Intergovernmental Fiscal Relations in Developing Countries

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This study considers a broad range of issues relating to intergovernmental fiscal relations in developing countries, with particular attention to their implications for the provision of urban services. It is designed to assist country economists and project analysts in dealing with intergovernmental fiscal relations in the context of urban sector or public service sector studies, and in assessing the implications of projects for urban institutions, and vice versa. A review of the literature suggests that in the past overly facile solutions were proposed for what are extremely complex political, economic and administrative issues. This emphasizes the need for explicit recognition of potentially conflicting objectives of fiscal policy, for a careful analysis of each fiscal policy instrument for each objective, and for consideration of the institutional reality of the country or city for which policy recommendations are to be made. Particular attention is paid to the design of the most important instruments of intergovernmental fiscal policy: the organizational structure of the public sector, direct controls by higher-level government over local authorities, urban tax policy, and intergovernmental transfers.
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I. INTRODUCTORY SUMMARY *

Intergovernmental relations, or the allocation of financial and administrative responsibilities among different levels of government, lie at the heart of many political systems: they reflect a country's style, its concerns, its goals. As a rule the most visible aspect and, in many ways, the real crux of intergovernmental relations is the control, direction, and size of intergovernmental fiscal flows. Intergovernmental fiscal relations inevitably have significant political as well as economic aspects and are, in their details, peculiar to each country. They are thus best analyzed in the context of a particular country, since a good deal of institutional detail is needed to bring out the issues in a meaningful way. The aim of the present paper is therefore simply to provide a general discussion of the subject as one step towards developing a framework of analysis. Intergovernmental fiscal relations are viewed here primarily from the perspective of the institutional context within which urban public services are provided in developing countries. 1/

* This paper has undergone several revisions and has benefited considerably from critiques received from various readers both within and outside the Bank. Johannes Linn, Charles McLure, David Nowlan, Lady Ursula Hicks, Bertrand Renaud, John English, and Douglas Keare deserve particular thanks for their comments, as does Rachel Weaving for her editorial assistance. In all probability, none of them would want to bear any responsibility for what is said here, nor should they.

1/ The focus of this paper on developing countries should not lead the reader to think that matters are much different in most developed countries: they are not, though the precise form of the problems and solutions in intergovernmental fiscal relations naturally varies widely from country to country. For an analysis comparing and contrasting some aspects of this question in developed and developing countries, see Bird (1977). It should be noted also that this paper does not, for the most part, consider the quite different problems of governing rural areas in developing countries; for a brief discussion of this issue see Bird (1970b, Chap. 5; 1974, Chap. 12). References are listed at the end of this paper.
The analysis attempts to trace out a middle ground between the height of abstraction that characterizes much economic writing on this subject and the swamp of local detail in which most case studies, lacking any analytical framework, seem inevitably to become submerged. But it should be emphasized that its conclusions cannot be applied to any particular country without much more attention to the details of the specific case at hand. 1/

The paper is divided into three main sections. Part II begins with a brief description of approaches to measuring the degree of centralization and the role of different levels of government in providing urban public services. While this account is neither complete nor thorough, it should suffice both to demonstrate that no simple measure of the degree of centralization is of much use, and to illustrate the range of alternatives and the complexity of the problems encountered in different countries.

There are a number of styles or patterns of local government— the British style of relative local autonomy, the French style of a basically unitary government, the traditional pattern of a semi-autonomous local elite, and so on (Aldefer, 1964.) In all cases, to understand the governmental structure that now exists one must first understand the past. In particular, the viability of independent local government in any country depends upon whether or not local communities have traditionally dealt

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1/ Illustrative references are made to the experience of different countries: these references are not necessarily accurate reflections of the current situation in the countries mentioned.
collectively with their problems. Intergovernmental relations have, however, seldom remained fixed in any country over time: both changes in the configuration of forces shaping governmental structure and exposure (sometimes involuntary, as through colonization) to new ideas or new influences have made such rigidity impossible. Indeed, a key factor in appraising the intergovernmental system in any country is its past responsiveness to new ideas and influences, since this suggests its capabilities to sustain such change as may be needed or desirable in the future.

Part II concludes with a brief sketch of two alternative paradigms of public sector structure, the "aggregation" and "devolution" models, and argues that analysts' often unconscious adoption of one or the other, with their convenient oversimplifications, may lead to quite inappropriate policy recommendations.

Parts III and IV of the paper discuss the major objectives which may affect the design of governmental structure and the major instruments of intergovernmental finance which may be used in order to achieve these objectives. Since political factors are the most important determinants of intergovernmental relations in all countries, even the most technical economic appraisal needs to be grounded in a clear understanding of the political situation if it is to be of much use. In addition to such familiar economic objectives as efficient resource allocation, Part III stresses the considerable analytical and practical difficulties associated
with equity goals of various sorts, and with explicitly political goals—in particular, those related to the fragility of national power in most developing countries. The general framework put forth remains empty unless it is combined with enough specific information (and assumptions) about a particular country to make it meaningful. Experiences in a few countries, in particular Colombia, are therefore cited in an attempt to make the generally abstract argument more concrete.

In addition to urban local governments, functionally-based organizations have become important providers of urban public services in many countries. Part IV, on policy instruments, argues that the greater technical efficiency usually achieved by such autonomous agencies is seldom costless in terms of other possible economic and political goals. Furthermore, the financial results of government enterprises are always, in the end, the consequence of political rather than market forces. It follows that it is entirely appropriate to analyze the financing and pricing policies of public enterprises in exactly the same way as any other governmental fiscal policies. Even when an enterprise is left entirely to the mercy of market forces—which is most unlikely, given their generally monopolistic nature—the decision to do this is a political one.
In view of the importance of public revenues in resource-short developing countries, particular attention is paid in Part IV to intergovernmental tax arrangements and related fiscal transfers. This discussion is very condensed, because these aspects of intergovernmental relations—unlike those discussed earlier in the paper—have been thoroughly treated in the traditional literature. Nevertheless, it makes clear that the recommendations for intergovernmental fiscal arrangements found in many reports by foreign advisers appear to reflect unexamined \textit{a priori} notions rather than solid analysis of the local political and economic situation. As argued throughout this paper, one cannot usefully recommend a particular tax-sharing or transfer scheme, for example, without first determining what the relevant policy objectives are, yet, in effect, this is exactly what has been done in most studies of intergovernmental fiscal relations in developing countries.

In the nature of the argument in this paper, no strong general conclusions can be drawn. The concluding section, Part V, simply pulls together some general comments derived from the previous analysis and briefly illustrates the need to be clear about objectives and about the analytical models being used, by sketching the alternative policy recommendations that might follow from different assumptions in the case of Colombia.
II. APPROACHES TO ANALYSIS

A. The Measurement of Fiscal Decentralization

The structure and importance of government activity varies greatly from country to country, as do the policy objectives and instruments which are the logical starting point for the analysis of intergovernmental fiscal relations. The apparent precision of fiscal figures has tempted many to use them to measure and compare the degrees of decentralization observed in different countries. 1/ Two recent studies 2/ have explicitly considered the relationship between fiscal decentralization and economic development. Smith (1973) found that in the past few decades municipal expenditures had grown in importance relative to central government expenditures in the Republic of Korea, the Philippines, Sri Lanka, Kenya, Tanzania, and Colombia, largely as a result of rapid urbanization, but that much of the expenditure by subnational governments in these and other countries was financed by intergovernmental fiscal transfers, as shown in Table 1.

The wide variation of circumstances in developing countries is clear from this table. In Syria and Panama, for example, subnational governments received only 4 percent of total government revenues, while in Brazil they received 60 percent. The proportion of their revenues that subnational governments received from the central government in grants and shared taxes ranged from 0 in Paraguay, where local government is insignificant, to 61 percent in Viet Nam (where it was also insignificant), and 90 percent in

1/ See Oates (1972), and, for a more recent attempt, Oates (1976).
2/ Smith (1973) and Kee (1975).
Indonesia. 1/ As Smith 2/ notes, it is difficult on the basis of figures such as these "...to discern any relationship between the reliance on central government financing and either (1) the form of government, or (2) the relative importance of subnational government finance." Table 1 does not suggest any clear relationship between size (or, for that matter, the part of the world in which the country is located) and the degree of decentralization as measured in this table. There is also no apparent relation between fiscal decentralization measured in this way and the degree to which political "power", as measured by a rather impressionistic index developed by Adelman and Morris (1971), is centralized. 3/

A study by Kee (1975) is a more systematic attempt to consider the factors explaining the degree of fiscal decentralization using a sample of forty-five developing countries. Kee's analysis, though far from conclusive, found the degree of urbanization to be an important factor in explaining the relative significance of subnational spending in developing countries. The level of development (as measured by per capita GNP) on the other hand, was not significant. Both of these results agree with Smith's more impressionistic analysis. But although Kee found, as one would expect, that larger intergovernmental fiscal transfers are associated

1/ A similar wide variation in the importance of intergovernmental transfers appears in the city data collected in the World Bank urban public finance case studies (Bahl, 1976, p. 9).
3/ For example, this index classifies political power in both Venezuela and Brazil as significantly decentralized while in both Taiwan and Paraguay it is classified as effectively centralized. Yet the proportions of their revenues subnational governments derive from their own sources would suggest the opposite conclusion about both these pairs of countries.
### Table 1: THE DEGREE OF FISCAL DECENTRALIZATION

<table>
<thead>
<tr>
<th>Country, Year</th>
<th>Subnational Revenues as Percent of Total Govt. Revenues (^a/)</th>
<th>Intergovernmental Fiscal Transfers as Percent of Subnational Revenues (^b/)</th>
<th>Subnational Revenues from Own Sources as Percent of Total Govt. Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya, 1968</td>
<td>19.5</td>
<td>16.9</td>
<td>16.2</td>
</tr>
<tr>
<td>Uganda, 1965</td>
<td>32.2</td>
<td>37.9</td>
<td>20.0</td>
</tr>
<tr>
<td>Tanzania, 1965</td>
<td>28.7</td>
<td>24.3</td>
<td>21.7</td>
</tr>
<tr>
<td>Nigeria, 1965</td>
<td>55.4</td>
<td>52.2</td>
<td>26.5</td>
</tr>
<tr>
<td>Zambia, 1967</td>
<td>8.3</td>
<td>18.1</td>
<td>6.8</td>
</tr>
<tr>
<td>Malawi, 1966</td>
<td>8.5</td>
<td>56.5</td>
<td>3.7</td>
</tr>
<tr>
<td>Philippines, 1963</td>
<td>19.4</td>
<td>42.3</td>
<td>11.2</td>
</tr>
<tr>
<td>Ceylon, 1968</td>
<td>5.3</td>
<td>20.8</td>
<td>4.2</td>
</tr>
<tr>
<td>Viet-Nam, 1967</td>
<td>7.1</td>
<td>60.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Korea, 1970</td>
<td>41.5</td>
<td>60.5</td>
<td>16.4</td>
</tr>
<tr>
<td>Taiwan, 1969</td>
<td>44.5</td>
<td>18.2</td>
<td>36.4</td>
</tr>
<tr>
<td>Indonesia, 1970</td>
<td>16.2</td>
<td>90.1</td>
<td>1.6</td>
</tr>
<tr>
<td>Israel, 1968</td>
<td>14.0</td>
<td>18.6</td>
<td>11.4</td>
</tr>
<tr>
<td>Syria, 1970</td>
<td>3.7</td>
<td>40.5</td>
<td>2.2</td>
</tr>
<tr>
<td>Turkey, 1964</td>
<td>12.3</td>
<td>46.3</td>
<td>5.7</td>
</tr>
<tr>
<td>Colombia, 1967</td>
<td>41.3</td>
<td>12.6</td>
<td>36.1</td>
</tr>
<tr>
<td>Brazil, 1968</td>
<td>60.4</td>
<td>21.0</td>
<td>47.7</td>
</tr>
<tr>
<td>Venezuela, 1969</td>
<td>19.5</td>
<td>71.8</td>
<td>5.5</td>
</tr>
<tr>
<td>Dominican Rep., 1964</td>
<td>12.3</td>
<td>65.9</td>
<td>4.2</td>
</tr>
<tr>
<td>Panama, 1968</td>
<td>4.2</td>
<td>4.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Costa Rica, 1968</td>
<td>9.8</td>
<td>44.9</td>
<td>5.4</td>
</tr>
<tr>
<td>Peru, 1967</td>
<td>5.8</td>
<td>10.3</td>
<td>5.2</td>
</tr>
<tr>
<td>Paraguay, 1971</td>
<td>6.4</td>
<td>0.0</td>
<td>6.4</td>
</tr>
</tbody>
</table>

\(^a/\) Includes transfers from higher-level governments.  
\(^b/\) In some cases includes taxes collected by central government for subnational governments.

Source: Smith (1973, p. 22)
with more decentralized expenditures, the size of local governments' revenues from own sources (net of transfers) was found to be independent of the size of intergovernmental transfers, thus implying that "...central funds are neither complementary nor substitute for local tax effort". Since local revenues were therefore unaffected by transfers, while expenditures of course expanded, Kee concluded, rather paradoxically, that "...fiscal decentralization, i.e., independence of local government, is a function of its dependence on central government funds."

This conclusion, like the apparent lack of correlation between fiscal and political centralization, is more a reflection of the difficulty of measuring centralization than a valid finding from statistical analysis. 1/ No simple measure of fiscal centralization can adequately measure how far local governments are independent of central governments. The degree of real local autonomy, in the sense of independent decision-making authority, cannot be assessed simply by considering the relative importance of local revenues or expenditures in the public sector budget as a whole. Different measures are useful for different purposes, but none yet devised gives a clear or unambiguous picture of the power relations that are at the heart of this discussion.

1/ The vast literature on the effects of intergovernmental fiscal transfers on local budgetary responses in North America, summarized in Bird and Slack (1977, Appendix E) makes it clear that the basis for Kee's conclusion is both conceptually and econometrically very weak. On the problems of measuring centralization, Bird (1970), Oates (1976), and Breton and Scott (1978).
The draft IMF manual on government finance statistics suggests that "a government may be considered to have substantial autonomy when it has the power to raise a substantial portion of its revenue from sources it controls and its officers are independent of external administrative control in the actual operation of the unit's activities" (International Monetary Fund, 1974, 19; emphasis added). As the underlined phrases suggest, this definition too is far from clear-cut. To reduce its ambiguity somewhat, it is further stipulated that a subnational government is to be deemed dependent if it (1) lacks its own officers, (2) depends for a substantial portion of its revenue "on appropriations or allocations made at the discretion of another government", (3) must submit budget estimates to another government, which may raise or lower them, or (4) has important aspects of its administration--personnel administration, plans and contracts, etc.--controlled by another government.

Perhaps because strict application of these tests would render almost all subnational governments in developing countries dependent, each of these conditions is in fact weakened somewhat in application to individual cases. Despite its ultimate ambiguity, however, this careful attempt to distinguish "independent" from "dependent" local governments is worthwhile if only to point up the inherent difficulties in the concept of local autonomy itself, let alone in attempts to measure it statistically. As even the
limited information in Table 1 shows, different fiscal indicators suggest different results, and none is clearly superior to the others.

The difficulty of using fiscal figures to measure decentralization persists if we focus on a single country. Table 2 for example, depicts the structure of the Colombian public sector in 1973. Perhaps the outstanding feature of this structure—characteristic of many other countries (see Table 1)—is the much greater importance of the central government as a revenue-raiser than as a spending agent. Over one-quarter of the current revenues raised by the central government are transferred to other levels of government, particularly the national decentralized agencies, and spent by them. Although the central government receives 55 percent of the total current revenues of the total public sector, it accounts for less than one-third of total public sector spending.

National government (central government plus decentralized agencies), however, is clearly by far the dominant fiscal power in Colombia in terms of both revenue and expenditure, accounting for 79 percent of total consolidated public sector current revenues, 72 percent of consolidated expenditure, and 68 percent of consolidated investment. Much of the decentralization in Colombia is thus functional, in the form of national autonomous agencies, rather than geographical (departmental and municipal governments).

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1/ Agencies organized on a functional basis, with branches covering the country.
Table 2:  THE STRUCTURE OF THE PUBLIC SECTOR IN COLOMBIA, 1973  
(millions of current pesos)

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Central Government</th>
<th>Decentralized Agencies</th>
<th>Departments</th>
<th>Municipalities</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Current revenues</td>
<td>44,059</td>
<td>24,130</td>
<td>10,512</td>
<td>3,486</td>
<td>5,931</td>
</tr>
<tr>
<td>(2) Current Expenditures</td>
<td>33,411</td>
<td>13,741</td>
<td>10,600</td>
<td>4,450</td>
<td>4,620</td>
</tr>
<tr>
<td>(3) Current Surplus (deficit) $^1/$</td>
<td>10,648</td>
<td>10,389</td>
<td>(88)</td>
<td>(964)</td>
<td>1,311</td>
</tr>
<tr>
<td>(4) Investment Expenditures $^2/$</td>
<td>19,170</td>
<td>3,307</td>
<td>9,674</td>
<td>1,650</td>
<td>4,539</td>
</tr>
<tr>
<td>(5) Total Expenditures $^3/$</td>
<td>52,581</td>
<td>17,048</td>
<td>20,274</td>
<td>6,100</td>
<td>9,159</td>
</tr>
<tr>
<td>(6) Total Surplus (deficit) $^4/$</td>
<td>(8,522)</td>
<td>7,082</td>
<td>(9,762)</td>
<td>(2,614)</td>
<td>(3,228)</td>
</tr>
</tbody>
</table>

$^1/$ Before intra-public-sector transfers: (1) - (2)
$^2/$ Gross fixed investment only
$^3/$ (2) + (4)
$^4/$ (3) - (4)

Source: World Bank data
The fiscal weakness of the subnational governments proper in terms of own revenues, especially at the departmental level, is equally clear from Table 2. This situation has changed very little over the last decade, despite the appearance of various reports which have stressed the need to strengthen the fiscal basis of the subnational levels of government. 1/ While the municipal and departmental levels together accounted for 29 percent of total public sector spending or 6 percent of GDP in 1973, their own current revenues, excluding transfers, came to less than 4 percent of GDP. Measured in this way, the size of Colombia's public sector has not changed since 1963, but the central government has become more important as a revenue raiser, with its current revenues rising from 7 percent of GDP in 1963 to 10 percent in 1973, while those of the subnational governments have fallen (from 5 percent to 4 percent). The importance of the departments and municipalities as spenders has not changed over this period, however, owing to a substantial rise in intergovernmental fiscal transfers.

These developments suggest that in Colombia, in line with Kee's findings (1975), that subnational governments have maintained their "independence" only by becoming progressively more dependent on central government transfers. If he who pays the piper calls the tune, then on the basis of this discussion Colombia's might be considered a fairly centralized government (as also in terms of the IMF

1/ Bird (1970b); Musgrave (1971). For a more detailed examination of statistical trends in centralization ratios in a particular country, and an account of the conflicting results of different measurements, see Bird (1970a).
criteria outlined above, because the central government appears to exert significant control in a number of respects, as seen below). On the other hand, as suggested in Table 1, in both fiscal and more judgmental political terms, Colombia appears in fact to be one of the least centralized developing countries. The crucial issue here is how to treat the decentralized public agencies. 1/ The main conclusion which emerges from this discussion is simply that centralization, like beauty, appears to lie to a significant extent in the eye of the beholder.

B. The Provision of Urban Public Services

The difficulty of developing simple measures of the relative degree of centralization is even more obvious if we consider the ways in which similar urban public services are provided in different countries. Utility services in developing countries are usually the direct responsibility of the public sector, though this general principle takes many different organizational forms, as Table 3 indicates for one urban utility, water and sewerage services. Thirty-one organizational structures are distinguished in the 28 countries listed in Table 3. Although urban water and sewerage services are most commonly provided by local autonomous agencies (11 cases), the use of national and regional agencies is also by no means unknown (6 and 2 cases, respectively). There are a dozen instances in which either the national (6 cases) or local (6 cases) government is the direct supplier of the service.

1/ The data for Colombia in Table 1 excluded the decentralized national agencies. For a similar brief discussion of the difficulty of measuring centralization in Brazil, see Mahar and Rezende (1975, 390-91).
### Table 3: THE PROVISION OF URBAN WATER AND SEWERAGE SERVICE

<table>
<thead>
<tr>
<th>Country</th>
<th>City</th>
<th>Institutional Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Latin America</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>Mexico City</td>
<td>Local autonomous agency</td>
</tr>
<tr>
<td>Panama</td>
<td>Panama City and others</td>
<td>National autonomous agency</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Large cities</td>
<td>Local autonomous agency</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>San Jose and others</td>
<td>National autonomous agency</td>
</tr>
<tr>
<td>Colombia</td>
<td>Bogota and others</td>
<td>Local autonomous agency</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Kingston</td>
<td>National autonomous agency</td>
</tr>
<tr>
<td></td>
<td>Other Towns</td>
<td>National autonomous agency (separate)</td>
</tr>
<tr>
<td><strong>Africa</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zambia</td>
<td>Lusaka</td>
<td>Local government</td>
</tr>
<tr>
<td>Uganda</td>
<td>Kampala</td>
<td>National government</td>
</tr>
<tr>
<td>Zaire</td>
<td>Kinshasa and others</td>
<td>National government</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>Addis Ababa</td>
<td>Local autonomous agency</td>
</tr>
<tr>
<td>Sudan</td>
<td>Khartoum</td>
<td>National government</td>
</tr>
<tr>
<td>Kenya</td>
<td>Nairobi and others</td>
<td>Local government</td>
</tr>
<tr>
<td></td>
<td>Mombasa</td>
<td>Regional autonomous agency</td>
</tr>
<tr>
<td></td>
<td>Small cities</td>
<td>National government</td>
</tr>
<tr>
<td>Ivory Coast</td>
<td>Abidjan</td>
<td>National government</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Lagos and others</td>
<td>State autonomous agency</td>
</tr>
<tr>
<td><strong>Asia</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>Manila</td>
<td>Local autonomous agency</td>
</tr>
<tr>
<td>Korea, Rep. of</td>
<td>Seoul</td>
<td>Local government</td>
</tr>
<tr>
<td>China, Rep. of</td>
<td>Taipei</td>
<td>Local autonomous agency</td>
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<td>Indonesia</td>
<td>Jakarta</td>
<td>National autonomous agency</td>
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<tr>
<td>India</td>
<td>New Delhi and others</td>
<td>Local autonomous agency</td>
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<td>Pakistan</td>
<td>Lahore, Karachi</td>
<td>Local autonomous agencies</td>
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<td>Bangladesh</td>
<td>Dacca, Chittagong</td>
<td>Local autonomous agencies</td>
</tr>
<tr>
<td>Nepal</td>
<td>Kathmandu</td>
<td>Local government</td>
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<tr>
<td>Burma</td>
<td>Rangoon</td>
<td>Local autonomous agency</td>
</tr>
<tr>
<td>Afghanistan</td>
<td>Kabul and others</td>
<td>Local government</td>
</tr>
<tr>
<td><strong>Middle East</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jordan</td>
<td>Amman</td>
<td>Local autonomous agency</td>
</tr>
<tr>
<td>Algeria</td>
<td>Algiers</td>
<td>National government</td>
</tr>
<tr>
<td>Israel</td>
<td>Tel Aviv, Haifa</td>
<td>Local government</td>
</tr>
<tr>
<td>Tunisia</td>
<td>Tunis</td>
<td>National autonomous agency</td>
</tr>
</tbody>
</table>

**Source:** Based on a review of World Bank reports by Prabhas Sharma.
Similar tables could be drawn up for other services. There are large institutional differences from country to country, as one might expect: in Tunis, for example, all major public utilities are provided by national government agencies (Prud'homme, 1974). There are peculiar situations such as that in Kingston, Jamaica, where water and sewerage services are provided by a national agency for the metropolitan area alone, while the Kingston municipal government is responsible for water supply in certain outlying rural areas, and all other public utilities in Kingston and elsewhere on the island are provided by other national authorities (Bougeon-Maassen and Linn, 1975).

The range of institutional structures employed to deliver public services is sometimes wider than is suggested by Table 3. In Colombia, Bogota's major utility services are each provided by separate local autonomous agencies; single local autonomous agencies supply all services in two other major cities; and a mixture of local governments and local, regional, and national autonomous agencies provide services in other urban centers.

Table 4 illustrates the division of responsibility for services in Cali, Colombia in 1975. The significant involvement of central government in the provision of local services (either directly or through use of its financial or regulatory power) and the existence of a fragmented set of agencies at all levels of government, appear to be fairly typical of cities in the developing world. To illustrate the complexity of intergovernmental relations...
Table 4. Responsibility for Service Provision by Level of Government, Cali, Colombia

<table>
<thead>
<tr>
<th>Function</th>
<th>Municipality</th>
<th>Department</th>
<th>Nation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water supply</td>
<td>P(EMCALI)</td>
<td></td>
<td>R(Tariff Board)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>S(ICT)</td>
</tr>
<tr>
<td>Sewage disposal</td>
<td>P(EMCALI)</td>
<td></td>
<td>S(CVC)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>R(Tariff Board)</td>
</tr>
<tr>
<td>Electricity</td>
<td>P(EMCALI)</td>
<td></td>
<td>S(CVC;CHIDRAL)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>R(Tariff Board)</td>
</tr>
<tr>
<td>Telephones</td>
<td>P(EMCALI)</td>
<td></td>
<td>S(Telecom)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>R(Tariff Board)</td>
</tr>
<tr>
<td>Roads</td>
<td>P(CMA; Valorization; Paving Fund)</td>
<td>S(Valuezation)</td>
<td>S(FNV)</td>
</tr>
<tr>
<td>Housing</td>
<td>S(INVICALI)</td>
<td></td>
<td>P(ICT)</td>
</tr>
<tr>
<td>Transportation</td>
<td>P(Transit Fund)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Law Enforcement</td>
<td>F(CMA)</td>
<td></td>
<td>P(Central Government)</td>
</tr>
<tr>
<td>Fire Protection</td>
<td>P(Voluntary)</td>
<td>F(CMA)</td>
<td></td>
</tr>
<tr>
<td>Street Cleaning</td>
<td>P(EMSIRVA)</td>
<td>F(CMA)</td>
<td></td>
</tr>
<tr>
<td>Refuse Collection</td>
<td>P(EMSIRVA)</td>
<td>F(EMCALI)</td>
<td></td>
</tr>
<tr>
<td>Markets</td>
<td>P(EMSIRVA)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parks</td>
<td>P(Cultural Fund)</td>
<td>F(CMA)</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>S(CMA)</td>
<td>P(FER)</td>
<td>F(Central Govt.)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>F(Dept.)</td>
<td>S(SENA)</td>
</tr>
<tr>
<td>Health</td>
<td>P(CMA)</td>
<td>P(Dept.)</td>
<td>F(Central Govt.)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>F(Beneficencia)</td>
<td>P(ICSS)</td>
</tr>
<tr>
<td>Property Assessment</td>
<td></td>
<td></td>
<td>P(IGAC)</td>
</tr>
</tbody>
</table>

Legend:  
P - primary expenditure responsibility  
S - Secondary expenditure responsibility  
F - direct financial support  
R - regulatory authority  
CMA - Central municipal administration  
Other entities in parentheses are decentralized autonomous agencies controlled primarily by the indicated level of government.
in Cali, and, to some extent, the importance of the central government's role in providing urban services, we shall consider in a little more detail the provision of health services.

The principal authority responsible for health services in the Department (state) of Valle, in which Cali is located, is the national Ministry of Health, whose local manifestation is called the Sectional Health Service. In reality, however, the Sectional Health Service is the same as the departmental Secretariat of Health. Furthermore, the Sectional Health Service is organized in nine districts, the first of which in principle covers Cali. There is in reality no such district, since the municipal Secretariat of Health acts, by contract, as the district office. In short, health services in Cali are provided by the municipal government, acting as an agent of the central government. In this case what has been called the Colombian tradition of "centralized policy and decentralized administration" (Harvard, 1964,p.19), appears to work out surprisingly neatly in practice.

The financing of health services is, however, much more complicated than their administration. In addition to a transfer from the national government of 20 percent of the situado fiscal ("tax allowance") for Valle, 1/ there are various special national transfers for health. There are also direct departmental and municipal budgetary allocations for health, as well as the gambling profits from the departmental beneficiencia, the agency which receives the profits of

1/ A sort of revenue-sharing scheme, explained in Part IV D below.
the departmentally-run public lottery. In the past, the beneficencia made its own investments, under the control of the Health Service, but since 1975 all revenue from this source is supposed to pass directly to the Sectional Health Service. The Health Service also receives a share of the national beer tax directly, that is, without these revenues passing through the Departmental budget. Finally, the Health Service receives some revenues on its own account from hospital charges. 

Similarly complex but different tales could be told for almost every service shown in Table 4. The overwhelming impression afforded by any examination of intergovernmental relations in Colombia—as in many countries—is that nothing seems straightforward, and no one, at any level of government, appears to have a very clear picture of what is going on, or of the net

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1/ Incidentally, the head of the Health Service, who is also the Secretary of Health of the Department, is also the President of the beneficencia.

2/ Each of the 49 hospitals has its own budget and administration, although the rates charged are controlled by the Service. About 80 percent of total Health Service expenditures are on hospitals. In addition to these complex intergovernmental organizational and fiscal arrangements, the national government indirectly plays an important role in health in Cali through the operations of the Colombian Social Security Institute (ICSS). In fact, the ICSS spends more on health in Valle than the whole Sectional Health Service—although only a relatively small proportion of the population is eligible for ICSS services (which are financed through special taxes or wages).
effect of all the complex interrelations that characterize the provision of virtually every service. The numerous instances in which what happens in practice differs from what is prescribed by law add to this general confusion, which is exacerbated by the rapid turnover of top personnel, the lack of incentives to clarify the system, and the general scarcity of resources. The proliferation of autonomous agencies at all levels of government makes it difficult to describe the governmental system as "centralized" or "decentralized" let alone to measure the degree of decentralization.

The usual defence of such complexity is the alleged need to restrain subnational authorities from acting unwisely (which in some instances appears to mean no more than their responding to local rather than higher-level political pressures) or from engaging in corrupt practices. An important effect of the system thus created, however, is to prevent subnational governments from doing anything very effectively even if they wanted to do so and were capable of doing so.

Despite the complex division of responsibilities in many countries, it is the central government which really counts, not only because of its directive and financing role, but even more because it is ultimately responsible for the existence and nature of the myriad other agencies and enterprises that constitute the public sector. In particular, the characteristic fiscal weakness--
and correspondingly small degree of independence—of local
governments proper are to a significant extent the direct result
of decisions taken by the central government. It is true that the
independent decisions taken at the lower levels of government are
often not commendable—most municipal fiscal legislation in Cali,
for example, appears to consist of one or another tax exemption—but
there is no question that the effect of central policy in many
countries has been to weaken general-purpose local governments.
These governments may well have been weak anyway; but they have
not been much helped by the policies of other levels of government.

Colombians, for instance, tend to look to the central govern-
ment for almost everything, and, on the evidence, they are right to
do so. Subnational governments in Colombia are clients, both
politically and fiscally, of the central government and have
relatively few degrees of freedom. In this, it may be suggested,
they do not differ very much from subordinate levels of government
elsewhere in the developing world.

The preceding discussion makes no pretence at being complete,
even for Colombia. Nevertheless, on the assumption that it offers
us at least a glimpse of reality, three main points emerge. The
first is simply that further consideration of data without a clearer
theoretical framework is likely to be of little use. Second, owing
to the variety and complexity of intergovernmental relations, theory
cannot substitute for detailed observation of particular circumstances.
The "best" governmental structure for a given country at a given time can be devised only with full knowledge of the circumstances and its particular policy objectives. Finally, the preceding discussion also suggests that, in one sense or another, central governments usually get, so to speak, the local governments that they deserve. Since the degree of decentralization turns out to be largely a policy choice of the central government itself discussion of transfers and tax allocations is generally an inappropriate starting point for the analysis of intergovernmental fiscal relations. Instead, one must first consider the whole gamut of policy objectives and instruments open to government: this is the task of the remainder of this paper.

C. Alternative Conceptual Frameworks

Different analysts considering the same set of circumstances but starting with different paradigms will in all likelihood reach different conclusions. There are two broad ways of looking at the division of governmental responsibilities, which may be called the aggregation model and the devolution model. Many economists tend to follow the first approach, of aggregation, which seems both to make sense with respect to the U.S. governmental model -- often the only one with which they are familiar -- and to reflect the idea of the sovereignty of the individual common in economic thinking. In the theoretical version of this approach, most developed in the recent "public choice" literature, one starts with the individual and builds up, or aggregates, through various levels of collectivity (the family, the neighbourhood, the municipality, the region, the state, the nation, the world) to the extent necessary to satisfy individual demands in an efficient fashion.

1/ For a review of much of the theoretical literature along these lines, see Bulutoglu (1974). An excellent recent summary and application of "public choice" theory to the problem of governmental structure is Sproule-Jones (1975).
In addition to being attractive to Western-trained economists, the aggregation model, which in a sense assumes that the smaller the unit the more "fundamental" it is, is also relevant when there are economic or noneconomic reasons why geographical location (or membership in different geographically-based collectivities) is considered relevant to policy. Countries in which there is a strong tradition of local self-rule, or with ethnic, linguistic or other noneconomic bases for geographic separateness and strong community rather than national loyalties, are cases in point 1/—though it must be noted that the national policy of many such countries is of course consciously against the decentralizing tendencies arising from such forces. As shown in Part III below, application of the aggregation model results in a complex and overlapping set of governmental units—though not necessarily (or even likely to be) those that exist in the real world.

The devolution approach, while it too has many (often unconscious) adherents among economists, is perhaps best epitomized in practice by the French governmental model and in principle by traditional public administration thought. Its central idea is that the nation-state (however defined) is in some sense the natural or fundamental organizational unit, so that all decentralization below this level requires special justification. Whereas in the aggregation approach one starts with the individual and then, so to speak, "justifies" turning over various functions to increasingly remote

1/ An alternative approach to the problem of governmental structure might indeed focus on such "affinity groups" as a more appropriate basis than either the individual or "total" collective approaches stressed here.
units, most of them governmental in character, in the devolution approach one starts with the presumption that all public sector activities within given political boundaries will be performed by the central government apparatus and then justifies, usually on some sort of "efficiency grounds" (see below), turning various activities over to lower levels of government. The latter may simply be field administrations of the central government or have some degree of autonomy in making decisions within a restricted sphere. 1/ Unlike the aggregation model, the devolution model does not purport to be a complete theory rooted in the postulates of microeconomics. Largely for this reason, it is less satisfactory to the economic theorist. Nevertheless, there can be no question that it is the devolution approach which best characterizes both the way in which intergovernmental fiscal relations now work in most developing countries and how most planners and other officials seem to think they should work.

1/ Complete local autonomy and complete central control are of course extremes as non-existent in the real world as perfect competition. Nevertheless, the vision of these two ideal types provides a useful scale along which to array both actual governmental systems and the recommendations of those who would change them. For some purposes, it is useful to go further and distinguish three basic types of governmental structures so far as vertical or hierarchical relationships are concerned: a unitary system, a unitary system with some field (or regional or local) administrations, and a multi-level system with some effective decentralization of decision-making (United Nations, 1970).
It is important in making recommendations with respect to any particular country to be sure that the model underlying the recommendations is consistent with that which (usually implicitly) governs thinking and action in the country. This is important not only for the acceptability of the analysis and of advice offered, but also because if the model used is wrong, even if the recommendations are, for whatever reasons, initially accepted, the enormous transitional costs of the institutional changes required to overcome the inertia of the prevailing system will almost certainly lead to failure in the end. With regard to grants to local from central government, the devolutionist is likely to recommend that they be conditional, because his real interest is in imposing central preferences on local government, while the aggregationist will recommend that they be unconditional, stressing their effect on the resources received by the locality, because his real interest is in helping local aspirations to be realized. (See Part IV below.)

Both groups of "experts" are, however, united in their disregard of the overriding need of politicians to maintain the system. In most developing countries, where national unity is rather fragile, this need alone generally makes the centralizing model of the planner a more accurate depiction of the objectives of central government decision-makers than the decentralizing model attributed here to the economist.

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1/ For a recent analysis of the neglected subject of the obstacles to reform arising from transition problems, see Feldstein (1976).
Indeed, much of the writing by economists about intergovernmental relations in developing countries has probably been too far off what decision-makers see as the point to be of much use. 1/

The remainder of this paper develops this argument in a number of different contexts and suggests an alternative approach to analysis. Instead of assessing intergovernmental fiscal relations in a particular country in terms of this or that normative model, and making recommendations designed to move reality closer to the postulated norm, a more useful approach is to work within a positive framework relevant to the particular country in question. 2/

This approach is much more difficult to implement; it requires much more knowledge of institutional specifics, including in particular the initial conditions and the relevant policy objectives of the country in question. This knowledge is then used to assess how to attain the policy objectives.

1/ On the other hand, those economists most closely attuned to the realities of developing countries have generally, despite ritual obeisance to the desirability of local autonomy, been quite centralist in their general orientation; for a good recent example see Hicks (1976).

2/ For a related argument, see Head (1974) and Bird (1970c).
III. POLICY OBJECTIVES

This section discusses some of the many objectives which people hope to obtain through government and how these objectives affect intergovernmental fiscal relations. In deference to the prevailing stress in the literature, we first consider economic objectives. The rather abstract level of this discussion is also characteristic of the literature, and the sterile conclusion to which we are led suggests strongly that the fundamental questions are political, not economic, in character. The second and third sections of Part III therefore discuss more explicitly political considerations.

A. Economic Objectives

The principal policy objective considered in most economic analysis of governmental structure is the efficiency with which resources are allocated to the production of public services. Some studies of government organization (especially by noneconomists) appear to identify economic efficiency with an even narrower concept that may be called "technical efficiency". A technically efficient unit of production is one that attains the lowest long-run average cost of production, that is, reaps all production economies of scale. In this approach, the area and/or population served should be at least large enough to support the technically least-

1/ The possible effect of alternative governmental systems on such macroeconomic objectives as stabilization is not discussed in this paper. For an interesting discussion of some aspects of this problem, see Breton and Scott (1976).

2/ Some of the argument in this section follows Bird and Hartle (1972); for another recent review, see Bulutoglu (1974).
cost method of producing the service. The optimal structure of government thus tends to be defined in terms of the economies of scale in the production services.

This approach has a superficially appealing simplicity and potential quantifiability about it, but unfortunately it is often neither simple, feasible nor necessarily economically efficient. One problem in applying it is that very little is known about the relationship between the cost of producing a service and the scale on which it is produced (Shoup, 1969; Hirsch, 1970). Another is that what little we do know indicates that the "technically efficient" size of population (and area) served differs for every function performed by government. Further, the different functions of each service may each be most efficiently performed on a different geographic basis (Linn and Valverde, 1976). For example, the efficient size of police force for traffic control may not be the same as the most efficient size for crime control. Unless one is prepared to make the very strong (and apparently unrealistic) assumption that there are sharp discontinuities in the hierarchy of functions when ranked by economies of scale, it appears that setting up governmental decision-making units solely with a view to minimizing production costs would yield an exceedingly complex and administratively costly system.

Moreover, the unit of government which produces a service need not be the unit which consumes it, that is, provides the service to its inhabitants. One of the fundamental distinctions made

1/ Area and population need not affect costs similarly (see Shoup, 1969, 143) but this refinement is ignored here.

2/ For a recent striking recognition of this in the context of a comparison of large public utilities, see Corti (1976), who concluded (p. 45): "The past twenty years' experience suggests that advanced industrial countries can have a deconcentrated, devolved system without apparently suffering financial, technical, or industrial-relations penalties. In fact, the reverse appears to be the case. Evidence does not point to biggest being best."
in elementary public finance texts is between the provision of services by a governmental unit and the production of services by that unit. This distinction has increasingly been recognized in practice in many countries with the development of intergovernmental agreements (between governments on the same level) and service-contract arrangements (between governments on the same or different levels). The Colombian health service mentioned earlier is one example.

A limitation of the technical efficiency criterion more important than its theoretical and empirical ambiguity is the fact that it ignores benefits. Minimizing costs is not the same as maximizing welfare (the present value of future net benefit streams, in terms of cost benefit analysis). If welfare is to be maximized, a governmental structure must, to attain economic efficiency, take into account the demand for public services as well as the conditions under which they are supplied. Since in many countries governments cannot provide goods and services to all areas, this consideration suggests that sub-national governments may be required in order to secure the optimal amount and mixture of public and private consumption by citizens.
The central problem in the provision of public goods--conventionally defined (Head, 1974) as those goods which are consumed equally by all persons within the relevant jurisdiction, and which cannot feasibly be charged for--is to find out what goods should be produced and in what quantities. Since a public good is (by assumption) consumed by individuals just like any other good, the problem is really to get individuals to reveal their preferences in a situation in which it is not in their interests to do so. The way in which this revelation takes place is through the political system. To the economist, then, the principal function of political institutions is to determine what individuals want by way of public services, and to provide the desired services.

When a government decides to provide a service to its citizens, however, some of the benefits from that service will often "spill over" jurisdictional boundaries and be consumed by residents of other jurisdictions. The usual argument is that each government will, quite properly, be concerned primarily with satisfying the preferences of its own residents (and voters) and will hence consider only the benefits and costs of different actions internal to its jurisdiction. Public services will thus be extended to the point at which the marginal internal benefits
(those felt within the unit) equal marginal internal costs. This point may well differ from the "socially" optimal point at which marginal social benefits equal marginal social costs. 1/

In these circumstances, even the most perfect demand-revealing mechanism will not indicate the optimal amount of the public service. Possible solutions are to pay a conditional grant to induce the decision-making unit to take account of the benefits accruing outside its boundaries in deciding how much of the service to provide, 2/ or to enlarge the jurisdiction which provides the service (by amalgamation or by passing the function up to a higher level of government).

What might be called "the economically optimal constitution" would then be determined by the geographic range of the spillover effects of collective action. Unfortunately, there are a few obvious complications. Two such complications have already been mentioned in reference to economies of scale. One is that the range of externalities in the consumption of a collective service may well be quite different from the range appropriate to its least-cost production. Furthermore, even assuming we could know the range of relevant externalities with any certainty, there seems no reason to expect it to be identical, or even closely

1/ Since each government's decisions affect those taken by the others, there is no presumption that the "distortion" resulting from spillouts and spillins (of both benefits and taxes) will necessarily result in either over- or underproduction in the public sector (Williams, 1966).

2/ This result is achieved by altering the per-unit price facing the local area to the point at which it will undertake the socially optimal amount of the activity. (It is a lot easier to say this than to know by how much the price has to be altered.) Note that grants given for this reason are in the nature of contractual payments rather than unilateral transfers (Breton and Scott, 1976).
related, for any two governmental functions or for there to be significant discontinuities in the ordering of functions in this respect.

Alternatively, one may recognize that most governmental activities in fact consist of a cluster of functions, and subdivide them so that different parts are provided by different governments.

Even complex alignments of responsibilities may in some instances be well-defined and well-founded. More generally, however, the lines of responsibility are blurred, and there is much overlap. Even in the centralized Tunisian system, for example, it has been suggested that there is far too much overlapping supervision and control (Prud'homme 1975). As a rule, as Sharefkin (1975) has noted, the actual complex inter-governmental arrangements for providing urban services have little to do with the complexity called for in the literature.

Even if we could overcome the many empirical and conceptual difficulties and derive "the" economically efficient constitution, the assumptions needed to make this construct "the best" are so strong and so unrealistic that it does not offer us much of a guide. Not only is "the best" defined with respect to the present distribution of real income, which is inconsistent with government's activities as a redistributor, but its determination requires that we have a single set of values against which to judge it. For a
solution to be "optimal", there must be a determinate (national) social welfare function that is substantially shared by most residents. But in most cases the very existence of communities and regions means that there will be conflicting values in at least some relevant respects.

The argument to this point may now be briefly summarized as follows: (1) On the assumptions that the consumption of most collective services is spatially differentiated and that people have different tastes for collective services, collective demands will in general be most efficiently satisfied by a high degree of autonomous fiscal decentralization. (2) On the other hand, the existence of spillovers suggests that larger units of organization are needed to internalize the relevant externalities arising as a result of the provision and financing of collective goods and services. There is thus an apparent conflict in the economic criteria for the organization of governmental decision-making units. The problem is accentuated by the fact that one would expect the "optimal" size from both points of view--the avoidance of spillovers and the satisfaction of heterogeneous preferences--to be different for every function and subfunction of government. There is thus no unique solution in economic terms to the question posed initially concerning the "optimal" structure of government.
B. Distributional Objectives

Although equity is generally discussed under the heading of "economic" considerations, it is an expression of a political or philosophical judgement. It is therefore appropriate to discuss some equity aspects of intergovernmental relations at this point, before turning to more obviously political considerations.

The central equity concern in most analyses of intergovernmental fiscal relations in developing countries is humanitarian rather than egalitarian in nature: not equality as such, but the effects of the governmental system on the provision of urban public services to the poorer segments of society—in the form of, say, "minimum needs" packages. 1/ The simple rule that guides those who take this approach is that if a system is pro-poor it is good; if it is not, it should be changed.

There are, of course, excellent reasons—economic, political, humanitarian, and ethical—for taking this stance. Nevertheless, several questions may be raised about the way in which subnational fiscal systems are customarily appraised in this respect. It is not clear, for instance, why those who are concerned with improving the living standards of the poor focus

1/ In contrast, an egalitarian approach might be concerned with the effects of alternative intergovernmental systems on, say, the general coefficient of income inequality in the society in questio
so much on the fiscal system. It is demonstrably wrong in most developing countries to think that the fiscal system indicates in any direct or obvious way the overall impact of government activity on income distribution. Much more important are many other rules, regulations, and policies (e.g. on protection and exchange rates) that affect the primary distribution of resources. 

If the distribution of income is considered to be too unequal, or if the poor are considered not to receive a sufficient or fair proportion of the nation's wealth, then there is a problem. Whether or not the fiscal system makes the distribution worse or better is very much secondary to the basic fact that the distribution is in some sense unacceptable and therefore requires rectification, whether through the fiscal system or in some other way.

This point may perhaps be made clearer by an example. The usual analyst of, say, the distributional effects of primary education is ecstatic if he concludes that poor consumers receive a net subsidy in the sense that the benefits they receive from the system exceed the amount they pay for it. Yet this may only mean that the poor get one year of free schooling (valued at so much in monetary terms) while the rich get ten. In other words, if one's principal concern is humanitarian, the focus of distributional analysis should be explicitly on the absolute rather than the relative amounts of public services. 

For an excellent analysis of some of these factors, see Berry and Urrutia (1976). This point is recognized clearly in Meerman (1977).
rich, or relative to the proportion of their income taken in taxes. In many cases, what may be required in a "just society" is that the poor get not simply the same absolute amount of public services as the rich but that they get much more in order to make up for their lack of so much else. In short, an appraisal of the effects of alternative intergovernmental relations on the poor requires a much more careful specification of the relevant norm than is common in fiscal discussions.

Many studies of the distributional effects of subnational fiscal systems, like most conventional fiscal incidence analyses, are not only often irrelevant for policy making, but also methodologically invalid and generally statistically highly suspect. These issues have recently been explored in depth in various publications (Bird and DeWulf, 1973; De Wulf, 1975; Meerman, 1977). Thus they are not reopened here.

A third question which can be raised is whether distributional considerations are the proper domain of subnational governments. (Oates, 1972) Redistribution for its own sake, it is commonly asserted, is not one of their proper functions, and those local fiscal policies which are designed with redistribution in mind are generally both ineffective and inefficient, largely because of the openness of the local economy. The rationale for saying that subnational policies should be structured

1/ For a recent critique (on quite different grounds to that taken here) see Pauly (1973); and for a still different approach, Breton and Scott (1978).
solely on grounds of efficiency, rather than equity, is that only the total impact of government policy on redistribution is significant, and that any desired effect can most efficiently be attained by the central government directly.

In its strong form, this position seems fully tenable only if the central government perceives itself as possessing the primary responsibility for redistribution, and acts on that perception. It is less applicable in most developing countries, where there is unlikely to be a smoothly operating central government tax-transfer mechanism which acts as an overriding redistributor. Insofar as their governments have clear redistributive goals, they must usually attempt to achieve them through all the instruments they can get their hands on, including both local fiscal policies and various intergovernmental devices. The redistributive impact of local public finance (and the rules that govern it) cannot, therefore, be simply ignored: the effects on the well-being of the poor of changes in local taxes are as relevant and legitimate matters of concern as changes in national taxes. Moreover, as argued below, local governments in most developing countries are in practice agents of the national government. Since their fiscal policies are therefore part of national policy, there appears to be no reason why local finance cannot be as much a part of redistributive finance as national finance (Linn, 1976c). Furthermore, it may be suggested for the same reason that the rich have less chance to escape taxation than is usually suggested (other than by fleeing
abroad) because what is at issue here are not locally differentiated redistributive policies but national policies implemented through local (as well as other) fiscal instruments. 1/

C. Political Objectives

Many developing countries are also relatively new nations, and it is thus only to be expected that the political leaders at the center tend to compensate for the centrifugal tendencies they see around them by concentrating more and more power at the center. In Zaire, for instance, where the nation-state has undergone significant centrifugal pressure, including a prolonged civil war, this tendency has been carried to the point of contemplating the complete disappearance of any form of local government (Prud'homme, 1973). 2/

1/ The discussion of equity in this section has focused on redistribution among individuals. In some countries, however, the principal political discussion of equity has taken place in the context of intergovernmental fiscal relations rather than with respect to the more fundamental (to the economist) state-individual relations. While few developing countries have taken this "reification" of subnational units as far as countries like Canada, the tendency is not uncommon, particularly among officials of lower-level governments in countries with some degree of formally-entrenched "federalism". Some observers have, indeed, argued that interregional disparity is so severe in developing countries that the traditional "federal" principle of financial independence is irrelevant and invalid (Sastri, 1970; Musgrave, 1971,725). In this view, the central government in the exercise of its planning responsibilities, including the alleviation of regional disparities, must (and should) override the autonomy of local governments. Autonomy is thus sacrificed to control. There seems no need to go to this extreme, however. What a concern with regional "balance" would seem to require is at most the national provision of a minimum level of services, not the suppression of all regional variation. For an exploration of this issue, see Breton and Scott, 1978.

2/ Other examples are Nigeria, which also had a civil war, and Kenya, where in 1963 the independence constitution provided for some regional autonomy—which in 1964 was suppressed because of the danger of regional fragmentation.
Even the countries of Latin America, most of which have been independent for 150 years or more, obviously exhibit this tendency as revealed in the history of, say, Mexico (Oldman, 1967).

Decentralization is politically expensive for any regime because it means reducing central authority and creating other power centers which can make claims on resources and act counter to central goals. On the other hand, it may sometimes be a politically expedient way to meet demands on the state: by placing divisive issues at lower levels of government, conflict with the central government may be reduced. It has even been suggested that central delegation of tax power to local governments may sometimes reinforce acceptance of the legitimacy of the central government! (Uphoff and Ilchman, 1972, 201-202). Whatever the merits of this argument, it is clear that politically the desirability and feasibility of decentralization depends very much on particular circumstances.

However, when coupled with the customary argument (explored below) that only the center can administer modern government programs efficiently, and with the predilection of national planners to keep "control" of as much as they possibly can, these political factors are more than enough to explain the cold reception policy-makers have given the conventional recommendations of many fiscal reports to create a stronger local or regional fiscal base. To them, the probable result of such proposals is a stronger base for potential rivals or for national disintegration.
There is little doubt that in many developing countries centralization is carried well beyond what can be justified on economic grounds alone, where there is a strong degree of local identification (such as in Colombia). Indeed, perhaps the most important single fact about local government in developing countries is that the central government always controls local government finance, and hence local government. 1/

This situation should be no cause for surprise. In the typical developing country, no level of government has a surplus of talent or revenues. Hard-pressed central governments are therefore usually understandably reluctant to turn over resources to local governments. 2/ Indeed, central control is sometimes used to block local initiatives which might cost money, as has reportedly been the case in Morocco (Johnson, 1972). More frequently, however, the central government in effect imposes expenditure obligations on local governments.

1/ This point does not simply refer to the fact that local governments, by definition, derive their authority from the central government in almost every country of the world.

2/ They seldom appear to recognize the possibility that bestowing more revenue-raising authority on local governments may in fact lead to an increase in the total revenues available to the public sector (Smith and Smith, 1971).
Much of the extensive central government interference in the details of local government operations which characterizes almost every developing country is justified in terms of the need to curb the wasteful effects of local political control. In Indonesia, for example, many independent municipal organizations were formed during the 1960s to take functions out of "politics" and put them into professional hands (Linn et al., 1976). In reality, however, much control over local governments is clearly exercised because the central government doubts whether the localities will do things the way the center wants them to be done.  

What is at issue is not just what is done but who is to decide what is done.

The political case for decentralization is more or less the obverse of that sketched above. To one who believes in man rather than the state as the basic element of society, for example, the fact that there are centrifugal tendencies in any nation-state is an argument not for the centralization of power but for its decentralization. Local autonomy is thus simply a pragmatic recognition of the fact that groups caught by the chance of history within the same national boundaries differ and without good reason to the contrary they should be free to exercise these differences. In this sense, local autonomy minimizes political externalities due to heterogeneity though perhaps at the expense of increasing decision-making costs (Bulutoglu, 1974; Buchanan and Tullock, 1962).

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Currie (1974) for example, has argued strongly that a strong national government policy is needed to cope with urbanization pressures.
It also leads to more responsiveness to citizen's needs.

The traditional political literature is replete with further arguments for decentralization: (1) the need for specialized knowledge of local conditions; (2) the desirability of flexibility and trial by experiment with respect to changes in governmental functions; (3) the desirability of promoting local initiative and responsibility. Obviously this list is neither complete nor mutually exclusive, nor are any of these criteria particularly clear. Yet they suffice for our present purpose, which is simply to note that once these factors are taken into account the confused and obscure shape of the "optimal"
constitution which one might have felt able to perceive, however
darkly, through the economic optic employed earlier becomes even
more confused and obscure.

Perhaps the point might be strengthened in the minds of
economists if rephrased in terms of more familiar, though not
necessarily more meaningful, terminology. Unless the tastes and
preferences of all residents of a decision-making unit are identical,
those in the minority with respect to any collective decision are
subject to a "political externality" in that their preferences are
overridden by the majority. To minimize this externality, given
clustering of preferences, a governmental decision-making unit may
be needed at every street corner. 1/

This reasoning is, however, almost certainly less applicable
in developing countries than in the highly developed American urban
areas for which these arguments were originally developed. If one
makes the conventional assumption that individual differentiation
of wants increases as one moves higher up the hierarchy of wants,
then tastes for particular public services are likely to vary less
in developing countries than in the U.S., partly because the
services tend to be more basic or essential--for example, clean
water and basic protection of life rather than golf courses and
swimming pools. A second argument pointing in the same direction

1/ This result is much the same as that reached in respect of the
efficient satisfaction of collective demands--when spillovers
are ignored. The criterion of minimizing political externalities
(maximizing "access") may thus, however, conflict directly with
that of minimizing economic externalities in the provision of
collective goods and services by internalizing spillovers in
larger governmental units.
is the more limited horizon of most people in poor countries: if one knows of only a few of life's myriad possibilities, one's demands are likely to be much more like those of one's equally deprived neighbor than if both are daily exposed to countless different life styles. Both of these factors therefore suggest that provision of uniform services is likely to be less "coercive" in poor than in rich countries.

These same factors are also relevant in appraising the provision of merit goods through government. By merit goods in this context are meant simply those private goods which are provided through government for other than purely distributive reasons (Head, 1974). The classic example—which of course encompasses a redistributive element also—is compulsory education, with the emphasis on "compulsory". Individuals are forced to consume merit goods whether they want to or not, because, in the opinion of those making the decisions, it is good for them to do so. Their own preferences are thought too perverted by ignorance or bad information to be worth taking into account.

Phrased in this fashion, it is clear that this notion has much in common with the sort of ethical authoritarianism ascribed in Part II to many adherents of the devolution view: at the extreme, the only reason for having any lower level units of government is administrative convenience, because there is no need to take demand factors into account at all. Without going this far, if
poor people in poor countries are indeed more ignorant and have more homogeneous preferences, there is indeed a stronger case for ignoring and overriding local preferences in poor than in rich countries.

Another approach to this whole problem is to consider the costs of obtaining information and reaching a decision, that is, to work with a "satisficing" rather than a maximizing model. Several points might be made in this connection. One is that the cost of reaching decisions probably rises as more people are involved, assuming that they have different tastes and preferences. In a population of given size, the greater the percentage of the population that is involved in the decision-making process, the greater the cost. The more heterogeneous the population, the larger the proportion that must be involved to reduce political externalities by a given amount. This analysis suggests, again, that more homogeneous (smaller?) units are generally more efficient than less homogeneous ones. 1/

Another argument in favor of relatively small governmental decision-making units is the view, familiar from administrative theory, that some degree of decentralization is essential for effective problem-solving in a complex environment (Simon, 1957).

Furthermore, within a given unit, one might postulate a "least cost" decision rule at the point where the marginal cost in terms of adding to the cost of decision-making by adding one more person to the decision set is just equal to the marginal cost in terms of political externalities by leaving him out. See Buchanan and Tullock, 1962, Chapter 6. This "solution" too requires a determinate social welfare function. The importance of "transactions costs" in designing an optimal governmental structure is developed in detail in Breton and Scott, 1978.
Again, then, we have an argument for autonomous separate geographic governments to reduce the need for the costly transmission and processing of information and to make the problems faced at least potentially solvable.

Decentralization also involves a hierarchical structure of government since people always have at least some shared values which require collective decisions above the community level. De facto federalism thus seems inevitable in large states, if only because of the limits on the span of control of the center and the need to economize on transactions costs by some degree of specialization, whether territorial or functional.

The argument to this point is very similar to that for perfect competition as an efficient solution to the problem of determining the "correct" output and price of private goods and services. Just as the application of the competitive model to the real world has to be severely tempered by the reality of concern with income distribution and of market imperfections, so similar, indeed worse, difficulties arise in applying the market analogue in the public sphere. But in neither case does it follow that the answer to these difficulties is to centralize all decisions, or even necessarily to coordinate them centrally.

Even some of the most authoritarian and centralist regimes have at times placed a great deal of stress on the importance of participation, right down to the smallest unit of social organization
(outside of the family). The purpose of popular participation in this case may be primarily to educate people to want what is being done for (or to) them anyway. It is of course true that people often do not know what is in their own best interests because, for example, of the very limited perspective they have on the world. On the whole, however, this sort of "participation" is hardly what democratic theorists have in mind. Henceforth, when we have occasion to refer to the virtues (or otherwise) of participation we shall be referring to the more conventional (western) sense, in which people may not only discuss decisions, but they may also make them--even "wrong" ones!

To sum up this discussion of political objectives, again no clear general 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.

D. Administrative Objectives

A number of reasons are often offered in support of collecting most taxes at higher levels of government--the great difficulty of combatting evasion, particularly by industry, at the subnational level, and most importantly, the argument that local administration
is invariably less satisfactory in a number of respects than central administration. Among the factors customarily mentioned in this connection are the scarcity of administrative talent in local governments, the alleged greater susceptibility of local officials to corruption and political influence, and the connected characteristics of greater turnover, lower pay, and lesser status.

While there is some merit in many of these points, they are often greatly overstressed. Local administration is not the same as bad administration and may often be better than central administration, owing to greater knowledge of local needs. Often, for example, centrally-imposed service standards are considerably higher than those that local officials would opt for--particularly if they had to finance them from local sources.

Many of the vices attributed to local governments--excessive paper shuffling, lack of quality control, undue focus on inputs rather than outputs--as well as some of the other points listed above, are endemic to all governments and not the exclusive preserve of local administrations alone. It is of course true that central officials usually have more pay, status, and--not unconnected--power, than local officials, and that these factors combine with many other aspects of life in many countries to draw the more able officials into the central government. But this result is not necessary; it is rather, to a considerable extent, the result of conscious or
unconscious central policy decisions to the effect that local
governments are relatively unimportant.

In principle, many of these factors could therefore be reversed: a developing country could quite consciously put its
most able officials into the subnational sphere ("closer to the
people")—and, further, by providing greater opportunities at
the local level perhaps even draw into the public service now hidden
and wasted talents. (Smith 1973) As the previous section’s analysis
should have made clear, however, in most countries the likelihood
of this happening is extremely small.

A common view is that local governments are inherently more
conservative than central governments, so that the latter frequently
need to prod the former into action (Aldefer, 1964). In many
developing countries, however, it is not at all clear that
increasing the degree of national government influence, whether
through an autonomous agency or in some other way, will necessarily
constitute an improvement from the point of view of the poor. The
national influence may as often be used to reinforce the position
of the local elite as to offset it. The outcome really depends on
the relative degrees of benevolence and authoritarianism at the
two levels of government, a point which can hardly be resolved in
abstract.
What is usually meant by "political influence" on local administrations is that the wrong political influences are at work—wrong, that is, from the point of view of the speaker in question. By political influence is often meant responsiveness to the wishes of one's constituents. Taking a function out of politics by turning over its performance to an autonomous agency, for example, in effect substitutes one political judgement (called "technical") for another: it is by no means clear that this will necessarily result in an improvement in net social welfare. The almost universal tendency of reformers, whether internal or external, to bypass the existing messy and rigid structure by creating new agencies to carry out new policies has resulted in most countries in the fragmentation of power and the introduction of a new set of interests into the policy-making process (Lindheim, 1974). Mention of this aspect of the inter-governmental situation in many developing countries really moves us from the discussion of policy objectives to that of policy instruments.
IV. POLICY INSTRUMENTS

A. Functional Fragmentation

The issues discussed in Part III have been considered in the theoretical literature mainly in the context of the spatial fragmentation of urban areas that is characteristic of the United States. While similar urban fragmentation is not uncommon in developing countries—the Manila metropolitan area provides one of the clearest examples—the more characteristic form of fragmentation is functional rather than spatial in nature, as indicated in the earlier account of the provision of urban public services in Colombia. Indeed, Kalnins (1974) has coined the word "demunicipalization" to denote the process of fragmentation of traditional municipal functions that has occurred in Colombia, largely as a result of the lack of human, technical, and financial resources at the local level. 1/ This fragmentation has been accomplished mainly through intervention by national autonomous agencies and has been perpetuated and strengthened by the centrifugal tendencies of these agencies.

The organizational structure of urban public utilities is obviously affected by the size and density of the population served. 2/ In such large countries as India and Brazil regional provision of public utility services (possibly supported by some national coordination) will reap most potential technical economies 3/, while

1/ Mahar and Rezende (1975) call the similar process in Brazil "decentralized centralization".

2/ This and immediately following paragraphs owe much to J.F. Linn.

3/ As Corti (1976) suggests, the financial and technical problems of coordination require some central role but there is no apparent reason for central provision (or production) of such services.
in many small countries even provision at the national level may not provide a large enough scale of operations to permit the achievement of minimum unit cost. In practice, whatever theory may suggest as optimal, the importance of the required investments in the total public sector budget makes it probable that in small countries public utility services will be provided directly by a national government agency.

The influence of city size on public utility organization is somewhat more complex. In small towns and rural centers the unit costs of providing utility services tend to be high, due to the small scale of operations and low population densities. When combined with the scarcity of administrative and technical skills and weakness of local financial capacity (especially in poor areas), national or regional responsibility for the provision of services for these towns and centers tends to be the rule.

For medium-size cities local production and distribution of public utility services is technically more feasible, especially with regard to water supply and sewage disposal. Although technological considerations continue to favor regional or national production of electric power, there is no technical reason why responsibility for distribution cannot remain with local authorities. Similarly, long-distance telephone services will certainly have to be a national responsibility, but local services could conceivably be left to local administration, provided technical standards were adequately coordinated and regulated. The main constraints on local control in these cases are presumably administrative and financial in nature. As noted earlier, it is often argued that locally
controlled agencies are more subject to pernicious political influences and thus are less able to attract and hold good technicians or administrators.

For large cities, the scale of operations is likely to be large enough to take advantage of most economies in production. There generally appear to be no administrative, technical and financial obstacles to independent local administration of utility services in large cities, subject to regulation to ensure uniform standards where necessary for efficient operation of the system.

Even in the very largest cities, however, public utility services in most countries—even water and sewerage—are increasingly provided at the national level. In Colombia, for example, this trend is noticeable particularly in the power and telecommunications fields. In Tunis, a recently-created national agency has even taken over responsibility for sewage disposal (Prud'homme, 1974). These examples could be repeated many times over.

While the reasons for this trend towards increased national involvement no doubt differ from country to country, several common factors may be provisionally identified. First and perhaps most important, the explosive growth of the large metropolitan areas has resulted in a need for large-scale and sophisticated investments, which in turn has made growing demands on scarce administrative and technical skills and has often required significant foreign contracting and borrowing. National governments have also become
increasingly involved as a result of the large claims by big cities on limited natural resources, and their impact on the surrounding environment, particularly as concerns water supply and sewerage operations.

Secondly, in some countries, growing consideration of income distribution has led to greater national government interest in (and hence control over) the distributional impact of public utility service provision and pricing. Concern that widening the disparities between rural and urban areas by providing better services to the latter may encourage migration is another reason for national involvement in the provision of services.

Finally, international lending agencies have had a noticeable influence in a number of countries. In Kenya, for instance, pressure by the Swedish Aid Organization led to the formulation of national sector policy for water and sewerage, with long-term implications for the organization and control of the sector, pointing generally towards greater national control. Much more pervasive has been the influence of the World Bank, whose concern for the technical, financial and administrative viability of the utility sector to which so much of its lending is directed has often resulted in the creation of supra-local, independent agencies.

In this regard the international agencies simply follow the thrust of the traditional literature on public utility organization
(Sharefkin, 1975): financially independent public utilities, it is asserted, are generally well-run, honest, and efficient, while politically-controlled utilities are not only markedly worse in each of these respects but also likely to be run at a financial loss. The clear implication in this argument is that it is the organizational structure adopted which gives rise to these results.

This view appears to receive ample support: visiting experts find, for example, the technological world of the electricity authority a refreshing contrast to the messy political world of the Ministry of Finance or, even worse, the office of the local mayor. In the face of all this evidence, it may appear folly to suggest not only that the apparently clear connection between organizational form and observed results is quite unproven but also that the honest efficiency of the technocrat may not produce the "right" results anyway. Nevertheless, this is the line which is taken here.

In the first place, there is little theory or fact on which to assess the comparative efficiency of organizational alternatives. In addition to the economic references cited earlier, see such standard references as Pugh (1971) and Perrow (1970).
striking difference in results between governmental and autonomous agency provision of public services can be readily explained. If so, this suggests that more attention should be paid to the real questions, namely, the underlying interests of policy makers and the relevant trade-offs.

The point may be illustrated by considering briefly two respects in which autonomous agencies are generally claimed to be better than direct government operation: staff competence (including honesty) and financial viability. 1/ It is quite true that the staff of most autonomous utility agencies are more competent and more honest than those of most local governments. They are also, however, (a) better paid, (b) better insulated from public pressure and influence, (c) in most instances more securely tenured, and (d) generally able to partake of a certain technocratic esprit de corps. 2/ The difference in staff performance thus reflects not the inherent superiority of the autonomous agency, but the miserable conditions under which local government officials

1/ In effect, only in these agencies does a competent "civil service" (as conventionally defined) exist in many countries.
2/ In Kingston, Jamaica, for example, the water commission, which is under direct central government control, has more power to appoint staff than does the nominally autonomous metropolitan area government (Bougeon-Maassen and Linn, 1975). Because it has more revenue, it also has more freedom from central government financial domination. In general, the central civil service has higher status, as well as wages, and hence, unsurprisingly, gets better staff than do local authorities.
work in most developing countries. All of the characteristics cited above--perhaps even a somewhat more broadly-defined esprit--could in principle be inculcated and fostered in any organization, autonomous or not. Similar staff competence might then be expected.

As already suggested, however, one reason why it may not be desired to improve local government is the high costs most central governments would attribute to the strengthening of possible alternative power bases. Moreover, even if it were desired to do so, it may prove very difficult owing to such factors as the much greater weight of tradition in governmental structure proper and the difficulty of rationalizing the creation of an elite administrative corps without the protection of an accompanying technological "mystique". 1/ Nevertheless, in principle there is no reason why the same staff could not be recruited and retained under the same conditions by any governmental agency, autonomous or not. What is more important is the question of whether it is desirable to have certain (or all) public services run essentially by a technocratic bureaucracy insulated from public (political) pressures.

Perhaps the most important distinction between autonomous agencies and governments is that the former are concerned primarily with providing services while the latter are concerned both with

1/ For example, hardly any serious study of the revenue system in most developing countries has omitted recommending the creation of an elite corps of tax officials as an essential step towards rationalizing and improving the system. Indeed, on many grounds it is probably more important to have a well-run tax system than, say, a well-run telephone system. Yet almost no country has insulated the tax administration the way the telephone administration is customarily insulated. One reason for this reluctance may be simply that taxes, unlike telephones (or water? or electricity?), are considered too important to insulate from politics. Another may be that everyone thinks he understands what tax officials do, while few lay claim to such competence in the field of telecommunications.
providing services and with managing conflict. In other words, a key political task in any jurisdiction is to resolve the inevitable conflicts of interest among individuals and groups in such a way as to maintain the viability of the governmental system. 1/

Given the deep cleavages and the tenuous nature of the political power exercised by governments in many developing countries, it is not surprising that political institutions often demonstrate more signs of compromise (including "pay-offs", patronage, and corruption) 2/ and/or overt use of coercion than of efficient service provision. The principal objective of all political authorities, no matter what their explicit service aims, is to remain in power, if only because without power they can render no services. What is surprising is the extent to which governments have foregone the opportunity to use the utility services to help attain their basic goals of maintaining power and advancing their aims. While this is an interesting topic for further research, the only readily apparent explanation for it is the strength of technological mystique—especially when backed by the essential outside financial sources that have so often fostered the establishment and growth of autonomous agencies.

1/ Autonomous agencies must of course also "mend their fences" and maintain their political viability, but this role is clearly less important than in the case of governments proper.

2/ Parenthetically, corruption may be greater at the local than at the national level simply because it is cheaper (to the corruptor)
The common assumption in the literature that bureaucratic rather than political determination of who gets what is in some sense "better" is, however, suspect. In particular, it is not clear whether over time a bureaucratic system will necessarily serve the interests of the public (especially the poor) better or worse than a political system. It is quite true that the more autonomous a utility, the more service it is likely to deliver in a more efficient way. What tends to be sacrificed are values other than those of narrowly-defined technical efficiency.

Autonomous utilities, for example, may be expected to so structure their environment as to reduce or avoid feedback from the public (consumers) other than that which supports the agency's own organizational goals. Most such organizations are not required to learn about the real needs of their clients, who have little influence or effect on what they do. Demand is usually "articulated" through fixed-coefficient (price-independent) technical forecasting. Such organizations may be expected to press continually for large capital-intensive expansions of facilities to "meet demand"--demand that to some extent has been created by setting prices below equilibrium levels, thus developing a clientele to support agency expansion. 1/

To mention one example, bureaucratic power structures may tend in effect to restrict their output (for example, by asserting "too high" quality standards) 1/ while political structures may tend to give something, even a lower quality service, to as many as possible: the latter may therefore result in more people having access to a poorer system than the former. 2/

In the abstract, one cannot say which alternative is better (and for whom) but the question at least needs to be considered more explicitly than appears often to have been the case. 3/

The effects of autonomy on finances are not wholly predictable, since some utilities may be entirely self-financing while others may rely on general support, especially for large capital projects. Growth-oriented utilities, indeed, commonly demand general support for their projects, but under no circumstances will independent public utility managers be prepared to transfer funds to general revenues (Sharefkin, 1975).

1/ Such restriction at any point in time does not necessarily contradict the aim of system expansion, since in the case of most utilities the main organizational rewards lie in expanding productive, rather than distributive, capacity and the higher the output standard set the greater the "need" for expanding capacity to "serve" any given population. (Below-equilibrium pricing of "high-standard" output similarly adds to pressures to expand production capacity.)

2/ Compare Cohen (1974) who argues that delivery systems respond to organizational imperatives and may be directly contradictory to access to the decision-making process by recipients.

3/ To mention only one possible complication, poorer public service may result in higher total costs as the better-off private sector compensates for service deficiencies in various ways (storage tanks, auxiliary generators, messenger services).
There may perhaps be some general presumption in view of the public savings gap in most developing countries that utilities should be at least self-financing (including capital expansion). Whether certain utilities should generate revenues for general government activities, however, is not a question which can be answered in abstract nor can the question of whether any such surpluses should be paid over to the national or local governments. As hinted above, there would probably be far too great a struggle in most countries to get agencies to a self-financing position for there to be much hope of moving beyond this position in the near future (Vars, 1976).

As one step toward greater financial flexibility, a super-agency charged with providing all services may perhaps be better than separate agencies for each service: although the question of an overall budget transfer remains open, the multi-functioned agency can much more readily transfer funds among services, e.g., taxing telephone users to subsidize lower-income water consumers (Linn, 1976b). While what happens depends of course on the precise internal rules applied, cross-subsidization of this sort can be designed to be from the rich to the poor, while there is a good deal of evidence to suggest that subsidization to utilities out of general revenues is more likely to benefit the rich than the poor (Koenigsberger, 1972; Bird, 1976).
In principle public utilities clearly occupy an important place in the public finances of the developing countries, particularly local public finances. But precisely what that place should be in practice remains a question for careful, detailed study in each instance. Broadly, the case for organizational autonomy is strongest when a high premium is put on goal effectiveness or the provision of services, since goals can most effectively be achieved when an organization is given a simple specific task, control over its own revenues, and is not subject to direct political control and consultation. When goal articulation or coordination (that is, the management of conflict) has a higher value, a more explicitly political organization is required (Self, 1972). The choice of form itself, however, inevitably reflects the political rather than the market environment. To go beyond this sort of general statement one must consider the specifics of the real world, for these abstractions only come alive when applied to actual situations.

B. Direct Controls

Central governments customarily exercise a great deal of detailed control over subnational governments in developing countries directly, through administrative rules and regulations, and indirectly, through financial operations of various sorts, such as transfers or direct central expenditures. In contrast to
the situation, in most developed countries, the more important controls in developing countries are direct in nature, as one might expect in view of the general political scenario sketched earlier.

One of the most important ways in which central governments control subnational governments is through appointing the chief executive officer of the subnational administration and, in some cases, appointing (at least approving) all senior officials. Many local government officials thus bear a two-way responsibility: up to their masters and down to their (so to speak) subjects. The same is true of central government appointments to the boards of autonomous agencies, although these officials are usually given a good deal more discretion, for reasons discussed above.

Even where central governments do not appoint or directly control the appointment of local officials, they generally determine their quality. Apart from centralizing all the significant decisions and thus attracting capable officials to the center for this reason, they do this through such means as setting local salary scales, as in the Philippines, Kenya and Indonesia, for example. Indeed, among the reasons why autonomous agencies are generally more successful in administration than local governments -- success being determined by some technical criterion -- one must surely include the facts that agencies can pay higher, more competitive, and attractive salaries. They are also less hampered by central government interference on staffing. In general, as noted earlier, agencies have more authority, less responsibility (in a political sense), and better human material to work with. It should not therefore be surprising that they "do" more, though, as argued above, whether
they do the right thing or not is another question.

Much the same remarks can be made about the accounting and budgetary systems which are imposed on local governments in most countries. Local plans and budgets are generally subject to central government approval, sometimes in detail but more often in total. The nature of this control has generally been quite restrictive in both intent and effect, despite the usually poor quality of intergovernmental information flows (in both directions). Even if a local administration were somehow able to overcome its inherent problems (plus the handicaps imposed on it by central policies) to come up with some new idea, the chances are strong that the central government will turn it down as part of, say, a general policy of forbidding costly local innovations.
On the surface, the purpose of most financial and budgetary controls appears to be to improve information transmission and hence management. In practice, however, the budgetary and accounting controls in many countries obscure rather than improve information, and their principal effect appears to be to prevent local governments from doing anything the central government does not explicitly want them to do. Even if a local administration were somehow able to overcome its inherent problems (plus the handicaps imposed on it by central policies) to come up with some new idea, the chances are strong that the central government would turn it down as part of, say, a general policy of forbidding costly local innovations.

The mere existence of a powerful central government means in practice that all significant local measures are cleared with the central government first. In Kenya, for example, budgets are subject to approval by the Ministry of Local Government, as is each separate investment project and the source of finance for all loans. This Ministry also controls staff salaries, promotions, and other personnel matters and exerts detailed control over such municipal functions as awarding contracts. In general, local governments in Kenya can do only what they are specifically authorized by national statutes to do, and even then they must usually
receive administrative approval. The result of this is obviously a very limited and cumbersome process of local government. Similar systems exist in most other developing countries. 1/

Sometimes control is implemented through intermediate levels of government. In India, for example, there are no direct central-local relations, and municipalities are highly dependent on state governments in both law and fact (Bahl, 1975). Municipal financial resources are severely limited by state law, and most municipalities require state approval, so that, for instance, it may take 2 to 3 years to implement a simple municipal sewer project (Bhattacharya, 1970). This essentially negative state role toward municipal action has in some areas significantly exacerbated the tremendous strain placed on municipal administrations by bur-

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1/ For example, in Thailand, too, central government control is particularly tight because of the heavy dependence of local governments, which have few independent tax sources, on central transfers. Much of the rest of local revenue comes from surcharges on national taxes or tax sharing arrangements. The various central controls have been said to be so hampering as to render local planning impossible, even if the locality had the desire or the capability of planning. Strict limits on local expenditures and revenue structures are found in Zambia (Saunders, 1974). In Jamaica too the dependence of local governments on the central government is very marked: not only is local government authority and functioning narrowly circumscribed by central regulation, but it is also subject to alteration at any time. The position is perhaps more extreme than in other developing countries because of the small size of the island, the lack of any tradition of local community action, and the politicized nature of local government under centralized political parties. The central government restricts tax powers, sets tax rates, doles out grants, approves all borrowing, audits, imposes uniform procedures, approves all regulations, approves budgets, approves key staff appointments, and so on. In essence, local government in Jamaica is no more than an administrative arm of the central government. In contrast, in Colombia there is no effective central (or departmental) control over local plans and budgets.
geoning urban populations. The variations within India, however, are reputedly very great. Although within any particular state the rules tend to be applied uniformly, the rules applied by different state departments may vary widely (Bhattacharyya, 1972).

Besides attempting to control accounting and expenditure procedures, central governments affect local government expenditure patterns in numerous other ways, determining not only the level of services which must be provided by local governments, but also in some instances the methods which must be used to provide them. Local governments can also be forced or induced to spend on certain items rather than others if, for instance, the central government builds schools or hospitals which the local government is then charged with operating.

Although autonomous agencies operating primarily at the urban level are generally less subject to direct central government control, even when they are in fact agencies of the central rather than the local government, they are by no means free of such control. The rate structures even of entities that are self-financing are usually subject to central government intervention or approval. In Colombia, for example, the rates charged for their services by the municipal utilities are controlled by the central government: changes in either the rates or the base (property values, to some extent) need formal approval before they can be implemented. Finally, in some instances the decisions of autonomous agencies regarding the provision of services are heavily subjected to central influence through, for example, planning agency decisions.
Whether autonomous agencies engaged primarily in the provision of urban public services are in effect taxing bodies or whether they are subsidized by other governmental bodies is thus ultimately a central government decision, whether that decision is conscious and open or whether it is the result of a series of partial decisions on different policy issues at different levels. Given the difficulty of determining what the net fiscal flows among government and quasi-government units are in most developing countries, it appears that the second of these alternatives may be a more accurate general description of reality.

Controls by central government over the raising of capital by subnational units of government and autonomous agencies are common. These controls may take the form of limits on the amounts or the kind of borrowing permitted, or they may take the form of a requirement that the central authorities approve all borrowing. In some instances, the principal source from which subnational governments can borrow may be (de jure or de facto) the central government itself, through some sort of loan fund, either a general municipal loan fund or specialized funds for, say, particular types of public works (Bhattacharya, 1970). In an exchange-short developing country it is of course reasonable that there be tight control by the National Planning office over external borrowing by public authorities at all levels. The rationale for the present degree of control over internal borrowing by local authorities in many countries is by no means so clear, however.
In Colombia, for example, borrowing over 1 million pesos (less than US$35,000) as a rule needs approval by several agencies of the central government, including the National Planning Department (for loans over 5 million pesos only), the Ministry of Finance, and, in most cases, the Bank of the Republic, 1/ almost regardless of the purpose or duration of the loan. Since every subnational government entity in Colombia has significant cash management problems owing to the irregularity and unreliability of receipts (including transfers and payments of bills by other levels of government), and since the only way most of them manage is by borrowing from local banks, most large local authorities are continuously engaged in securing the necessary approvals. Since it has been estimated that credit applications in Colombia must go to over a hundred officials for approval (some of them several times), it is not surprising that it reportedly takes a year or so on average for a municipality to be authorized to borrow, say, $50,000. It is clear that this system is not conducive to efficient local fiscal management.

Local revenues, whether taxes or intergovernmental transfers, arrive at discrete, and sometimes irregular, intervals, while expenditures (e.g. salaries) must generally be paid out in a continuous stream. The result is often significant financial embarrassment even for those governments which are basically in a position of fiscal balance. To overcome these difficulties, some localities (like Nairobi) have been able to use cash surpluses from their public

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1/ Formal approval is required for internal credits exceeding 1 million pesos or over 1 year in duration. It is apparently not unknown for borrowers to divide a loan into several smaller loans in order to avoid the registration procedure.
utility operations, paying interest, while others (like Cali) have had to make special arrangements with local commercial banks. Whether or not a general municipal loan facility is created, it would appear that cash management needs to be closely studied in most countries and that a case can often be made for some sort of short-term municipal credit facility to avoid such needless difficulties.

C. Taxation

Important as are the various direct controls discussed above, considerably more attention is paid in the economic literature to taxes and transfers, the principal forms of local government revenues in most countries (e.g. Hicks, 1976). Indeed, many studies of intergovernmental fiscal relations ignore everything dealt with in this paper up to this point and focus solely on the design of tax and transfer systems. Rather than review this extensive discussion here, we shall simply consider a few points related to the general thrust of the present paper, treating alternative forms of tax and transfer arrangements as potential instruments to achieve various possible policy goals.

At first sight, for instance, it always seems rather odd to outside observers that the large cities of all developing countries appear to have so much difficulty in financing the urban public services demanded by their rapidly expanding populations. After all, if the richest areas in these countries cannot finance their own needs, who can? Matters are not so simple, however. In the first place, for many reasons mentioned earlier, the management of these cities customarily leaves a great deal to be desired. More relevant to the

1/ In this connection it must of course be remembered that the problems facing these cities are of such a magnitude and complexity that no one in any country could be expected to handle them without an enormous amount of difficulty, if at all (Bird 1977).
The present story, however, is the extent to which urban management is crippled owing to the constraints imposed by higher-level authorities. It is in part for this reason that cities often do not take full advantage of all the revenue sources in principle available to them. Indeed, there are many examples where cities have tried to exercise their putative powers to the full, but either these powers were promptly reduced or some other compensating action was taken by higher governments to keep the urban authorities in the desired client status.

There is in most developing countries a truly formidable list of restraints on the taxing powers of local authorities. The

1/ The Philippine experience cited earlier affords an instance of this process. Similarly, in Indonesia, when Jakarta developed the fuel tax as a lucrative source of local revenue, it was taken over by the national government and replaced by an inelastic grant. The apparent reason for this action was central fear that other regions would also do well from this tax and hence become strong enough to threaten national unity (Linn et al., 1976).
most important is often their limitation to relatively few tax sources. In Colombia, for example, local governments are precluded by law from taxing any base—income, sales, net wealth, etc.—already taxed by the nation. Given the spending pressure due to urban growth, these limits in effect dictate the nature of the urban revenue structure. In almost all cases this structure keeps municipalities in a continual financial bind.

Not only are the taxes which cities can levy decreed from above; often the rates at which they are imposed are also specified in the law. Even if the rates are not set—occasionally with some variation according to the size of the city as in Colombia and the Philippines—the central government usually retains for itself the power to approve, or disapprove, all changes in local tax rates, at least for the more important taxes. 1/ The North American system, in which municipalities determine their own property tax rates, is apparently followed nowhere in the developing world.

Access by urban area governments to the most productive tax sources is commonly denied or severely restricted. Even when it is permitted, it is almost invariably in the form of limited local piggybacking on national sales or, less commonly, income taxes. Though local tax supplements of this sort confer no great indepen-

1/ As noted earlier, the same is true of nontax revenues—sometimes to the point where bus fares in the capital city are set by the President directly!
idence on local governments, those which can use them are viewed with envy by many in other countries which cannot. 1/

Sometimes local governments are legally permitted to tap certain revenue sources but are pre-empted (or feel they are pre-empted) from so doing because taxes are already levied on these items by the central government. Motor vehicle taxes in countries with very high tariffs may sometimes provide an example. Local governments are also generally prevented from taxing the activities of other levels of government. This latter is a serious problem with the property tax in some capital cities, particularly when, as is not uncommon, all state enterprises are also exempted from paying local taxes.

In principle, higher-level governments sometimes make payments in lieu of taxes to lower-level governments (as in Kenya), although non-payment and arrears are reportedly not uncommon, as is to be expected when no enforcement is possible and other claims

1/ Piggybacking is one form of "tax overlapping", by which is meant the existence of taxes on the same bases levied by different levels of government. Despite the attention paid to it—and the effort to avoid such "duplication"—tax overlapping is not in fact a very serious concern in most developing countries. National government treatment of local government taxes, however, is a real issue in many countries. If, for example, all or most local government taxes are deductible from income for purposes of computing the national income tax, the net progressivity of the local fiscal structure is different from what one might at first think. Similarly, if some sources of local revenue are deductible and others (user charges or special assessments, for instance) are not, the local tax structure may be affected for this reason. (Credits for local taxes against national taxes are almost unknown in developing countries.)
on resources are pressing. Sometimes, higher-level governments (or government enterprises) do not pay taxes even when they are liable to them. 1/ In other instances, some local government inputs are exempted from national taxes. Though few, if any, countries, appear to exempt wage payments by local governments from income tax, many exempt interest on bonds, presumably including local government bonds, if any.

In many countries the central government influences not only the structure and level of local taxes but also the administration of these taxes. This influence may range from the general controls over local government administration, mentioned earlier, to direct administration, either in the form of tax supplements on national taxes, or through administering locally-established taxes.

In the case of the Colombian municipal property tax, for example, the national government establishes both the tax base and, in effect, the tax rates--or at least that portion of the tax rates which yields some revenue for the municipal budget. The property tax is levied on assessed values established by the local office of the National Geographic Institute. The fiscal problem for Colombian cities has at times clearly been exacerbated in the past by the Institute's tendency to follow its own desires as to what should

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1/ Often, too, governments at all levels do not pay for the services received from municipal utilities, or if they do, they pay after considerable delay.
be assessed and when (Bird, 1970b). Centralizing a function may improve the technical proficiency with which it is carried out, but it very often also reduces the degree of responsiveness to local conditions and needs. Even when central intervention does not go as far as in this case, the extent of cooperation between local and central tax authorities, and the extent of technical assistance, training, and so on offered by the central government, can be important determinants of the outcome of the local taxing process.

Other means of controlling local tax administration include determining the penalty structure, limiting the enforcement practices which may be employed by local government, and failing to provide adequate appeal facilities. The benefits derived by local units from the taxing powers granted them may also be limited, for example by requiring that revenues from particular sources be spent on particular activities (e.g. motor vehicle taxes for road expenditures, or lottery revenues for welfare).

In Colombia, a 10 percent amusement tax ceded to the municipalities a few years ago by the nation is not earmarked, but 25 percent of the 14 percent municipal amusement tax itself is, for some reason, earmarked for the "Cultural Fund", with 75 percent of this amount to be spent on school construction. Similarly, all proceeds from vehicle taxes, the rates of which are established by national law, are also earmarked for the collection agency, the Transit Fund, which uses them principally to pay for traffic control services. Through devices such as these the central government of
Colombia's (unusual) lack of direct control over municipal expenditures appears to be more than offset by its extensive set of controls over local revenues, including denial of the authority to tax (where the base is already used by national government), restriction of rates (property tax), determination of the tax base (property tax), and approval (user charges and borrowing).

In many large urban areas in developing countries the revenue situation may be summarized as follows: if a city has a significant source of revenue largely under its own control, this is likely to be the real property tax, supplemented by a variety of business licenses, fees, and so on, none of which is usually designed or imposed with much logic. When local governments have any access at all to income and sales taxes, this is usually through piggybacking or, most commonly, tax sharing (see below). Cities are normally precluded from taxing either income or sales directly. There appear to be no hidden golden tax eggs city governments in developing countries can gather, and hence their dependence on intergovernmental fiscal transfers seems more likely to increase than to decrease in the future.
D. Intergovernmental Fiscal Transfers

The principal economic reasons for intergovernmental fiscal transfers have all been mentioned earlier. One, rooted in some version of the "aggregation" model, points to unconditional transfers, basically on redistributive or "regional balance" grounds. A second argument suggests conditional grants, to ensure that local governments (assumed to possess some independent decision-making authority) provide the "right" amount of public services, taking into account spillover effects as well as, in most cases, the presumed superior correctness of central to local government wishes. Another possible rationale mentioned was that central governments may often be more efficient tax collectors--a "devolutionist" notion in most cases, but one often accompanied by relatively unconditional sharing of the tax proceeds (see below).

While a good deal more could of course be said about each of these points, two characteristics of all intergovernmental transfers in developing countries deserve more emphasis than they seem to have received to date. The first is that, no matter what the stated rationale for such a transfer, its amount and distribution is always a matter of political bargaining. At the extreme, indeed,
the desired transfer pattern is determined and then some rule or formula is thought up which will yield this result. 1/ The second characteristic is that the government receiving the transfer is therefore in a real sense at the mercy of the higher level government.

When combined with the usual difficult position of the national fisc, the fragility of national power is sufficient to explain why fiscal transfers to sub-national governments in most developing countries are both less important and less easily understood in terms of explicit criteria than those in developed countries. This also explains why, even in those countries in which there are explicit bases for such transfers, they are seldom in fact made in the way or at the time the law prescribes. It is little exaggeration, in fact, to say that fiscal transfers in many developing countries probably constitute one of the least reliable sources of local revenues. In these circumstances, one must look with some skepticism at all schemes for more and better

1/ Even when there are explicit grant formulas, there is often political bargaining about grants (e.g. in Indonesia, Linn et al. 1976). In Colombia, where there is also an explicit formula, there is nevertheless some evidence that the actual allocations received can and do deviate from the formula amount.
fiscal transfers as a cure for the problems besetting urban fiscal systems in developing countries. The remainder of this section expands these points.

Intergovernmental fiscal transfers in developing countries commonly take one of two forms of revenue sharing. The first, which may be called the derivation variety, consists of returning the revenues whence they originated and in essence amounts to central administration of a local levy at a set percentage of national taxes on a particular basis. 1/ The main problem with this approach is usually thought to be that it favors unduly the more prosperous parts of the country where most of the shared tax revenues originate. Since, however, the most pressing fiscal needs in developing countries are often in just these areas, where rapidly growing cities are located, this may be less of a defect than is often alleged.

The other variety of tax sharing is a form of tax aid, or a grant the amount of which is determined by the national collection from certain taxes but the distribution of which is determined according to a formula. Most of the formulas employed have no obvious logical basis, though population tends to play a prominent role, thus channelling more funds to urban than to rural areas. There generally appears to be no logical reason why the amount of the total to be distributed should be governed by the collections of the particular tax or taxes selected for sharing.

1/ While in principle the percentage could be varied, it is usually fixed in practice for at least some years. In the extreme, all the proceeds of the tax may be paid to the local authorities.
Many tax sharing arrangements thus amount to little more than poor grant systems: local governments have no real influence over what they get (or when they get it); they cannot affect the rates of the taxes collected "for" them; and the central government in many cases has devoted no apparent thought to the appropriate distribution basis. In Thailand, for example, shared taxes are sometimes allocated on the basis of source and sometimes in equal shares, neither of which makes much sense. It would seem better in such cases to treat the shared tax as a grant and to develop a simple sensible granting formula, such as that suggested in a recent study for Colombia (Musgrave, 1971).

Many of these points may be illustrated by again considering briefly Colombian experience. In Colombia, the most important form of fiscal relations between the different levels of general government is tax sharing. There are national taxes shared with departments and with municipalities, departmental taxes shared with municipalities, and even municipal taxes shared with the national government or its agencies.

The major explicit intergovernmental fiscal transfer in Colombia is the situado fiscal (or "tax allowance"). There are several interesting features about this transfer payment, which was first established in 1971 at the same time as the departments (states) were charged with the provision of public health and
primary education. The total amount to be transferred is 15 percent of the "current revenues" received by the national government net of the amounts turned over to the subnational governments in other tax sharing arrangements. 1/

Once this amount has been established, it is then divided as follows: 30 percent of the total is distributed in equal shares to all departments, national territories, and the Special District (of Bogota); and the other 70 percent is divided in accordance with population. 2/ The rigidity of this distribution formula is perhaps its most notable characteristic: it is presumably intended to act as a defence against regional and political struggles for more transfers, although its efficacy for this purpose is open to doubt.

Once the amount to go to a particular department has been determined, 80 percent of it is paid to the Regional Education Fund and the remaining 20 percent to the Sectional Health Service (see Part II above). 3/ Though health and education are indeed the activities

1/ The percentage was 13% in 1973 and 14% in 1974. In addition, Law 46 of 1971 provided that if the ordinary revenue of the national government rose more than 15% above the average of the last three years, this share could be raised by 2 percentage points, up to a maximum of 25%.

2/ The population figures used in this calculation pertain by law to the last census approved by Congress, which is still the 1964 Census. Those areas which have grown rapidly over the last decade therefore receive less per head under this formula than one might at first expect.

3/ These percentages may apparently be varied in accordance with the wishes of the central government. They were presumably set initially so that the tax allocation would accord with the expenditure "need" in the two fields.
that press most heavily on its finances, none of this grant is at the free disposal of the department—or even passes through the departmental budget. ¹/

To sum up, the situado fiscal is important in that it affords the subnational governments some access to the much more elastic national revenue base. The benefit received by relatively prosperous and fast-growing departments like those which contain the major cities is lessened, however, by the distribution formula which both favors sparsely-settled regions and is based on 1964 census data. ²/ Furthermore, all of the funds are earmarked for particular services which are nominally under departmental control but in reality are primarily directed from, and responsible to, the center. Despite the introduction of the situado fiscal, departmental finances continue to be in as difficult a situation as ever. A very similar conclusion can be reached with respect to the other major tax sharing, that of the sales tax. Thirty percent of sales tax collections—about 10 percent of central government revenue—is redirected to the subnational governments: 26.4% of this amount

１/ On the other hand, as the grant is earmarked for the two activities which press most heavily on the finances of the department in any case, the constraint exerted by this explicit designation of revenues is perhaps somewhat less than it seems.

２/ The bias in favor of the poorer areas is of course quite conscious, and would presumably be applauded by the Musgrave Commission (1971) and many other observers. In the present context, however, the result is that the chances for Colombia's better-off areas to stand on their own feet is somewhat reduced by their lack of direct access to lucrative revenue sources -- without, it may be suggested, much relief being afforded to the more backward parts of the country, which need not just money but a viable administrative structure in order for more money to do any good: see Bird, 1970b, chapter 5.
to the departments (supposedly their pension funds) and the balance to the municipalities, again on the basis of population. For both municipalities and departments, their share in the national sales tax is in fact the major unconditional intergovernmental fiscal transfer. 1/

The Colombian maze of tax sharing arrangements may be more complicated than that in some other countries, but some features seem not uncommon. There are instances of apparently

1/ There have been some delays and problems in making these transfers, owing largely to various legal and accounting requirements. It should perhaps be emphasized that delays in inter-governmental transfers arise in Colombia with regard to cash flows and cash management and not budgetary preparation. While all levels of government are on the same fiscal year (equal to the calendar year) basis, the lower levels do not prepare their budgets until after the draft budgets for the higher levels have been prepared. They are therefore able to include official estimates of transfers in their budget receipts.

In some other countries (e.g. Kenya) local budgeting is made unnecessarily complex because national grants and expenditures are not clearly known in advance. The same phenomenon has been noted in Jamaica, where the central budget cycle is such that local governments are not informed of what national grants they can expect. Similarly, when responsibility for assessment and collection of taxes is shared, as in the case of the property tax in Jakarta, there are often so many delays and lags in the transfer of revenues to local government that expenditure forecasting is made unduly hard.
irrational division of revenues and nonpayment of legally obligated intergovernmental transfers in other developing countries. In almost all, tax sharing arrangements appear to be the outcome of \textit{ad hoc} responses to passing problems, rather than of rational division of taxing and spending responsibilities on economic or administrative grounds.

The situation is little better in the case of outright intergovernmental grants. It was noted earlier that grants intended to induce local governments to allow for spillover effects in the provision of urban public services would be of the conditional type, which means made for a specific purpose, and requiring a matching contribution from the recipient government. Very few grants in developing countries require such matching. The most common variety of matching in these countries is probably implicit, in the sense that the central government will finance a capital project, whose operating costs must then be met by the local government. \footnote{The effect of central transfers on local expenditure patterns depends on specific circumstances and is not discussed further here. See the comment on Kee (1975) in Part II above, and, for a summary of much of the relevant literature, Bird and Slack (1977, Appendix E).}

There are relatively few \textit{general} intergovernmental grant programs in developing countries, apart from the tax sharing already mentioned. Where such programs exist, they are usually limited and characterized by a lack of clear allocation criteria, as one might
expect in view of the inherently highly political nature of such grants in all countries. Apart from the common use of population as a criterion—perhaps as some sort of crude measure of need—the structure of grant programs in developing countries rarely indicates whether their principal objective is equalization of recipients in some sense, the provision of minimum services, or to give some sort of incentive (for example to local tax effort) or reward.

One of the more complex granting formulas is in the Republic of Korea, where local governments receive a percentage of national tax, distributed on a "needs" basis (Bahl and Wasylenko, 1976). Formula grants for specific services such as education are also found in India. In many instances, national grants reflect expedient solutions to political crises rather than well-worked out schemes. Some intergovernmental transfers seem inevitable owing to such factors as externalities, tax competition among subnational units, regional disparities, and the limited revenue and administrative resources at all levels of government, especially at the lower levels, where expenditure needs are almost certain to rise more quickly than revenues. What is needed in most countries, however, is a clearer formulation of the objectives that are supposed to be achieved by grants and the criteria to be applied in designing them. For example, the absence of provisions for matching is striking, as is the lack of any clear analysis of fiscal potential or capacity or effort indexes (Smith and Smith, 1971). In short, grants in developing countries are

1/ For one of the very few econometric analyses of grants in a developing country see Bahl and Pillai (1976), on India.
usually in practice (a) discretionary and (b) uncertain. As one would expect, both characteristics significantly affect the role grants play in local government finance.

One reason why few explicit grant formulae exist in developing countries is perhaps the political situation which makes it dangerous for central governments to be explicit in such matters. Another may be the general lack of the information that would be required to design and implement such formulae, a lack which can also be attributed to political factors.

In any case, it would appear to be quite unrealistic to put much faith in either the willingness or the ability of the central governments in most developing countries to design and implement a regular explicit program of intergovernmental grants incorporating any of the more common devices discussed in this connection in the theoretical literature. The most that might be expected is the sort of crude formula transfer related to tax sharing which in fact exists already in several countries--and even this is likely to look better on paper than it does in practice.

For these reasons, much of the discussion in the usual treatment of intergovernmental finance in developing countries (e.g. Hicks, 1976) has an air of unreality about it. What appears to be assumed in such proposals for general grants with relatively elaborate formulas is (1) a clear perception of objectives (usually
with the explicit or implicit premise that the relevant objectives are centrally determined), (2) a competent administration with no "independent" political aims to be achieved through grants, which not only knows what it wants but also knows how to get it, and will do so. Given these conditions it is no difficult task for any competent economist to set up an appropriate grant system, but the thrust of the present argument is that these conditions simply do not exist in most countries and that recommendations based on the assumption that they do may lead to quite unexpected results.

E. A Policy Matrix 1/

Many of the arguments presented in the preceding paragraphs may be summarized in a policy matrix (Table 5). The purpose of this matrix is to relate policy instruments to objectives and in doing so to establish the contrast between the desired (or stated) impact of an instrument--reflected by the + and - signs without brackets-- and the actual (or likely) impact--reflected by the signs in brackets. The matrix also allows the distinction between the objectives of the "devolution" approach (D) to intergovernmental relations on the one hand, and those of the "aggregation" approach (A) on the other (see Chapter II above).

1/ The following paragraphs were contributed by Johannes Linn.
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<th>Economic Efficiency (A)</th>
<th>Equity (Commun.)</th>
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<th>Local Accountability (A)</th>
<th>Local Effectiveness (A)</th>
<th>National Unity (A)</th>
<th>Provision of Merit Goods (A)</th>
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Legend: + positive, - negative, 1 unknown. Impact on policy objective: signs in parentheses indicate likely actual impact of instrument; signs without parentheses indicate desired or expected impact.
The matrix as shown in Table 5 is quite tentative, not only in the sense that there are a lot of question marks shown, but, also in the sense that the + and - signs as shown may not be universally applicable in all countries or cities at all times. One of the central points of the analysis in this paper has been to emphasize the need to allow for the particular circumstances of a country's or city's historical, political and institutional setting. The policy matrix must therefore be checked and refined in the light of these particular conditions before using it in any specific policy context.

However, even in its tentative form the matrix shown in Table 5 permits a number of important conclusions. First, the complexity of goals and the likelihood of goal conflicts in the application of instruments is amply demonstrated, although some of these conflicts can be seen to result from the common failure to distinguish between the devolution and the aggregationist approaches. Second, many instruments may not have the stated or desired impact on particular goals, and they may have impacts on other goals which are not explicitly considered. Finally, virtually all instruments considered in this chapter (with the exception of most transfers) tend to reduce local autonomy while increasing goal effectiveness. Given the prevalence of the devolutionist approach to inter-governmental fiscal relations among most national government decision makers in developing countries, and the aggregationist
bias of most foreign advisors, it comes as no surprise that the latter usually propose fiscal reforms to increase local autonomy through the appropriate use of the policy instruments shown in Table 5, while in fact most governments are primarily interested in increasing goal effectiveness and therefore apply the instruments in exactly the opposite direction.
V. CONCLUSION

It is difficult to summarize this survey of intergovernmental relations in developing countries partly because of the wide-ranging nature of the discussion. Nevertheless, two simple but important conclusions emerge with some force. First, in virtually all countries there is almost no room for independent local fiscal action. Second, it is extremely difficult in most countries to determine with much precision the nature of central government policy towards local government finance, and it is even more difficult to determine exactly how that policy is carried out.

In every country examined the organizational structures charged with the delivery of urban public services are amazingly complex. Three aspects of this complexity deserve special mention. First, there is in every country inadequate information on the system of intergovernmental relations. Often it is difficult even to identify the relevant laws and regulations, let alone to get a clear picture of what they mean or whether and how they are implemented. It is much harder to obtain a reliable set of numbers on the fiscal flows among governments and quasi-governmental organizations. Second, it appears that in almost every country the lines of authority and responsibility as they affect the provision of urban public services are blurred and confused. In some instances, it is clear that those agencies that are responsible for doing certain things
do not in fact have the authority to do them. Third, the complexity of the administrative structure is usually matched by its inadequacy. Despite the fog of statistical and political obscurity in which intergovernmental relations are customarily shrouded, it seems fair to say that the overall situation is that indicated in the first conclusion above—that the system is generally highly centralized, at least in intent, even if all the rhetoric is to the contrary. These sweeping general statements must of course be modified immediately to take into account individual peculiarities of history, style and design in particular countries.

This preliminary survey suggests, however, that the most important need in analyzing the intergovernmental fiscal relations in any particular developing country is a clear understanding of the political environment and, in particular, the relative importance attached to goal effectiveness versus goal coordination—that is, the provision of services versus the management of conflict. One must also determine whether the pluralist (aggregation) or the unitary (devolution) model best characterizes the aspirations and behavior of the rulers: usually, it has been suggested here, it will be the latter. Finally, in making policy recommendations, one must determine how far he is prepared to accept this framework or to what extent he is prepared to impose his own framework—and to estimate the probable effectiveness of policy recommendations based on different frameworks.
All these matters are important, but their relative importance will vary with circumstances and tastes (and with whose circumstances and tastes are taken into account, and by whom). In no case does economic or political theory offer a very sure guide to how best to achieve these multidimensioned goals—except to indicate that the best way probably varies from case to case. Finally, it is always very hard to assess how far the various goals are in fact being achieved, or, even harder, how much has to be given up of one objective to achieve a given amount (or quality) of another—a tradeoff which will certainly vary with time, place, and circumstances.

In short, the importance to be attached to different objectives of policy (possible or actual); the methods of achieving them; and the success with which they are achieved, and at what cost, are all in a fundamental sense unknowns. Much the same could be said about most areas of concern to social science. The point of mentioning all this here is simply to emphasize what seems so often to be neglected: that one cannot evaluate what is going on without a set of norms or standards and also, a point which is even less often noted, that no general validity can be attributed to the set of standards that happens to be held by any particular analyst (usually implicitly and usually as a result of his perceptions of his own society). 1/

1/ As it is this assertion that aroused the most adverse reaction among reviewers of earlier drafts of this paper, the reader is again referred to the more detailed arguments on the welfare methodology of policy recommendations in Head (1974) and Bird (1970c).
The diversity of human experience in this as in other fields cannot be understood unless one grasps that there are many objectives which conflicting political actors are striving after in many different contexts. The resulting variety of institutional forms can be appraised in either a relativistic or absolutist fashion: for clarity, however, the standards employed must be stated explicitly. Economists are well advised to recognize that the design of governments is preeminently a political calculus, and that economists' usual concerns simply constitute one part of the whole. The thoroughgoing centralists who appear to be so common among planners will be well advised to recognize how they have oversimplified the problem by simply assuming that they (or "the leader") know all the relevant goals in detail, and that they therefore need not ruminate on such vague and woolly matters as have just been discussed.

Within such a general political economy framework, once established, the central question of the optimal assignment of expenditure responsibilities and revenue sources can then be approached. As noted earlier, the pluralist model accepted by most western economists suggests a complex and at least superficially overlapping set of governmental institutions and cross-transfers is optimal in an allocative sense (interpreting allocation broadly to encompass both merit goods and redistribution). 1/ Though the complex systems in

1/ Sproule-Jones (1975) provides a particularly clear example of the different conclusions which emerge from the thoroughgoing individualistic approach of public choice theory: his criticism of the existing governmental structures of Canada and Australia is that they are inadequately complex, in contrast to the opposite criticism more often heard in these as in other countries (e.g. in several of the Bank studies cited in this paper).
most developing countries appear superficially to match these specifications, there is no reason to think that they bear any but a coincidental relationship to that which would be optimal in terms of economic reasoning. In fact, the fuzziness and lack of information that characterizes intergovernmental relations in most developing countries is precisely the opposite of what is needed. 1/ There is little room in optimality analysis for that ambiguity beloved of politicians. It should be recalled, however, that the broad political scenario of central-local relations sketched above would lead one to expect that a good deal of confusion and uncertainty, and, above all, obscurity would be very useful so far as most central bureaucrats and politicians are concerned. It should therefore be no surprise that this is precisely what one finds.

If, on the other hand, the aggregation model is rejected in favor of the devolution model, much more stress may be placed by the analyst on cleaning up the tax jungle, on rationalizing (by which is usually meant centralizing) the provision of services, and so on. Even a brief survey of the literature shows that this is the more characteristic approach. Few analysts seem willing to accept the prevailing complexity and confusion as, in effect, precisely a way of implementing central control while minimizing serious political conflict through dissipation and ambiguity. (There is also, of course, a serious question in many countries as to who gains and who loses through minimizing conflict!)

1/ On the other hand, it is quite understandable, in view of the characteristically high turnover of officials, the lack of resources and interest in "cleaning up" the situation, and the pervasive belief that the creation of new agencies offers a way out.
In any case, whatever the model followed and whatever the particular set of institutional arrangements--horizontal or vertical, national or local, autonomous or dependent, private or public--determined to best satisfy its requirements, another important finding of this preliminary survey, namely, the need for flexibility, must always be kept in mind.

The need for flexibility and frequent review of intergovernmental relations is commonly recognized in the theoretical literature on formal political federations (Wheare, 1964), but applies far more broadly. The growth of population, of price levels, and of real incomes exerts pressure on intergovernmental relations, as of course do the various political factors mentioned earlier. Any set of institutional arrangements optimal at one point in time, in terms of any model or interpretation of the prevailing situation, is thus unlikely to remain so for long. How the constitution gets changed is therefore an extremely important question, though not one which can be explored in detail here (Breton and Scott, 1978).

Perhaps most interesting is the question of how far these changes should be institutionalized. In general, only in formally federal countries--where by definition the pluralist tendency is strongest--are there formal and regular procedures for reviewing intergovernmental relations. In most developing countries it is the central government that determines, usually in many hidden and indirect ways, how the intergovernmental structure adapts over time.

One possible aim for outside analysts interested in these problems might be to try to get such reviews on a more institutional-
lized and regular basis, for example through the establishment of permanent bodies for reviewing local government and intergovernmental grant programs. The interest of the analyst is to make as clear and explicit as possible the criteria by which decisions are made and the results of those decisions. Otherwise, we shall continue to be in the position of suggesting changes in a system we do not understand and whose effects and mechanisms are largely a closed box to us.

In Colombia, where it appears that the desired (acceptable) degree of local autonomy is low indeed, the most realistic course for reforming intergovernmental relations might be to introduce a more explicit and coordinated centralization than now exists, for example by abolishing the departments except perhaps as administrative regions and fully accepting central responsibility for such services as health and education (e.g. Kalnins, 1974).

The starting point for a less centralist path is probably a reformed property tax, more sensitive to local fiscal needs (which probably means with some local control over rates). A national grant system along the "foundation" lines familiar in North America, and including incentives for tax effort, should also be designed and implemented; it would be no more difficult to understand or work than the present hodge-podge system of shared taxes and could be both distributionally and administratively more satisfactory.

Finally, if a still more decentralized path is chosen (or is to be recommended by an analyst of the aggregationist persuasion), some way of creating an effective training and retention system in
subnational civil service—other than by creating still more "autonomous" entities—will clearly have to be found, remote though this prospect is from achievement at even the national level. Less idealistic perhaps, but equally difficult, is the need substantially to simplify the present system of financial administration and control in such matters as credit and intergovernmental payments.

In practice, what seems most likely is that the centralist path will continue to be followed, though given Colombia's political traditions it is unlikely this can be done very openly. Instead, a continuation of the process of "secret centralization", in which subnational functions are in effect taken over not by the central government but by some national decentralized agency, seems the most likely prospect for the future, as it has been one of the most striking manifestations in the past.

A full exploration of even the Colombian case would require a far more careful analysis than is possible here. The point to be emphasized for present purposes is, again, the need to be clear precisely what we are talking about when we deal with intergovernmental fiscal relations—and the particular position from which we are talking. The principal objective of this paper has not been to provide a detailed map of this complex area for any one country but simply to sketch a sort of perspective of map-making—and to indicate why such a perspective seems needed. In this as in so many other areas of policy analysis, the problem is not that we do not know much (though that too is true) but that so much that we think we know is, if not wrong, then misleadingly clear. This paper will have succeeded if it obscures some false clarities.
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