Public Sector Decentralisation in Federated Countries

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Posted Date: 29 August 2024

doi: 10.20944/preprints202408.2183.v1

Keywords: State owned enterprises; SOE; supply efficiency; public enterprises

 doi:10.20944/preprints202408.2183.v1

Article

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Abstract: A framework for analysis that focusses on options for structuring and funding the State Owned Enterprises (SOEs) is required in order to apply concepts and information more effectively to policy analysis and program creation. Regardless of the political or economic driving reason for SOE organisation, the requirements of the people must be met in developing countries necessitate that the strategy be viewed from this angle. The types of SOEs and the applicability of fiscal federalism are examined in this article. There are certain lessons to be learnt from the past, and a bad policy can have unintended repercussions. Strategies must be developed for the organisation of SOEs while taking into account the various starting situations.

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Introduction

State ownership has typically been seen as black-and-white in state-owned enterprise studies, meaning that the government that owns the SOE is not taken into consideration when determining whether a company is state-owned or not. Theoretically and ideologically, it is now more challenging for academics to draw attention to the distinctions between SOEs controlled by national and local governments. governments. This research aims to fill this gap. It is commonly assumed that the democratic countries are more decentralised. There are exceptions though: former Socialist Republic of Yugoslavia was far more decentralised than France. With the advance of democracy across the world it is time to consider the working of SOEs of national governments and those of sub-national governments.

There is a consensus that SOEs are quite different from private enterprises, not just in ownership but also in the way they manage their finances and human resources. Compared to a regular enterprise, state-owned enterprises are typically expected to be less efficient due to political interference, but unlike profit-driven enterprises they are more likely to focus on public objectives. When the colonies gained independence the public objectives were very clear: economic growth and provision of basic needs. That used to be the focus of politics and public administration in developing countries before fashionable words like entitlements, capabilities, functionings and empowerment diverted their attention. Of late, with the decentralisation drum rolling on, scholars in the field of public administration and the people in the trenches in the fight against poverty have a tough time deciding their strategy. Who is responsible for provision of basic needs: the markets; the government at some level – national, regional or local, a parastatal at some level or none of these?

Decentralisation

With the centralised state losing legitimacy after the fall of the USSR, suddenly decentralisation seemed to be the latest fashion in the matters of governance in general including ownership of SOEs. The potential benefits of decentralisation attracted all kinds of supporters under its large tent including free-market economists with suspicion of the SOEs to those who believe in pervasiveness of market failure including anarcho-communitarians like postmodernists, multiculturalists, environmentalists and activists for various causes. This sudden love for decentralisation can be attributed to the fact that decentralisation appeared to be crucial to the dual political transition that in the 1990's had become imperative for the developing and post-communist world: promotion of institutions to bring efficiency to the market and bolstering fledgling democratic experiments. The World Bank embraced decentralisation as a major governance reform on its agenda. International agencies have not hesitated in including decentralisation as conditionality in their projects.

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The reality of decentralisation turned out to be quite different from that imagined by its advocates. Under the rubric of decentralisation, steps were taken which satisfied a political agenda to the detriment of public administration:

1. In much of Africa, local governments were created but given neither power nor responsibility for SOEs. This move is often explained as an attempt by bankrupt central governments to create a new target for political dissatisfaction without relinquishing real power.
2. In the middle income countries of Latin America, central governments have transferred resources and responsibilities for some SOEs to the sub-national governments. This arrangement has been explained as an attempt to 'buy off' a growing number of disaffected local political constituents.
3. In the Eastern Europe, inefficient SOEs have been given over to sub-national governments; a move explained as a hasty effort by newly victorious political forces to consolidate their positions at the local level, complimented by an effort by the central governments to 'push the deficit down'.

Inevitably, this has meant a lot of back-tracking and and many false starts, especially in Latin America, which does not have low average incomes, but continues to be the most unequal region in the world. Countries like Perú have become examples of how not to reorganise SOEs.

Decentralisation literature usually recommends the transfer of powers and responsibilities from the national to sub-national governments. Political arguments in favour of such transfer are strong as militaristic dictatorial regimes tend to centralise power. However, this is a simplistic view. Often military dictatorships and other autocrats have devolved powers to local governments. This in turn weakens regional governments, incapacitating them to pose any challenge to the central leadership. In Pakistan whenever the Military takes power, attempt is made to increase decentralisation at district level.

Decentralisation is also viewed as a mechanism for controlling the size of the public sector. From this perspective, government sector is viewed as a Leviathan that seeks its own aggrandisement through maximising the extraction of tax revenues from the populace. Decentralisation places constraints on the Leviathan to channel resources to itself. In some international organisations pushing structural adjustment and transitional reform, decentralisation has often been used in the same breath as privatisation.

Relevance of Fiscal Federalism

While decentralisation of administrative authority is comparatively simple, decentralisation of finances is somewhat complex. Figure 1 shows the various routes to decentralisation in the context of financing of needs of the communities.

There is a large body of literature on decentralisation in public economics, often referred to as fiscal federalism. The theory of fiscal federalism has evolved in western democracies to understand the emerging fiscal problems created by progressive national integration of economic systems within a decentralised political structure. When the role of the government ceased to be merely protective, the ‘social’ state emerged and more government services became available to citizens to fulfil their needs, the discrepancies between the capacities and needs of the subordinate units of governments became glaring. This development caused some students to view the federal political structure as anachronistic and anti-democratic .

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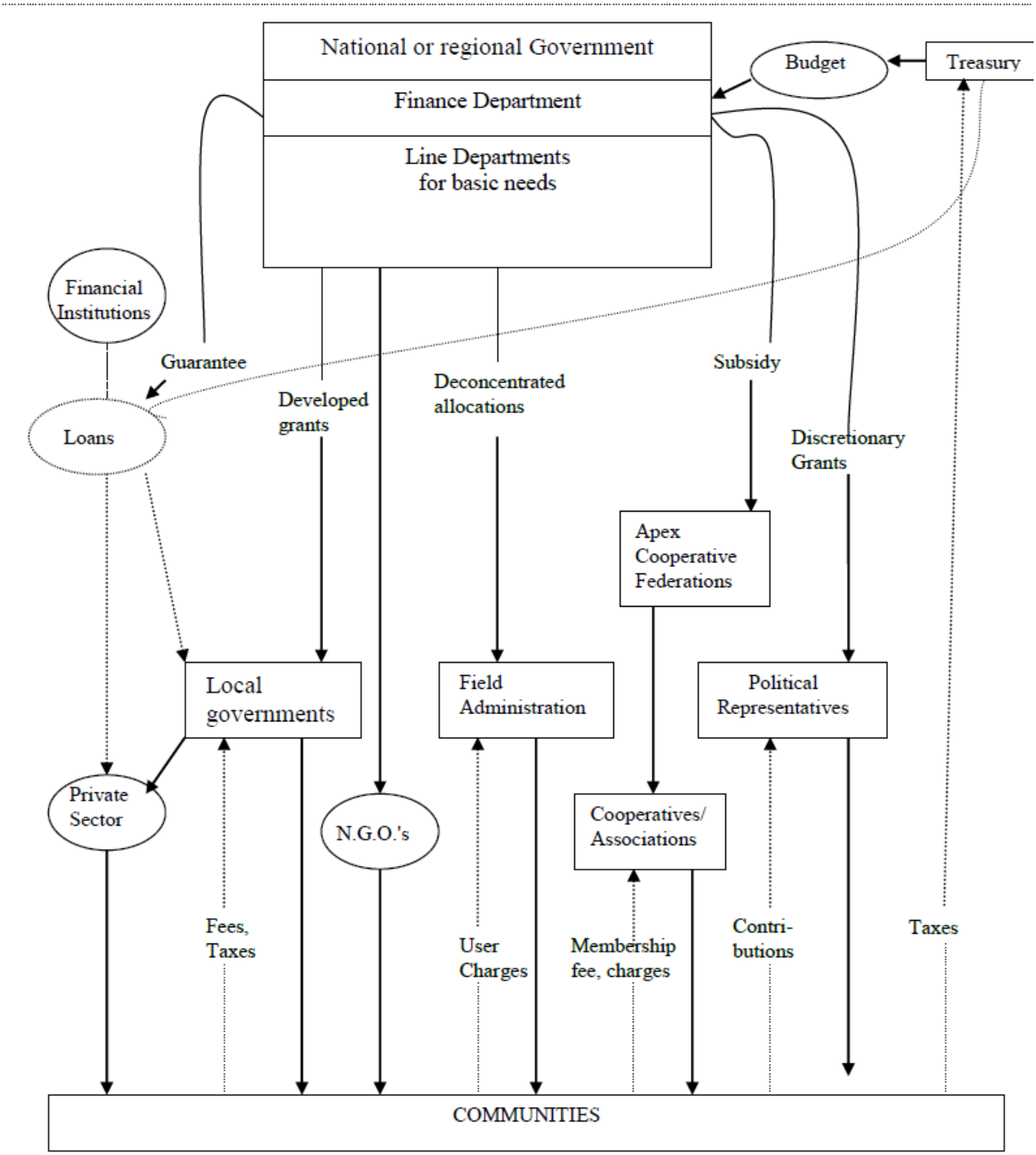

Figure 1. Financing of Basic Needs and Economic development in developing countries.

It has been argued that federal polity had outlived its usefulness and the conditions which made it necessary in the process of development no longer prevailed. But political centralisation was not desirable in view of the strong federal spirit prevailing in countries like the United States and Australia. The challenge was to formulate a theory and policy proposals that could integrate the economy presuming a political structure that was decentralised in the power sense. This theory contends that the decentralised levels of government have their *razón de ser* in provision of goods and services whose consumption is limited to their own jurisdiction directly or through SOEs.

Thus the case for decentralisation is often based on allocative efficiency in public administration. Because tastes and preferences for public services vary among communities, welfare gains are

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achieved by decentralising decisions relating to SOEs to the level of government that best incorporates a community of common interests. Validity of this conclusion in a developing country situation is open to question. The traditional approach to development in political science, law and economics sees developing societies as incomplete versions of developed ones, lacking some essential ingredients of mature developed societies. Democrats, legal scholars and economists recommend that new institutions and policies be transplanted from developed societies into developing ones. Yet, the theories of fiscal federalism evolved in western democracies may have doubtful relevance to developing countries. As Diana Conyers warns most developing countries inherited relatively centralised systems of government from their colonial powers, and in the first years of independence there was often a tendency to strengthen central control in order to encourage national unity and discourage fissiparous tendencies. These countries have not experienced the process of evolution from the town hall up to the national government experienced in industrial countries. The implication of decentralisation from national governments to sub-national governments in developing countries must be evaluated in terms of specific circumstances of each country. The argument that the inhabitants of different jurisdiction have different tastes is questionable in developing countries where basic needs, which are quite well known, are yet to be met.

Decentralisation of SOEs, Public Policy and Supply Efficiency

Contrary to optimism shown by the World Bank, empirical studies show no improvement when SOEs are decentralised. Analysis of database of Ugandan health system and find that local government SOEs in the health sector are starved of funds as the local governments increasing expenditure towards publicly financed private goods.

SOEs in developing countries need to be more efficient in terms of optimisation of limited resources as also more focussed on the public needs. For example, inefficiency and corruption in Food Corporation of India and State Civil Supplies Corporations has led to widespread malnutrition among the poor in India. While the standard decentralisation model says little about supply efficiency, the assumption is that as an organising principle, decentralisation brings the government closer to the people and makes the leadership accountable to the people thereby increasing efficiency. Few empirical studies are available with comparison of efficiency with robust statistical analysis. Most of the available studies show that the supply efficiency declining with decentralisation.

Reasons for Poor Performance of Sub-National SOEs

One obvious reason for poor performance of sub-national the inevitable diseconomies of scale. Perhaps the even more important reason for inefficiency is the human factor. In terms of provision of water SOEs, the World Bank cosidered it as a desirable trend as it brings the level of responsibility closer to the user. Yet, even this protagonist of decentralisation noted that the water SOEs in more than 400 urban centres of less than 100,000 inhabitants in Perú do not have the economies of scale in operations, and are unable to offer attractive working conditions and vocational training to qualified personnel and to plan and run operations at a satisfactory level. Presciently, it predicted the next two or three years, it is likely that response capacity of the new sector will worsen. On the other hand, in case of Tunisia, the steady improvement occurred after centralisation of water and sanitation services to national level SOE due to streamlining of vocational training and formation of a competent cadre of technical professionals.

Technocrats in developing country SOEs are likely to operate quite far from technical production frontier; and it is likely that the sub-national level technocracy will be farther away. Technical and administrative services of national SOEs offer better careers, greater diversity of tasks and comparatively less political interference. They can invest in research and development, training and other measures of long term growth, something that the small sub-national SOEs cannot do. The professionals working with the local SOEs suffer from isolation and low level of interaction with other professionals. Local SOEs can neither attract the best talent nor acquire the technical skills of technocrats available to higher level SOEs.

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Another reason for lower level of supply efficiency is high level of corruption in lower levels of governments. Decentralisation of corruption could be viewed as a desirable trend in that it may have redistributive effects. There is reason to believe that the level of corruption at the local level is much higher and offsets the probable beneficial redistributive effects of decentralisation of corruption. The local politicians and bureaucrats, the distinction between them is less rigorous, are likely to be more subject to pressing demands from local interest groups with whom they develop unethical relationships. They view their SOEs as a source of personal aggrandisement. Monitoring and auditing are lax at the local level and there are fewer obstacles to corruption.

Conclusions

Any strategy relating to SOEs needs to consider which level of government is likely to be more sensitive to provision of people's needs and more efficient in supplying them. Forms of ownership of SOEs including hybrid ownership and joint provisioning need to be clearly understood. There are common lessons to be learned; yet, every country situation is unique. Cultural and historical conditions differ and the governments' readiness to act on specific SOE issues varies. In view of the variety of initial conditions existing in different countries, the strategy for reorganisation of SOEs needs to be custom tailored; keeping in mind how such a strategy affects financing and provisioning of the people's needs.

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