

Preface

Sustainable and inclusive growth in emerging Asian economies requires continued high levels of public sector investment in infrastructure, education, health, and social services. However, the increasing complexity and regional diversity of these investment needs make it difficult to plan and execute such investments centrally. Therefore, these responsibilities, especially with regard to infrastructure investment, need to be devolved progressively more to regional governments, which have a better understanding of local needs. However, the growth of sources of revenue and financing for local governments has not kept pace, forcing them in some cases to rely on unorthodox funding measures such as shadow banking, or else cutting spending below desired levels. Moreover, the ability to raise funds varies widely among regions and districts, leading to the need for systems of both horizontal and vertical transfers to support equitable levels of spending and to achieve minimum performance targets set by the central government. Even if adequate funding is available, there need to be safeguards to ensure that debt levels are sustainable.

Fiscal decentralization has been implemented in many Asian economies as a response to these needs, as well as a result of political shifts, mainly the increasing democratization in some economies. However, it is still a work in progress. There are many inconsistencies between revenue and expenditure assignments at the local government level, as well as a lack of clarity and overlapping assignments, which typically lead to inadequate funding shortfalls, at least in some districts. Transfer programs also have issues, including the lack of equity and disincentives for own-revenue generation. Some economies have enabled local governments to borrow significant amounts to cover shortfalls, but systems to monitor such borrowing and ensure sustainability are still being developed. Capacity limitations at the local level also make the effective implementation of fiscal decentralization more difficult.

The purpose of this book is to take stock of some major issues regarding fiscal decentralization in Asia, and to develop findings and policy recommendations. However, it is not intended to be a comprehensive examination of all issues, or to cover all economies in the region. Part I provides an overview of the issues of fiscal decentralization. In Chapter 1, Morgan

and Trinh provide a framework for examining issues related to expenditure assignments, revenue assignments, intergovernmental transfer programs, and mechanisms for monitoring and enforcing fiscal sustainability at the local level. In Chapter 2, Smoke examines the political, institutional, and environmental factors that have hindered the effectiveness of fiscal decentralization programs.

Part II examines mechanisms for promoting fiscal sustainability at the local government level. In Chapter 3, Chakraborty examines whether the application of fiscal rules has resulted in an increase in the fiscal space for public capital investment spending in major Indian states. The analysis shows that there is a negative relationship between fiscal rules and public-capital investment spending at the state level during the rules based fiscal regime. In Chapter 4, Barrios and Martínez-López investigate the way the differences in fiscal capacities, which are primarily determined by regional differences in gross domestic product per capita, influence regional public borrowing depending on the existing fiscal equalization scheme. In Chapter 5, Martínez-Vazquez and Vulovic analyze the effects of the various broad types of borrowing regulations on the narrow definition of fiscal sustainability at the subnational level.

Part III provides studies of central–local government relations related to specific topics in individual economies. In Chapter 6, Fan and Wan explore the efficiency of the transfer system in the People's Republic of China (PRC). They evaluate the equalized effects of transfers with data of 2,800 countries from 1995 to 2009, investigate the function of earmarked transfer on vertical governance, and estimate the impacts of transfer on local economic growth rates. In Chapter 7, Zhang and Li show how innovative fund raising and financing channels can lead to the upgrading of local governments' infrastructure construction and public service capability in the PRC. In Chapter 8, Nasution describes the division of responsibilities between the central and local governments, government financing and administration of public funds and state-owned enterprises, the fiscal transfer system, and the need of the subnational governments to expand their capacities to mobilize their own revenues in Indonesia. In Chapter 9, Bessho provides an overview of Japan's local public administration and finance systems and analyzes how Japan's municipalities restore their fiscal balance after a fiscal shock. In Chapter 10, Morgan and Trinh describe the experience of fiscal decentralization in Viet Nam, including recent issues and policy.

Part IV examines the behavioral implications of central–local government relations. In Chapter 11, Das investigates whether the composition of expenditure of the subnational governments in India has an impact on the degree of indebtedness of the states. In Chapter 12, Goel and Saunoris

analyze the effect of the various forms of government decentralization on institutional quality in a large sample of nations. In particular, they use corruption and the shadow economy to proxy for institutional quality, and virtual, physical, and fiscal decentralization to account for the different dimensions of government decentralization.

Inevitably, issues and conditions vary across economies to such an extent that it is difficult to draw broad or consistent lessons from these studies. Nonetheless, we believe that these studies will provide valuable insights for policy makers dealing with issues of fiscal decentralization in Asia.

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