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Decentralization and local competitiveness in Latin America

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A Challenging and Appealing Region: the big picture



- ✓ Economic Structural Adjustment in the 90's partially successful -There is work still to be done...national and local competitiveness still elusive
- ✓ Modernization of National Governments and Decentralization are important objectives of most countries and are *both linked*
- ✓ Agenda: Inter-governmental Fiscal Reform and Improved Governance crucial for national and local Development

Structural Adjustment: The first wave of reforms



- ✓ The region learned the hard way (hyperinflation) the need for fiscal stability...
- ✓ ...and the imperative of cautious monetary policy
- ✓ Privatization advanced a long way but there is still work to be done, some bad experiences raised questions about this policy both for governments and investors (water case)
- ✓ As a result, macroeconomic stability is better now than years ago, low inflation and reasonable growth rates (but associated to commodity prices) slowly lifting people out of poverty, access to financial markets, struggling with international trade terms

Institutional Adjustment : why the second wave of reforms?



Macroeconomic stability is not enough to improve national and local competitiveness and development opportunities...a responsive and accountable Government, as well as clear intergovernmental roles, rules and incentives are also crucial

Institutional Adjustment : Agenda of the second wave of reforms



- ✓ National Government Reform: quality policies
 - National Governments focus on macroeconomics (fiscal/monetary policies), strategic policy making, market regulation
 - More effective legislative bodies and judiciary

- ✓ Decentralization and subnational governments: quality public service provision
 - Elected public officials increase accountability
 - Clarifying intergovernmental responsibilities
 - Strengthening sub-national governments as local service providers (social, infrastructure, urban planning, security)
 - Increasing tax powers, reforming fiscal transfers and developing local financial markets

Subnational Governments limitations

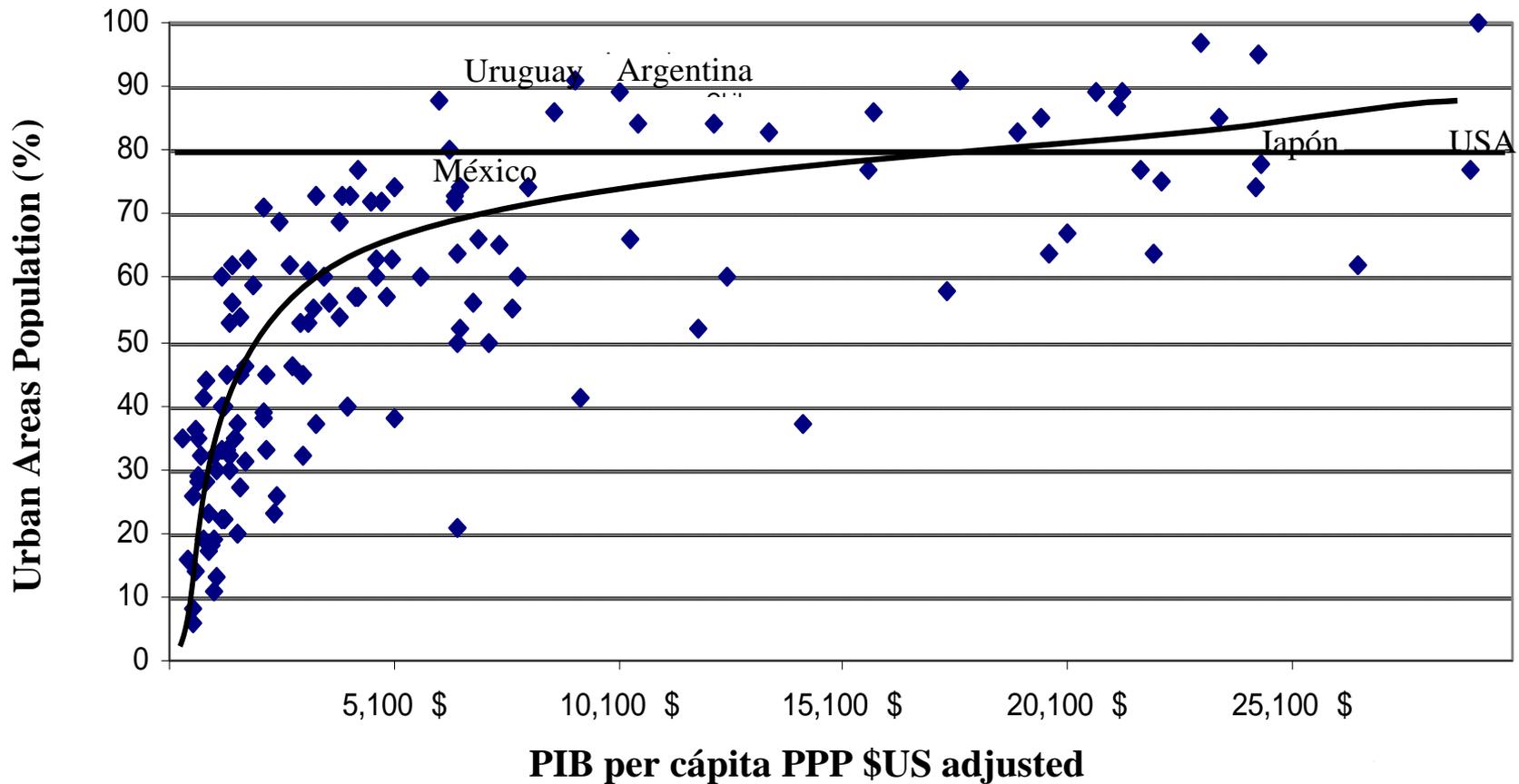


- ✓ Limited autonomy of subnational governments decrease its effectiveness for managing cities and local development:
 - Predetermined provision of public services
 - Excess dependency from fiscal transfers from the central governments

Table 1: Intergovernmental fiscal relations (selected countries)

| | Average Latin America | | Average Industrialized | |
|------------------------|--------------------------|-------------|---------------------------|-------------|
| | Income | | Income | |
| | % GDP | % Total | % GDP | % Total |
| Public Sector Total | 25.6 | 100.0 | 42.4 | 100.0 |
| Central Government | 20.9 | 81.6 | 27.8 | 65.6 |
| States | 3.4 | 13.3 | 9.0 | 21.2 |
| Municipalities | 1.3 | 5.1 | 5.5 | 13.0 |
| <i>After Transfers</i> | | | | |
| Central Government | 16.1 | 64.9 | 22.8 | 53.5 |
| States | 6.1 | 24.6 | 11.7 | 27.5 |
| Municipalities | 2.6 | 10.5 | 8.1 | 19.0 |
| | Expenditure | | Expenditure | |
| | % GDP | % Total | % GDP | % Total |
| | | | | |
| Public Sector Total | 27.9 | 100.0 | 47.8 | 100.0 |
| Central Government | 18.4 | 65.9 | 27.2 | 56.9 |
| States | 6.9 | 24.7 | 12.6 | 26.4 |
| Municipalities | 2.6 | 9.3 | 8.0 | 16.7 |

Table 2: PIB per capita and world urbanization levels



Transaction costs vs. Agglomeration Economies



- ✓ Increase in GDP per capita as a consequence of urbanization levels at US\$ 5,000 and 70% of urban population. As cities expands transaction costs also increase and counterbalance positive effects of agglomeration and scale economies

Pro-competitiveness policies



- ✓ Rationale for intervention: compensating for market and government failures
- ✓ National Governments
 - Lowering barriers for businesses, preventing monopolies from disturbing markets (international trade, national transportation infrastructure, public/private partnerships, incentives for expanding access to financing and... active industrial policies?)
- ✓ Subnational Governments
 - Lowering transaction costs and increasing opportunities for businesses (regional/local infrastructure and services, registry, permits and regulations; public/private partnerships, active fiscal policies, regional-local promotion, political brokers)

Dilemmas for governmental and intergovernmental action



- ✓ National agreements on policies vs. regional dynamics (*political consensus, legitimized capture of decisions by big businesses*)
- ✓ Active industrial policies vs. market regulation (*concentrated strategic objectives, choosing winners*)
- ✓ Intergovernmental contracts vs. clear rules, defined responsibilities and autonomy (*synergies, institutional transaction costs*)
- ✓ Pursuing privatization vs. turning to public/private partnerships? (*privatizing a public utility?, political interference*)

Some Conclusions



- ✓ Intergovernmental institutional/fiscal arrangements matter for local development and competitiveness: forest vs. tree
- ✓ Interinstitutional cooperation should lead to good results, but may create huge transaction costs
- ✓ Do not forget the old good ideas that lead to (national and local) development:
 - Rule of Law
 - Property rights
 - Public Accountability
- ✓ No magic bullets have been identified...to be continued