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THE EFFECTS OF DECENTRALISATION ON PUBLIC INVESTMENT: EVIDENCE AND FOUR LESSONS FROM BOLIVIA AND COLOMBIA

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The Effects Of Decentralisation on Public Investment: Evidence and Four Lessons from Bolivia and Colombia*

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Abstract

Hundreds of studies have failed to establish the effects of decentralisation on a number of important policy goals. This paper examines the cases of Bolivia and Colombia to explore decentralisation's effects on government responsiveness and poverty-orientation. I first summarize economic data on the effects of decentralisation in each. In Bolivia, decentralisation made government more responsive by re-directing public investment to areas of greatest need. In Colombia, municipalities increased investment significantly as decentralisation deepened, while running costs fell. In both countries, investment shifted from economic production and infrastructure to social services and human capital formation. Resources were rebalanced in favour of poorer districts. The contrast between the two also highlights four important lessons. In order for decentralisation to work well, (i) local democracy must be free, fair, transparent and competitive; (ii) sub-national governments must face hard budget constraints; (iii) central government must be scaled back; and (iv) significant tax-raising powers must be devolved to the periphery. Where all four conditions obtain, decentralising resources and political authority can generate real accountability where none existed before, and improve the quality of government a society achieves.

Introduction

Over the past few decades, decentralisation has become one of the most debated policy issues throughout both developing and developed worlds. It is seen as central to the development efforts of countries as far afield as Chile, China, Guatemala and Nepal; and in the multiple guises of subsidiarity, devolution and federalism it is also squarely in the foreground of policy discourse in the US, UK and EU. But surprisingly, there is little agreement concerning the effects of decentralisation in the empirical literature. Advocates argue that decentralisation can make government more responsive to the governed by "tailoring levels of consumption to the preferences of smaller, more homogeneous groups".[1] Opponents dispute this, arguing that

* This research was financed by the World Bank Research Committee and the DFID-LSE Crisis States Programme. I am very grateful to Carolina Mejía for expert research assistance, and to Pranab Bardhan, Tim Besley, Teddy Brett, Shanta Devarajan, James Dunkerley, John Harriss, Luis Felipe López, Mauricio Merino, Ken Shadlen and seminar participants at the CSP-Delhi and UNDP-Mexico meetings for their thoughtful suggestions. I owe a special debt of gratitude to my collaborators in the *Decentralisation, Local Governance and Violence in Colombia* project: Marcela Ceballos, CODHES, Diana Hoyos and Fabio Sánchez. All remaining errors are my own.

[1] J. J. Wallis & W. E. Oates, 'Decentralization in the Public Sector: An Empirical Study of State and Local Government', in H. S. Rosen (ed.), *Fiscal Federalism: Quantitative Studies*, Chicago: University of Chicago Press, 1988, p.5. See also, for example: E. Ostrom *et.al.*, *Institutional Incentives and Sustainable Development: Infrastructure Policies in Perspective*, Boulder: Westview Press, 1993; R. D. Putnam, *Making Democracy Work: Civic Traditions in Modern Italy*, Princeton: Princeton University Press, 1993; World Bank, *World Development Report: Infrastructure for Development*, New York: Oxford University Press, 1994; UNDP, *Informe Sobre Desarrollo Humano 1993*, Madrid: CIDEAL, 1993.

local governments are too susceptible to elite capture, and too lacking in technical, human and financial resources, to produce a heterogeneous range of public services that are both reasonably efficient and responsive to local demand.[2] But neither side is able to substantiate its arguments convincingly with empirical evidence.

Consider the broadest surveys of decentralisation experiences. In their wide-ranging 1983 survey, Rondinelli, Cheema and Nellis note that decentralisation has seldom, if ever, lived up to expectations. Most developing countries implementing decentralisation experienced serious administrative problems. Although few comprehensive evaluations of the benefits and costs of decentralisation efforts have been conducted, those that were attempted indicate limited success in some countries but not others.[3] A decade and a half later, surveys by Piriou-Sall, Manor and Smoke come to cautiously positive conclusions, but with caveats about the strength of the evidence in decentralisation's favour. Manor ends his study with the judgment that "while decentralization …is no panacea, it has many virtues and is worth pursuing", after noting that the evidence, though extensive, is still incomplete. Smoke asks whether there is empirical justification for pursuing decentralisation, and finds the evidence is mixed and anecdotal.[4] The lack of progress is striking.

This paper examines some of the key questions on decentralisation by comparing the remarkable case of Bolivia with the more complex case of Colombia. It compares the results from a significant amount of mature research on Bolivia,[5] with much more preliminary work on Colombia arising from the LSE-DFID-Los Andes project on *Decentralisation, Local Governance and Violence*. The conclusions I am able to reach are accordingly much stronger and better founded for the Bolivian case than Colombia. Nonetheless, as we shall see, teasing out the similarities and differences between the two is a revealing exercise in and of itself. Furthermore, focusing on two broadly similar countries in the same region limits problems of data comparability, and geographic and cultural context. Bolivia is particularly deserving of study because reform there consisted of a large change in policy at a discrete point in time. Colombia, however, is more relevant for many middle-income countries because of its wealth, level of development, and relatively high state capacity.

I define decentralisation as the devolution by central (i.e. national) government of specific functions, with all of the administrative, political and economic attributes that these entail, to democratic local (i.e. municipal) governments that are independent of the centre within a legally delimited geographic and functional domain. The rest of the paper is organised as follows. Section 2 reviews the Bolivian and Colombian decentralisation programmes, focusing on their legal and budgetary aspects. Section 3 provides summarised analysis of the economic outcomes of decentralisation in each country. Section 4 summarises the effects of

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[2] See, for example: R. C. Crook & A. S. Sverrisson, 'To What Extent Can Decentralized Forms of Government Enhance the Development of Pro-Poor Policies and Improve Poverty-Alleviation Outcomes?', Manuscript, 1999; J. Samoff, 'Decentralization: The Politics of Interventionism', *Development and Change*, 21 (1990), pp.513-530; B. Smith, *Decentralization: The Territorial Dimension of the State*, London: George Allen & Unwin, 1985.

[3] D. A. Rondinelli *et al.*, 'Decentralization in Developing Countries: A Review of Recent Experience', *World Bank Staff Working Paper* No. 581, Washington, DC: World Bank, 1983.

[4] S. Piriou-Sall, 'Decentralization and Rural Development: A Review of Evidence', Washington, DC: Manuscript, 1998; J. Manor, *The Political Economy of Democratic Decentralization*, Washington, DC: The World Bank, 1999; and P. Smoke, 'Fiscal Decentralization in Developing Countries: A Review of Current Concepts and Practice', *Democracy, Governance and Human Rights Programme Paper* No.2. Geneva: UNRISD, 2001.

[5] See, for example: J. P. Faguet, 'Does Decentralization Increase Responsiveness to Local Needs? Evidence from Bolivia', *Journal of Public Economics*, 88 (2004), pp.867-894.

reform in Bolivia and Colombia, and concludes with four lessons that the two cases provide for other countries that seek to decentralise.

The Bolivian and Colombian Decentralisation Programmes

Popular Participation in Bolivia

On the eve of revolution, Bolivia was a poor, backward country with extreme levels of inequality, presided over by a "typical racist state in which the non-Spanish speaking indigenous peasantry was controlled by a small, Spanish speaking white elite, [their power] based ultimately on violence more than consensus or any social pact".[6] The nationalist revolution of 1952, which expropriated the "commanding heights" of the economy, land and mines, launched Bolivia on the road to one of the most centralised state structures in the region. The government embarked upon a state-led modernisation strategy in which public corporations and regional governments initiated a concerted drive to break down provincial fiefdoms, transform existing social relations, and create a modern, industrial, more egalitarian society.[7] To this end the President directly appointed Prefects, who in turn designated entire regional governments and associated dependencies, forming a national chain of cascading authority emanating from the capital.

The intellectual trends of the 1950s-1970s – *Dependencia* theory, Import Substitution Industrialisation, and Developmentalism – contributed to the centralising tendency, as did the military governments which overthrew elected administrations with increasing frequency from the 1960s on.[8] With political power so little dispersed, there was little point in establishing the legal and political instruments of local governance. As a result, beyond the nine regional capitals (including La Paz) and an additional 25-30 cities, local government existed in Bolivia at best in name, as an honorary and ceremonial institution devoid of administrative capability and starved for funds; and in most of the country it did not exist at all.

Although the 1994 reform was sprung on an unsuspecting nation, the concept of decentralisation was by no means new. For more than 30 years a decentralisation debate focused on Bolivia's nine departments ebbed and flowed politically – at times taking on burning importance, other times all but forgotten. The issue became caught up in the country's centrifugal tensions, as regional elites in Santa Cruz and Tarija consciously manipulated the threat of secession to Brazil and Argentina respectively – with which each is economically more integrated than La Paz – to extract resources from the centre. The Bolivian paradox of a highly centralised but weak state, and a socially diverse population with weak national identity, meant that such threats were taken seriously by the political class, which blocked all moves to devolve more power and authority to Bolivia's regions.

So what spurred the change of tack, and why then? Two factors stand out. The less important one arises from Bolivia's failure to achieve sustained, healthy growth despite wrenching economic reform overseen by the IMF and World Bank. Fifteen years of near-zero per capita economic growth sapped the credibility of the state and fomented social unrest. The new *Movimiento Nacional Revolucionario* (MNR) administration of President Sánchez de Lozada saw the structure of government itself as an impediment to growth. Decentralisation was an

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[6] H. Klein, *Historia de Bolivia*, La Paz: Libreria-Editorial Juventud, 1993, p.237 – my translation.
[7] J. Dunkerley, *Rebellion in the Veins: Political Struggle in Bolivia 1952-82*, London: Verso, 1984.
[8] Klein (1993).

attempt to deepen structural reform in order to make the state more efficient and responsive to the population, and so regain its legitimacy in the voters' eyes.

The more important factor arises from the rise of ethnically-based, populist politics in the 1980s, which undercut the MNR's traditional dominance of the rural vote, and posed a serious challenge to its (self-declared) role as the 'natural party of government'. This rural dominance was itself born out of the MNR's agrarian reforms of the 1952-53 revolution. Hence a party with a tradition of radical reform, which found itself in secular decline, sought a second, re-defining moment. In a typically bold move, it sought to reorganise government, re-cast the relationship between citizens and the state, and so win back the loyalty of Bolivians living outside major cities. To a very important extent, decentralisation was a gambit to capture rural voters for at least another generation.[9]

Against this background, the Bolivian decentralisation reform was announced in 1994. The Law of Popular Participation (LPP), developed almost in secret by a small number of technocrats,[10] was announced to the nation to general surprise, followed by ridicule, followed by determined opposition of large parts of society.[11] It is notable that opposition to the law, which was fierce for a few months, came principally from the teachers' union, NGOs and other social actors, and not from political parties. Based on their public declarations, the position of the former was an incoherent mix of accusations and fears that denoted a deep suspicion of the government's motives, and not a careful reading of the law. The lack of opposition from parties can largely be attributed to the sweeping reforms that were being enacted by the MNR government at the same time as decentralisation. With privatisation of the main state enterprises, education reform, and a comprehensive restructuring of the executive branch all being pushed at once, decentralisation was relegated to the second tier of political parties' concerns. The opposition focused its attention elsewhere, and it never became a fighting point.

First made public in January of that year, the law was promulgated by Congress in April and implemented from July. The scale of the change in resource flows and political power that it brought about were enormous. The core of the law consists of four points:[12]

- **Resource Allocation.** Funds devolved to municipalities doubled to 20 percent of all national tax revenue. More importantly, allocation amongst municipalities switched from unsystematic, highly political criteria to a strict per capita basis;
- **Responsibility for Public Services.** Ownership of local infrastructure in education, health, irrigation, roads, sports and culture was given to municipalities, with the concomitant responsibility to maintain, equip and administer these facilities, and invest in new ones;

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[9] At the time MNR strategists gleefully predicted such a result. They proved wrong.
[10] D. Tuchschneider, 'Una Visión desde la Planificación Participativa Municipal', in Grupo DRU, UIA-SNPP, *Participación Popular: Avances y Obstáculos*, G. Rojas (ed.), La Paz: CID, 1996.
[11] 'Injertos Tramposos en 'Participación Popular', *Hoy*, 19 January 1994; 'La Declaratoria de Guerra del Primer Mandatario', *La Razon*, 27 January 1994; and 'Arrogancia Insultante', *Presencia*, 27 February 1994 are only three of the many articles which appeared in the Bolivian press documenting popular reaction to the 'Damned Law'. These are documented in Unidad de Comunicación, Secretaría Nacional de Participación Popular, *Debate Nacional sobre la Ley de Participación Popular*, La Paz: Secretaría Nacional de Participación Popular, 1995.
[12] Secretaría Nacional de Participación Popular, Ministerio de Desarrollo Sostenible y Medio Ambiente, *Ley de Participación Popular, Reglamento de las Organizaciones Territoriales de Base*, La Paz, 1994.

- **Oversight Committees** (*Comités de Vigilancia*) were established to provide an alternative channel for representing popular demand in the policy-making process. Composed of representatives from local, grass-roots groups, these bodies propose projects and oversee municipal expenditure. Their ability to have disbursements of Popular Participation funds suspended if they find funds are being misused or stolen can paralyse local government, and gives them real power;
- **Municipalisation.** Existing municipalities were expanded to include suburbs and surrounding rural areas, and 198 new municipalities (out of 311 in all) were created.

The change in local affairs that these measures catalysed is immense. Before reform local government was absent throughout the vast majority of Bolivian territory, and the broader state present at most in the form of a military garrison, schoolhouse or health post, each reporting to its respective ministry. After reform, elected local governments sprouted throughout the land.

The terrain in which they sprouted was of course very different from place to place – power and resources were decentralised to huge cities and tiny villages, at the tops of mountains, deep in the jungle, and everywhere in between. In order to try to establish common minimum technical and administrative standards in local public management, central government launched a series of capacity-building programmes aimed at teaching municipalities how to draw up a budget, contracts, manage public funds, raise local revenues, and manage personnel, amongst others. These programmes were available to all municipalities, but aimed disproportionately at poorer, less experienced ones. The long-term aim was clearly to nudge municipalities towards greater efficiency and economic self-sufficiency.

The Decentralisation Process in Colombia

Like Bolivia, Colombia was traditionally a highly centralised country, with mayors and governors directly named by central government. Governors, in particular, were the President's *hombres de confianza,* and carried out his will in the regions. But unlike Bolivia's 'big bang' reform, decentralisation in Colombia developed over the years as a much more gradual, incremental process. Hoyos and Ceballos identify three broad phases:[13]

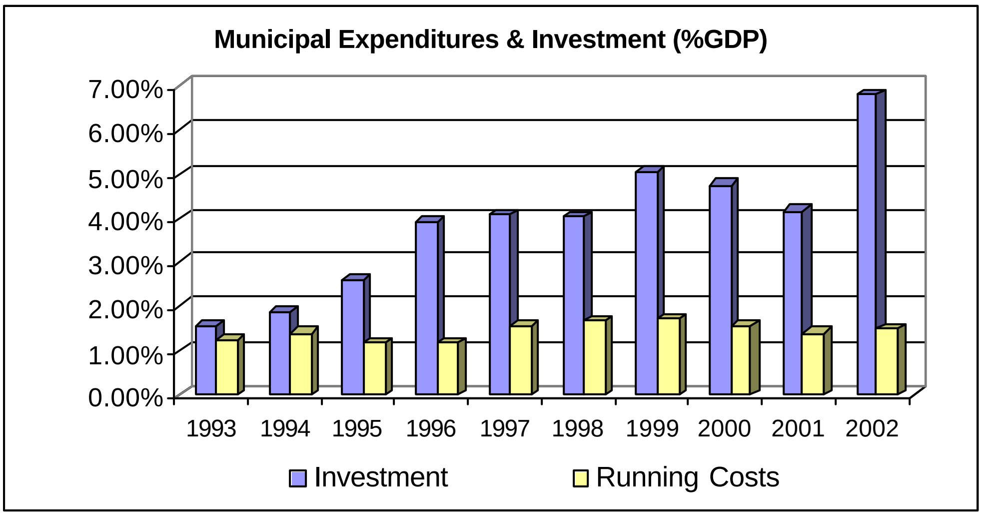
- **Phase 1** began in the late 1970s and early 1980s, and included a number of fiscal measures aimed at strengthening municipal finances. Most important of these were Law 14 of 1983 and Law 12 of 1986, which assigned to municipalities increased powers of tax collection, including especially sales tax, and established parameters for the investment of these funds;
- **Phase 2**, which began in the mid-1980s, was more concerned with political and administrative matters. Amongst the most important of these measures was Law 11 of 1986, which regulated the popular election of mayors and sought to promote popular participation in local public decision-making via *Juntas Administradoras Locales*, amongst others. Reforms enshrined in the 1991 constitution, such as citizens' initiatives, municipal planning councils, open *cabildos*, the ability to revoke mayoral mandates, referenda, and popular consultations, further deepened political decentralisation. The 1991 constitution also established the popular election of governors;

[13] D. Hoyos & M. Ceballos, 'Decentralisation and local democracy in Colombia: The evolution of electoral behaviour 1988-2000', Manuscript, 2003.

- **Phase 3** consisted of a number of laws that regulated the new constitution, and other fiscal and administrative reforms of the period. These laws assigned greater responsibility to municipalities for the provision of public services and social investment, and provided additional resources for the same by increasing central government transfers to local governments significantly. The laws mandate that the bulk of transferred funds should be spent on education and health, with little discretion left to local governments. Automatic transfers to regional governments rose from about 20% to over 40% of total government spending, placing Colombia third in the region after the two big federal countries, Brazil and Argentina.[14]

The aggregate effect of two decades of political and fiscal reforms was a large increase in the authority and operational independence of Colombia's municipal governments, accompanied by a huge rise in the resources they controlled. Municipalities were allowed to raise and spend significant sums of their own taxes, central-to-local government transfers increased more than three fold,[15] and municipal governments were permitted to issue public debt. Overall municipal expenditures and investments rose from 2.8% to 8.3% of GDP, as detailed in figure 1. This rise was due entirely to increased investment, while running costs remained stable over the period.

Figure 1



Source: *Decentralisation, Local Governance and Violence* project

What drove decentralisation in Colombia? As befits a much longer and more elaborate process, we cannot limit the motivating factors of reform to a few discrete goals. Hoyos and Ceballos group the many reasons into two categories. The first of these is the **challenge of political instability**. Colombia is a violent country – much more so than Bolivia – with a long history of civil conflict, armed rebellion, persistently high levels of 'common' crime, and the use of violence as an explicit tool of political mobilization. The late 1970s saw levels of violence rise again as the internal conflict intensified. At the same time, social protests and pressures from regional groups multiplied, linked to the central state's inability to meet demands for social services and public investment. Secondly, **the political hegemony** over the instruments of the state of the traditional Liberal and Conservative parties began to be

[14] Alesina *et.al*., 'Decentralization in Colombia', *Fedesarrollo Working Paper* No.15, Bogotá: Fedesarrollo, 2000. The regional average is 15%.
[15] Sánchez *et.al*., 2000, show that central transfers grew from 2% of GDP in 1990 to almost 7% in 1997.

seen more and more as a liability – less the solution to a previous round of civil violence (*La Violencia*) and more a cause of the next one. Colombians from across the political spectrum became convinced that the inability of the state to respond to society's demands – and its outright absence in many areas (the 'internal frontier'), combined with the waning legitimacy of an arbitrarily restricted democracy,[16] were leading to public sector inefficiencies, civic discontent, and ultimately armed violence.

Thus from the start, decentralisation in Colombia was a multi-faceted tool designed to serve a combination of purposes particular to Colombia's troubled democracy. Through it, policy elites sought to increase the levels of electoral and citizen participation within the existing institutional framework. They sought to open the political system via popular elections at the regional and local levels, where they hoped new parties and movements would emerge and eventually assume power, so breaking the liberal-conservative hegemony over the resources of the state.

The Impacts of Decentralisation

The Impact of Decentralisation in Bolivia

The extent of the change is perhaps best appreciated by examining the changes in resource flows it catalysed. Figure 2 shows that before decentralisation 308 Bolivian municipalities divided amongst them a mere 14% of all devolved funds, while the three main cities took 86%. After decentralisation their shares reversed to 73% and 27% respectively. The per capita criterion resulted in a massive shift of resources in favour of smaller, poorer districts.

Figure 2

The Changing Allocation of Public Funds

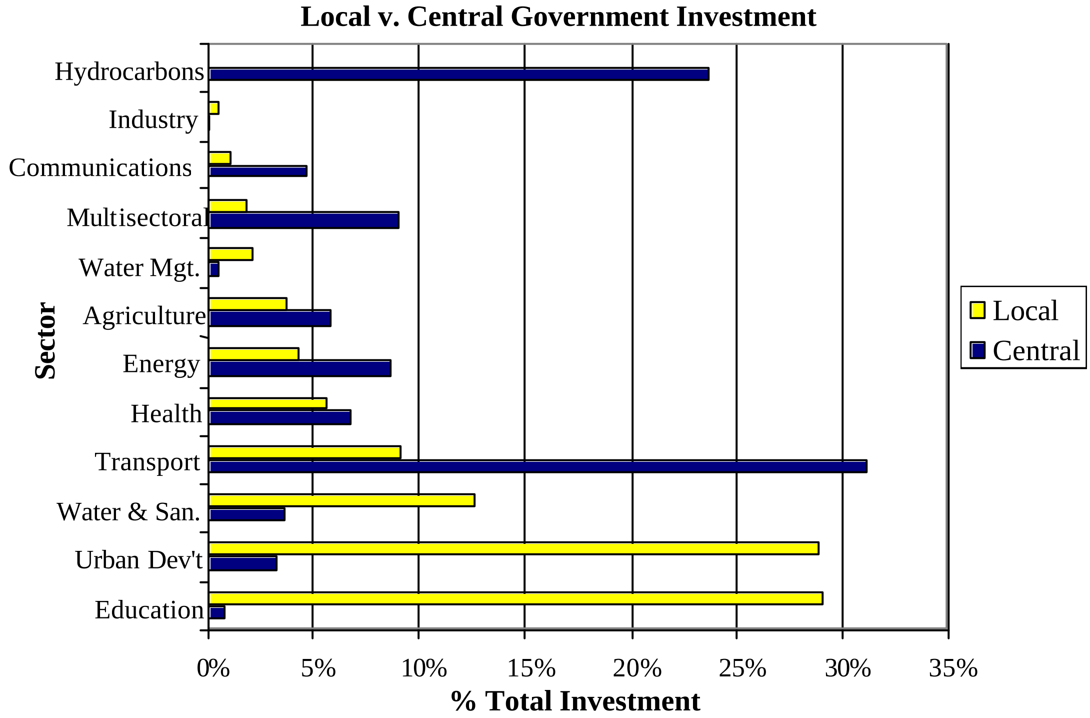
	Central-to-Local Revenue Sharing (Bs'000)			**% of National Total**	
City	**1993**	**1995**	**% Change**	**1993**	**1995**
La Paz	114,292	61,976	-46%	51%	10%
Santa Cruz	51,278	63,076	23%	23%	10%
Cochabamba	25,856	38,442	49%	12%	6%
3 Cities Sub-total	**191,427**	**163,494**	**-15%**	**86%**	**27%**
Rest of Bolivia	**32,099**	**444,786**	**1286%**	**14%**	**73%**
Total	223,525	608,280	172%	100%	100%

N.B. Average exchange rate: US$1=Bs.5

Source: Original calculations; database compiled from official Bolivian sources.

[16] The *Frente Nacional* (1957-74) quelled *La Violencia* by sharing out the fruits of power equally between Liberals and Conservatives, and restricting electoral competition to those two parties.

Figure 3



Source: Original calculations; database compiled from official Bolivian sources.

A more important and telling change was to the composition of investment. Figure 3 shows central and local government investment by sector for the periods 1991-93 and 1994-96. The differences are large. In the years leading up to reform, central government invested most in transport, hydrocarbons, multisectoral[17] and energy, which together accounted for 73% of public investment during 1991-93. Following decentralisation, local governments have invested most heavily in education, urban development, and water and sanitation, together accounting for 79% of municipal investment. Of the sectors accounting for roughly three quarters of total investment in both cases, central and local government have not even one in common. The evidence implies that local and central government have very different investment priorities. Call this Bolivia's 'decentralisation stylised fact 1'.

It is also instructive to examine how investment was distributed geographically among Bolivia's municipalities before and after decentralisation. Figures 4 to 6 give us a rough sense of this by placing Bolivia's municipalities along the horizontal axis and measuring investment per capita as vertical displacement. A highly skewed allocation would appear as a few points strewn across the top of the graph, with most lying on the bottom; an equitable distribution would appear as a band of points at some intermediate level.

[17] A hodgepodge, including feasibility studies, technical assistance and emergency relief, that is difficult to categorise.

Figure 4: Investment per capita, 1991-93

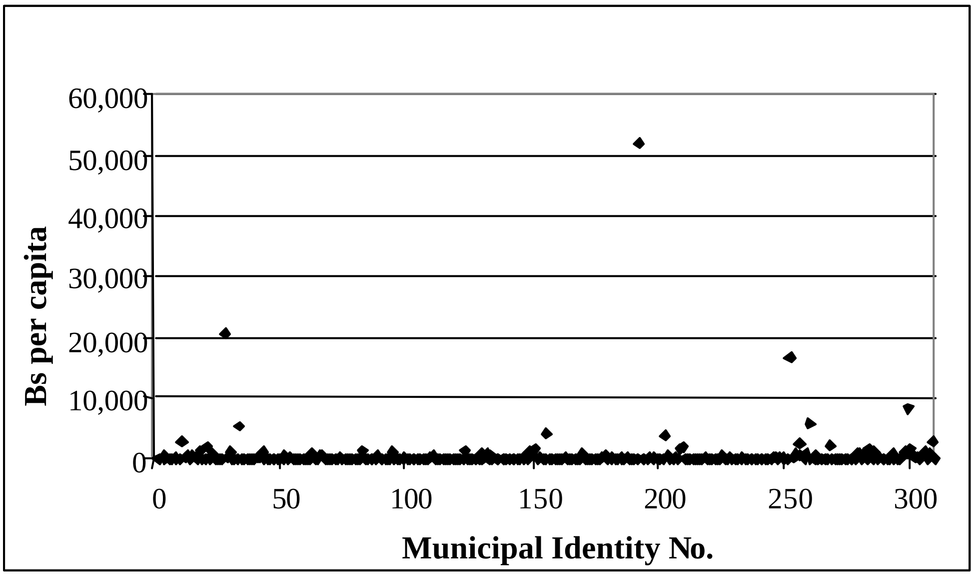


Figure 5: Investment per capita, 1991-93

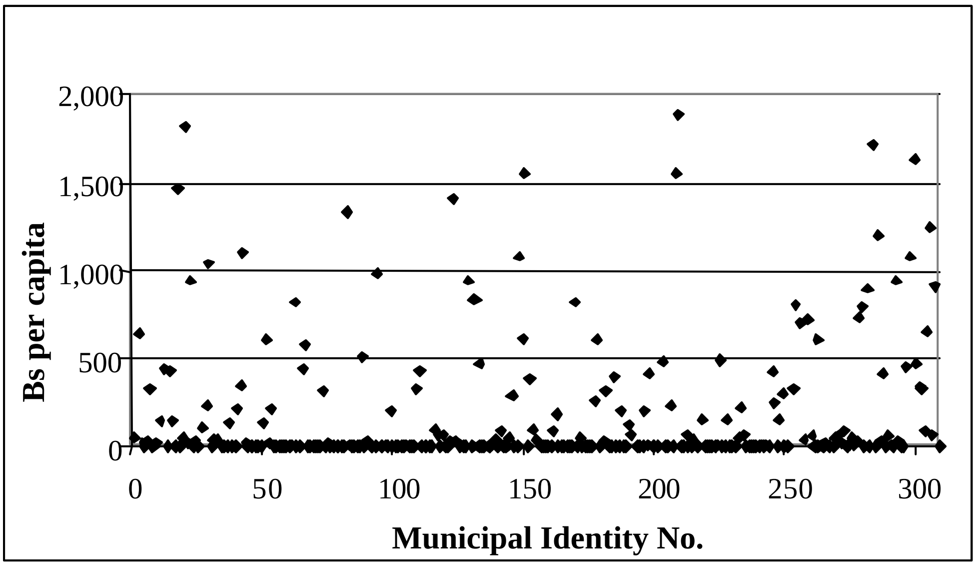
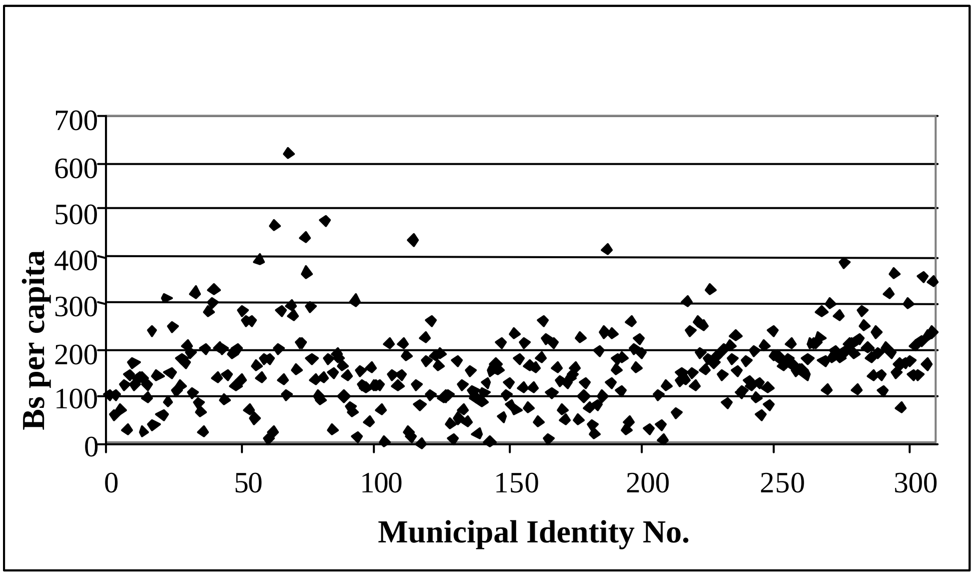


Figure 6: Local Investment per capita, 1994-96



Source: Original calculations; database compiled from official Bolivian sources.

What does the data show? Figure 4 shows that per capita investment before decentralisation was indeed highly unequal, with large investments in three districts and the vast majority at or near zero. Figure 5 corrects for the skewing effect of the highest observations by excluding the upper twelve and showing only those below Bs.2000 per capita. Though the distribution now appears less unequal, there is still monotonically increasing density as we move downwards, with fully one-half of all observations on or near the horizontal axis. Investment under centralised government was thus hugely skewed in favour of a few municipalities that received enormous sums, a second group where investment was significant, and the unfortunate half of districts that received nothing. Compare this with figure 6, which shows municipal investment after decentralisation. This chart shows no district over Bs.700/capita, a broad band with greatest density between Bs.100-200 per capita, and only a few points touching the axis. Average municipal investment for this period is Bs.208/capita, and thus the band contains the mean.[18] These crude indicators imply that central government, with a much larger budget and free rein over all of Bolivia's municipalities, chose a very unequal distribution of investment across space, while decentralised government distributes public investment much more evenly throughout the country. This is stylised fact no.2.

A third stylised fact uses econometric models of public investment to show that decentralisation increased government responsiveness to real local needs.[19] After 1994, investment in education, water and sanitation, water management, and agriculture was a positive function of illiteracy rates, water and sewerage non-connection rates, and malnutrition rates respectively. That is to say, although investment in these sectors increased throughout Bolivia after decentralisation, the increases were disproportionate in those districts where the objective need for such services was greatest. I argue that these changes were driven by the actions of Bolivia's 250 smallest, poorest, mostly rural municipalities investing

[18] Investment sums here are much lower because they exclude central government funds.
[19] Faguet (2004).

newly devolved public funds in their highest-priority projects. Detailed econometric models showing these results for education are provided in Annex 1.

The fourth stylised fact uses a similar technique to show that centralised investment was economically regressive, concentrating public investment in richer municipalities and ignoring poorer ones.[20] Decentralisation, by contrast, shifted resources towards poorer districts; after 1994, public investment rose in municipalities where indicators of wealth and income are lower. The four stylised facts are summarised as follows:

1. Decentralisation shifted public investment into social services and human capital formation, at the expense of economic production and infrastructure;
2. Decentralisation distributed investment more equally across space;
3. Decentralisation made investment more responsive to local needs;
4. Decentralisation shifted investment towards poorer districts.

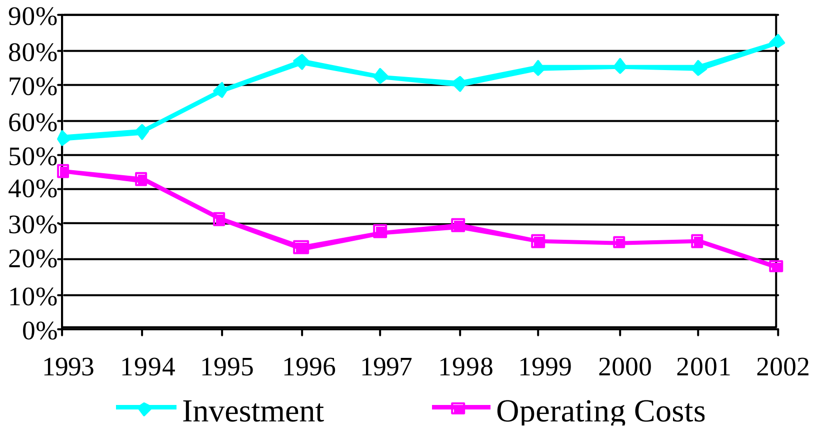
The Impact of Decentralization in Colombia

For the purposes of this paper, 1993 is the base year, after which full decentralisation was rolled out throughout the country. This view takes account of the piecemeal nature of Colombia's earliest decentralisation measures in the 1970s and 1980s, and considers that 'real' decentralisation did not begin until the full raft of reforms included in the 1991 constitution, plus accompanying regulatory laws, were promulgated. Before 1991-92 there was undoubtedly a decentralising process underway in Colombia. But it is a mistake to consider pre-1991 Colombia to be 'decentralised'. This study accordingly counts 1993 as Colombia's first full year of decentralisation. Focusing on the decade that begins with 1993 allows us to examine the full process as it evolved and the full implications of these deep reforms took hold.

As for Bolivia, statistics from Colombia tell an eloquent story. Figure 7 plots municipal investment and running costs as a percentage of total municipal resources. We see that the ratio of investment to running costs rose from rough parity (55:45) to more than 4:1. Figure 8 details municipal investment and personnel costs in constant pesos. While invested sums rose steadily to over four times their initial values, personnel costs remained essentially constant. This refutes critics who claim that decentralisation leads to increased bureaucracy at the expense of productive investment. It also refutes those who say that inexperienced or politically captured local governments will go on a hiring spree, so wasting scarce resources. The numbers tell the opposite tale: as decentralisation advanced and reform deepened, municipalities dedicated more and more of their resources to public investment, and less and less to operating costs; and they did it without increasing the payroll.

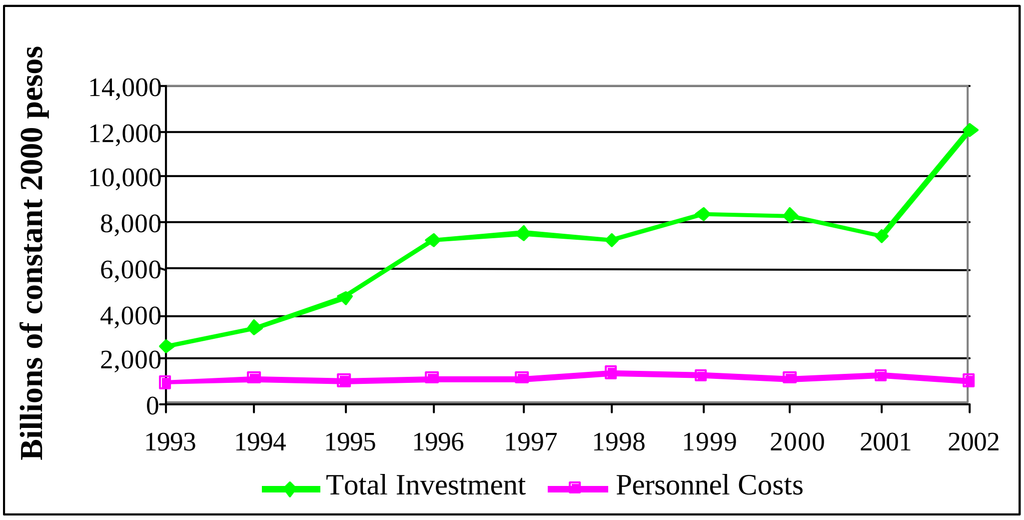
[20] J. P. Faguet, 'The Determinants of Central vs. Local Government Investment: Institutions and Politics Matter', *DESTIN Working Paper* No.02-38, London School of Economics, 2002, at: http://www.lse.ac.uk/Depts/destin/workpapers/determinants-of-central.pdf.

Figure 7: Municipal Investment and Operating Costs as % of Total Resources



Source: *Decentralisation, Local Governance and Violence* project

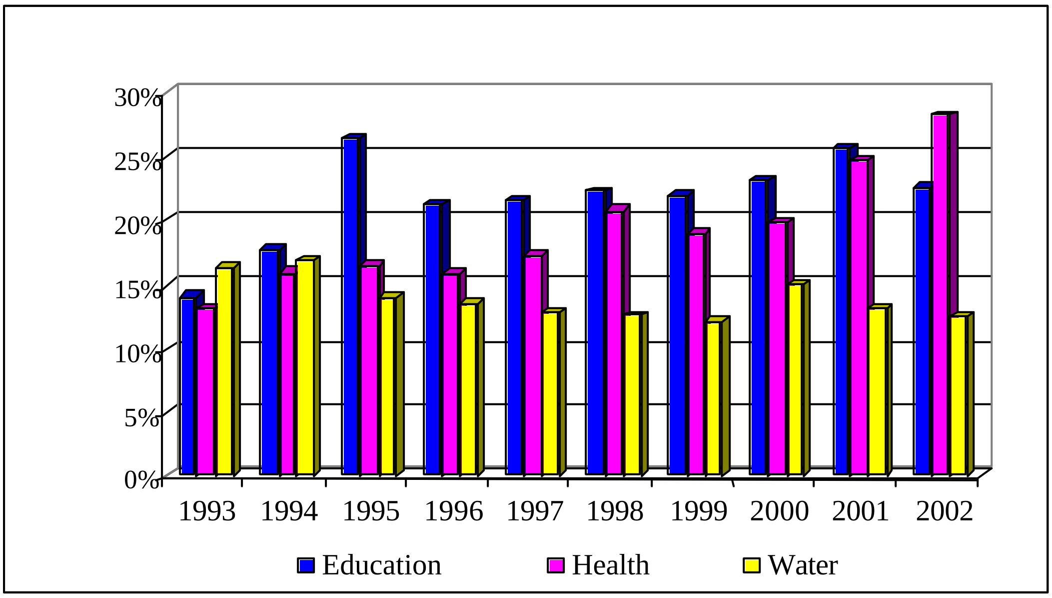
Figure 8: Investment and Operating Costs



Source: *Decentralisation, Local Governance and Violence* project

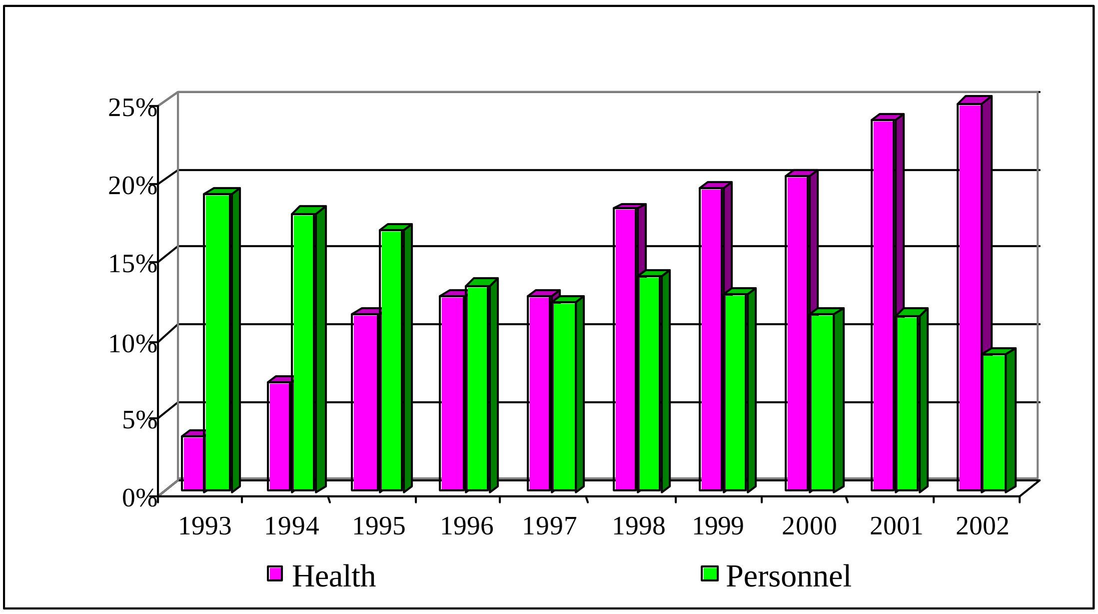
How was this increasing investment budget spent? Figure 10 shows the share of aggregate municipal investment corresponding to education, health and water, year by year. The share of investment in education rose by two-thirds over the period, while that of health more than doubled. Investment in potable water decreased modestly. But perhaps these numbers are biased by a few big cities? Figure 10 shows unweighted municipal averages (i.e. where all municipalities are treated equally) of investment shares in order to correct for any possible such biases. For simplicity I focus on two categories, health and personnel. The graph confirms the trends identified above. The share of municipal resources dedicated to health rose seven-fold, while that spent on personnel fell by half. These figures contradict those who claim that local government is too ignorant, corrupt, or inept to invest in basic social services, which should be left instead to a wiser and more technocratic central government. Decentralisation coincided with an increase in social investment locally, and as decentralisation deepened the trend accelerated.

Figure 9: Composition of investment (% of total)



Source: *Decentralisation, Local Governance and Violence* project

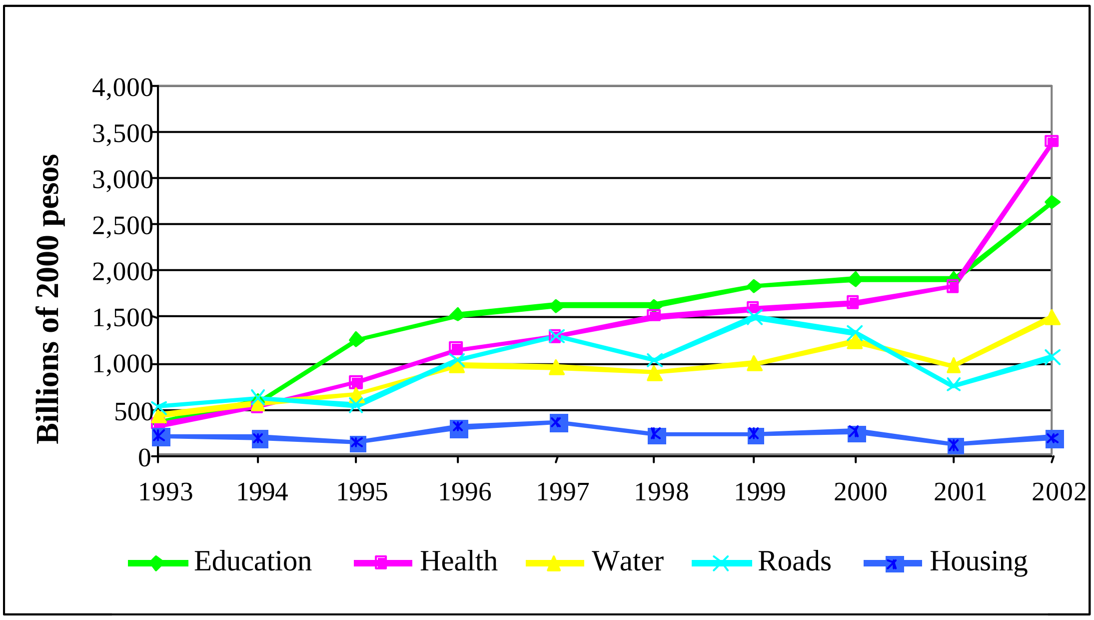
Figure 10: Unweighted Average of Municipal Expenditure Shares



Source: *Decentralisation, Local Governance and Violence* project

Dealing in investment shares to some extent obscures the scale of the changes that occurred in Colombia. Figure 11 shows investment by sector in billions of constant 2000 pesos, and allows us to compare social investment (i.e. human capital formation) with investment in physical infrastructure. We see that education, health and water investment rose between three and seven times in constant peso terms, while investment in roads doubled and housing remained broadly stable. Assuming that 1993 represents the end of the centralised regime, we can conclude that under decentralisation investment in social services and human capital formation increased significantly at the expense of physical infrastructure, again the opposite of what many of decentralisation's critics contend.

Figure 11: Municipal Investment in Constant Terms



Source: *Decentralisation, Local Governance and Violence* project

But decentralisation was not entirely trouble-free for Colombia. During the period in question, Colombia's stock of public debt doubled and interest payments tripled. This formed part of a deteriorating fiscal performance from the mid-1990s onwards, which led Colombia to sign a formal agreement with the IMF for the first time in its history, in an attempt to stem capital flight and ease pressure on the peso. Colombia suffered its most serious recession in three generations. Alesina and others have blamed this fiscal deterioration largely on unbalanced local-central government fiscal relationships.[21]

It is a matter of record that decentralisation was followed by significant borrowing by sub-national governments, and then a string of bankruptcies, which ultimately cost the national treasury dearly.[22] It is also true that fiscal imbalances between central and state governments in Argentina and Brazil, including especially an implicit, political guarantee of sub-sovereign debt, contributed significantly to the recent Argentine economic collapse, and to Brazilian financial instability in the late 1990s. But is important to remember that in Colombia the economic events in question occurred during an extraordinary period. President Samper stood accused by the United States of having been elected with drug money. As American economic sanctions took their toll and Colombians poured into the streets demonstrating against their government, the administration undertook a comprehensive campaign to win the support of political and regional elites. The costs of this campaign were considerable, and added significantly to Colombia's fiscal woes. Within Colombia, many commentators have accused the Samper administration of failing to scale back the central state as decentralisation demands, in order to wield more political patronage. Disentangling the effects of this crisis in

[21] Alesina *et.al.* (2000).
[22] Alesina *et al.* (2000).

legitimacy from those of decentralisation *per se* is a complex task. Suffice it to say that a decentralisation programme with built-in, unnecessary fiscal imbalances contributed to Colombia's fiscal problems of the late 1990s, but is not solely responsible for them.

Conclusions and Recommendations

What lessons can we draw from Bolivia and Colombia? In both countries, decentralisation made government more responsive by re-directing public investment to areas of greatest need – e.g. Bolivian investment in education and water and sanitation rose after 1994, where illiteracy rates were higher and water and sewerage connection rates lower, respectively. By shifting resources towards poorer districts, decentralisation made investment much more equitable across space. Uses of public monies shifted in both countries from economic production and infrastructure to social services and human capital formation. In Bolivia, it is impressive that these shifts in national investment aggregates were driven by the smallest, poorest municipalities investing newly-devolved resources in their highest-priority projects. Something similar is probably also true for Colombia.

It is useful to reconstruct both countries' decentralisation stories from the ground up. In both, decentralisation created of hundreds of local governments throughout the country. These proved more sensitive to local conditions, and more accessible to lobbying and grass-roots pressure, than a central administration that simply abandoned large expanses of territory as convenience dictated. Decentralisation engaged thousands of neighbourhood councils, peasant communities, *ayllus*, *mallkus*, and *Juntas de Acción Comunal*, as well as interest groups and business associations that previously had little voice in how their communities were run. By locating real resources and political power in municipal institutions it reached out to rich and poor strata alike, offering them the means to improve their lives, and a concrete incentive to participate.

In both countries, reform changed not only the form of government but also its substance. Those central officials stationed beyond national and regional capitals before decentralisation had little incentive to concern themselves with local demands. Career success was determined by ministerial fiat unrelated to local outcomes in distant districts. Business interests and the rich might eventually hope to gain some favours from the centre, but throughout most of the country ordinary citizens' ordinary concerns were effectively shut out. Decentralisation changed this by creating local authorities beholden to local voters. Throughout the national territory it put real power over public resources in the hands of ordinary citizens; and it changed the way both countries are run.

But decentralisation is no panacea. It is entirely possible to do it badly. It is here that the country comparison is most informative. In Bolivia, the vote was in practice more restricted than Colombia. Bolivia had further to go to make decentralisation – and indeed democracy – work.[23] Fortunately, a number of systemic reforms were enacted in the 1980s and 1990s that paved the way to a well-ordered municipal system. These increased transparency in the vote count, ensured voting secrecy, provided for independent oversight of the voting process, and increased the number of polling stations in rural areas. But they also included non-electoral reforms, such as a new, efficient citizen registration process (which in turn permitted voter registration), and the extension of rural literacy programmes (especially amongst women). Their collective effects were a broad increase in voter registration and improved voter participation. But the secret to the success of these reforms lay in large part with the design

[23] J. P. Faguet, 'Decentralizing the Provision of Public Services in Bolivia: Institutions, Political Competition and the Effectiveness of Local Government', PhD Dissertation, London School of Economics, 2002.

of the decentralisation programme itself. The LPP brought rural areas into the municipal system, and then devolved significant authority and political responsibility to them. Whereas before rural dwellers voted, if at all, for cantonal officials who had neither resources nor political power, now fully-fledged municipal governments with real resources and legislative authority were at stake. The prospect of gaining control over these drove political parties into the countryside in search of rural votes. The prospect of benefiting from them pushed villagers and farmers into municipal politics and into the voting booth. In this way the concerns and opinions of the previously ignored rural 50% of Bolivians were brought into the political mainstream, as electoral politics penetrated deeper and deeper into the hinterland. This, then, is the first lesson, and it is an important one. In order for decentralisation to work well, local democracy must be free, fair, transparent and competitive.

The second lesson, well illustrated in the Colombian experience, is a negative one. In order for decentralisation to work well, sub-national governments must face hard budget constraints. Reform programmes featuring automatic central guarantees of sub-national debt – whether legally explicit or politically implicit – lead to fiscal imbalances that can ultimately threaten the nation's macroeconomic stability. Colombia (as well as Argentina and Brazil) is a good example of this. In Bolivia, by contrast, central government was too poor, and perhaps too wise, to guarantee municipal debt, and the few cities able to borrow were left to their own devices.

To a large extent, hard budget constraints are implicit in the very definition of decentralisation. By contrast, debt guarantees imply a continuing central intervention in local affairs that violates the functional independence that decentralization presupposes. Alesina *et.al.* suggest simply banning sub-national governments from taking on debt, allowing them only to 'borrow' against future Treasury disbursements.[24] Another solution could be strict limits on borrowing levels and maturities; a third would be for the centre to simply refuse to bail out local governments. This last option may well be politically impractical in many countries. In any event, the precise form is less important than the principal – decentralisation requires hard budget constraints.

The third lesson follows on from the second. If decentralisation means devolving resources, responsibility and authority from higher to lower levels of government, then it also implies that the higher levels must be scaled back. The central headcount must be reduced, as officials are transferred to regional and local governments, or simply fired. Maintaining central government at full strength even as local governments grow in size and importance is a bad recipe, as Colombia discovered too late.

The fourth lesson is also better illustrated in the case of Colombia, which not surprisingly has made more progress in this respect than Bolivia. This is the importance of devolving significant tax-raising powers to the periphery. In the first place, this provides more resources for local services. Secondly, to the extent that public investments and expenditures imply a direct cost to the local economy, policy debates will weigh competing options more carefully, and better decisions will be made. If local budgets come entirely from central-local transfers, by contrast, citizens may feel less ownership over municipal resources, and accordingly less interest in how they are spent. This translates directly into less interest in local government generally, and less oversight and accountability.

[24] Alesina *et.al.* (2000).

Getting these lessons right is of seminal importance to any decentralisation programme. Under the right circumstances, decentralising resources and political authority can generate real accountability where none existed before, and improve the quality of government a society achieves.

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Annex 1

Econometric Estimates of the Effect of Decentralisation on Education Investment

Test: $b_2 – b_1 = z\mathbf{S}_m + h_1\mathbf{Z}_{1m} + \ldots + h_5\mathbf{Z}_{5m} + e_m$

	Model*				
Independent Variable	I	II	III	IV	V
Private Sector PCV1	-0.000983	-0.00121	-0.00106	-0.0003	-0.00056
	(-2.466)	(-3.004)	(-2.689)	(-1.004)	(-1.619)
Project Planning PCV1	-0.000538	-0.00049	-0.00055	-0.00037	-0.00052
	(-0.919)	(-0.830)	(-0.925)	(-0.703)	(-0.879)
Civil Institutions PCV1	0.000973	0.00101	0.00103		
	(1.752)	(1.774)	(1.839)		
Training & Capacity Building PCV1				-0.00063	
				(-0.591)	
Information Technology PCV1					0.00118
					(1.010)
Illiteracy Rate (Adult)	0.000173			0.00019	0.0002
	(2.906)			(3.116)	(3.306)
Illiteracy Rate (Over-6's)			0.00018		
			(2.505)		
Literacy Rate		-0.00011			
		(-1.844)			
Local Education Authority	0.005603	0.00534	0.00543	0.0053	0.00479
	(1.421)	(1.356)	(1.378)	(1.354)	(1.379)
_constant	0.0075759	0.02037	0.00806	0.00722	0.00704
	(1.814)	(3.728)	(1.816)	(1.862)	(1.731)
R-square	0.0176	0.0136	0.0162	0.0155	0.0172
Prob>F	0.001	0.0025	0.0016	0.0128	0.0104

* OLS regressions reported with robust standard errors
t-stats in parentheses; PCV1 = 1st pricipal component variable

Investment rises under decentralisation where the illiteracy rate is higher, and thus where need is greater. This implies that local government is more sensitive to local need than central government. This finding is not sensitive to specification or the measure of illiteracy used, as is evident in the above figure, where the literacy rate is significant and negative. The results imply that the centre assesses local preferences less accurately than local government. Educational investment falls where the private sector is stronger, a finding which is again insensitive to specification. This is most likely because private firms lobby for resources to flow to other sectors where they stand to profit more. The results for urban development support this interpretation. Civil Institutions, by contrast, lead to an increase in investment after decentralisation, suggesting grass roots support for education (i.e. parents worried about their children). Participative planning methodologies have no effect on investment, nor do information technology or local training and capacity-building activities.

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