



# Policy Insights No. 5

## Decentralisation and Poverty Reduction

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Decentralisation has become a key issue in development policy in the past two decades. Whereas the advantages and risks of transferring power and resources to local tiers of government have been debated for quite some time, it is only very recently that the linkages between decentralisation and poverty reduction have been addressed. This *Policy Insight* highlights key determinants for a pro-poor decentralisation process and discusses major lessons learnt for donors.

### Introduction

Progress towards achieving the Millennium Development Goals (MDGs) is slow and alongside the question of increasing aid money, the development of pro-poor institutions is crucial. Decentralisation would not be implemented solely for the direct purpose of poverty alleviation, but the ensuing changes in the institutional architecture are very likely to impact on governance, participation and the efficiency of public-service delivery, all of which are important variables for poverty outcomes. Evaluation reports of PRSPs by the IMF and World Bank highlight the need to strengthen institutional capacity for successful implementation of pro-poor policies. The implementation of a coherent decentralisation strategy, along with indicators to monitor progress, is a promising tool to improve capacities and institutional quality at the local level.

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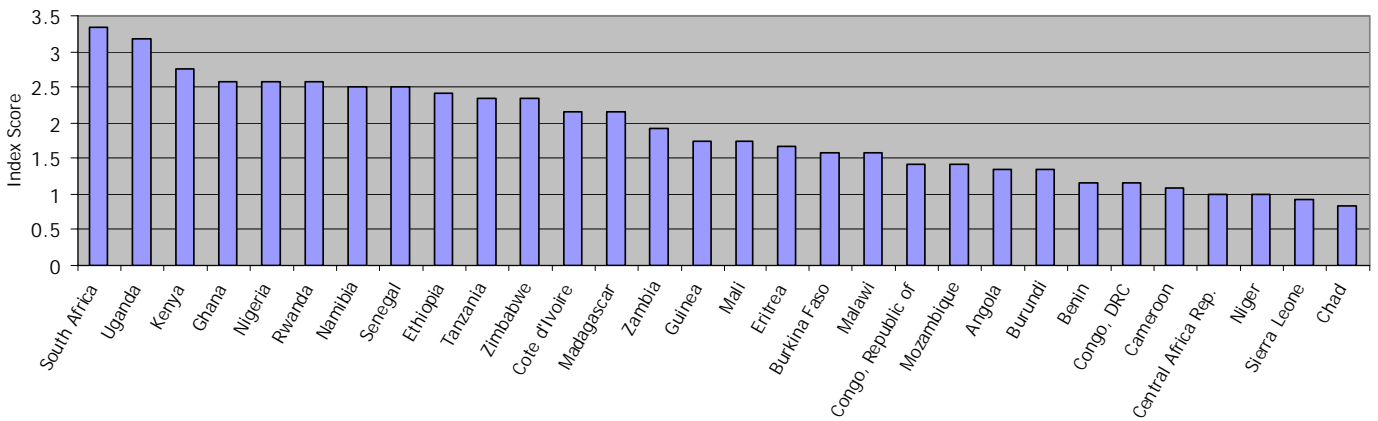
### Box 1. What is Decentralisation?

Decentralisation consists of a transfer of public functions from higher tiers to lower tiers of governance. It can be administrative (transfer of civil servants and public functions to the local level), fiscal (devolution of fiscal resources and revenue generating powers), political (devolution of decision-making powers) or a mixture of these.

While almost all developing countries are experiencing some form of decentralisation, the degree of actual implementation differs widely.

According to World Bank research on the decentralisation experience in 30 African countries, only a very small number of countries, including South Africa and Uganda, have undertaken a comprehensive devolution of powers and resources to the local level. In the majority of the countries reviewed, the decentralisation process is at its first stages and resembles de-concentration, rather than real devolution. The ranking of countries in Figure 1 is based on a score index (ranging from 0 = no decentralisation to 4 = maximum decentralisation) that measures the degree of decentralisation reached. The index is based on average scores for a country's progress in political, administrative and fiscal decentralisation.

Figure 1. Extent of Decentralisation in Africa



Source: Ndegwa, N. (2002).

## Linkages between Decentralisation and Poverty: Theory and Reality

In theory, decentralisation should have a positive impact on poverty, as it is likely to *i)* make the voice of the poor better heard; *ii)* improve their access to and the quality of public services; and *iii)* reduce their vulnerability. An effective devolution of powers offers the opportunity to set up democratic institutions in which the poor can actively participate, decide and lobby for their interests. Improved knowledge and induced competition lead to a better matching of local needs and better policies. These improvements will bring about efficiency gains, in particular in the area of service delivery in terms of access, quality and targeting. As the capacity of citizens to monitor local officials and politicians is higher in a decentralised system, there are opportunities for an increase in transparency and thus for a reduction in corruption and an overall improvement in local governance. This latter is expected to help to reduce the vulnerability of the poor.

While, in theory, decentralisation can be a powerful tool to initiate improvements in instruments and policies for the poor, the reality looks less promising. Based on a comprehensive review of experiences in 19 countries, an OECD Development Centre study finds that in only one third of the analysed cases, decentralisation has actually lead to improvements in poverty reduction. In the majority of the countries, decentralisation had no impact at all (Table 1).

Table 1. Does Decentralisation Reduce Poverty?

Positive Impact on Poverty Reported	No Impact/Negative Impact on Poverty Reported
➤ Bolivia	➤ Brazil
➤ China	➤ Burkina Faso
➤ Ghana	➤ Egypt
➤ India (West Bengal)	➤ Ethiopia
➤ Mexico	➤ Guinea
➤ Philippines	➤ India (Andhra Pradesh)
➤ South Africa	➤ Malawi
	➤ Mozambique
	➤ Nepal
	➤ Paraguay
	➤ Sri Lanka
	➤ Uganda
	➤ Vietnam

Source: Adapted from Jütting *et al.* 2004.

Even more worrying, in countries where the state lacks the capacity to fulfil its basic functions and in environments with high inequalities at the outset, there is a definite risk that decentralisation will increase poverty, rather than reduce it. The ambiguous evidence suggests that the link between decentralisation and poverty reduction is not straightforward and that the outcome is largely influenced by country specificities, as well as by the process design.

## Determinants of Pro-poor Decentralisation

While country characteristics like the size of the country and income levels have less influence than one might expect, factors related to the design and implementation of the decentralisation reform (e.g. elite commitment, powers and resources delegated, information flow on local institutions, participatory mechanisms), are crucial for achieving pro-poor decentralisation. The following points discuss the relative importance of the factors of influence. These have been gathered in four groups, each reflecting the corresponding domain of policy action.

- ◆ **Political:** commitment of the elites/central government as well as the establishment of a transparent and participative process is crucial.

Pro-poor decentralisation requires that authorities at the central level are able and willing to carry out reforms. This implies that: local governments receive substantial, stable and reliable resources; that investments in local human capacity are made; that the national government follows coherent policies; and that donors' support is substantial and coherent.

A good information flow between local governments and the population enables citizens to participate in decision making (e.g. in India quotas are reserved for marginalised groups in all *Panchayati Raj* Institutions). It, thus, favours the empowerment of the poor, efficiency achievements and improvements in governance. A strong civil society and the adoption of measures to include it in the process of decentralisation might further reinforce these pro-poor outcomes. Yet this will depend on the organisational structure of civil society, its composition and its capacity to represent and promote the interests of the poor. Attention should be given to monitoring administrative behaviour through, for example, vigilance committees (Bolivia), investigating commissions (South Africa) or inspectors and social audits (India).

- ◆ **Administrative:** a clear division of functions between different actors should be assured; time for capacity building at local/regional level should be allowed.

Most countries in the process of decentralisation experience some form of central government's interference. This can be direct (e.g. Guinea in local politics) or indirect, as a consequence of policy incoherence. In Nicaragua, for example, while decentralisation formally delegated wide functions to local governments for local development, it left to the National Assembly the responsibility of approving municipal budgets, thus largely reducing local political power and resources. Without resources and with inadequate powers, local governments are often forced to limit their action to municipal activities, such as paving roads.

Central governments tend to legitimise their interference in local policies by pointing to the local government's lack of capacity. Yet, this argument usually hides their unwillingness to delegate power effectively. The experience of Indonesia, Morocco, Thailand, and Pakistan shows that local government capacity can increase slightly but perceptibly in the years following decentralisation. The devolution of powers can generate "learning by doing" processes which help local governments to build up capacity through practice. In Indonesia, the adoption of radical and rapid decentralisation (big bang approach) helped to raise local capacity even if the degree of capacity reached is not considered to be satisfactory. In states characterised by large inequalities, low literacy rates and a poorly developed political and civil society, a more gradual and central state-led reform might be more appropriate. In Madhya Pradesh the central state gradually delegated functions to local governments and at the same time it created parallel administrative structures to build local human capacity. As decentralisation leads to a redistribution of power, it involves delicate compromises and power struggles.

- ◆ **Fiscal:** A secure resource flow to local governments is crucial.

Where local governments' policies were funded only by the collection of local revenues, decentralisation brought about an increase in interregional disparities and this in particular where regional growth rates largely differed in the country, as in China. At the same time, the practice of funding local policies principally through central government transfers is typical of states that are trying to undermine the reform. Dependence on central transfers reduces the powers and legitimacy of local governments. Resources should thus come from both the central government and local taxes. Local governments may also look for the support of the private sector (for-profit and NGOs) for the delivery of public services, through totally delegating responsibilities and functions to private providers (privatisations) or through the adoption of institutionalised forms of collaboration which provide for a share of risks and costs between all the actors (public-private partnerships). Yet, especially for public-private partnerships, a deeper understanding of how these forms of collaboration work in contexts where the boundaries between the private and public sector are unclear and public institutions weak is needed.

- ◆ **Role of local governments:** entry points for establishing and improving pro-poor policies; but the central state has still a strong role to play.

The role of local governments for establishing pro-poor policies at the local and regional level is crucial. It is important that after decentralisation, measures are implemented that allow monitoring the progress in achieving improvements in targeting, participation, service

delivery and administrative procedures. Examples of monitoring instruments are public expenditure tracking surveys (PETS) and quantitative service delivery surveys.

The overall responsibility for implementing pro-poor policies remains, however, with the central state. This is even more so in environments with high inequalities based on traditional social institutions e.g. gender or caste. Recent research in India suggests that giving power to local tiers of government is not sufficient to increase the participation of marginalised groups. The central state has to ensure that existing social inequalities are taken into account and are not re-enforced once the decentralisation process has started. The latter one has been the case in Uganda, where judicial reform favoured local councils that often discriminate against women. To have a pro-poor impact, decentralisation has to be accompanied by complementary measures such as investments in education or promotion of land reform.

Whereas it is undisputed that in the case of public goods with inter-jurisdictional spill-over effects (e.g. vaccination), the central state should continue to take the lead in their delivery, with local governments playing a subsidiary role, the debate is still not settled when it comes to those goods that are not exclusively public such as health, education, water and sanitation.

## Lessons for Donors

In September 2004, the Development Centre and the DAC Network on Governance of the OECD organised a workshop on “Decentralisation and Poverty Reduction: From Lessons Learned to Policy Action” in Paris. The workshop, attended by more than 70 policy makers and specialists, aimed to assess poverty reduction approaches to decentralisation and discuss recommendations to improve donors’ support and policy action. It was concluded that donors should better co-ordinate, engage in a long-term commitment to pro-poor decentralisation as well as analyse profoundly the local context. The following points seem to be crucial milestones for donors’ involvement in decentralisation processes with a pro-poor focus:

- ◆ Donors’ policies should be more coherent and their action better co-ordinated.

Donors have simultaneously supported decentralisation, and favoured sectoral wide approaches (SWAPs) that tended to recentralise power. Furthermore, the large focus of aid policies on community-driven projects has frequently brought donors to support parallel administrative structures that in some cases have undermined the authority and capacity of the elected local governments. To avoid this, policy coherence can be improved through

systematically consulting local governments before approving community development projects. Equally, donors have to better co-ordinate their interventions on the basis of consistency and their own experiences. Improved co-ordination is required between decentralisation and others important policies/reforms (e.g. PRSPs).

- ◆ Donors should be more aware of the political economy of decentralisation as a change process.

Decentralisation is a political process that will not produce gains on all sides; as with all reforms it creates winners and losers. Hence, it will be important to ensure that winners are made reform champions – and losers will have a forum where their complaints are dealt with. One should also think about various forms of compensation.

Donors should, therefore, promote reforms on several levels within the government – including the intermediate levels that have an administrative and political role to play; otherwise reforms will not produce sustainable results. While planning entities might be more willing to engage in decentralisation, the Ministries of Finance or of Internal Affairs may be more reluctant, in particular when it comes to managing the process.

- ◆ Donors should emphasise the instrumental character of decentralisation to create an enabling environment for poverty reduction at local levels.

Decentralisation should be promoted as an important instrument for poverty reduction, not as an end for itself. As the link between decentralisation and poverty is not straightforward, donors should work to straighten this link through exercising pressures on governments for pro-poor outcomes, constantly monitoring the process and adopting flexible, impact oriented (learning by doing) and country-specific policies. In order to ensure effective monitoring, the adoption of service delivery standards and pro-poor desired outcomes is required.

- ◆ Donors should encourage transfer systems with incentives for improved effectiveness as well as help building sustainable local revenue generating powers.

These transfer systems will help to develop an equilibrium between the downward accountability of local governments to citizens and the upward duty to central-state institutions. A clear division of functions, training for local authorities and transparency are corner stones in the process of building sound local fiscal capacity.

In conclusion, donors have an important role to play in promoting pro-poor outcomes. However, the ownership of reforms has to be with national governments. It is their responsibility to decide when and what to decentralise and to which degree. To achieve pro-poor decentralisation, the commitment from the national elite and the support of the population is fundamental, while sound donor support could substantially help to achieve this task.

## Box 2. Do's and Don'ts for Donors

Donors should:

- ◆ Co-ordinate their actions and be committed to pro-poor decentralisation;
- ◆ Stress the link between decentralisation and poverty;
- ◆ Create systems of incentives for good governance and pro-poor outputs;
- ◆ Monitor that the central state does not intervene directly or indirectly in local politics and policy;
- ◆ Monitor corruption and fiscal imbalances;
- ◆ Support policies to strengthen local governments, their independence and their tax-raising capacity (favour co-ordination between local government, creation of regional funds);
- ◆ Be flexible (thus impact monitoring and learning by doing);
- ◆ Before supporting decentralisation, they should understand how they can help and the formal and informal institutional obstacles.

Donors should avoid:

- ◆ The creation of parallel structures;
- ◆ Considering decentralisation a panacea that can be applied everywhere;
- ◆ Considering decentralisation as a unique reform: one size does not fit all.

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