh and Kenya, respectively; and Beijing and Shanghai have provincial status in China. In many countries, the criteria for special treatment are less ad hoc, and cities are usually differentiated according to population size.'" Large cities are given more taxing powers and expenditure responsibilities, and in some countries the chief local officers are paid at a higher rate. The most important of these extra powers is typically the authority to tax at a higher rate.

The status of special city in effect creates a separate intergovernmental system. This has both positive and negative features. Placing the city directly under the nation's president, the common model, has the potential to enable more effective coordination of various ministry activities within the urban area and allow for special treatment of cities which are qualitatively different from other urban areas in the country because of their function, size, and development. It does not allow, however, for the development of a unified intergovernmental system which might establish a role for local government as a sector.

Conclusion

Empirical analysis suggests that about 15 percent of total government spending in developing countries may be attributed to subnational governments. But the aggregate statistic understates the fiscal importance of urban local governments. The contribution of local government to the financing of public services in the larger metropolitan areas is much higher—as much as a third to a half. This is perhaps of more substantial fiscal importance for local governments than many would have expected. But do these fiscal shares indicate a commensurate degree of fiscal autonomy? The answer to this question depends on the way in which countries organize themselves to finance and deliver services at the regional and local levels.

One hypothesis is that subnational governments under federal systems are given more fiscal powers. This seems true for state governments, but we cannot find evidence that the greater fiscal autonomy given to states is usually extended to local governments. The choice of a federal or unitary system, by our reckoning, is not a principal determinant of the degree of fiscal autonomy of local government.

In fact, the main difference among countries turns out to be the degree to which the central or state government controls the everyday operation of the local governments. As noted above, central governments can control the fiscal operations of local authorities in many ways: local budgets and borrowing may have to be approved by the center, the principal local administrative officer may be appointed or approved by the government, all or a portion of the local council may be appointed by the central government, and local units may be restricted in what revenue sources they may tap. The real issue, however, is the degree to which the higher level of government chooses to exercise these controls. Two local governments may have responsibility for providing primary education services. In one instance decisions about the number and compensation of schoolteachers may be made locally. In the other these decisions may be a responsibility of the education ministry, allowing relatively little local autonomy. The same kind of situation arises if increases in local tax rates must always be approved. In some countries rate increases are granted freely once the local council requests them, in others increases need no approval at all up to certain limits, and in still others the central government strongly resists increases.

The contrast between Kingston and Nairobi is a useful example of different approaches to limiting the fiscal autonomy of local government in two cities not too dissimilar in size or colonial heritage. Before its two-year abolition beginning in 1984, the Kingston–Saint Andrews Corporation (KSAC) had little responsibility for expenditure aside from that for a few basic urban services. The central government in Jamaica provided and maintained all primary social services and infrastructure either directly, with autonomous agencies, or through franchises to the private sector. For all practical purposes, the KSAC had no taxing powers. The city of Nairobi, conversely, has a full range of responsibilities for expenditure, the power to tax property and (until 1975) even income, and some authority to borrow funds. But in Kenya the central government aggressively exercises its rights to approve and amend the budgets of local governments, control the amounts and sources from which local governments can borrow, and approve all increases in tax rates. Though such controls exist in most countries, they are not always applied with such fervor.

In the last analysis, what really matters is the will of the central government to allocate more fiscal autonomy to local governments. The signs are not strong that the will is there. The subnational government share of fiscal activity is not increasing, and one is hard-pressed to find examples of local governments being given substantially increased taxing powers, especially access to the buoyant income and consumption tax bases. Three examples illustrate how central governments have backed away from granting more local autonomy. The central government in Kenya unilaterally abolished an income-elastic local income tax in 1975 and replaced it with a grant of a fixed amount. The octroi, the main source of city revenue, was abolished in Bangladesh in 1981 and replaced by a grant of a fixed amount. Federal and state governments in Nigeria abolished the local government's cattle and poll taxes.

The Structure of Large Metropolitan Areas

The division of fiscal responsibility between central and local governments is the vertical dimension of fiscal decentralization. The horizontal dimension is the way large metropolitan cities organize themselves to finance and deliver services within their areas. The issue takes on special significance when one remembers that some of these cities are larger than many countries and that some account for a significant fraction of national population.

Metropolitan cities almost always have more fiscal autonomy than other cities in a country, but the similarity ends there. Some deliver services and levy taxes and charges primarily through an areawide general purpose government, others use autonomous (decentralized) agencies, and still others rely on a fragmented system of many small municipalities. The choice of one of these systems of horizontal fiscal relations implies a tradeoff between the various advantages and disadvantages of each. Again, it is not a question of a best way to do things, but rather of the weights attached to the efficiency and equity benefits.

At issue here are the fiscal implications of the three general models of urban governance: centralized metropolitan government, under which a single local government has responsibility for all or nearly the full range of local functions and has a service boundary that includes the entire urban area; functional fragmentation, under which the provision of services is areawide but is split between the general purpose local government and autonomous agencies; and jurisdictional fragmentation, under which responsibility for the same local functions lies with many local governments operating in the area. The structure of urban government in most areas is a hybrid of these, though one form is usually dominant.

To illustrate the practice of urban governance in developing countries, we describe the systems used in several representative metropolitan areas before turning to an evaluation of the implications for equity and efficiency.

Centralized Metropolitan Government

The most common form of local government in developing countries is areawide general purpose local government, that is, centralized metropolitan government. Under this form most of the basic services provided in the metropolitan area are the responsibility of the city government, and no other general purpose local government (municipality) operates within the urban area. But the urban service area is usually overlapped by one or more special purpose districts, for example, a water supply authority or a bus company. Seoul, Kingston, and Jakarta have more or less representative forms of centralized metropolitan governance.

SEOUL. The Seoul city government, the only general purpose local government operating within its urban area, is responsible for a wide range of services.' It is far from an autonomous local government: Seoul is a special city under the direct control of the central government. The chief administrative officer is the mayor, who is appointed by the president and can exercise broad decisionmaking and executory powers with little or no check at the local level. One exception to this centralized administration is school finance, which is administered by a semiautonomous Board of Education composed of six members appointed by the president, with the chairman being the mayor of Seoul. The Board of Education is responsible for educational planning, including decisions on expenditure, in conjunction with the Ministry of Education. Although the education budget does not have to be approved formally by the city government, it is recorded as a special account in the Seoul city budget.

There is little decentralization in fiscal decisionmaking, either in terms of other local government bodies operating within the metropolitan area or in terms of influences at the neighborhood level on expenditure decisions. The city is divided into nine administrative wards, or *gu,* whose boundaries appear to be more the result of history or accident than of design for planning purposes.' These *gu* are large enough that one would not expect them to hold a more homogeneous population than does the city as a whole. In point of fact, these administrative units serve as channels through which information on neighborhood problems can be transmitted to the central administration, as units for tax assessment and collection, and as centers for issuing licenses, permits, registrations, and so forth. Decisions regarding the level and functional distribution of expenditures within any given neighborhood remain at the city level.

In terms of horizontal fiscal relations, Seoul is perhaps as centralized as any city we have studied. This gives it the advantage of ease in coordinating activities and in implementing plans. There is less chance for duplication of services than under other systems, and the size of the city should allow for the capture of economies of scale in the provision of some services. But because the local government is quite large, it is difficult to manage, and there is no ready mechanism for responding to intracity differences in demand for the package of public services to be delivered.

KINGSTON. The KSAC is a general purpose local government with area-wide responsibility for the delivery of services.' Three institutions make up the structure of public administration: the Municipal Council, the Municipal Administration, and the Water Commission.

The Municipal Council is responsible for all local public services with the exception of water supply. The council (elected every third year) consists of thirty-two popularly elected councillors and a mayor, who must be a councillor and who is elected by the council. The mayor, although having no special authority over the other council members, has particular weight in policy matters having been elected by, and thus able to speak for, the majority of councillors. The council prepares the budget and can raise revenues, determine tax rates, and borrow, always subject to approval by the central government. These powers may seem broad, but it must be remembered that the KSAC has been given limited access to revenue bases and little responsibility for expenditure. In 1984 it raised only 1.5 percent of total revenues from its own sources.

The KSAC administration is headed by the three statutory municipal officers: the town clerk, the city treasurer, and the city engineer. All are appointed by the council, and all can be removed from office by the council with the approval of the central government. The clerk is the chief administrative officer and has disciplinary powers over nonmunicipal officers. The treasurer works in close collaboration with the clerk, although the treasurer is also separately responsible to the council. The engineer reports directly to the clerk.

The Water Commission is a semiautonomous body whose functions are to provide water and sewerage services in the corporate area. It is administered by a board of nine members appointed by the Ministry of Public Utilities for five years and recallable at any time by the minister. In 1973 the mayor of the KSAC was put on the board for the first time since 1965, when the statutory requirement for local government participation on the board was abolished. The commission reports directly to the Ministry of Public Utilities, and its annual budget must be approved by the ministry.

By comparison with Seoul, Kingston allows for a good deal more citizen participation in making the budget. Conversely, the KSAC has very little responsibility for expenditure by comparison with Seoul and must coordinate all its activities with the central government and autonomous water company. Other than the locally elected council, there is no provision for allocating resources to neighborhoods or otherwise decentralizing fiscal decisionmaking powers.

JAKARTA. The city (district) of Jakarta (DKI) delivers a broad range of areawide services (Linn, Smith, and Wignjowijoto 1976). There is some degree of functional decentralization, in that a number of semiautonomous metropolitan public service enterprises exist; however, their autonomy is limited to day-to-day management. Governmental authority at the local level is shared between the metropolitan council and the governor. The governor is appointed by the president, three-quarters of the forty members of the metropolitan council are popularly elected, and the remaining members are appointed by the minister of the interior. The council's main functions are approval of the city budget, as proposed by the governor; review of the activities of the executive branch; and enactment of legislation concerning tax structure, rates and implementation, and orders regulating city affairs. In this last obligation, the council shares responsibility with the governor, who may also issue regulations through executive decrees. The executive of the DKI is headed by the governor, who is assisted by four deputy governors and a general secretary. The general secretary (sometimes also referred to as town clerk) coordinates the daily business of the executive agencies.

The DKI administration supervises the activities of several semiautonomous local public enterprises—which are in charge of particular service functions—and commercial corporations that are owned partly or entirely by the DKI. The budgeting and accounting procedures of these agencies are not subject to review by the metropolitan council or the minister of the interior, but they must be approved by the governor. Moreover, the governor has the authority to appoint the manager and staff of each.

An interesting feature of the structure of urban governance in Jakarta is the attempt to decentralize fiscal affairs to the neighborhood level. The city is divided into 5 municipalities, each of which is headed by a mayor. These municipalities are further partitioned into 27 districts, each administered by a district head. The districts in turn consist of 200 villages led by village heads, and the villages are further subdivided into neighborhood and family associations. These submetropolitan agencies are extensions of the governor's office. They are meant to serve as two-way channels of communication and control at the regional level to relay information from the grass roots to the governor's office and back. These sublocal administrative units have less autonomy than the lower-level local government units in the rest of Indonesia (that is, the municipalities, districts, and villages). In the DKI, sublocal officials are appointed by the governor or the general secretary, and the sublocal authorities do not have their own revenue, expenditure, and budgeting authority. The sub-local authorities are included in the general DKI budget, but their expenditures cover only staff salaries and office-related equipment.

Jakarta, then, is highly centralized like Seoul in that considerable power is vested in an appointed governor and in that a wide range of public services is delivered. It differs, however, in two important respects: a partially elected metropolitan council provides some citizen participation in making the budget, and there is a mechanism for reflecting neighborhood preferences in the mix of public services.

Functional Fragmentation

In functionally fragmented metropolises, the municipal government's responsibilities for services are limited, and basic functions are delegated to autonomous local bodies. The difference between centralized metropolitan governance and functional fragmentation is largely a matter of degree, because almost all urban areas are overlaid by some special districts; for example, water supply and sewerage are commonly provided by separate companies. In some metropolitan areas, however, this functional fragmentation has gone so far that local public enterprises have been created to finance and deliver even some of the traditional services of municipal government.

The advantages of functional fragmentation are easily seen. The delivery of services may be separated from political influence; a higher-paid, more professional staff might be secured if the regular government pay scales can be bypassed; and dedicated revenues from user charges form a basis for financing capital expansions that might not be available to a general purpose government. But it also has important disadvantages. The more autonomous the agencies that operate within a metropolitan area, the greater is their potential for duplication of efforts, the harder it is to coordinate urban development, and the less possibility there is to finance one service with the surplus generated through the provision of another. The experience with functional fragmentation in Cartagena illustrates some of the potential advantages and problems of this form of metropolitan governance.

The Republic of Colombia is a unitary democracy, organized on a national, departmental (state), and municipal level. Each department is headed by a governor appointed by the president, and each municipality by a mayor who is in turn appointed by the governor. The mayor shares political responsibility with the elected municipal council and is the link between the municipal administration and the autonomous statutory bodies that provide most local public services to a municipality. These statutory bodies have their own sources of revenue (from earmarked taxes and/or service charges) and are independent in their day-to-day operations as well as in their fundamental policy choices. In fact, this independence from legislative control is often cited as the main reason for the existence of such agencies. On the one hand, the agencies' freedom from the political process enables them to achieve a high level of management and strategic planning. On the other hand, their freedom from the budgetary control of the legislative bodies has made these agencies attractive tools in the hands of the president, governors, or mayors, who use them to pursue particular policies.

The municipal council's functions in Cartagena (Linn 1975) consist primarily of approving the municipal budget, determining tax rates and service charges, appointing the chief local government officers, and appointing the auditor for the principal autonomous agency, the Municipal Public Service Company. The functions of the municipal government are narrowly prescribed and almost entirely restricted to representative, general administrative, and coordinating activities. This explains why the mayor's position is not a full-time job. In summary, the municipal administration of Cartagena is primarily a tax collection agency.

The Municipal Public Service Company (EPM) provides the majority of local public services. The functions of the EPM include water supply, sewerage, the construction and maintenance of roads, fire protection, the administration of markets and slaughterhouses, the maintenance of parks, the collection and disposal of refuse, and the cleaning of streets. The EPM is governed by a board of directors, which determines the statutes of the enterprise, selects its general manager, approves its budget and important personnel decisions, decides (within legal limits) on the service charges and taxes to be levied by the company, and in general supervises the financial and economic development of the enterprise. The board of directors consists of six members, including the mayor of Cartagena, a representative of the president of the republic, two members selected by the municipal council, one representative of the local chamber of commerce, and one representative of the central bank. The board selects its own president. The general manager of the EPM is responsible for the day-to-day management of the company as well as for its long-term planning. He presents the EPM budget to the board for consideration and approval and selects the personnel of the enterprise, subject to approval by the board. He participates in the deliberations of the board but has no vote. There are three other major decentralized municipal agencies in Cartagena organized similarly to the EPM: the telephone company, the Valorization Department, and the Tourism Promotion Bureau.

The system of governance in Cartagena possesses some clear advantages over the systems of metropolitan government described above. The management and operation of the EPM and the other municipal enterprises can be more professional and detached from the political process, and financing through user charges is more easily accomplished than general tax increases. Conversely, coordination of activities has proven to be a problem with the autonomous agencies, despite their overlapping boards of directors. Moreover, the dedication of revenues from an activity (for example, telephones) solely to that activity is a rigid arrangement that may lead to overinvestment in that activity. This kind of earmarking can be avoided under a centralized structure of metropolitan governance.

Jurisdictional Fragmentation and Two-Tier Systems

A third approach to urban governance, jurisdictional fragmentation, allows many general purpose local governments to exist within the same urban area. This structure of local government is most often associated with the United States, where single metropolitan areas may house dozens or even hundreds of local governments with taxing power. But fragmented structures of local government are not uncommon in developing countries. For example, four cities and thirteen municipalities operate within metropolitan Manila; thirty-one of Sao Paulo's municipalities have populations in excess of 100,000; and Tunis is comprised of thirteen communes (municipalities). Many other developing-country cities use this form of governance: Dhaka, Lagos, Lima, Madras, Medellin, and Rio de Janeiro are examples. It is important to understand the crucial difference between the origins of functional and jurisdictional (geographic) fragmentation. Functional fragmentation is often a deliberate and rational decision; for instance, the functions of Colombian cities were split up among autonomous agencies mainly to enhance managerial and financial soundness. In contrast, geographic or jurisdictional fragmentation often is just a natural consequence of urbanization—the expansion of metropolises beyond old core cities into surrounding minor centers and formerly rural areas without *changes* in jurisdictional boundaries.

The advantage of a fragmented government structure is that it moves government closer to the people by creating smaller local government bodies. The disadvantages may be that it gives up the possibility of capturing economies of scale and may breed disparities in tax burdens and public services among local governments within the urban area. To deal with these disadvantages while retaining the inherent advantage of small local governments, overlapping metropolitan governments have been created. The strengths and weaknesses of this two-level governance might best be understood if one example, Manila, is considered and several metropolitan development authorities are described.

MANILA. The Manila metropolitan area is governed by nineteen local bodies: four chartered cities (including the city of Manila), thirteen municipalities, the Metropolitan Manila Commission (MMc), and an autonomous Metropolitan Water and Sewer Authority. In practice, the governance of this system is highly centralized. The MMC chief executive, the governor, is appointed by the national government, as are all local councils and the chief officers (for example, treasurer, assessor, and engineer) of each municipality and city. Since the lifting of martial law, however, the mayors and deputy mayors have been popularly elected.[24]

The size and wealth of local governments in urban Manila vary widely, from Manila City's estimated 1980 population of 1.6 million to Pateros municipality's 42,000. The MMC was created in 1975 to coordinate, integrate, and unify the services within metropolitan Manila. It does this by providing some services directly and by exercising direct supervision and control over local governments. The MMC derives about a third of its resources from taxes and about half from contributions by constituent local governments.

There is a formal structure for decentralized decisionmaking in the form of the barangay—a grouping of about 200 families who choose a chairman and six council members. The barangays, which have no independent taxing power but receive recurrent grants, have a range of minor responsibilities for public services. In the city of Manila alone, there are more than 900 barangays.

METROPOLITAN DEVELOPMENT AUTHORITIES. Metropolitan development authorities (MDAS) have been a popular way to solve the problems resulting from the geographic fragmentation of local governments in metropolitan areas. This approach has been especially popular on the Indian subcontinent. The following paragraphs give some idea of the form which MDAS have taken in Bombay, Calcutta, Karachi, Madras, and Tunis.

- The Bombay Metropolitan Regional Development Authority is mainly a financing agency which passes on loans to local authorities in the Bombay metropolitan area. It also has some responsibility for the capital budgeting and programming of metropolitanwide investment plans.
- The Madras metropolitan area contains three municipalities, one cantonment, and twenty-four town panchayats. The core city of the metropolitan area, the Madras City Corporation, contains approximately 75 percent of the population, but only 11 percent of the metropolitan land area. The Madras Metropolitan Development Authority was established in 1974 to prepare metropolitanwide development plans and to initiate and monitor their implementation. It also has a mandate to provide services and to improve employment opportunities for low-income groups. It employs a rolling five-year capital budget complemented by annual capital budgets.
- The Calcutta Metropolitan Development Authority (CMDA) was set up as a planning, supervisory, and coordinating agency, with some executive functions, in a highly fragmented metropolitan region. Its executive responsibility is generally limited to the investment stage—responsibility for operation and maintenance remain with the local authorities. This division of responsibilities leads to an inadequate provision for recurrent expenditure needs because of the limitations of the

local authorities' technical capacity to operate and maintain new facilities. The CMDA lacks a true fiscal base of its own and is dependent mainly on loans and transfers from higher levels of government.

- The Karachi Development Authority is a state body responsible for all land development and for planning and authorizing new development projects. It does not have an independent source of revenue, except for proceeds from bulk sales of water, which are constrained by the unwillingness of purchasers at lower levels of government to pay the set rates in full. Similar MDAS were set up in 1974 for Islamabad, Lahore, and Peshawar. In all cases the MDAS had responsibility for master planning and project preparation and execution throughout the metropolitan area and were under the direct control of provincial (state) governments.

- In 1972 the Tunis District was set up as a metropolitan authority. Its main functions are to coordinate, plan, budget, and supervise all public investments in the Tunis metropolitan area. Its staff is under the control of the governor-mayor of Tunis. A planning board of local representatives chaired by the mayor can suggest program and planning initiatives; but a supervisory council consisting of the prime minister and other ministers retains effective decisionmaking authority.

It is difficult to judge the success of metropolitan development authorities because the returns from efforts to plan and coordinate are not easily measured. Nevertheless, a number of general observations may be made. First, metropolitan development authorities are likely to be necessary and useful only if a substantial number of local governments operate within an urban area. In other cases, annexation or amalgamation of jurisdictions, interlocal compacts, or selective metropolitanwide provision of services by existing enterprises may be preferable.

Second, at least in India and Pakistan, the setting up of MDAS by state governments has usually implied some loss of local autonomy. Third, MDAS need to have executive functions and fiscal autonomy (resources) if they are to coordinate the delivery of services within metropolitan areas and provide certain services with areawide benefits. A planning agency with only advisory powers cannot effectively play this integrative role. Typically, MDAS have not been given such powers and as a consequence their effectiveness has suffered.

Fourth, MDAS often fail to combine development (investment) and operating responsibility and thus create the typical turnkey problem: the agency responsible for the capital outlay and planning does not allow sufficiently for the preferences and the technical, managerial, and financial capacity of the operating agency. The result is that local facilities deteriorate for lack of adequate maintenance.

Evaluating Experiences with Alternative Structures

How does one evaluate the structure of local government in a metropolitan area? What goals should be most aggressively sought in any reform of the structure? Which of the commonly used forms of horizontal relations best satisfies the norms for a good structure? In fact, each primary form of metropolitan government has advantages and disadvantages. One could make the case for each form being optimal, depending on the criteria used for evaluation and on whether one views the situation from the vantage point of central or local government. The norms for a good structure typically considered in such an evaluation are economic efficiency, technical efficiency, equity, cost containment, and autonomy of local government (Bahl and Campbell 1976). The paragraphs below describe these norms and survey the efforts of various countries to capture the advantages and offset the disadvantages of alternative systems of urban governance.

Economic Efficiency

One criterion used in evaluating government structures is whether resident preferences can be reflected in the local budget. The desire to increase the welfare of the population, what we will call the concern for economic efficiency, would seem to point toward more decentralized structures and smaller units of local government. The core of the argument is clear: the closer government is to the people, all other things being equal, the more likely a household is to have some effect on the budget and to receive something closer to the package of public services and taxes that it desires. Individual preferences are most likely to be satisfied if the size of the decisionmaking unit is smaller, local preferences are more homogeneous, and more fiscal autonomy is given to local governments.[25]

A fragmented structure of local government—many municipalities operating in the same urban area—would at first glance seem the best way to give resident consumers significant control over fiscal matters. But does the existence of smaller urban governments alone guarantee that government will be close to the people? The evidence suggests not. As noted above, most developing countries are not voting democracies, and therefore the decisionmaking process of local government may not reflect citizen preferences. For example, until recently the councils of Manila's eighteen cities and municipalities were appointed by the president. Even if the councils were popularly elected, there remains the possibility that the local government's fiscal activities would be so tightly regulated by the center (or state) that the demands of local residents would be partly neutralized. More damning is the fact that even local governments operating under a jurisdictionally fragmented system still may be too large to allow any significant measure of decentralized decisionmaking. For example, the core metropolitan jurisdictions of Calcutta and Manila have well over 1 million residents each. Finally, the smaller the local government, the less efficient its administration is likely to be and the less able it will be to provide a package of services that reflects the demands of citizens.

Gains in economic efficiency thus are the product of a system of governance in which governments are small enough to give local residents a choice, the political process allows local voters to reveal their preferences, and the local government has the fiscal autonomy and technical capability to reflect voter preferences in its budget and service delivery. These conditions are met in few developing countries.

Another important issue for economic efficiency that arises in connection with the fragmented structure of government is that some public services are characterized by externalities: the social benefits and costs of these services are different from those realized by the local community. As a result, the local community—left to its own devices—may underproduce or overproduce these goods, and there may be some losses of economic efficiency when government is brought closer to the people.

Here lies the efficiency tradeoff. Under a large metropolitan government, fiscal decisionmaking is far from the people and there are losses of economic efficiency by comparison with more jurisdictionally fragmented systems. Yet fragmented structures might better capture the preferences of local voters but could lead to overall losses in consumer welfare if they attempt to deliver and finance services whose benefits and costs are areawide.

In fact, governmental structures in metropolitan areas have reacted to the problem of economic efficiency in a predictable way. The accommodation in jurisdictionally fragmented areas—where one would guess there is the most commitment to fiscal decentralization—has been to assign functions characterized by significant externalities and economies of scale to the regional or central government and to assign the remainder to local governments. The system of local governments in the Manila metropolitan area is an example of a jurisdictionally fragmented structure in which an upper tier was created along these lines. The MDAS on the Indian subcontinent described above are another.

Metropolitan government removes fiscal decisions farthest from citizens. Hence the accommodation of creating small, subcity governmental units which could facilitate more citizen participation is not an unexpected development in some cities. In some cases, the subunits have been given control over some, albeit very limited, resources (earmarked taxes or grants) and the authority to select projects. The *alcaldes menores* (jurisdictions of minor mayors) of Bogota, the municipalities of Jakarta, the barangays of Manila, and the *juntas communales* (common councils) of Panama are examples of the actual devolution of resources. For example, Philippine barangays are supposed to receive a 10 percent share of local property taxes, a national grant, and a grant from the local government. Still, there is no evidence to suggest that the result of this devolution has been a substantial influence by neighborhoods on the package of services. In some cases, the decentralized structure is created, but there is no provision to pass resources to the subcity unit. Typically, this results in no more than an administrative decentralization of the metropolitan government; the *gu* subdivisions in Seoul, wards in Bombay, and districts in Bangkok serve such a purpose.

Citizen participation is not restricted to situations in which formal neighborhood governance exists. Informal organizations such as neighborhood associations and community boards have sprung up in many of the slums and squatter settlements in cities of developing countries, especially in Latin America. Their functions are to articulate citizens' demands, offer judicial and law enforcement services, and even provide some social services (often through cooperative self-help efforts). In some Latin American cities, this development is now being integrated with the formal structure of local government. One well-documented example is the valorization process in Colombia, in which the municipal community boards are an integral part of the decisionmaking process (Doebele, Grimes, and Linn 1979).

What we make of the current practice is that the trend is not in the direction of decentralization to capture gains in efficiency. Witness the creation of MDAS in cities which have decentralized structures of local government. Similarly, one does not sense much movement by metropolitan governments to assign fiscal responsibility to neighborhoods or to set up new subcity budgets. There are some decentralized municipal structures, but these exist primarily for administrative and perhaps political purposes. In the case of the functionally fragmented structures, the emphasis is so strongly on management and coordination, and on capturing the advantages of specialization and centralization, that there seems little attention left for the goal of economic efficiency. Satisfying citizen preferences with public budgets may be a noble goal for developing-country fiscal planners, but it would appear to be low on their list of priorities.

Technical Efficiency

Higher on their list is technical efficiency, that is, finding a method of delivering adequate public services at the lowest unit cost. A popular notion is that the cost per resident of delivering a public service declines as the number of residents increases; hence, gains in technical efficiency are the result of economies of scale. Such an argument would lead to a preference for areawide delivery of services, that is, for metropolitan government or functional fragmentation. Jurisdictional fragmentation would be the least preferred form of metropolitan governance.

Certainly the argument for economies of scale has much intuitive appeal. If one large government replaces many smaller governments, there are bound to be savings from the elimination of duplication of services, and with more size may come a greater possibility for cost savings through capital-labor substitution. These savings may be particularly important for metropolitan cities because of the superior ability of large local units to finance additions to the capital stock of local government. Because the consolidation of local governments increases the taxable capacity of the financing unit, it also increases the ability of local units to borrow and recover operating and capital costs through user charges. The construction and operation of markets and slaughterhouses, and even telephone and power companies, are examples of this.

To what extent does the argument for economies of scale hold up for developing countries? The literature seems clearly to show that there are economies of scale for such "hardware" services as public utilities and transportation (see chapter 3). These economies may be captured if the government is large enough to make the substantial capital investment required—for example, to build the proper-size sewage treatment plant, to extend the water distribution system, or to buy the fleet of buses. Jurisdictionally fragmented structures are at a disadvantage here *in* that they are not *large* enough to make the capital investment necessary to lower the unit cost of output. This is why in cities with fragmented structures, such as Calcutta and Manila, responsibility for capital-intensive services has been shifted to special purpose, areawide financing districts or has been assumed by a higher level of government. Capital-labor substitution is not the only way gains in technical efficiency might be captured by large local governments. Small governments probably cannot efficiently handle secondary education, hospital services, and even tax administration because of the construction and equipment costs involved and because specialty services might only be justified for large client populations. In the latter category might fall large markets, slaughterhouses, municipal sport stadiums, fire-fighting equipment for higher buildings, detective services, vocational schools, and hospitals with a broad range of services.

There is much less evidence that economies of scale exist in the provision of other public services. This is because many such services—for example, primary education, clinics, and street cleaning—are labor-intensive and have little room for capital-labor substitution.

In conclusion, if local government has significant responsibility for capital-intensive services, the advantages for the centralized metropolitan governance and functional fragmentation models will be greatest. Moreover, areawide provision may also capture the spillover costs and benefits of such services.

Equity

A third standard for evaluating a government structure is the pattern of geographical equity it produces. Specifically, the question is whether the government structure per se leads to disparities in tax burdens and service benefits between similar households living in different parts of the metropolitan area. This problem usually arises with jurisdictionally fragmented structures. It leads to the following kind of situation. High-income families will be pulled toward those jurisdictions with good public services and (because of the concentration of wealth) relatively low tax rates. Low-income families, zoned-out of these areas by high property values, will tend to cluster in jurisdictions which have become less wealthy and have higher tax rates and lower public service levels. The more municipalities within the metropolitan area, the greater the potential for this problem.

Do such disparities actually occur, and do people really vote with their feet in this manner? Certainly this has been the case in the United States, where a fragmented government structure has led to sizable fiscal disparities between city and suburban jurisdictions (AoR 1977, 1981).

There is not a great deal of evidence on this question in developing countries. A World Bank analysis of metropolitan Manila revealed a wide variation in efficiency of tax collection, tax effort, and per capita expenditures among the seventeen constituent local government units (Bahl, Brigg, and Smith 1976). For example, Makati, the wealthiest of municipalities, contained about 2 percent of the total municipal population in 1975 but accounted for about 41 percent of municipal revenues. Among the four chartered cities in the metropolitan area, Manila city's per capita revenues are several times larger than the average of the other three, and Manila city's tax burden appears well below the average of all local governments in the metropolitan area (Bahl, Brigg, and Smith 1976). Prud'homme (1975) reports a similar result from a study of 1973 data on metropolitan Tunis: per capita revenues in the commune of Tunis were 1.6 times higher than the average in the other twelve communes.

Areawide governments are a better choice on the grounds of geographical equity because taxes are levied on a uniform basis. There may still be disparities in service levels within the urban area—low-income neighborhoods with less ability to pay for services may not have the same access to these services as do high-income neighborhoods. Linn (1976c) found evidence of such disparities in Bogota with a correlation analysis between neighborhood income level and an indicator of level of services, and Bahl, Brigg, and Smith (1976) found similar results with an empirical analysis of disparities in levels of public services among neighborhoods in Manila city.

Cost Containment

A number of general management issues might be lumped under the heading of cost containment; that is, is one structure of local government more amenable than the others to control the growth in government spending? Local government expenditures might grow faster under a more highly centralized, metropolitan system of governance for several reasons. First, a large city will be more willing to take on the construction and expansion of capital facilities because of its broader revenue base and its broader discretionary taxation and borrowing powers. Such capital expenditures have a multiplier effect on total expenditures because they require future maintenance costs, and because they may occasion complementary costs (for example, the construction of a new municipal roadway probably also requires changes in traffic control, street lighting, street cleaning, bus routing, and so forth). Moreover, capital projects carry an interest cost in addition to the project costs.

A second reason why more centralized, areawide governments exert an upward long-term pressure on expenditures is that more revenues can be mobilized by larger than by smaller local governments. Larger urban governments are more likely to use income- and price-elastic consumption and income-type tax bases, and property tax administration is likely to be better in larger cities. Third, there is more political flexibility at the level of the metropolitan area than at the level of the submetropolitan jurisdictions to make discretionary changes in tax rates or user charges. This is because local tax increases can be more closely identified with particular elected officials than can areawide changes, which suggests that politicians will be more willing to make unpopular tax decisions at the metropolitan level than at the "neighborhood" level. As a result, greater reliance on areawide tax bases could raise the long-term growth rate of expenditure.

A functionally fragmented system also has features which might push up the cost of providing services. First, the budget-maximizing technocrat in charge of the autonomous agency may try to maximize the size of his operation rather than expand and allocate resources according to community needs.[26] Second, areawide, special purpose authorities may dedicate revenues from user charges (for example, water rates) to finance capital expansions. Because some utility operations generate a surplus under marginal cost pricing, more resources and hence expenditure growth might be expected. Third, autonomous agencies may raise taxes and charges outside the usual constraints faced by local governments in making fiscal decisions, and a faster rate of expenditure growth might occur.

This is not to say that a jurisdictionally fragmented system does not also have features which may stimulate costs. First, because economies of scale cannot be captured, costs may be higher. Second, administrative duplication may make costs higher, all other things being equal, under a more decentralized *system.* Third, planning and coordination are more difficult under a decentralized system, and as a result costs may not be contained as well. Fourth, a more decentralized system is less likely to make use of modern, cost saving management skills and technology.

It is difficult to draw a firm conclusion about the relationship between cost containment and government structure. Moreover, a particular systern may contain costs better in one developing country than in another. Again, it depends on the functions, taxing powers, and general fiscal autonomy given to local governments. All other things being equal, however, the view here is that the growth in expenditures is likely to be greatest under more centralized systems.

Autonomy of Local Government

There does seem to be some relation between the structure of local government within a metropolitan area and the degree of fiscal independence given to local government. Functional fragmentation seems more consistent with greater local autonomy. By setting up special purpose districts or agencies, local governments may gain back a measure of the autonomy taken away by central regulation. It has long been a practice to create separate water and transportation authorities to make possible a more professional (and less political) management, to avoid civil service regulations in employment practices, and to create more autonomy in taxing, pricing, and investment decisions. The use of autonomous agencies in Colombian cities is one good example of this practice—the public *empresas* in Bogota (which provide street cleaning, telephones, power, and the water supply) have proven to be effective in circumventing central controls on personnel policy that would have been binding had these services been delivered through general purpose local governments. Some provinces and cities in the Philippines have used local public enterprises to deliver and finance public and commercial services such as markets, slaughterhouses, and even a convention center. This separation from general government has enabled various pricing adjustments to be made (and avoided what might have been cumbersome civil service regulations) and even permitted the contracting out of management services (Greytak and Diokno 1983).

Conclusions: Reforming the Structure of Local Government

A jurisdictionally fragmented structure of local government seems to be least suited to the cities of developing countries. Theoretically, it offers a structure wherein consumer-voters can segregate themselves into groups with like preferences and can affect the mix of public services. But this efficiency advantage is rarely captured in developing countries because local governments have so little autonomy to make fiscal decisions, because the decentralized municipalities themselves are quite large, or because the local governments do not have the technical wherewithal to produce the package of services desired. Moreover, the costs associated with a geographically fragmented structure of local government—fiscal disparities, diseconomies of scale, planning and coordination problems—may be substantial. The trend in developing countries is clearly not in the direction of fragmented structures of metropolitan governance, perhaps because the cost of moving government closer to the people is perceived as being too high.

In many cases where jurisdictional fragmentation exists, or where the metropolitan area has spilled over into adjoining jurisdictions, reforms have been proposed to deal with the problems of coordination, uniform planning, and service provision. The most popular reform seems to be the creation of a metropolitan development authority. Other approaches to dealing with the problem are annexation (in Bogota.), the formation of municipal associations (in Medellin), and the creation of a metropolitan tier of government (in Manila). Remedies for geographic fragmentation are more easily found in developing countries than in industrial countries because the central (or state) governments in developing countries tend to have much more sweeping powers to set municipal boundaries, and because in general there is much less of a tradition of autonomous local governments to stand in the way of amalgamation. There are exceptions, of course. In Calcutta, there is a very strong political base at the municipal level and a very strong push to retain the autonomy of local units.

This would seem to leave metropolitan areawide government and functional fragmentation as the best choices for local government in the cities of developing countries. Again, however, there are problems as well as potentials.

The independence of autonomous agencies is both a blessing and a curse. On the one hand, it can produce professionalism in management, remove decisionmaking somewhat from the political arena, and dedicate revenues to the expansion and maintenance of a particular service. On the other hand, it becomes more difficult to coordinate the delivery and financing of services. Professional managers who are unchecked by local governments and who have access to substantial revenues from user charges may overspend on the function involved relative to what is spent on all other local functions. The problem of coordination which arises from functional fragmentation has been dealt with in three ways. One is to create boards with overlapping membership; for example, in Colombia the mayor may serve simultaneously on the boards of all local autonomous agencies. The experience with this approach in Colombia has not been uniformly successful. A second possibility is to limit the number of autonomous agencies and encourage multifunctions, for example, the Bombay Electric Company and Transportation Authority and the public services *empresas* in Cartagena. This provides some fungibility of revenues and reduces the problem of coordination, but only selected functions are covered. A third possibility is to control the operations of the authorities, that is, make them semiautonomous as in Jakarta. This retains the advantage of the professionalism of the separate authority but reintroduces political considerations into the decisionmaking process.

Metropolitan government has two important problems that call for reform. The first is that the management and financing of certain services are beyond the technical abilities of the city administration and need to be separated from the local political process. The creation of autonomous or semiautonomous agencies—some degree of functional fragmentation—seems to have been the answer to this problem. As noted above, the ties between these agencies and the city administration may be made in many ways. The second problem is that a way needs to be found to allow neighborhoods to reveal their preferences for public services and for the city budget to reflect them. There is no shortage of schemes to deal with this issue in developing countries, but we have been unable to find a clearly successful experience.

Summary and Conclusions: The Structure of Local Government and Decentralization

We began this chapter with the question of what is the best way to organize local government to deliver and finance services in developing countries. It will satisfy few that we have concluded with the answer, "It depends." It depends on whether the governments of developing countries are more interested in letting the preferences of people be reflected in the budgets of local governments—which suggests more decentralization—or in creating local governments that operate with maximum efficiency, equalize interregional fiscal capacity disparities, or give the central government maximum flexibility to mobilize and stabilize resources (all of which suggest more centralization). There is some indication as to how governments view these tradeoffs in that they have allowed only a relatively low degree of fiscal decentralization. Subnational governments account for only about 15 percent of all government expenditures, and this proportion has not been increasing.

This 15 percent share could be an overstatement of the fiscal responsibility of subnational governments. This is because there is an important distinction to be drawn between fiscal decentralization on the one hand and moving government closer to the people on the other. Even with more taxing power and expenditure responsibility, and even with the creation of smaller municipalities, local governments in developing countries may not be able to respond to the demands of citizens for different levels and mixes of services and financing. There are a number of constraints: local councils are often appointed rather than elected and therefore may not be representative of the local population; local taxing powers and responsibilities for expenditure are severely circumscribed; there may be administrative constraints on local governments that prohibit either an increase in taxation or an expansion of public services; and the chief officers who carry out the delivery of services are often appointed by a higher level of government. Because all of these constraints hold more or less for most local governments in developing countries, one might guess that the total share of government expenditures which is fully controlled by state and local governments is well below 15 percent.

There is much variation in the fiscal autonomy of local governments within countries. The general rule is: the larger the population, the more fiscal responsibility. The most fiscal latitude is given to large metropolitan areas, where local governments account for a third to a half of total government spending. Moreover, they tend to have more discretion to raise tax rates, broader tax bases, more expenditure responsibilities, and sometimes even the power to borrow from nongovernment sources. Still, these local authorities do not have anything like the same degree of autonomy as do many of their counterparts in industrial countries.

Three systems of horizontal fiscal relations seem to have emerged in the governance of metropolitan areas. The first, jurisdictional fragmentation—many municipalities operating within a single urban area—has the most potential for recognizing differences in preferences and allowing citizen participation. It fails, however, to produce uniformity of service levels and tax burdens within the urban area, to allow for effective planning or coordination of capital investments, or to deal with spillover effects. For this reason, the trend has been toward creating an overlying central tier of government (as in Manila) or a metropolitan development authority (as on the Indian subcontinent).

Many urban areas in developing countries are organized as a metropolitan government overlapped by one or two autonomous agencies (for example, a water company or a bus company). This form of governance has all the advantages of centralization—planning, capturing economies of scale, and internalizing externalities—but it neglects diversity of preferences because government is so large and so far removed from the voter. Some metropolitan governments have attempted to deal with this by creating small subarea administrative units, but mostly the problem seems to have been written off as a "cost" of urbanization. Whether the issue can be ignored as the great metropolitan areas surpass 10 and 20 million people is an interesting question.

The third system, the functional fragmentation model—in which services are delivered by a set of independent public service agencies—is popular in Latin America. It has potentially serious disadvantages of coordination and it leads to a government farther removed from the individual voter than does metropolitan governance. But it has the great advantage of specialized, professional management, and some degree of freedom from the political process. There have been attempts to deal with the problem of coordination by creating interlocking directorates covering all local governments.

The experience with local government in the metropolitan areas of developing countries, then, is one of accommodation. One model emphasizes local control and participation, another central coordination and control, and a third technical efficiency. Although there is an underlying trend toward centralization, each system has been altered to move toward the other two.