

# Handbook of Fiscal Federalism

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# Objectives

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- Review developments in literature—which have been extensive in last 15 years
- Examine impact for policy making
- Prepare a reference volume for researchers and policy makers
- Some of the chapters more than reviews, but reflect contributions to the subject

# Objectives of volume

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- How practice influences theory (asymmetric, contract federalism) ?
- How developments in theory reflect practice?
- How theoretical insights can be used to design policy?
  - Role of governance and institutions?
  - How can effective service delivery be assured?
  - Equity, efficiency and political constraints on revenue assignments?
  - Equity, equalization and institutional arrangements in the design of transfers?
  - Macro-economic stability—risks and opportunities

# Recent developments

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- Traditional “normative theory” (Musgrave, Oates, etc) unable to explain institutional arrangements
  - Supranational issues (EU)
  - Difficulties seen in different parts of the world:
    - Regional developments
    - Asymmetric arrangements
- In recent literature:
  - Dropping assumption of benevolent governments (from Musgrave, Oates)
  - More effective and realistic modeling of ***political economy*** issues
    - Legal, political and administrative issues become critical
    - Information flows
    - Incentives and sanctions
  - Support for Bank-Fund emphasis on “good governance” and accountability

# Institutional arrangements and policy challenges

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- Range of practices: Federalism and decentralization
  - Federalism effective in large, rich countries
  - Brazil, India (thriving)
  - Under stress in other countries (Pakistan, Nigeria—both late 60's conflicts)
  - Failure in others (West Indies, Rhodesia and Nyasaland)
- Unitary states with considerable autonomy
  - China, Indonesia
  - Increasingly in Latin America, but also in Africa
- Supranational arrangements in EU
- Major challenges in post-conflict situation: Balkans, Sudan, Iraq;
- Developing countries, as well as in the OECD (Bank-Fund-OECD network)

# Common considerations

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- Political economy considerations
  - Vertical interactions/ supranational, national to sub-national layers
  - Horizontal interactions across units at a given level
- Critical role of the design of institutions
  - Importance of information
  - Laboratory or yardstick competition
- How to ensure accountability: no simple solutions
  - Center: scale of diversion
  - Local governments: “capture” and “lobbies”
    - Madison’s warning about “factions”

# Broad issues

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- Intergovernmental interactions and competition
- Expenditure policies, institutions
- Tax assignments
- Financing issues (transfer design, borrowing; macroeconomic stability)
- Special issues:
  - Development context;
  - Natural resources
  - Environment
  - Corruption
  - Keeping countries together ?
  - Political institutions

# Intergovernmental interactions and competition

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- Vertical competition
  - Constitutions and legal framework, important starting point (Breton)
  - Asymmetric responses (Congleton); efficiency with checks and balances
- Horizontal competition (Salmon)
- Spatial interactions
  - Causes and effects of tax competition (Revelli; Wilson)
  - Contractual dimensions (Eichenberger & Frey; Spahn)
    - Responsibilities result of bargaining rather than principles



# Issues for policy making: spending assignments and outcomes

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- Who does what?
  - Normative and positive theories of government (Dafflon)
  - Size of government
  - Scope for contract federalism (Spahn)
  - Asymmetric decentralization and design (Congleton)
  - Difficulties in formerly planned economies (Rao)
- Service delivery focus: what works and who benefits?
  - Bardhan; J. Ahmad, S. Devarajan, S. Khemani, S. Shah.

# Issues for policy making: sequencing and information flows

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- Sequencing of measures
  - Increased resources not sufficient to ensure improvement in quality and access
    - (J. Ahmad, Devarajan, Khemani, Shah)
  - Possibility of capture (Bardhan)
- PFM issues—good governance
  - Importance of intertemporal decision making
  - Should one move towards performance budgeting and contracts
    - Spahn vs. E. Ahmad, Albino-War and Singh
    - Preconditions important
  - Importance of consistent information—reporting and tracking—essential for effective competition

# Issues for policy making: revenue assignments

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- Should mobile revenue bases be assigned to lower levels? (Ambrosiano & Bordignon)
- Revenue-sharing: pools or individual taxes:
  - Traditional vs political-economy approaches
- Importance of local own-source revenues at margin (Ambrosiano & Bordignon)
  - Credibility of intertemporal fiscal discipline
  - Hard budget constraints

# Policy issues: Financing Options and Constraints

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- Equity, efficiency considerations and transfer design (Boadway)
- Efficiency in special and general purpose transfer design (Ahmad and Searle)
  - Management and monitoring of special purpose transfers
  - Disincentives of “gap-filling” transfers
  - Equalization models
  - Institutional arrangements

# Issues for policy making: Borrowing

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- Macro-economic considerations—  
opportunities and risks
- Overall limits and apportionment between  
and across levels
- Options for control
  - E. Ahmad, Albino-War and Singh

# Emerging issues

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- Decentralization and management of natural resources (Brosio; and Ahmad and Searle)
- Decentralization and corruption (Shah)
- Decentralization and poverty reduction (Bardhan; Rao; J. Ahmad et al.)
- Environmental challenges (Dalmazzone)
- Decentralization and maintaining national unity (Bird and Ebel)
- Role of political institutions (Galligan)

# Next steps

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- Focus on effectiveness of process, service delivery; management of process
  - Research and policy advice in different parts of the world
  - Volume on management of fiscal decentralization (FAD)
  - Conference on effectiveness of service delivery (Moncalieri, summer 2007)
    - With ongoing research with UN (East Europe); FAD work
    - Bilateral donors
    - Multilateral agencies
  - Collaboration (with Bank and bilaterals) on countries on a case by case basis