

# **HOW TO MEASURE DECENTRALIZATION: THE CASE-STUDY FROM CENTRAL EUROPEAN COUNTRIES**

**By Zdravko Petak**

Assistant Professor

*University of Zagreb, Croatia*

*Faculty of Political Science*

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«Fiscal decentralization is in vogue. Both in the industrialized and in the developing world nations are turning to devolution to improve the performance of their public sectors.»  
(Oates, 1999: 1120).

## **1. DECENTRALIZATION IN GENERAL**

### **1.1 Introduction**

We start our short review article by citing the words written by Wallace Oates, one of the most prominent authors in the fiscal federalism field. He indicates that decentralization, in its various forms, became an all-pervasive phenomenon, like a globalization. After all, a strong connection between globalization and localization has been repeatedly elaborated in many studies. It has been considered that such a connection is the consequence of the failure of national government to provide an efficient way for provision of public goods and services.<sup>1</sup>

The reasons which lead up to the policies of decentralization could not be limited to one basic source (Manor, 1999). In developed countries decentralization particularly meant demand for more efficient and effective forms of governance in order to secure the competitiveness of a national economy. Gradual «implosion» of the traditional welfare state encouraged a shifting of great portion of social services from national to local governments. It was assumed that localization should be better policy framework for coping with the welfare demands of citizens than resting it to central government.<sup>2</sup> In developing countries, from the other hand, decentralization

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<sup>1</sup> In the study published by *The World Bank* with the title *Local Dynamics in the Era of Globalization*, there are several studies that describe deep connection between decentralization and globalization (Yusuf, Evenett, Wu, 2000: 5).

<sup>2</sup> In the contemporary political science literature there are several studies devoted to statistical correlation between decentralization and economic efficiency. Australian political scientist, Francis Castles, has been showed, examining the data for 21 developed countries, that there is positive correlation between fiscal decentralization and economic efficiency, which is measured by the

was particularly boosted by demands for economic development and more political stability. Centralized political systems showed itself in that part of the world as an inappropriate way for escaping traps of underdevelopment and instability. By the end, decentralization in ex-socialist countries took a function of one of the most important institutional arrangements which are necessary for transition to market economy and democracy (Bird, Ebel, Wallich, 1995: 1).<sup>3</sup>

### **1.2.Types of decentralization**

Decentralization is, technically speaking, the transfer of authority and responsibility for public services from the central government to subordinate or quasi-independent government organizations or the private sector (Rondinelli, 1998). It is not an unambiguous notion. Political economy of development which contains probably the largest portion of decentralization literature refer to various approaches, indicating manifold dimensions of the decentralization process (Rondinelli, Nellis, 1986; Manor, 1999; Agrawal, 1999). Decentralization theories<sup>4</sup> were, in the course of time took various shapes. In 1950s the most frequent notion in political sciences field was deconcentration, indicating the transmission of decision-making power from bureaucracy in nations capitals to bureaucracy at the dispersed locations. By 1970s, when was initiated the new wave in transmitting jurisdictions in public services provision, political scientists started to more frequently use the term decentralization. In the same time new terms, like devolution<sup>5</sup>, was coined for describing differences in scope of institutional changes connected with the transmission of decision-making to local level.

Numerous approaches to decentralization efforts could be confined to three basic forms: deconcentration, fiscal decentralization and devolution (Manor, 1999: 48).

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magnitude of economic growth and the level of inflation. Contrary, there exists positive correlation between fiscal centralization and the level of social welfare provision (Castles, 1999).

<sup>3</sup> “Over-centralization characterized these countries’ public administrations, just as did the rest of economic activity. Decentralization, if appropriately designed and implemented, may lead to improved public service provision. Decentralization is thus a key dimension of the national transition from a command to a market economy” (Bird, Ebel, Wallich, 1995: 1).

<sup>4</sup> In the political science field does not exist broad literature strictly dealing with the theory of decentralization. One of the relatively successful efforts was the book written by Manfred Kochen and Karl Deutsch (Kochen, Deutsch, 1980).

<sup>5</sup> The term devolution has been started to apply to the forms of decentralization that succeeded in shifting the fiscal and political power to local government level (Nostrum, Schroeder, Wynne, 1993: 166). Due to that fact devolution is sometimes labeled as the democratic decentralization (Manor, 1999: 5).

There are exist other forms of transmitting the decision-making power, like delegation, privatization, denationalization and deregulation that could be also connected with decentralization (Agrawal, 1999: 13-14). But these forms of organizational change do not directly describe the change in level of jurisdiction between central government and local government level.

Differences of various forms of decentralization are followed by differences in the scope decentralization policies. There are many differences in decentralization policies performing in developed countries like Canada or Great Britain, in comparison to transitional countries like Croatia and Bulgaria, or developing countries like Nepal and Columbia. Is it possible, nevertheless, to pose basic normative criteria for an efficient decentralization policy aside from the level of development of a particular country? Some scholars in the political economy of development have been arguing tht it is possible. James Ford, for example, elaborates five basic conditions for a successive decentralization (Ford, 1998: 3).

- The decentralization framework must link, at the margin, local financing and fiscal authority to the service provision responsibilities and functions of the local government, so that local politicians can deliver on their promises and bear the costs of their decision.
- Local communities must be informed about the costs of services and delivery optinos and the resource envelope and its sources, so that the decisions they make are meaningful.
- Communities need a mechanism for expressing their preferences in a way that is binding on politicans, so that there is a credible incentive for people to participate.
- There must be a system of accountability based on public and transparent information that enables communities to monitor the perfomance of the local government effectively and to react appropriately to that perfomance, so that politicians and local officials have an incentive to be responsive.
- The instruments of decentrlaization – the legal and institutional framework, the strucutre of service delivery responsibilities, and the intergovernmnetal fiscal system – must be designed to support the political objectives.

## **2. DECENTRALIZATION IN TRANSITIONAL COUNTRIES**

### **2.1. General trends in transition countries**

The decentralization process was particularly complex in transition countries. In those countries decentralization was inseparable from the implementation of the market system and democratic institutions. From this reason decentralization that has been performed in transitional countries became one of the most prominent research subjects for the social scientists (Dabla-Norris, Wade, 2002). Decentralization topic in the transitional world opened also some methodological questions, connected with the appropriateness of the existing theories. In the local government study field for many years existed domination of approaches based on some form of micro-analysis. Dominant theoretical approaches, like fiscal federalism or polycentrism have been confining themselves on micro aspects of various institutional arrangements in decentralization policies. Macro aspects of decentralization, describing differences between particular countries were put in the second plan. The begin of decentralization process in transitional countries opened the interest for macro dimension of the whole process. Scholars formulated question: is there possible to construct one type of theory which could be able to explain proclivity to decentralization in particular countries? Is it possible to find theoretical elaboration which could provide appropriate answer to the question: whether or not is decentralization a good choice for particular country?

World Bank's scholars Dunn i Wetzel (Dunn, Wetzel, 2000) tried to establish such a theory based on two basic principles: tried to establish such a theory pokušali su postaviti takvu teoriju zasnivajući je na dva bitna kriterija:

- Institutional development, consisting of the two additional criteria – credibility of government and degree of liberalization in respective country kredibiliteta vlasti u određenoj zemlji i stupnja u kojem je provedena liberalizacija
- General physical and demographic characteristics of the respective countries.

On the basis of such criteria they constructed one kind of matrix showing the proclivity to decentralization, showing the appropriate level of decentralization for

each respective country. Shortly speaking, the proclivity to decentralization could be in positive correlation both with physical and institutional characteristics of respective country. In other words, the larger countries should have higher proclivity to decentralization than the smaller ones, as well as the countries with higher level of institutional development should have more proclivity for decentralization than the countries with lower level of institutional development.

The above mentioned matrix is shown by the table 1. Along the vertical dimension countries are classified by physical and demographic characteristics, while along the horizontal classification is shaped by institutional dimension. In the top-right quadrant we can find countries with could be most inclined toward decentralization. In the down-left quadrant we can find countries that are least disposed toward decentralization. The countries that should be most disposed to decentralization should be Poland, Czech Republic, Hungary, Romania and Bulgaria, followed by Ukraine, Russia, Belarus, Kazakhstan, Uzbekistan and Azerbaijan.

Table 1. EXPECTED PROCLIVITY TO DECENTRALIZATION			
Physical and demographic characteristics		Institutional development	
		Relatively weak	Relatively strong
	Higher need for decentralization	<i>Ukraine, Russia, Belarus, Kazakhstan, Uzbekistan, Azerbaijan</i>	<i>Poland, Czech Republic, Hungary, Romania, Bulgaria</i>
	Lower need for decentralization	<i>Armenia, Georgia, Moldova, Turkmenistan, Tajikistan, Kyrgyz Republic, Albania, Bosnia&amp;Herzegovina</i>	<i>Slovakia, Latvia, Lithuania, Estonia, Croatia, Macedonia, Slovenia</i>

SOURCE: Dunn, Wetzel (2000: 6)

The common way for comparing the expected proclivity to decentralization with the real trends in respective countries is to show fiscal shares of subnational governments in total public consumption or in GDP. We have data for the first indicator (table 2). Data shows that the countries with the proclivity to decentralization are not those located in top-right, than in top-left box: Kazakhstan, Belarus and Russia. The only country from the group which was predestined for highest level of decentralization was Poland, with little less than 40 per cent of public

consumption located at the regional or local level. At the other hand among the countries with the lowest proclivity to decentralization was Romania, for which it was assumed to belong the group of countries that are most inclined toward decentralization. In the same time, the countries with the lowest level of decentralization are not those belong to down-left box than those belong to down-right box: Slovakia, Slovenia and Croatia. Fiscal data clearly shows that standard macro-economic measures do not confirm expected proclivity ranks to decentralization.

**Table 2. Shares of subnational governments in public consumption**

<i>Country</i>	<i>Share (in percent)</i>
Kazakhstan	45.45
Belarus	43.50
Russian Federation	40.91
Poland	38.87
Tajikistan	31.33
Latvia	29.65
Ukraine	29.57
Georgia	28.80
Azerbaijan	24.57
Moldova	23.64
Kyrgyzstan	23.35
Lithuania	22.64
Czech Republic	21.29
Estonia	21.12
Hungary	20.66
Albania	18.76
Bulgaria	18.72
Romania	11.37

Croatia	13.47
Slovenia	11.46
Slovakia	7.35

SOURCE: *Government Finance Statistics Yearbook*. Washington, DC: IMF, 2001.

Do we need additional measures for evaluating the proclivity to decentralization? The share of subnational units in public consumption or in GDP evidently does not describe correctly the inclination of a particular country towards more decentralized forms of governance. Many scholars have started to point out that methodological problem, suggesting the usage of more qualitative measures, which could be able to describe the quality of governance in a particular country, without relying only on fiscal data (de Mello, Barenstein, 2001). Without the relevant indicators on government credibility, social capital, soft or hard budget constraints and corruption it is not possible to speak precisely on real decentralization tendencies.

Fiscal data, in other words, should be supplemented by the above mentioned qualitative indicators. If we try to compare, for example, decentralization efforts in three ex-Soviet Union countries Kazakhstan, Belarus and Tajikistan with three Central European countries Czech Republic, Hungary and Romania it seems that, using only fiscal data, decentralization is more developed in the first group of countries. If we however, include in analysis additional indicators, like creditability of government, social capital or administrative capacity the whole problem seems to be completely different. It could be showed that high level of subnational shares in total public consumption should be set down to the failure of central state, as a particular form of government credibility which indicates the low level of that qualitative indicator.<sup>6</sup>

The other indicator from the qualitative cluster could be level of social capital. Many recent studies dealing with the decentralization policies showed that, for

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<sup>6</sup> British political scientist Adrian Campbell attributes it to the form of political behavior which he labels by the notion of *rebel autocracy*. It is a second element in the cluster which describes «the imperial tradition in local governments» in the former Soviet republics. It is «the tradition whereby local and (more particularly) regional governments are outposts of the central state, and consequently define themselves in relation to the higher-standing authorities rather than in terms of the population they serve». The other elements of the cluster include «the tradition of an uncountable command structure, with only a weak link between authority and responsibility» and «corruption as a recognized part of administrative life». See in: Campbell (1996: 38-40).

example, fiscal decentralization depend on the level of social capital and that its higher could indicate more democratic decentralization (de Mello, 2000). Higher level of social capital might therefore indicates higher level of decentralization.

For evaluting the real level of decentralization we can also use the indicator of the hard budget constraint or soft-budget constraint. The notion is originally coined by famous Hungarian economist Janos Kornai, by whih is described the strictness of fiscal discipline in the budgetary process. Fiscal decentralization that might lead toward soft-budget constraint will be an inefficient project, which undercutting decentralization efforts and devolution of decision-making process.<sup>7</sup>

Except the above mentioned indicators, scholars studying decentralization policies from the public management field oftenly use two additional indicators. The first one is administrative capacity, measuring management capabilities of local governments. It was shown that one of the very frequent causes of the decentralization failures should be attributed to low level of administrative capacity. Management capabilities could be defined by following aspects of the process of management: policy management, resource management and programme mana gement (Gargan, 1981: 650). The administrative capacity of local government sometimes coud be considered from developmental standpoint of view, transforming itself into development capacity of local governments (McGuire et al., 1994). We can conclude that administrative capacity play an indispensable role in explaining the real level od decentrlaization. Local governments units with, for example, relatively lower share in total public consumption, but with high level of administrative capacity can do more in decentrlaization than units with low administrative capacity and higher share in public consumption.<sup>8</sup>

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<sup>7</sup> The last studies of that indicator showed that decentralization can create incentives which lead toward soft-budget constraints (Rodden, Eskeland, Litvack, 2003). See particularly interesting case-study on Ukraine written by O'Connell and Wetzel.

<sup>8</sup> On the importance of administrative capacity for implementing decentralization policy in transitional countries see Verheijen (2002).

## **2.2. Decentralization in Central European countries**

Dynamics of local governments reforms was different from country to country. It is possible to distinguish three phases of reforms in the area of Central Europe (Péteri, Zentai, 2002: 18-19): the process of decentralization started in Hungary and Poland. Both countries prepared all legal prerequisites for an efficient decentralization between 1989-19993. By mid 1990s decentralization started in second group of countries, encompassing countries like Bulgaria and Latvia. The last group of countries, including Croatia and Slovakia, did not take part in decentralization projects since 2000. These countries still belong to most centralized systems of governance in the transitional world and the process of decentralization showed as the prerequisite for further political development.

Data in table 3 shows the share of local and regional governments in the distribution of power for providing basic public services. The lowest level is relating to public order and security affairs, in which is roughly one tenth of public money devoted to local level. It should be noted, however, that in many countries these figures are pretty low, capturing just 12 per cent of total public consumption in that field. The second service that is relatively centralized is social welfare. The similar situation is, however, in developed countries (with the exception of scandinavian countries), where national governments continues to be the main provider of welfare services (Petak, Kasapovic, Lalic, 2004).

Contrary, the highest level of local government involvement in the provision of public goods we can find in the housing affairs, where 78 per cent of all services is provided by local government level. Relatively high level of decentralization is also present in the areas of culture and recreation, education, health, transport and communication. There, however, countries that lie strongly below average level, like Slovakia, Croatia, Slovenia and Romania, representing the most centralized countries in the Central Europe.

Table 3. Subnational shares of General Government Expenditures (in percent)

	<i>Public order &amp; Safety</i>	<i>Eduaction</i>	<i>Health</i>	<i>Social Security &amp; Welfare</i>	<i>Housing &amp; Communal Amenities</i>	<i>Recreation &amp; Culture</i>	<i>Transportation &amp; Communication e</i>
ALBANIA	-	80.19	29.91	19.08	31.77	34.03	6.76
BULGARIA	2.17	59.53	44.11	8.30	68.95	26.69	12.19
CZECH R.	17.20	17.22	5.98	8.03	68.47	61.89	46.53
ESTONIA	1.08	49.84	2.19	7.87	94.14	41.74	15.02
CROATIA	2.29	16.70	0.95	0.95	49.57	58.38	27.30
HUNGARY	6.86	46.99	44.83	11.99	74.10	43.97	27.64
LETONIA	5.93	72.47	4.25	5.66	79.64	50.23	24.49
LITHUANIA	3.02	72.62	0.67	9.46	99.95	39.96	9.34
POLAND	34.30	72.47	87.36	17.49	86.92	76.13	65.34
ROMANIA	4.80	9.23	0.36	2.97	83.01	34.74	17.55
SLOVAKIA	5.69	2.40	0.26	0.49	56.74	27.00	18.78
SLOVENIJA	5.88	23.92	1.61	1.14	77.64	45.33	23.10

IZVOR: *Government Finance Statistics Yearbook*. Washington, DC: IMF, 2001.

## CONCLUSION

Since begin of 1990s across the world countries have been faced with the challenges of simultaneous globalization and decentralization. The requirements towards more decentralized forms of governing have their point of departure in the necessity for more efficient delivery of various public services. In order to accept these requirements many countries had started with decentralization of their governing structures. That process became particularly strengthened in ex-socialist countries of Central Europe, as one of the prerequisites for approaching their economies to standards of market economy. From that reason the elaborations of

possible trends in the process of decentralization became the flourishing topic of research for many domestic and foreign social science scholars and experts.<sup>9</sup>

Several countries made significant progress towards more decentralized forms of governing among former socialist states, but generally, that process is uneven among those states. Comparative analysis shows that countries differ in decentralization achievements, measured by fiscal and qualitative indicators. Country where the scope of decentralization policy is particularly prominent is Poland, where creation of new regional government units (*poviat* and *voivodship*) changed the entire public sector provision. Among countries with lower level of decentralization interesting case is Croatia, where in 2001 started comprehensive reform policy package, trying to increase low shares of local governments in education, health and social welfare services.

The second important thing connected with decentralization policies in Central Europe that should be stressed is the problem of uniform provision of local governments units. Many reform projects contain, like for example in Croatia, proposals for abolishment of the number of local governance units. The basic idea they provide is very simple: municipalities must fulfill certain set of conditions, in order to be able to provide the exact list of local public goods. I think that such an approach, based on one type of consolidation as an optimal policy, does not take into account the difference between provision and production. It does not matter when additionally has been indicated that various types of local government units will be faced with different types of requirements (Kopric, 2002) with small communes in more rural areas at the one side of the continuum and large cities in urban area at the other of continuum. Nevertheless, the crucial distinction between provision and production was not taken into account. What is the real consequence of the requirement for strict list of services that must be provided to citizens? Mono-centric type of governance continues to exist as a dominant way of governance. State legislators continue to decide upon package of services that would be provided to citizens, instead of they own decide upon such thing.

From that reason the critical point for the further development of devolution in Croatia and other Central European countries is to escape from the trap of

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<sup>9</sup> It must be noted that several very influential public finance theorists did not accept such decentralization enthusiasm, pointing out many difficulties that might be brought by decentralization policy (Prud'homme 1994; Breton 2000, Tanzi 2000).

consolidation as a panacea for the problems which local government units have been facing. As many important works written by *Workshopers* have been showing (Ostrom, Tiebout, Warren, 1961; Oakerson, 1999) the existence of overlapping jurisdictions and the distinction between provision and production of public goods enable even very small local government units to be efficient provider of at least some public services.

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