

The paper we presented has raised 5 points:

1. The role of the MoF in national budgets
2. The benefits and limitations of budget transparency
3. Use of participatory and performance budgets
4. The management of fiscal decentralization; and
5. Financial flow issues

I am going to briefly comment on the first 3 of and then discuss fiscal decentralization in particular.

**First, regarding the role of the MoF:** I think we can all recognize the central role of the MoF in preparing and structuring the budget process while also recognizing the need to broaden the role of participants. Are those assumptions transparent? (c)

The budget process has 4 phases: Formulation, approval, execution and audit. Especially in the first phase, it matters:

- Who is in the room
- In what stages of the budget cycle are stakeholders invited to participate? How often and how regularly are they engaged to have an impact?
- What assumptions are made about macroeconomic indicators, fiscal trends, weather, social data,
- What techniques are used to estimate revenue and expenditures
- What data is the basis for these assumptions, how accurate are they, how frequently is the data updated.
- What are the biases of those who participate, and their range of perspectives?
- How transparent are these processes?

There is evidence that currently, there are problems in all these areas. An IMF survey of 34 transitional economies, found that in the budgeting process:

- 95% were run by the MoF, in 47% it was the only agency involved; 25% fewer than 5 people involved

- In 85% of cases, revenue estimates were nearly all for 1 year only, and based on rudimentary extrapolation techniques;
- 50% of cases, macroeconomic assumptions were overstated – overly optimistic
- Half of the forecasts didn't extend beyond central government – didn't include subnational government
- Involvement of IMF in the process made zero difference to level of transparency in the process.

Therefore, there is a need to open up the budget n process, in particular to broaden the number of stakeholders who are consulted during budget formulation and to expand transparency about the key assumptions, data and techniques that are used to create fiscal policies.

**Second:** Transparency has two requirements : - to provide the information and to have a recipient who receives it. We need to go beyond simply making information available and ensure that we are providing it to stakeholders who can digest and examine it, and have the opportunity to comment and contribute to it.

**Third:** Regarding performance budgeting:

The idea of setting perf goals for how money is spent is a worthy principle but to do it effectively requires an earlier step, a difficult and time-consuming step, which is to structure the budget with cost accounting. This means organizing financial information so that it is possible to understand the actual costs of delivering specific activities, not just by department or function. To do this requires a lot of time and energy and capacity. To date only a handful of national or subnational governments have been able to accomplish this.

Similarly, participatory budgeting can be a valuable way to bring people into the resource allocation process, and to empower people who have no other connection to the budget process. However it requires a lot of energy and resources to help the community establish a participatory process, to manage it, to estimate the costs of ideas generated through the process, and to sustain the momentum. Many studies from around the world have confirmed both the value of participatory process and the requirement for capacity to keep it going.

**\*So now let me address the issue of fiscal centralization.**

**Fiscal Decentralization is one of 3 kinds of decentralization growing in the world:**

Political (the power of locally elected officials): administrative (powers delegated to local government civil service) and fiscal: which is about the powers of raising revenues and controlling expenditures.

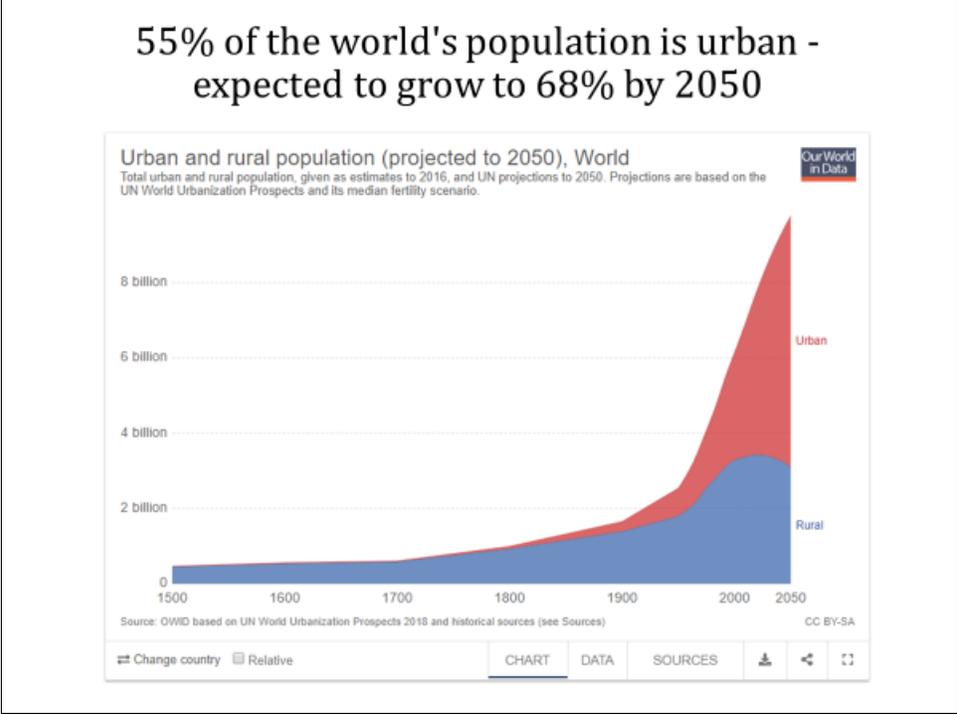
The percent of local expenditures administered by regional and local governments has grown from 20% in 1970s to nearly 40% in 2000s for a number of reasons.

A key rationale is to empower citizens by shifting resources and fiscal autonomy from remote, unresponsive central governments to local governments. Geraldine this morning mentioned the growing excitement and capacity in many local governments.

However there are many other factors driving rise in fiscal decentralization. These include:

Political reasons - including dramatic increase in the number of regional autonomy movements around the world which is leading to local governments demanding more control over how money is spent; and more authority to raise money; and the growth in number of people living in big cities.

Show two charts:



## Map of the world if all separatist movements succeed



The growth in fiscal decentralization is also driven by a:

- Desire to improve service delivery
- Desire to increase accountability
- Desire to redistribute resources from richer to poorer regions
- Studies show mostly positive effects (Channa and Faguet, 2016)

However the benefits of fiscal decentralization – in particular improved public services and social outcomes – depend on having efficient and accountable SNG governments. Which means that SNGs have all the same issues around transparency, forecasting accuracy, capacity that national budgeting process has. And these may be affected by: Geography, borders and resources

- Cultural, linguistic and ethnic factors
- Economics and industry
- Level of urbanization
- Presence of universities, hospitals and other factors providing technical capacity

And structural factors such as:

- Form of central government
- Structure of local governance
- Accountability mechanisms
- Disparities among regions

So the result is that there are thousands of variations of fiscal decentralization around the world and even within the same country specific regions may have very different arrangements, for example the Basque Region of Spain has quite different level of fiscal autonomy than Catalan region.

Now let me turn to a couple of specific mechanisms in fiscal decentralization.

A big challenge for fiscal decentralization is to balancing the macroeconomic role of the national government with the local know-how of sub-nationals. However, this goal runs into trouble in 3 areas.

**First, sub-nationals derive revenue from both: Own-source and Transfers.**

**With regard to Own-source revenues including:**

- Fees, user fees, taxes
- Borrowing

A strength is that accountability is strengthened when a significant proportion of local services are financed by local taxes and fees, So voters can hold elected officials accountable for the quality and cost of services. But this depends on how the local taxes are structured, and for what purposes. Also, in decentralized countries, local taxation must be supplemented by transfers from the CG to counter significant inequality in the revenue-raising capacity of local governments

**Intergovernmental transfers**, constitute 60-75% of subnational revenues in many countries.

But these are simultaneously “*revenues*” to sub-nationals and *expenditures* to national governments. Which means that incentive for national government is to minimize them.

There is also a challenge in how much flexibility there is – they can be provided in different ways (conditional, flexible, tied to formulae, etc.); the

- Degree of autonomy over how funds are used
- Oversight and control mechanisms
- To what extent the transfers are for the Operating budget vs. capital expenditures
- And Information and reporting systems

An advantage of conditional grants is that they can induce SNGs to do things they otherwise might not, for example by providing targeted funds to immunize 100% of children. They can be conditioned on achieving targeted results, or SNGs can compete for the funds. In this they are much Better than Unfunded mandates - which take away local discretion and do not provide financial support.

However, grants and mandates typically have reporting requirements. An unintended effect of these requirements is to shift the focus of SNGs away from substantive results to the process for filing reports and dealing with another layer of administrative burden.

My next point is that Revenue and Expenditure Assignments for SNGs Often are Misaligned.

Ideally, revenue responsibilities of local governments would match expenditure responsibilities

- So if local governments incur 30% of public expenditures, they should have, (either through self-generated taxes and transfers), 30% of public revenues
- In practice there often is wide disparity between SNG revenue and expenditure share
- Central governments *have much greater incentive* to issue expenditure mandates than to transfer revenue
- The resulting misalignment occurs both in countries when the CG collects almost all the revenue and in countries where local governments have significant revenue authority

- Misaligning revenues and expenditures weakens the link between resources and results, which undermines the core purpose of delegating fiscal authority.

To conclude:

Fiscal decentralization is important because SNGs are vital for the delivery of services, and a number of global trends are increasing the desire for local autonomy over revenues and expenditures.

However, the interdependence of different levels of government complicates efforts to link resources and results. Central government has most of the money; local government delivers the services financed by that money. Problems arise because of asymmetries in information and capacity, and clashing incentives. I'll stop there.