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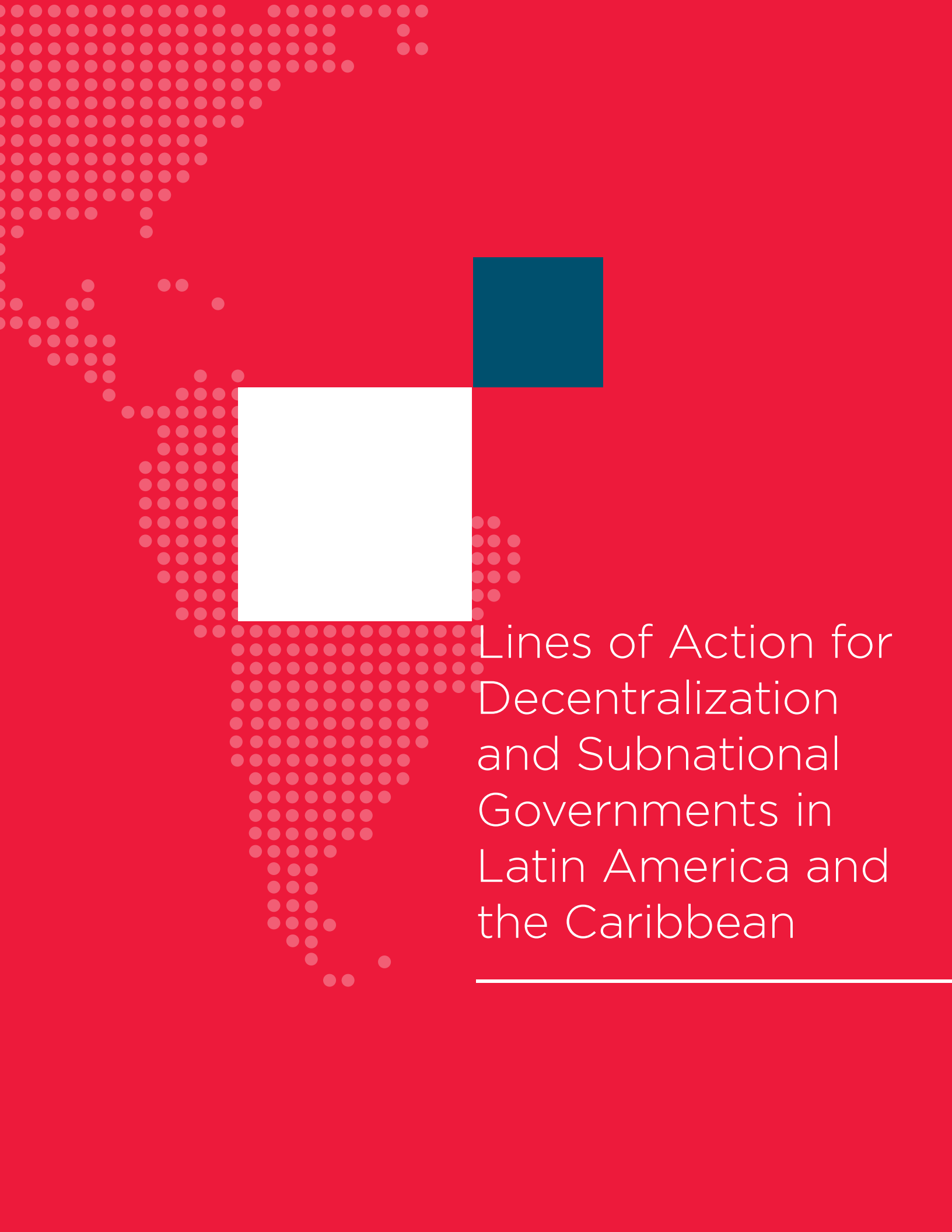
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Next Steps for Decentralization and Subnational Governments In Latin America and the Caribbean

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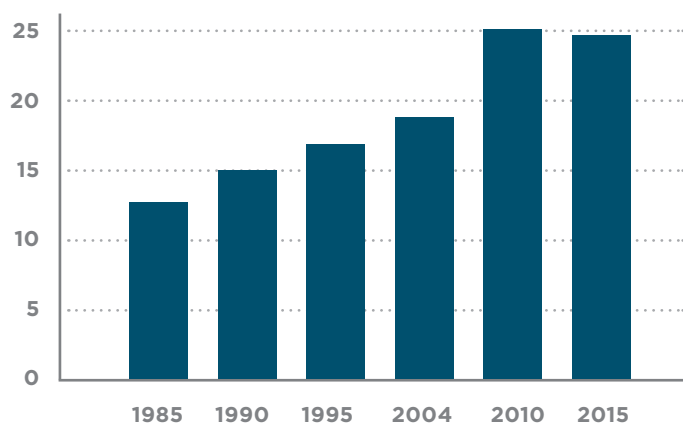
Lines of Action for Decentralization and Subnational Governments in Latin America and the Caribbean

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Decentralization: a set of policies that transfer responsibilities, resources, and/or powers from the central government to subnational governments, carries the promise of bringing governments closer to citizens, facilitating a more efficient allocation of resources and increased accountability.

In Latin America and the Caribbean (LAC), since the 1980s, subnational governments have become increasingly important in the provision of public goods and services that are critical for economic and social development. In fact, the subnational governments' share of consolidated public expenditures almost doubled between 1985 and 2015, from 13% to 25%.

Figure 1. Public expenditure: subnational government as a percentage of total government



Source: Informe de progreso económico y social (IPES): América Latina tras una década de reformas. BID. Daughters, R. and L. Harper. 2007. Fiscal and Political Decentralization Reforms, in: E. Lora (2007), *The State of State Reform in Latin America*, Stanford, CA: Stanford University Press. a survey of IDB fiscal specialists, IMF staff who prepare that organization's Government Finance Statistics, and the IDB's subnational government fiscal information platform.

Currently, the region has approximately 17,500 subnational governments, of which 400 represent intermediate levels of government and the remainder are municipalities. In the region's largest countries, subnational governments are responsible for providing education and health services, with substantial consequences for the size of the subnational public sector.

Given its strategic importance for development, the IDB has paid close attention to the decentralization process in the region, developing a series of projects and knowledge products to help Latin America and the Caribbean reap the full benefits of bringing governments closer to its citizens while mitigating potential risks.

To maximize its development impact, the IDB prepares every three years a strategy on how it is going to support the decentralization process in the region and strengthen the capabilities of subnational governments. This document, called **Decentralization and Subnational Governments Sector Framework**, summarizes the main findings of academic studies on the topic, analyzes the recent trends, advances and challenges in decentralization in Latin America and the Caribbean, discusses the IDB experience and value-added in the sector and outlines the main areas of work for the Bank in the coming years.

This strategy document serves as an important reference for any development practitioner to learn about how decentralization has evolved in Latin America and the Caribbean, where it is going and where it is best to invest limited resources for greater impact. In the following paragraphs we provide a summary of the key messages of this document.

For more information about our Decentralization and Subnational Governments Sector Framework, visit www.iadb.org/fiscalmanagement



International Evidence: What you need to know

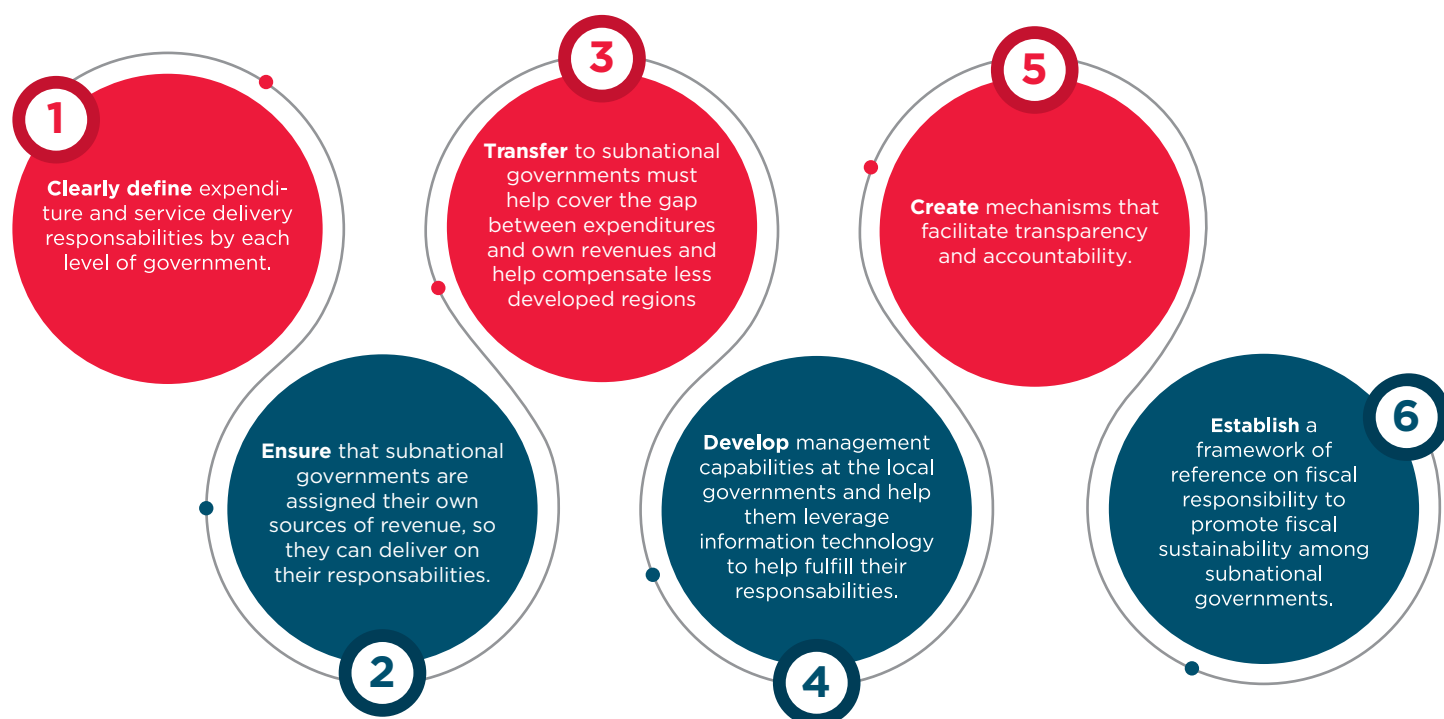
What is the impact of decentralization on development?

The international evidence is scant, and its results are mixed. The benefits stemming from decentralization will vary widely because it is a process subject to historical circumstances and political economy factors. Attention to details related to implementation and the scope, sequencing, and speed of reform, together with institutional design factors, are crucial to help improve expenditure allocation and transparency at the subnational level.

Nonetheless, there are important lessons we can extract from the experiences from other countries and regions to ensure governments provide better services to citizens and are more efficient and accountable for their actions. First, there must be a clear definition of expenditure and service delivery responsibilities by each level of government. Second, subnational governments must be assigned their own sources of revenue, so they can deliver on their responsibilities. Third, inter-governmental transfers must be coordinated to properly cover the gap between expenditures and own revenues at the local level as well as help compensate less developed subnational governments. Fourth, subnational governments must develop their management capabilities and be able to use information technology to help fulfill their responsibilities. Fifth, there is a need to create mechanisms that facilitate transparency and accountability at the subnational level.

And last, all of this should take place within a fiscal responsibility framework that promotes fiscal sustainability among subnational governments.

Figure 2 (Infographic): 6 Lessons on Decentralization for Policymakers



Challenges and Advances in Latin America and the Caribbean

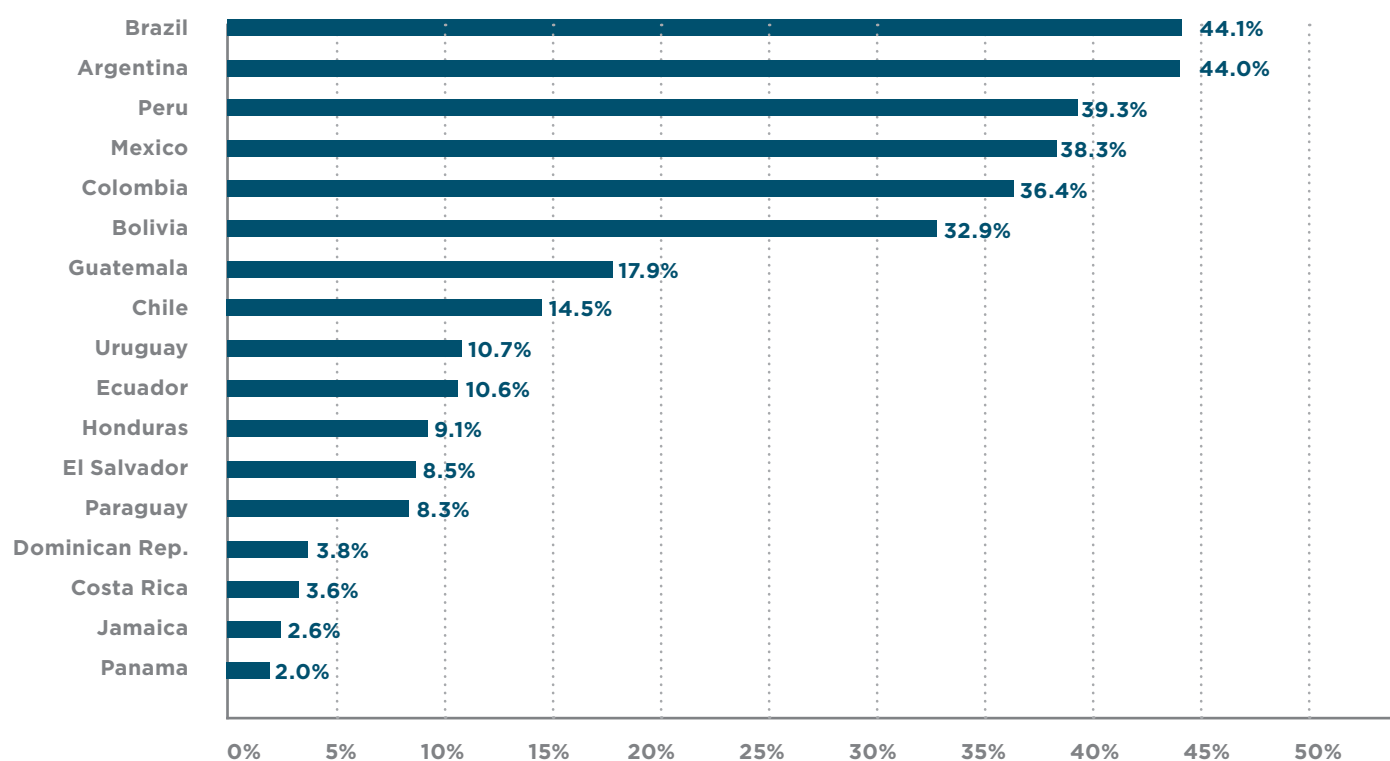
Practically all LAC countries have made efforts over the past three decades to bring government closer to the citizens through greater decentralization to subnational governments and/or territorial de-concentration of the central government.

In the last three years, Chile and Panama embarked on decentralization efforts. In 2015, Panama enacted a law that decentralizes public administration while Chile reformed its Constitution in late 2016 to allow the democratic election of regional governors from

2020 onwards. Mexico and Argentina strengthened regulations to ensure greater commitment to fiscal responsibility by subnational governments. Meanwhile, growth in the subnational public sector in the Andean region stagnated due to the reduction in transfers linked to extractive industries following the end of the commodity boom.

The level of decentralization continues to vary widely in the region. While more than 40% of consolidated expenditures in Brazil and Argentina were executed at the subnational level in 2015, the equivalent figure in Costa Rica and Jamaica was below 5%.

Figure 3: Share of subnational government spending in 2015 (as % of total government spending)



Source: Survey of IDB specialists, IMF Government Finance Statistics, and the IDB's subnational government fiscal information platform.

In general, the countries of the region can be classified into three main groups:

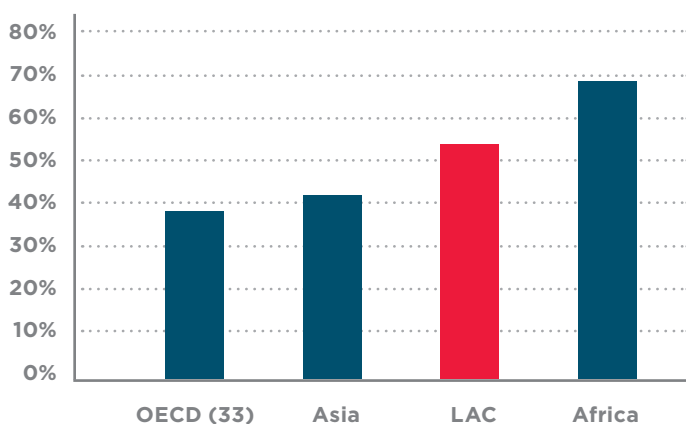
Federal, such as Argentina, Brazil, and Mexico;

Unitary with a high level of decentralization, such as Bolivia, Colombia, Ecuador, and Peru;

Unitary with a lower level of decentralization, such as Chile, Paraguay, Uruguay, and the Central American and Caribbean nations.

Subnational governments in the region still have a high dependence on transfers to finance their spending, reducing their incentives for accountability and efficient management. Moreover, they are subject to deficient inter-governmental arrangements that lack proper definitions of spending responsibilities and how such expenditures will be matched with own sources of revenue. Subnational governments also have low institutional capacity, which affects the level of the quality of services provided to citizens as well as transparency.

Figure 4: Subnational government transfers as a percentage of financing for subnational expenditure in the regions of the world.



Source: IMF Government Finance Statistics, 2016

In addition to such traditional problems, subnational governments also face some emerging challenges, including catching up in the adoption of new digital technologies to improve efficiency and effectiveness of services, accessing other sources of financing while maintaining fiscal responsibility, addressing climate change and making better use of transfers to promote balanced territorial growth.

Opportunities for intervention

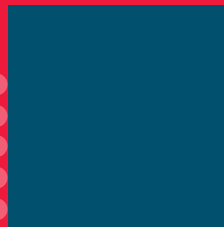
Because of such diagnosis, the two greatest opportunities for intervention in the region are: facilitate conditions that promote institutional capacities and structure incentives for more efficient and effective subnational management, which should help improve the quality of life for all citizens.

Specifically, support should be provided for interventions and changes that systematically address institutional weaknesses in the sector, which can be divided in four major areas of action:

- 1 Strengthen** intergovernmental arrangements;
- 2 Improve** expenditure management and service delivery of subnational governments;
- 3 Improve** generation of own revenue sources and improve access to financing for subnational governments; and
- 4 Increase** transparency and accountability.

These are the areas where the IDB is focusing its interventions in the sector, following four important principles. First is to focus on developing institutional capacities. Second, the Bank ensures its interventions recognize the interdependent nature of the sector's challenges. Third, consider the incentives of each stakeholder. And fourth, Bank projects will be implemented, considering the local context, such as degree of decentralization and the different characteristics of subnational governments.





What can the
IDB offer?

The Bank has sustained a privileged position in supporting the sector in the region thanks to its continuous support and fluid dialogue with national and subnational authorities, broad country coverage, a track record of good practices and innovation, and high technical capacity in the sector. In the last three decades, the sector has accounted for about 10 percent of all the Bank's loan portfolio.

Between 2015 and 2017, the Bank approved 12 loans in the decentralization and subnational governments for more than US\$2 billion to improve expenditure management, investment and service delivery as well as improving management of local taxes and investment financing. The Bank has also supported measures to improve debt management, transparency, and accountability.

In the same period, the IDB has also approved 45 technical cooperation operations worth approximately US\$30 million, which included support to decentralization reforms in Chile, Mexico, and Panama as well as diagnostic assessments and proposals for improving subnational public financial management in Argentina, Mexico, and the Dominican Republic and innovations in cadastral management.

Figure 5: IDB Support to Subnational Governments (2015-2017)

IDB's Support to Subnational Governments (2015-2017)

12 loans totaling more than

US\$ 2 Billion

45 technical cooperations totaling

US\$ 30 Million

The IDB offers a team of highly qualified specialists with presence in the field and with local deep knowledge. As a result, Bank interventions are tailored to specific needs of countries. In addition, the Bank has a diversity of instruments that give the institution the flexibility to support different types of interventions in the sector. For example, besides loans to finance large-scale projects, the Bank has resources to finance technical cooperations, the creation of knowledge products to inform policymaking, and the promotion of policy dialogue to exchange best practices among key decision makers.

Figure 6: (Infographic): IDB's Competitive Advantages in the Sector



How does the Bank measure its contribution to the sector?

To evaluate whether our projects have helped advance the objectives of decentralization in the region, the IDB considers four dimensions of success:

- 1 **Inter-governmental** arrangements must improve subnational public management.
- 2 **Subnational governments** improve the efficiency and quality of expenditure and service delivery.
- 3 **Subnational governments** improve own-source revenue collection and access to financing.
- 4 **Subnational governments** operate with greater transparency and accountability.

In brief, we believe at the IDB that in order to build a better future for Latin America and the Caribbean, it is critical to adequately manage the decentralization process and strengthen subnational governments. Well managed decentralization can bring governments and citizens closer together, and help to ensure that scarce resources are allocated to the right places, to prop up the agenda of development of the region and improve lives.

We invite you to join our community and share your thoughts on this topic by subscribing to our blog [Blogs.iadb.org/recaudandobienestar](https://blogs.iadb.org/recaudandobienestar)

Visit www.iadb.org/fiscalmanagement to download the IDB's Decentralization and Subnational Governments Sector Framework.



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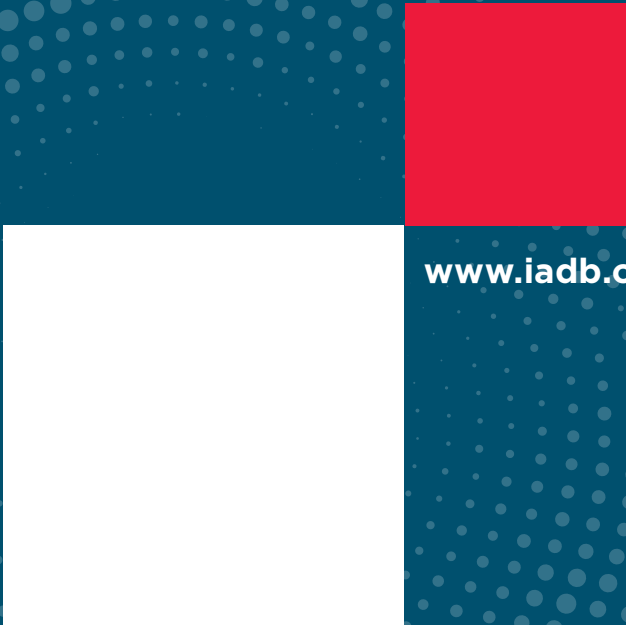
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