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Division for Public Institutions and Digital Government
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Africa Workshop on Subsidiarity and Decentralization for Sustainable Development

Fiscal Federalism and Decentralization

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I. The Role of Subnational Governments in Development

- **Public sector decentralization** has been a prominent global phenomenon, although it varies in form and importance
- **Low- and middle-income countries adopt or reform decentralization** with varied objectives--improved public management/governance/accountability; stronger economic growth; more efficient/inclusive service delivery; and promotion of peace and stability, among others
- The attainment of these goals is based on **expected greater SNG knowledge of local conditions/needs and closer connection to local people** compared to central governments
- Part of the **rationale for decentralization/subsidiarity** is a public finance theory known as **fiscal federalism**

II. Fiscal Federalism

Public Finance: Role of Government

- Stabilization (Central)
- Distribution (Central)
- Allocation Functions (Lowest Possible Subnational Level)

Fiscal Federalism:

Role of Subnational Governments

Economic Principles

Political/Institutional Context

1. Local Functions

Defining and Costing Needs

3. Public-Private Partnerships

2. Local Finances

Local Own-Source Revenues

Transfers: Fiscal Gap/Other National Goals

Loans: Market and Subsidized

Private Sector Financing

1. Functions assigned to subnational governments based on fiscal federalism principles adjusted for context

2. Finances (appropriate mix) assigned to ensure subnational governments can provide assigned functions

3. Subnational governments can as needed engage private sector partners

Subnational Finance and Other System Elements Must Work Together

- For subnational governments to meet their responsibilities, a credible **intergovernmental fiscal system** must be in place or developed:
 - Expenditure Assignment/Management
 - Local Revenue Generation/Autonomy
 - Intergovernmental Transfers (unconditional/conditional)
 - Local Government Investment Finance/Borrowing (including donor funds in developing countries)
- Beyond these fiscal elements, **effective fiscal decentralization depends on appropriate administrative and political decentralization**

III. Fiscal Decentralization

Situation and Trends

- Middle- and low-income countries tend to have less fiscal decentralization than higher income countries, but there is great variation

<u>Country Income Level</u>	SNG Expenditure Share of GDP	SNG Share of Total Public Expenditure	SNG Share of Total Public Investment	SNG Share of Total Tax Revenue	Intergovernmental Transfers/Total SNG Revenue
High	14.0	28.0	44.1	19.7	51.4
Upper- Middle	8.0	23.0	41.5	13.9	58.0
Lower- Middle	4.5	19.0	34.8	13.0	44.4
Low	2.0	12.0	18.0	4.4	53.0

IV. Implementation

- **There is no “best” assignment of subnational government functions and revenues:** fiscal federalism principles must be applied to be compatible with **economic, institutional, political and cultural context** across/within countries
- **Common implementation challenges** include
 - **Economic realities** (limited/narrow economic bases, pervasive poverty, etc.)
 - **Lack of good information** (to design and manage systems) **and empirical evidence** (regarding what works)
 - **Capacity constraints** (technical, managerial, governance)
 - **Political realities** (at both the national and subnational level and in relations between them)

Implementation Strategy

- **Fiscal decentralization reforms are demanding and can rarely all be done simultaneously**
- **There is a need for a strategic implementation strategy, which may, for example, include:**
 - Determining appropriate starting points and a path for the sequencing of reform(s)
 - Considering the use of piloting and experimentation before mainstreaming reform design
 - Creating appropriate incentives to adopt reforms
 - Appropriately enhancing capacity development
 - Adopting an ongoing learning and adaptation approach to intergovernmental fiscal reform
 - Working effectively with international development partners interested in providing support

Thanks for your attention!

**Feel free to contact me for further
information**

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