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Accountability for Fiscal Decentralisation at the Sub-national Level

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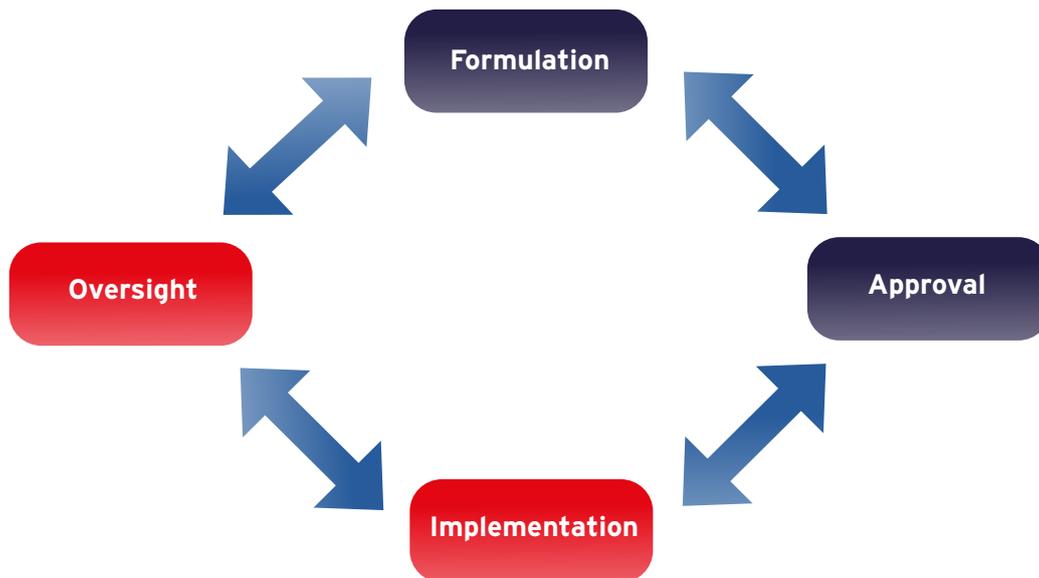
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Introduction

Political decentralisation is the transfer of decision-making powers to sub-national¹ levels of government (SNGs), accompanied by the 'transfer of authority to representative and downwardly accountable actors, such as elected local governments'.² For decentralisation to work effectively, budgetary authority needs to be transferred to elected SNGs so that they have decision-making power regarding spending and taxation. This is known as fiscal decentralisation.³ At the same time, SNGs need to be held accountable - both to the electorate through periodic elections; and through agencies of horizontal accountability⁴ for their compliance with laws, regulations and other authorities governing them.⁵



As part of the Westminster Foundation for Democracy's (WFD) briefs on financial accountability, this brief focuses on holding fiscally decentralised SNGs to account for how funds under their control are spent. This brief focuses on:

- political or democratic accountability as an important prerequisite to fiscal decentralisation;
- the importance of PFM systems and bureaucratic capacity in improving accountability at the SNG level; and
- capacity challenges at the sub-national level in holding SNGs to account for funds spent.

1. The term 'SNG' refers to the second level of government (such as states or provinces) or a third level of government (municipalities). Over time, powers and responsibilities have been transferred from the central government level to elected officials at the SNG level. This process is known as decentralisation. See OECD, Making Decentralization Work: A Handbook for Policy-Makers, OECD Multi-level Governance Studies, 2019, online at: <https://doi.org/10.1787/g2q9faa7-en>.

2. Elizabeth Linda Yuliani. 'Decentralization, Deconcentration and Devolution: What Do They Mean?'. April 2004. Online at: https://www.academia.edu/4644194/Decentralization_deconcentration_and_devolution_what_do_they_mean.

3. Roy Bahi. 'The Pillars of Fiscal Decentralization'. Development Bank of Latin America. No. 2008/07. December 2008. Online at: <https://scioteca.caf.com/handle/123456789/257>.

4. Horizontal accountability is defined as 'the existence of state agencies that are legally enabled and empowered, and willing and able, to take actions that span from routine oversight to criminal sanctions or impeachment in relation to actions or omissions by other agents or agencies of the state that may be qualified as unlawful'. These agencies include the classical institutions of the executive, the legislative, and the judiciary; it also extends to various overseeing agencies, ombudsmen and audit offices. This brief focuses on oversight by the legislature and external audit office. See Summary Hub, 'Horizontal Accountability in New Democracies'. Online at: <http://summaryhub.com/article/149/horizontal-accountability-in-new-democracies>.

5. <https://www.ipsasb.org/publications/study-3-auditing-compliance-authorities-public-sector-perspective>

What is the difference between political and administrative decentralisation?

Political decentralisation is the transfer of decision-making powers to SNG levels of government, accompanied by the 'transfer of authority to representative and downwardly accountable actors, such as elected local governments'.⁶

Fiscal decentralisation is an important prerequisite for political decentralisation. As the Organisation for Economic Cooperation and Development (OECD) notes: 'if SNGs have little freedom to choose the levels of local public goods, especially when transfers are accompanied by mandates that specify how the money is to be allocated...the decentralisation is only partial.'⁷

Political decentralisation is distinct from administrative decentralisation. In the case of the latter, powers are simply transferred to lower-level central government authorities, or to other local authorities that remain 'upwardly accountable to the central government'.⁸ While administrative decentralisation is intended to bring services closer to the citizenry, decision-making still occurs at the central level of government. Box 1 details Ukraine's SNG governance arrangements, in which full political decentralisation has not yet been achieved.

Box 1: Towards full political decentralisation in Ukraine?

In Ukraine, while voters directly elect regional and district councils every five years,⁹ these regions and districts lack an executive function. Instead, the President appoints executive heads of regions and districts at the national level.¹⁰ This institutional framework 'severely limits the self-governance' of regions and districts. In this sense, regional and district levels in Ukraine 'function most frequently as territorial entities of the central government'.¹¹ In line with achieving full political decentralisation, the central government has signalled the desire to allow the regional and district councils, which are already directly elected, to create their respective executive committees. This would require a constitutional amendment. However, there has been no progress to date.¹²

6. Collins Juma. 'The Concept of Decentralization: Kenya's Experience and Lessons from Mozambique Introduction to decentralization in Kenya'. 2011.

7. OECD, Making Decentralization Work: A Handbook for Policy-Makers, OECD Multi-level Governance Studies, 2019, online at: <https://doi.org/10.1787/g2g9faa7-en>, p. 118.

8. Ibid.

9. There are 24 regions in Ukraine, which are known as oblasts. Population sizes range from 4.4 million to 380,000. There are 490 districts (rayon) and population averages about 50,000. See 'Local and Regional Government in Ukraine and the Development of Cooperation Between Ukraine and the EU'. European Union, 2011, p. 3.

10. Valentyna Romanova and Andreas Umland. 'Ukraine's Decentralization Reforms Since 2014 Initial Achievements and Future Challenges'. Chatham House. The Royal institute of International Affairs. September 2019. Online at: <https://www.chathamhouse.org/sites/default/files/2019-09-24-UkraineDecentralization.pdf>.

11. OECD. 'Maintaining the Momentum of Decentralisation in Ukraine'. OECD Multi-level Governance Studies, chapter 3.

12. Valentyna Romanova and Andreas Umland. 'Ukraine's Decentralization Reforms Since 2014 Initial Achievements and Future Challenges'. Chatham House. The Royal institute of International Affairs. September 2019.

What are the advantages of political or democratic decentralisation?

Political or democratic decentralisation promotes downward accountability. Local officials are accountable to the local electorate, not to the central government. This enables citizens to monitor the quality of service at the local level, and hold local officials accountable through local representatives. As a result, 'decentralisation dramatically tightens the accountability loop between those who produce public goods and services and those who consume them'.¹³

Additionally, at the sub-national level, administrators can work with community-based organisations and civil society organisations to 'identify prevailing problems and respond to these challenges through innovative and effective solutions'.¹⁴ For example, in the Machakos County in Kenya, citizen participation in local decision-making processes has been enhanced in several ways. The public is invited to attend and follow the proceedings of county level meetings, providing individuals the option to express their opinions and influence budget allocations and development programmes. Equally important, financial documents that outline revenues and expenditure are accessible to the public for audit.¹⁵

How is accountability for fiscal decentralisation bolstered by strong bureaucratic capacity and public financial management systems?

Accountability for fiscal decentralisation needs to be bolstered by strong bureaucratic capacity and PFM systems. The administrative capacity of a SNG to 'deliver its mission/mandate in an efficient, fair, accountable, incorruptible and responsive manner' - entails, among other things, the ability of the SNG to carry out prudent fiscal and financial management with a high degree of transparency. Strong PFM systems include:¹⁶

- **Procurement systems** that include: accurate and complete data for all procurement methods for goods, services and works; a competitive procurement process in place; and procurement information that is available publicly;
- **Internal controls** that: respect segregation of duties; commitment controls that respect expenditure ceilings or cash limits and payments compliant with regular payment procedures.
- **An internal audit system** with: wide coverage across government entities; and that consistently produces annual audit programmes and management responses.
- **Annual financial reports:** prepared annually and comparable with the approved budget; submitted on a timely basis for external audit; and in conformity with international accounting standards.

'Bureaucratic capacity' must underpin strong PFM systems. Indeed, 'having adequate human resources at the SNG level is one of the primary conditions for success of decentralization reform'. Lower levels of government often have less administrative capacity.

13. Michael Mbatea. 'Decentralization, Governance and Accountability: Theory and Evidence'. *Journal of African Democracy and Development* Vol. 1, Issue 2, 2017, p. 4.

14. Ibid.

15. Ibid.

16. PEFA Framework.

For example:

- In Ukraine, 'the lack of human capital and capacity to effectively administer the duties of governance at the local level' is 'one of the most critical challenges facing decentralization reform in Ukraine'. As of January 2015, there were 84,500 officials in local governments compared to 268,000 in central government.¹⁷
- Kitui County in Kenya has been characterised by a bloated and unskilled workforce that has led to poor financial management practices.¹⁸ See Box 2, below.
- In Pakistan, it was noted four years after devolution of powers to the provinces in 2010 that many organisations 'lack the technical capacity to undertake newly assigned functions and rather than developing a dedicated and well-trained cadre, the provincial governments have taken short term and ad hoc measures to fill vacant slots'.¹⁹

Box 2: Comparing bureaucratic and PFM capacity in two Kenyan counties

A 2017 article appearing in the Journal of African Democracy and Development compared the outcome of decentralisation reform in Kenya in two counties. Decentralisation included devolution, 'where the central government transferred fiscal and political functions/responsibilities to independent sub-national units which enjoy autonomy under state law'.²⁰

The author argues that outcomes of decentralisation differed greatly in Machakos and Kitui counties. In Kitui County, 'weak bureaucratic capacity has translated into poor financial management'. This is owed, in part to lack of a skilled workforce stemming from 'political interference in the appointment process of local staff', the majority of whom were 'either nominated by the ruling political party or absorbed from the previous centralised government'.²¹

Alternately, Machakos County has developed a skilled workforce, with appointments based on merit. 'Staff competency, especially in financial management, has been high, as reflected in independent audit reports by the State's Office of the Auditor General'.²²

Compared to the central government, local governments often have a 'more limited institutional capacity' to implement effective PFM systems.²³ The OECD points out that SNGs 'face formidable obstacles in view of resource constraints or deficient capacity more generally'.²⁴ This is reflected in the review of the four key indicators of PFM and control in 20 SNG units, which demonstrates that in the majority of cases, central government capacity exceeds SNG capacity. See Box 3. In Pakistan, PFM capacity generally remained the same or backslid at both the federal and provincial levels in the years following devolution. See Box 4.

17. OECD. 'Maintaining the Momentum of Decentralization in Ukraine'. OECD Multi-level Governance Studies, p. 240.

18. Michael Mbatea. 'Decentralization, Governance and Accountability: Theory and Evidence'. Journal of African Democracy and Development Vol. 1, Issue 2, 2017, p. 9.

19. Jinnah Institute. 'Devolution. Provincial Autonomy and the 18th Amendment'. 2014, pp 21-22.

20. Michael Mbatea. 'Decentralisation, Governance and Accountability: Theory and Evidence'. Journal of African Democracy and Development Vol. 1, Issue 2, 2017, p. 9.

21. Ibid, p. 11.

22. Ibid.

23. Blog. 'Public Financial Management at the SNG Level in a Rapidly Decentralizing Country'. Local Public Sector Initiative (LPSI). January 2019. Online at: <http://www.decentralization.net/2019/01/public-financial-management-at-the-SNG-level-in-a-rapidly-decentralizing-country/>

24. OECD, Making Decentralization Work: A Handbook for Policy-Makers, OECD Multi-level Governance Studies, 2019, online at: <https://doi.org/10.1787/q2g9faa7-en>, p. 118.

Box 3: SNG vs. national PFM data in five countries

SNG data was compared to central government data from Public Expenditure and Financial Analysis (PEFA) assessments in 20 SNG units covering five countries—Albania, Ethiopia, Georgia, Kenya and Ukraine.²⁵ Looking at four key financial management and control indicators:²⁶

- SNG scores exceed national scores in only 6.25% (5/80) of cases;
- SNG scores were on par with national scores in 35% (28/80) of cases; and
- National scores exceeded SNG scores in 58.75% (47/80) of cases.

Box 4: PFM capacity in Pakistan post-devolution (2010)

Pakistan's 18th constitutional amendment in 2010 had the effect of devolving significant power to Pakistan's four provinces. Joint concurrent (federal-provincial) powers were devolved to the provinces. The scope of executive authority at the centre was reduced. Following devolution in 2010, there was little improvement—and some backsliding—in the four key indicators of PFM and control analysed in this brief. The PEFA indicators were compared at the federal level and in two provinces over two time periods:²⁷

- Procurement scores actually backslid at the federal level in Pakistan (from C to D+) as well as Punjab province (C to D), with a slight improvement in Sindh province (C to C+).
- Internal audit scores, which were identical for both provinces and at the federal level (D), did not change during the two time periods.
- Scores for financial statements were the same for all three jurisdictions (C+), and had all backslid from a B or a B+ during the two time periods.

A common concern associated with decentralisation is the risk of capture by local leaders and powerful special interest groups. In the Philippines for example, it was demonstrated that 'local elites influence procurement allocations and engage in overpricing in jurisdictions where they finance election campaigns for incumbent political officials'.²⁸ Similarly, local elites can discourage development of a strong SNG with strong PFM systems that can control malfeasance and prevent corruption.

25. The selection of Albania, Ethiopia, Georgia, Kenya and Ukraine is based on the availability of recent PEFA scores since 2016 at both the national and SNG levels.

26. The four PFM functions are: procurement, internal controls, internal audit and financial reporting.

27. Pakistan: federal level 2009 and 2012; Sindh province, 2009 and 2013; Punjab province, 2007 and 2012.

28. Michael Mbatea. 'Decentralization, Governance and Accountability: Theory and Evidence'. *Journal of African Democracy and Development* Vol. 1, Issue 2, 2017, p. 7.

How effectively are SNGs held to account for funds spent?

Earlier in this brief, it was noted that SNGs need to be held accountable - both to the electorate through elections; and through agencies of horizontal accountability for their compliance with laws, regulations and other authorities governing them. In the case of the latter, two such horizontal accountability mechanisms covered in this brief are: oversight of spending by the legislature and the external audit office.²⁹

Comparing national and sub-national PEFA scores from the same five countries,³⁰ PEFA scores related to external audit and *ex-post* legislative oversight were generally weaker at the SNG level. It was noted that:

- *Ex-post* oversight scores of SNG legislatures exceeded national parliaments in only 10% (2/20) of cases; likewise, SNG external audit scores exceeded national external audit scores in only 10% (2/20) of 20 cases.
- SNG legislatures were on par with national legislatures in 35% (7/20) of cases; and SNG external audit scores were on par with national audit scores in 25% (5/20) of cases.
- National legislatures exceeded SNG legislatures in 55% (11/20) of cases; and national external audit scores exceeded SNG scores in 65% (13/20) of cases.
- Generally, the external audit function was stronger at the central government level in four of the five countries, the exception being Kenya.³¹ Interestingly, only in Kenya was legislative oversight at the SNG level on par with the national level.³²

Conclusion

Political decentralisation is an important prerequisite for fiscal decentralisation. Without the former, SNGs are upwardly accountable to the central government rather than the electorate, which inevitably undermines the responsiveness of SNGs.

One academic recently characterised horizontal accountability as 'perhaps the most neglected element of accountability in decentralised systems'. A strong PFM system, supported by bureaucratic capacity, is crucial in order that systems be put in place that allow SNGs to account for funds spent. The PEFA assessment results of four key PFM and control indicators (procurement, internal controls internal audit and annual financial reporting) demonstrates that SNG capacity lags behind central government capacity in a majority of cases. SNG scores exceed national scores in less than 10% of cases. The mechanisms of horizontal accountability examined in this brief - namely legislative oversight and external audit were also found to be weaker at the SNG level in the majority of cases. Strong PFM systems and bureaucratic capacity are required to bolster financial management systems and practices.

29. More information on the role and function of external audit offices (referred to as Supreme Audit Institutions at the national level) is provided in the WFD brief entitled 'Are Supreme Audit Institutions 'Fit For Purpose' in the age of COVID-19 and beyond?' (Brief number 1 in the eight-part series on PFM), published October 2020. More on information on legislative oversight, in particular the role of public accounts committees, is provided in the WFD brief entitled 'A Critical Review of Public Accounts Committees' (Brief number 2 in the eight-part series on PFM, published October, 2020).

30. The aggregate PEFA scores for 'external audit' (PI-30) cover: 30.1 'audit coverage and standards'; 30.2 'submission of audit reports to the legislature'; 30.3 'external audit follow-up'; and 30.4 'SAI independence'. Aggregate PEFA scores for 'legislative scrutiny of audit reports' (PI-31) cover: 31.1 'timing of audit report scrutiny'; 31.2 'hearings on audit findings'; 31.3 'recommendations on audit by the legislature'; and 31.4 'transparency of legislative scrutiny of audit reports'. See 2016 PEFA Framework.

31. In Kenya, two SNG jurisdictions were on par with the central government's external audit function in four of the six SNG cases; and SNG external audit scores exceeded national scores in two other cases.

32. With respect to legislative oversight, five out of six SNG jurisdictions in Kenya were on par with the national level. The national legislative oversight score exceeded SNG score in the other instance.



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