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I. Introduction

Ensuring adequate subnational revenue is a core concern of fiscal decentralization. Public finance principles for selecting and designing subnational revenue sources have been widely used during the prominent wave of decentralization efforts in developing countries over the past three decades. Available empirical literature, however, suggests that subnational revenue generation often fails to meet needs and expectations, even where normative advice has been or seems to have been followed.[1]

Are the principles inappropriate, or are they just poorly applied? This paper argues that both factors are often at play. Basic principles are valuable, but they can be challenging to use and do not cover certain critical factors. Even if the principles are relevant and well applied, implementation commonly faces powerful constraints. Yet despite unsatisfying performance, revenue system design remains substantially based on a conceptually narrow normative framework that lacks a sense of pragmatic strategy and is often overwhelmed in practice by contextual factors it fails to or only weakly considers.

The necessity for "context specific" reforms is by now well accepted. Bahl and Bird (2008) recently underscored the need for adopting an inductive approach that helps to determine what works rather than a deductive one that makes theoretical statements about what should work. Less explicitly recognized is that the breadth and diversity of relevant contextual factors extends well beyond the realm of those typically considered, such as political will, level of development, federal versus unitary system, public sector capacity, etc.[2] These are important--reforms suited for capacitated and dynamic urban governments in more advanced and more democratic developing countries may offer little to new rural councils in least developed countries. At the same time, national political and bureaucratic structures and dynamics, local political factors, and civic capacity, among others, also affect how subnational revenue reforms play out, whether or not they are taken into consideration in designing and implementing reforms.

The next section provides an overview of the broader context of fiscal decentralization, followed by a section that summarizes key mainstream principles of subnational revenue assignment and challenges commonly encountered in applying them. The fourth section turns to a number of prominent underexplored factors that contribute to the divide between theory and practice but have not been sufficiently considered by fiscal

[1] Bahl and Linn (1992); Shah (1994, 2004, 2006c); Prud'homme (1995); Tanzi (1996, 2001, 2010), Ter-Minassian (1997); Bird and Vaillancourt (1998); Litvack, Ahmad and Bird (1998); Smoke (2001); World Bank (2001, 2005); Ahmad and Tanzi (2002); Ebel and Yilmaz (2003); Bardhan and Mookherjee (2006), Bird (2006, 2011); Bahl and Bird (2008), United Cities and Local Governments (2010).

[2] Diversity is a theme throughout the decentralization literature. Several volumes focus on single countries, including Bahl and Smoke (2003) and Alm, Martinez-Vazquez and Indrawati (2004). Some are regional specific and interdisciplinary, including Burki, Ahmad and Dillinger (1999), World Bank (2001), Smoke (2003), Wunsch and Olowu (2003), and World Bank (2005). Others are cross-regional, including Bird and Vaillancourt (1998), Ahmad and Tanzi (2002), Bardhan and Mookherjee (2006), Shah (2006c), Smoke, Gomez and Peterson (2006), Connerley, Eaton and Smoke (2010), Martinez-Vazquez and Vaillancourt (2011), and Dickovick, Wunsch and Connerley (forthcoming)

decentralization academics and practitioners. I close with a few summary comments on thinking about the divide between subnational revenue theory and practice.

II. The Broader Context of Intergovernmental Fiscal Systems

Subnational revenue assignment occurs in a broader national context, both fiscal and beyond. Tanzi (2010) outlines four distinct approaches to intergovernmental fiscal arrangements that are observed globally. These include: 1) empowering subnational governments to set up their own tax systems; 2) retaining all taxes centrally and sharing proceeds with subnational levels through transfers; 3) assigning certain taxes exclusively to subnational governments; and 4) sharing revenue from certain nationally–collected taxes (perhaps with limited minor tax options for subnational governments).

There are advantages and disadvantages to each approach, and in multi-tier systems, arrangements may differ among levels. As Tanzi argues, there is no "optimal" solution, since the choices a country makes depend on technical matters, historical trajectories, political forces and other factors. The usual fiscal decentralization considerations regarding an appropriate balance between central control and local autonomy, the desired degree of redistribution, and the extent of tax competition, among others, are important. How reformers make design decisions is at least implicitly shaped by the relative importance of national goals in pursuing decentralization—democracy, development, conflict resolution, etc.—as they evolve with broader economic and political dynamics.

Within this larger fiscal context, sustained successful use of revenues depends on developing a multi-dimensional constitutional/legal/administrative framework and the means for its implementation and enforcement. The requirements, however, go beyond typical fiscal decentralization factors, such as the legal status, powers, functions and autonomy of subnational governments. Subnational revenue generation also depends ultimately on creating a more extensive enabling environment, including elements not specific to decentralization.[3] The nature of property rights, for example, affects property tax policy and administration, and legal provisions for local governance (elections and beyond) and civil society rights create space for developing citizen engagement to discipline local government performance.[4] These factors heavily influence how accountable subnational governments are likely to be to their constituents.

III. Fiscal Federalism and Revenue Assignment

Fiscal federalism principles remain the policy cornerstone for decentralizing expenditure and revenue functions. These principles, which are largely based on standard economic concepts interpreted in a spatial and multi-level context, are generally well defined and

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[3] This is discussed in Shah (1994, 2004); Ahmad, Litvack and Bird (1998); Bahl (2000a); Ebel and Yilmaz (2003). Rodden et. al. (2003); Ebel and Taliercio (2005); Smoke (2006, 2007); Bahl and Martinez-Vazquez (2006), and Boex and Yilmaz (2010).

[4] Yilmaz, Beris and Serrano-Berthet 2010 summarize subnational accountability requirements.

accepted.[5] They have been repackaged from time to time, and a few have been added or embellished to move beyond basic concerns of the original theory. They remain in various ways relevant for designing systems and individual revenue sources.

1. The Basic Principles

Many versions of the basic principles, both simple and elaborate have been outlined over the years.[6] Desirable subnational revenue characteristics typically include the following:

- Adequacy: covering subnational budgetary needs (based on the "finance follows function" principle)
- Buoyancy: growing in proportion to the economy and expenditure needs
- Stability: avoiding large fluctuations in revenue yields that would undermine the ability of subnational governments to provide services
- Efficiency: minimizing distortions of economic decisions made by individuals and firms (e.g. resulting from differentiated base assessment and rates); and ensuring correspondence between payments and benefits (including limiting tax exporting).
- Equity: ensuring fair treatment among equals (horizontal) and across different groups (equals) framed in terms of income but can use other points of reference.
- Autonomy: allowing subnational governments discretion to make independent decisions (creating a ink between revenue generation and service delivery).
- Administrative feasibility: ensuring the scale and complexity of administration is consistent with capacity and affordable to the subnational government.
- Political feasibility: maximizing the likelihood of acceptance of a source through consistency with political reality, e.g. taxpayers see value for money, fair treatment, less visible/onerous (small payments over time versus large lump sums), etc.
- Integration/consistency: ensuring the logic of the full set of subnational revenues and consistency with the rest of the national fiscal system, (e.g., limiting overlap with central taxes and revenue disincentives in transfer and lending mechanisms).

This set of principles is in the first instance intended to ensure that subnational revenues meet core public finance principles in the context of a multi-level government system with distinct territorial jurisdictions. Key concerns include that: each level of government should have clear functions and bear responsibility at the margin for financing them; own-source revenues should ideally be sufficient for subnational governments with the greatest fiscal capacity to fully finance their functions, and so on. The extent to which the principles are actually applied in the design of the system and prevail in its operation is no simple matter to assess.[7]

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[5] Fiscal federalism is introduced in Oates (1972) and revisited in Oates (1999). Derivative work and critiques include Shah (1994), Prud'homme (1995), Tanzi (1996, 2001), Ter-Minassian (1997), Litvack, Ahmad, and Bird (1998), Bird (1999), Bahl (2000a), McClure and Martinez-Vazquez (2000), Smoke (2001), Ebel and Taliercio (2005), Bahl and Bird (2008), Boadway and Shah (2009) and Bird (2011). Literature on "second generation" fiscal federalism includes Oates (2005) and Weingast (2006, 2009).

[6] The most recent and perhaps the most succinct summary is provided in Bird (2011).

[7] See, for example, Bahl and Linn (1992), Shah (1994), Bird (1999, 2011), Bahl (2000a), Bird (2001), Ebel and Taliercio (2005); Taliercio (2005); Ebel and Weist (2006), Bahl and Bird (2008), Smoke 2008.

2. The Reality of Subnational Revenue System Design and Implementation

There are three broad issues in assessing subnational revenue assignment. The first is whether the division of revenue sources between central and subnational governments generally meets accepted principles. The second is whether individual sources are designed to meet accepted principles and are collectively consistent with the principles (given that different sources are better at meeting certain individual principles). The third is how well the subnational revenue system as designed is implemented on the ground.

International experience suggests that central governments do not often devolve inappropriate revenue sources, e.g. taxes on mobile bases, taxes that seriously compete with national revenue sources, etc. Common subnational sources include property tax, user fees and charges, various types of licenses and fees and limited types of business taxes, and at intermediate or urban levels, motor vehicle revenues and business or sales taxes.[8] Piggybacking on selected national taxes, especially by intermediate levels, is also often recommended and sometimes practiced. The common local revenue sources are rarely controversial, although the details of how they are structured and managed may be.

There is some debate over a few sources, such as natural resource taxation, VAT and business taxation. Such debate draws on the principles, but it is often also related to the type of system involved (federal or unitary), managing interregional conflict, and financing regional/metropolitan versus other local governments.[9]. In some cases, problematic revenues emerged in a particular context, became productive, and were difficult to modify or eliminate later. Examples include the octroi and its variations (in South Asia and elsewhere), the regional services council levy (a combination payroll and turnover tax) in South Africa, and the graduated personal tax in Kenya and Uganda (an unusual and complex hybrid of a PAYE tax, a presumptive income tax, a wealth tax, and a poll tax).

It is fair to say that most developing countries err on the conservative side and assign fewer revenue sources than could be justified by fiscal federalism principles, often, keeping the most productive sources for the national budget. Central management of these major sources, however, is often justified because of the nature of the bases and the inherent advantages of centralized administration for some taxes. If and exactly how these resources are shared with subnational governments, of course, matters a great deal.[10]

The design of individual revenues and their aggregate effects are harder to definitively assess because of the diversity of experience, but there seem to be nontrivial lapses in adherence to basic principles. First, although there is great variation, own source revenue assignments are often inadequate.[11] Determining overall revenue adequacy (including transfers), however, is complicated by the vagueness, inconsistency, and incomplete

[8] Bird (2006, 2011), Bahl and Bird (2008), and Smoke (2008) review key literature in more detail.
[9] This is a VAT levied on the basis of income (production, origin) rather than consumption (destination), which is advanced by Bird (1999, 2001, 2005, 2009).
[10] Literature on intergovernmental transfers is reviewed in: Bahl and Linn (1992), Shah (1994, 2006a), Ter-Minassian (1997), Bahl (2000b), Bird and Smart (2002), and Schroeder and Smoke (2003).
[11] See United Cities and Local Governments (2010) concluding chapter (Martinez-Vazquez and Smoke).

adoption of functional assignments. One indicator of inadequacy is the tendency for subnational governments to use unproductive or unofficial sources, although the former can reflect historical factors or unwillingness to collect productive allowable taxes.[12]

Adequate buoyancy is elusive due both to the types of revenues assigned to subnational governments and their not uncommon failure to take administrative actions needed to ensure base growth (e.g., revaluing and indexing property assessments). In principle, subnational revenues can be relatively stable, but this depends on good administration and the willingness of subnational governments to enforce collection during more difficult economic times or periods of political pressure, e.g. leading up to subnational elections.

Subnational revenue systems often compromise efficiency to various degrees. Examples include the choice of instruments (e.g. turnover taxes); differential treatment of taxpayers or sectors in pursuit of policy objectives (e.g., favorable tax rates to spur development in some locations or industries); poorly developed or enforced assessment and collection (increasing possible political manipulation of tax burdens); and the adoption of taxes with "exportable" burdens (although this is not universally opposed and may be to some extent seen as desirable in certain instances, such as taxes that fall primarily on foreign tourists).

Horizontal equity is generally a greater concern of subnational tax policy than vertical equity given potential spatial inefficiencies created by subnational redistributive taxation. How this plays out, however, depends on certain design and implementation decisions. Equity can be affected, for example, if there is preferential treatment of certain taxpayers or groups due to subnational tax regulations and weak or selective administration.

Revenue autonomy varies considerably, but it is often limited by the central government due to concerns over national fiscal policy management and/or local capacity. At the same time, subnational governments may fall to take advantage of autonomy that is granted because they do not know how to do so where decentralization is new or capacity is weak. Alternatively, disincentives in the fiscal system or political conditions may undermine the motivation of subnational governments to exercise their revenue powers.

Administrative feasibility may be compromised by pursuing non-revenue raising objectives and or adopting poorly defined or unduly complex administrative procedures.[13] Political feasibility is often difficult to determine and effective adoption of subnational taxes may be challenging in developing country environments, especially in the poorest countries where citizens are not used to receiving and/or paying for services.

Inconsistencies in the overall fiscal framework are not uncommon. These may appear in the form of insufficient harmonization of central and subnational taxes. Weak incentives for subnational revenue generation are common in intergovernmental transfer programs, which may also undermine subnational borrowing even by fiscally capable subnational governments. The central government may set up lending mechanisms for capital

[12] This is discussed in Prud'homme (1992), Lewis (2003b), and Taliercio (2004, 2005).
[13] See, for example, Mikesall (2002, 2007), Bird and Wallace (2003), Lewis (2003a, 2006), Taliercio (2004, 2005), and Ebel and Taliercio (2005).

investment when subnational governments do not have access to the financial market, but then fail to enforce loan repayment, undermining revenue generation incentives.[14]

The extent to which allowable subnational revenues are successfully adopted varies considerably. In some cases, constitutional or legal assignments of subnational revenues have not been implemented. National agencies with regulatory power may choose to restrict how certain sources are used, and individual subnational governments may not use sources assigned to them. Such behaviors usually result from fiscal and political incentives or capacity issues, as suggested above and discussed more fully below.

3. Overall Assessment

Central governments often follow basic fiscal federalism principles in devolving revenues, but they do so conservatively, and legal frameworks may not be fully implemented. Individual source design is unevenly consistent with principles, and central governments commonly exert more control than needed. Several factors contribute to the gap between theory and practice. First, technical aspects of revenue design are not straightforward. Some tough tradeoffs are embedded in the fiscal federalism principles, and this complicates their use in determining a workable mix of subnational taxes and the design of individual sources.[15] Even if principles are followed such that each source is designed to best meet its comparative advantage, the principles can be prioritized to different degrees, and how the full set of revenues works together is important.

Second, the lack of appropriate and reliable information for good policy design and administration can create challenges. Information that is available may be kept in different agencies and some definitions may change over time, making the assembly of data challenging and compromising data consistency.

Third, there is a common perception that there is often insufficient "political will" for decentralization in general and for allowing subnational governments revenue autonomy in particular. Various explanations are given for the lack of political will, but the bottom line is that it influences the revenue sources assigned to subnational governments and the extent to which these are implemented by the central and subnational governments.

Fourth, incapacity is often cited as a key factor in limiting the access of subnational governments to revenue. The underlying logic is that even if the central government meaningfully devolves revenue powers, subnational governments do not have sufficient or appropriate capacity to implement them. In addition, some have charged that revenue reform initiatives may build the wrong type of capacity, e.g. too much focus on valuation and not enough on collection in property tax administration.[16]

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[14] See Peterson (2000), Friere and Petersen (2004).

[15] For example, sales, turnover and property taxes may be productive and buoyant, but difficult to administer, and they may create inefficiencies and inequities. User charges may be efficient but inequitable. A less visible tax may be politically feasible but reduce efficiency because the benefit-cost link is hidden.

[16] For example, see Kelly (1993, 2000, 2003).

Finally, economic realities constrain subnational revenue generation. Intermediate and metropolitan governments are often in a position to raise substantial revenues if given the opportunity, but the situation can be rather different in rural areas with a high incidence of poverty. Even in productive agricultural areas, appropriate revenue sources are often controlled by the central government, leaving subnational governments dependent on transfers and creating challenges for developing a subnational benefit-revenue link.

In short, although revenue assignment principles are known and used to define reforms, weak or uneven revenue generation and poorly designed subnational revenue systems are among the most prominent flaws of decentralization in developing countries. Even where progress has been made, broader systemic reform has been elusive.

IV. Broadening the Analysis for More Effective Revenue Policy

Both the academic and practitioner literatures recognize many constraints outlined above and take them into account in conducting analyses. At the same time, mainstream analysis does not sufficiently consider other factors that can influence the extent to which even the most conceptually adherent reforms are properly designed and implemented.

1. National and Intergovernmental Political Economy

Fiscal decentralization and revenue assignment obviously have political as well as technical foundations. There are literatures on the political economy of taxation and decentralization. Second-generation fiscal federalism has taken up related issues, but in a somewhat ad hoc way.[17] Generally speaking, this work does not get enough consideration in thinking about the challenges of subnational revenue design and implementation.

An interdisciplinary social science literature focuses on the political economy of taxation, considering how the shape of revenue systems relates to the structure of the public sector, government capacity and state-civil society relations.[18] Among the most influential approaches are the public finance approach, which focuses on minimizing the impacts of taxation on economic development and other national goals; a taxpayer-focused approach, which considers how ideology, value and culture influence taxpayer willingness to pay and compliance; a political institutions approach, which explains the development of state capacity and tax systems through historical analysis; a crisis-based approach that considers how conflict drives tax expansion and modernization; and a fiscal contract approach in which revenue maximizing governments use state-provided benefits to "negotiate" with payment minimizing taxpayers. Some of this work is technical, but most recognizes that deeply embedded historical factors, the nature of political systems, and the relationship between the state and citizens condition how much and which revenues can be raised.

[17] See, for example, Oates (2005), and Weingast (2006, 2009).
[18] See, for example, Therkildsen (2001), Sabates and Schneider (2003); Schneider (2003), Moore (2004, 2007), Addison and Levin (2006), Brautigam, Fjeldstad and Moore (2007), and Torgler (2007).

The political nature of decentralization is reflected in a considerable academic literature on the political economy of decentralization.[19] In policy circles, the role of politics is often abstractly and simplistically framed, as noted above, in terms of the need for adequate "political will" to decentralize.[20] In the world of practice, the term political will implies the commitment of a munificent and unified center to improving the lives of the people by empowering locally elected governments. A key message of this literature is that the main motives for decentralization are usually complex and may be rather less benign, depending on incentives to decentralize faced by legislatures, political parties and government administrators. Sometimes the motivations for decentralization have little or nothing to do with normative fiscal or political justifications. Furthermore, even strong (or apparently strong) political will is not sufficient. Many countries that have developed robust constitutional and/or legal decentralization frameworks have only incompletely designed and implemented them or have even undermined them in practice.

The main consideration is why, under what conditions, and how decentralization was undertaken, and what this implies for the level and durability of "political will" to genuinely empower subnational governments. It is well known that decentralization efforts in developing countries have often been responses to domestic crises that create pressures or opportunities for major change.[21] Since crisis implies urgency, there may not be enough time (or genuine intention) to develop more than a shallow consensus on the shape and process of reform. Frail or rushed consensus may go hand in hand with a limited appreciation of the nature of decentralization, adoption of poorly designed frameworks, insufficient attention to implementation, and indifference or resistance from important actors who—after reform is already official--come to perceive decentralization as damaging to their interests and act accordingly. The bulk of these dynamics occur in the response of the bureaucracy (see below) to political decisions to decentralize.

National politics obviously support or undermine fiscal decentralization policy. Politics influence which functions and revenues are decentralized, the degree to which the center is willing to grant subnational autonomy, and the process and support structures that enable subnational governments to assume new responsibilities. Reluctance to decentralize may reflect an unwillingness of the center to relinquish functions and resources, or efforts to pursue reforms superficially may result from clashes between the legislature and the executive or among groups within legislatures, which can be based on party politics or factions within dominant parties. On the other hand, a regime may also strategically decentralize to gain support and to consolidate power.

Intergovernmental political dynamics may also play a role. In many developing areas, subnational governments are not strong, but in some countries, particularly in Latin America, politically influential subnational governments may take advantage of a crisis

[19] Various elements of the literature are reviewed in Manor (1998), Eaton (2002, 2004), Wunsch and Olowu (2003), Ribot (2004), O'Neill (2005), Ribot and Larson (2005), Bardhan and Mookherjee (2006), Smoke, Gomez and Peterson (2006), Ahmad and Brosio (2008), Connerley, Eaton and Smoke (2010), Hiskey (2010), Eaton, Kaiser and Smoke (2011).

[20] For a more detailed discussion of this issue, see Smoke (2003).

[21] Literature on this issue is reviewed in Smoke, Gomez, and Peterson (2006).

or an unstable situation to place demands for greater empowerment on the central government.[22] In other cases the impetus may not come from below, but the central government makes decisions based on intergovernmental relations considerations.

Ethiopia, for example, pursued a decentralization in which ethnically identified states were empowered by a new constitution to hold the country together after secession of an important state, Eritrea. Indonesia faced a similar situation after the 1997 Asian financial crisis, the fall of the Suharto regime, and the loss of the province of East Timor. In that case, however, the reform empowered cities and districts and initially marginalized the provinces in the hope of averting secessionist ambitions. In a few federal systems where states have power over local governments, the center has tried to ensure that intermediate tiers do not unduly control lower tiers. Brazil, for example, directly supports municipal governments, and India tried less successfully with constitutional amendments to push state governments to empower local governments. Many more examples could be given, but the point is that these intergovernmental attitudes and political dynamics matter because they can determine subnational empowerment and revenue assignments.

Finally, although many political scientists adhere to the idea of path dependency in political dynamics, they recognize that situations can change rapidly, as demonstrated by some of the preceding examples. In competitive political environments or when a crisis suddenly develops, incentives to shift course by recentralizing or decentralizing (or appearing to do so) can quickly emerge.

2. The National Bureaucratic Environment

Ultimately most of the national responsibility for detailed design and implementation of decentralization falls to administrators rather than politicians. These actors, however, often have diverse views on decentralization, which often takes place in complex and poorly coordinated bureaucratic environments.[23] A wide variety of central agencies often have a role in developing, implementing and overseeing key reform parameters. These include local government oversight ministries (Ministry of Local Government, Home Affairs, Interior, etc.), coordinating ministries with a broad mandate to oversee an aspect of public sector operations (Ministry of Finance, Planning, Civil Service, etc.), special purpose ministries (Ministry of Rural Development, Urban Development, Special Areas, etc.) and ministries involved in service delivery (education, health, transport, etc.).

Even if there is (or appears to be) broad national consensus for decentralization, these agencies may have incompatible opinions regarding how far decentralization should go and what their role in it should be. The impetus for reform may even come from ministry-based policy analysts, but if it comes from one ministry without consulting others that perceive the initiating agency as a rival, broad support may be withheld during implementation even if the initiative has political support to become law. In some cases,

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[22] Much of the relevant literature on this is reviewed in Smoke, Gomez and Peterson (2006), Hiskey (2010) and Eaton, Kaiser and Smoke (2011).

[23]. Many of these weaknesses are elaborated in Smoke and Lewis (1996); Tendler (1997); Litvack, Ahmad, and Bird (1998); Cohen and Peterson (1999); Smoke (2007), and Eaton, Kaiser and Smoke (2011).

central agencies may overtly or covertly obstruct decentralization when this reduces their power and control over resources. Such behavior can be related to the relationships between agencies and political parties or legislatures, but it may also result from bureaucratic competition or the unwillingness of an agency to accept a diminished role.

Another critical problem is that even if major central government agencies are not overt rivals, they may have little or no incentive to work together cooperatively, even though this is crucial for effective decentralization. In some cases, powerful agencies may engage in direct competition for control of the decentralization agenda (or some aspect thereof) and the substantial internal and external resources that may be involved. Weak cooperation can hinder the development and operation of the subnational system.

One might argue that such concerns are likely to be relevant for larger decentralization policies, but that control over fiscal decentralization is concentrated in a Ministry of Finance and/or a Ministry of Local Government. This is often true, particularly on the revenue side. In poorly coordinated environments without clarity on responsibilities, however, serious problems can arise even between core actors, resulting in incomplete and/or inconsistent policies that complicate subnational government assumption of rightful powers and functions. In Uganda, for example, the Ministry of Finance and Ministry of Local Government separately developed local financial management systems within a few years of each other, and revenues promoted by one were undermined by actions of the other. Similar situations have arisen between the Ministry of Finance and Ministry of Home Affairs in Indonesia, the Ministry of Economy and Finance and the Ministry of Interior in Cambodia, and comparable bodies in other countries.[24]

The actions of other central agencies can also affect how fiscal decentralization plays out. In some countries, development budgets are under the Ministry of Planning, while the Ministry of Finance oversees recurrent budgets, complicating effective use of overall subnational resources. The Ministry of Finance or special bodies subject to government control may manage subnational lending. Civil Service Commissions may have authority over subnational employment, and sectoral ministries may control aspects of subnational sectoral budgets, determine conditional transfers formulas, and manage user fee policies. Special districts or corporate entities may sometimes substantially manage particular services. Not all of these instances of central roles in subnational finances involve direct interference in revenue generation, but they can compromise subnational autonomy and may weaken subnational government incentives to collect own-source revenues.

These concerns do not argue against the exercise of legitimate central government authority, such as national standards for service delivery, financial management, or information and monitoring schemes. These are important elements of a well-designed intergovernmental system if reasonable and principle based. Inadequate regulations and oversight can result in substantial subnational variation in bases or tax rates, which can create problematic interjurisdictional competition and complicate local tax effort comparisons needed for policy design. The problems highlighted here result from fragmentation and competition among central agencies or their indifference to the

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[24] Smoke (2008) provides these examples and references with more information.

legitimate roles of others in overseeing subnational governments. Of course, control and oversight can be excessive. Even with agreement to devolve revenues, efforts to limit the autonomy with which they are executed can be overbearing. Many decentralization frameworks, for example, devolve the property tax, but onerous regulations and arbitrary central interventions can limit local autonomy and revenue productivity.

It would not even be safe to assume that a single ministry will act consistently. Different departments within ministries can compete for to control policy agendas and resources. Within a Ministry of Finance, various aspects of fiscal reform—local revenues, transfers and lending—may be under different departments that function independently, resulting in policy inconsistency. In Indonesia, for example, bureaucratic battles across directorates in the Ministry of Finance were long a major factor in obstructing property tax decentralization (which finally occurred in 2009) and subnational borrowing reform.[25] More generally, the problems of poorly coordinated elements of the subnational fiscal system—intergovernmental transfers that create disincentives for local revenue generation and/or borrowing—are well known and well documented.

Finally, the role of international development agencies as partners of government bureaucracies should not be underestimated.[26] Although they have arguably modified behavior, donors long supported primarily technical approaches to subnational revenue reform, not uncommonly through parallel mechanisms that were not politically and institutionally workable and sustainable. There was also a (now increasingly dissipating) tendency to draw on experiences of advanced countries, recommending reforms that were difficult for many developing countries to implement successfully. Perhaps most important, large international development agencies suffer from competition among internal departments, and these may reinforce the rivalries among government agencies outlined above. In some aid dependent countries, donors have contributed to the development of internally inconsistent fiscal decentralization policies and systems.[27]

3. Subnational Political Dynamics and Accountability

It is well known that some of the key subnational governance assumptions (explicit and implicit) of mainstream fiscal federalism and democratic decentralization theories are only weakly met in many developing countries.[28] Even with policies and systems that are consistent with key fiscal principles and under the most favorable national political and bureaucratic conditions, subnational revenue generation can face daunting subnational political challenges. Some are specific to revenue generation, but the general nature of subnational political systems and dynamics is the overarching concern. Unfortunately,

[25] Smoke (2008) and Smoke and Sugana (2012) discuss this case.
[26] Donor behavior to support decentralization is discussed in Smoke (2000), Romeo (2003), Fritzen (2005), Donor Partner Working Group on Decentralization (2011).
[27] Examples are given in Blair (2000), Fjedlstad (2006b), Connerley, Eaton and Smoke (2010), Eaton, Kaiser and Smoke (2011) and Development Partner Working Group on Decentralization (2011).
[28] Reviews of decentralization from various perspectives, mostly not specific to revenue generation, are provided in Tendler (1997), Manor (1998), Schneider (1999), Blair (2000), Olowu (2003), Wunsch and Olowu (2003), Ribot (2004); Shah and Thompson (2004), Ribot and Larson (2005), Bardhan and Mookerjee (2006), Shah (2006b), Cheema and Rondinelli (2007), Connerley, Eaton and Smoke (2010).

these issues are highly complex and hard to study formally. Available empirical evidence is limited, conflicting and sometimes hard to interpret. This section outlines some of the key issues (with a focus on electoral, non-electoral and other accountability mechanisms), selectively reviews some empirical literature that sheds light on these issues, and briefly explains how decentralized government accountability can be further compromised by other influential actors in the subnational institutional landscape.

How subnational governments use revenue powers depends in great part on where local political power really lies—economic elites, certain ethnic/religious groups, members of particular political parties, labor unions, civil society movements, etc.-- and the resulting incentives faced by local politicians. Subnational governments, for example, may tax businesses relative to individuals or some sectors too heavily or too lightly, creating both behavioral distortions and inequities. Under certain scenarios, high levels of autonomy may lead to considerable elite capture, the exploitation of certain groups and arbitrary or politicized enforcement of revenue compliance. Corruption may be more or less likely under decentralization depending on the nature of social and political relationships.

A well conceived fiscal decentralization framework that includes an appropriate degree of upward accountability and incentives for subnational governments can help to reduce politicized revenue behavior, but the character and exercise of local accountability also matters a great deal. Ultimately, how this all comes together in terms of revenue generation and service delivery will affect whether citizens feel fairly treated (in terms of benefits received for revenues paid and relative to other local residents), and, therefore, whether they will be inclined to make local revenue payments demanded of them.

Certain subnational revenue sources are particularly complex for politicians to deal with. The property tax, for example, is considered to be a good local tax (although administratively challenging), but it is very noticeable to those who pay it directly. Concentration of land ownership and a stark division between the rich/elite and the poor in developing countries also complicate effective use of this tax. Certain groups may have sufficient political power to limit their tax burden. Visible inequities in administration and uncertainty about how tax proceeds are used can create resistance to compliance and generally undermine citizen trust in their subnational government.

Elections are typically seen to be a cornerstone of decentralized governance, and much effort has gone into expanding citizen participation in subnational elections and civic engagement/feedback mechanisms, even in environments where western-style political competition is limited (e.g. Vietnam). Cultural traditions, ethnic identification, and political party loyalties (which may be linked to ethnic loyalties), however, can influence elections and lead to politicization of decisions and revenue generation, such that patronage, clientelism and non-democratic behavior prevail. Further challenges include weak (poorly understood by the general population) civic engagement processes and dominance of civil society by interest groups, local elites or external actors. In some countries, an array of accountability channels with various roles, revenue sources and decision-making processes can co-exist with subnational governments. Any of these factors can compromise the downward accountability required for the expected benefits of decentralization to materialize. They can also exacerbate the effects of or directly interact with national dynamics outlined above, such that some subnational governments and actors are privileged through party, ethnic or commercial linkages with the national legislature and/or key central government agencies.

Subnational Elections

Fiscal federalism assumes the existence of a political mechanism for subnational governments to determine citizen preferences for how revenues are raised and used.[29] The democratic decentralization literature would frame this in terms of the need for fair and competitive subnational elections, although there are other ways for local governments to be held accountable. A growing number of countries hold politically competitive subnational elections, but councils may be only partly elected, elections may be from closed party lists that limit voter choice, or one political party may dominate.

The specific nature of electoral processes can also matter, but the precise effects of using different systems can be quite mixed from a fiscal federalism perspective. An interesting example is the Mexican state of Nayarit, which recently reformed its constitution to move away from the dominant Mexican system of local elections from closed party lists for municipality-wide council seats.[30] Nayarit adopted a system in which a portion of seats is based on open electoral competition for positions attached to individual constituencies within the municipality. Preliminary evidence suggests that service delivery expenditures have been decentralized away from the central areas. This may or may not be efficient for economic development, but it suggests that internal decentralization of representation induced more responsiveness to constituents of territorially based councilors.

At the same time, case studies suggest that some expenditure shifts, especially in social services, occurred according to more personalized, clientelistic principles, and that local revenues have declined relative to states not subject to electoral reform. There is, however, an interesting exception—the largest municipalities in Nayarit did not suffer revenue declines, perhaps suggesting that greater distance of councilors from constituents in large jurisdictions facilitates action for the common good. Another puzzle is that revenue declined even though the federal constitution prohibits re-election, a provision intended to offset a "favors for votes" mentality. This may suggest that despite the impossibility of re-election, councilors behaved to promote future electoral prospects of their party, although one goal of the reform was to reduce party power in local elections.

This single untidy case illustrates—admittedly simplistically and under specific conditions—the great complexity involved in developing local electoral systems and the effects that this may have on accountability and revenue generation. Unfortunately there is not much broader evidence, although a few recent studies in Europe are interesting. One study found that less competent mayors in an Italian region are more easily re-elected if they favor less visible revenues (surcharges on personal income tax) than when

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[29] A useful review of the literature and perspectives on local elections is found in Bland (2010).
[30] Gomez-Alvarez (2012) reviews the Nayarit reform.

they rely on more visible ones (property taxes).[31] The latter, however, decrease transparency and compromise the accountability of local government action. There is also research documenting that tax rates decrease as party majorities increase in French departmental assemblies, and that this effect is more pronounced for right-wing majorities than for left-wing majorities.[32] Of course, revenue reduction is presumably what voters wanted, so it may indicate good subnational governance, and reducing subnational tax burdens is more likely to be desirable in an industrialized than in country than in a developing country. The key point here is that research is needed to understand the fiscal effects of subnational electoral practices and outcomes in developing countries.

Another critical issue here is horizontal accountability—between elected local councils and staff who execute the local budgets. It is critical to have a clear division of roles, for example, with elected councilors setting policies in areas where they have responsibilities and overseeing technical staff members who implement them. It is not uncommon in newly decentralizing countries for staff transferred from the central to subnational governments to maintain strong upward accountability relationships, leaving elected local councils in a weak position to deliver on their downward accountability commitments to their electorates. The degree of control that councils have over staff is important, but how it is executed also matters—councilors can, of course, undermine revenue collection.

There are no simple conclusions regarding the effects of subnational elections on decentralization or revenue behavior. Much depends on the numerous elements of context outlined above and the specific rules and processes surrounding electoral and fiscal systems, which can be the product of both central and subnational constitutions and laws. What can be said is that subnational elections can matter a great deal for fiscal performance, and that no presumption should be made that the adoption of cutting-edge fiscal decentralization reforms will result in the normative benefits attributed to them if the local political processes do not provide an adequate environment for this to occur.

Non-Electoral Governance Mechanisms

Even where the subnational accountability challenges outlined above are not prominent and adequate electoral competition exists, elections are recognized to be a blunt means for improving downward accountability. Moreover, local elections are not an important accountability channel in some developing countries. There has been considerable attention in recent years to adopting other types of local accountability mechanisms, such as participatory planning and budgeting, town meetings, general or service-specific oversight boards or user committees with various non-governmental representatives, and social auditing of local resource use, among others. These can be useful both in promoting better public understanding of how revenue sources are defined and levied and how the proceeds are being used for subnational expenditures. Improved political mechanisms supplemented with more broadly based participation and citizen engagement mechanisms should be expected to lead to better subnational service

[31] See Bordignon and Piazza (2010)
[32] See Dubois, Leprince and Paty (2007)

delivery performance, which can in turn improve the use of subnational taxing powers and help to develop local social capital.[33]

There are, however, two important qualifications. First, participatory mechanisms can be just as technical as fiscal mechanisms, and their intended benefits can just as easily be undermined by politics. Rules and processes for participatory budgeting or planning, for example, can be well articulated to meet normative principles, but what matters is how they are applied. If they are used but participation is token or non-inclusive and advisory rather than influential, broad improvements in service coverage/quality and citizen willingness to pay subnational taxes should not be expected. If such mechanisms are captured by elites, whether political parties, business leaders or even powerful but non-representative citizens groups or NGOs—their impact is likely to be limited or different than intended. Even well intentioned explicit attempts to improve inclusivity, such as a mandatory share of involvement of underrepresented groups (e.g. a certain percentage of women or ethnic minorities) in formal processes, do not automatically make participation meaningful in terms of its impact on decision-making or outcomes.

The second qualification is at the heart of all subnational processes: the use of accountability mechanisms requires a degree of awareness, capacity and interest on the part of citizens. Local budgets or participatory forums may be available to the public, but not everyone may even know that they exist. Equally important, people may not know how to access these mechanisms or how to interpret or use them, and they may feel uncomfortable about participating or expressing their true opinions. In terms of subnational revenue specific arrangements, mechanisms to appeal property tax assessments or local business license fees, for example, will not be effective if people do not know about them or face barriers in using them, such as the lack of appropriate knowledge, poor access to advice, or even outright intimidation.

Subnational Politics, Decision Making and Public Sector Reform

A neglected consideration is how subnational dynamics affect the adoption of public sector reforms and performance. A core question is how subnational politics affect resource allocation in decentralizing environments, and what this implies for revenue compliance. Another concern is how politics affect the adoption and impact of reforms specifically undertaken to improve performance, including revenue generation.

A central theme in the literature on the subnational resources is corruption. On the one hand, corruption could decrease if decentralization improves accountability and citizen trust. Alternatively, it could increase if reform personalizes relationships between the electorate and their representatives. Most studies on this subject are anecdotal or based on case studies (that use different methodologies and are of uneven quality), perceptions of citizens and business leaders or questionable measures/indicators of corruption.

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[33] See, for example, de Mello (2002), Blair (2006), Commins (2006), Platteau (2006), Manor (2007), and Brinkerhoff and Azfar (2010).

Recent literature on corruption offers some encouragement. For example, one study found that fiscal decentralization is associated with reduced corruption even where political representation is high.[34] A less-definitive/more-nuanced assessment argues that the nature of the relationship depends on fiscal arrangements and political features in each country.[35] Specifically, incentive systems set by the center for local governments, and the alignment of local government interests with those of the local constituency influence whether decentralization increases or decreases corruption. If citizens understand the dynamics, revenue compliance is likely to be affected.

Evidence on the use of local revenues suggests the role that local politics might play in altering rule-based allocations. Education allocations in Uganda, for example, often did not reach intended end-users (schools).[36] Whether or not the resources were used productively elsewhere, politics undermined the formal budget system. Also notable is that within local governments, there were considerable variations in terms how much of a school's entitlement was received. This suggests that certain schools had power to claim more of what they were due. A judgment about whether this constitutes corruption would require more information, but the existence of such disparities in budget executions (and presumably outcomes) should be expected to influence the willingness of residents to engage in local affairs and to pay local taxes.

Some experiences suggest that expected benefits of adopting technocratic reforms to improve revenue systems can be offset by behavioral adjustments rooted in political and social dynamics. Revenue growth and stability, for example, improved in Uganda with private collection of local taxes, but leakages persisted.[37] They simply shifted from the collection point (the collector-taxpayer transaction) to the district administration (the contractor-local government transaction). Research on the Uganda Revenue Authority, which was established to reduce corruption, found that behavior of individuals depends on the interests of social groups to which they belong.[38] Formal rules were initially followed, but over time shifted back to behaviors based on social relations. Thus, technocratic reforms (in this case promoted by donors) perhaps halfheartedly, naively or opportunistically (in search of other objectives) embraced by national or subnational bureaucrats, may not recognize that effective reform requires stimulating foundational changes in the behavioral culture of the public service. This is a time consuming process and does not happen easily even with major changes in formal structures and procedures.

Compliance and Local Political Dynamics

Tax compliance is obviously critical for effective subnational revenue generation. There is limited empirical evidence, but available analysis indicates that compliance can improve or deteriorate under decentralization. The effect seems to depend on economic conditions, citizen attitudes about subnational governments, and variations in subnational

[34] See Altunbas and Thornton (2012).
[35] See Bjedov, Madies and Schnyder (2010).
[36] See Reinikka and Svensson (2004).
[37] See Iversen et. al. (2006).
[38] See Fjeldstad (2006a),

political dynamics, including the willingness and ability of subnational governments to enforce the tax code.

On the optimistic side, the city of Porto Alegre (Brazil), which is famous globally for pioneering participatory budgeting, mobilized considerable support for tax reform and substantially improved compliance through local participatory mechanisms.[39] The city dramatically increased revenue yields during a period of national reform when transfers were also rising rapidly. Of course, Brazil has more developed institutions and political mechanisms and a more active civil society than many developing countries. On the opposite end of the spectrum, tax compliance in Senegal decreased after collection was devolved to local councilors due to poor service provision and weak confidence in local authorities.[40] Compliance was found to be best among foreigners and new residents who strategically used tax payment to establish themselves as legal community members.

Local tax compliance in Tanzania was positively related to ability to pay and (perceived) probability of prosecution, but negatively related to perceptions of oppressive tax enforcement and weak satisfaction with services.[41] Although the research suggests that unduly harsh treatment may weaken compliance, some element of coercion seems to improve performance. Successful enforcement, in turn, is associated with the capacity of individual local governments and the insulation of revenue collection from direct influence by elected councilors. Inability to pay played a role in declining service charge payment in South Africa, but variations in compliance within and between communities with similar socioeconomic characteristics suggest that poverty does not tell the whole story.[42] A key factor again seems to be whether citizens believe that local governments are providing adequate services and treating them fairly. Similar sentiments emerge from a survey in Uganda, where local tax compliance is poor. Only 11 percent of respondents believed that local taxes were devoted substantially to improving services, but 75 percent indicated a willingness to pay more for better services.[43]

Definitive conclusions cannot be drawn from this brief review of limited literature, but the findings do suggest that revenue compliance is related to taxpayer perceptions of value for money and fairness in the subnational revenue system and that appropriate enforcement can be productive. It also suggests, however, the need for efforts to inform and actively engage citizens around the mobilization and disposition of subnational revenues, something that is often lacking in decentralization reform programs.

The Broader Subnational Accountability Landscape

As if the complexity of subnational government institutions and politics was not challenging enough on its own, another important consideration is the murky landscape of subnational accountability relationships that not uncommonly prevail in developing

[39] Schneider and Baquero (2006) review the literature and examine the Porto Alegre experience.
[40] The nature of the system and the research are explained in Jull (2006).
[41] Fjeldstad and Samoa (2001) and Fjeldstad (2001) elaborate on the research and the results.
[42] See Fjeldstad (2004, 2005) for details.
[43] The results are reported in Jeer (2004) and Jeer (2005).

countries. The above discussion focuses on subnational governments, but they may be far from the only actor on the scene. Devolved systems of government may exist in parallel with deconcentrated administrative systems, and both may have operational departments in the same sectors and jurisdictions. This is not necessarily a problem if their respective roles are defined and respected. If this is not the case, or if the deconcentrated system has superior funding and is delivering services that are the legal responsibility of the local governments (with the approval of or at the explicit direction of a parent ministry at the national level), there is a serious accountability problem.

Other problems of this nature also exist. In some countries, such as Kenya and the Philippines, national political dynamics have resulted in the creation of constituency development funds, which award parliamentary constituencies (which may be geographically identical to or overlap subnational government jurisdictions) funds for service delivery. These can be considerable. In Kenya, for example, more resources flow through the constituency fund than through transfers to local governments. Community driven development programs, which provide grants from a national ministry or body (often funded by international agencies) for service delivery to (mostly nongovernmental) local actors, may compete with nascent subnational governments. In some countries, nongovernmental service providers play a major (independently from subnational governments) role in delivery of basic services. In situations where there are so many lines of accountability and funding channels for service delivery with insufficient clarity on specific responsibilities and many actors providing the same types of services, citizens are likely to be confused about what to expect from elected local governments. This, in turn is certain to affect their willingness to pay subnational taxes.

4. Capacity and Leadership

At the risk of raising perhaps the most clichéd point in the literature, capacity and leadership can matter greatly in how fiscal decentralization and revenue generation play out. At one level, this is obvious, but what seems to matter is the nature and location of the capacity and whether the political incentives to use it are in place.

Empirical work on this topic is limited, but mostly confirms that capacity and leadership can shape outcomes realized by decentralized systems. The capacity and qualifications of municipal mayors in Colombia have a positive affect on local public finance.[44] In a study comparing two islands in the Philippines, the more economically successful and higher capacity island had strong local leaders who were more successful at using the room for maneuver provided by decentralization to improve performance.[45] A study of selected districts in Indonesia found that variation in tax performance among districts is associated with concrete actions initiated by district heads, presumably in response to the enlargement of their official powers and incentives to improve governance.[46]

[44] See Avellaneda (2009).
[45] See Lange (2010).
[46] See von Lube (2009) for a review of the literature and the empirical results.

If capacity matters, a few comments about capacity building are in order. A large share of resources for fiscal decentralization goes to capacity building, but critics argue that it is often treated in a perfunctory, boilerplate way.[47] Capacity building can be "supply driven" (by the central government) or "demand driven" (by subnational governments), and it can be "classroom based" or "on the job." Many developing countries continue to focus on traditional supply driven classroom training. There is anecdotal evidence and a growing consensus that "on the job" training demanded by local governments for specific tasks they are in the process of implementing is a better way of developing and retaining skills. Thus, a general course at a training institute on property valuation or setting user charges may be less useful than, or should be supplemented by "on the job" training provided as subnational revenue administrators are in the process of undertaking these functions. Although not strictly a revenue issue, how capacity building is handled may well affect the ability of subnational revenue administrators to perform effectively.

Another key capacity issue is the preparedness of civil society to play its critical role in improved decentralized governance and its presumed impact on improvements in subnational government performance. Holding a training seminar on participatory budgeting does not constitute much of an effort at citizen capacity building in the context of the issues discussed above, but that is mostly how this has been approached in developing countries. Some international agencies and NGOs place greater emphasis on civic engagement, but they tend not to link those efforts to local government incentives. The importance of a more engaged and capacitated citizenry for the success of decentralization and willingness to pay local taxes cannot be emphasized enough.

Finally, capacity is an issue at the national government level as well. The various central actors developing subnational revenue powers, systems and related local capacities may themselves not have sufficient capacity to meet these obligations. A related concern is that, especially in aid dependent countries, much of the capacity applied to develop subnational revenue systems is external or externally financed (above civil service remuneration), and this capacity may not be transferred to national institutions. Even if it is, skills may not be used effectively in the absence of appropriate incentives.

5. Lack of Strategic Orientation in Decentralization and Fiscal Reform Programs

The preceding discussion documents the complexity of making fiscal decentralization—whether in general or with respect to revenue assignment—work effectively. In various explicit and implicit ways the analysis points to weaknesses in how decentralization reforms are implemented—often too quickly or two slowly, and with relative inattention to embedded political and institutional constraints that affect performance. In recent years there has been a growing interest in how to better implement and sequence fiscal decentralization.[48] Most of this work is not specific to, but is relevant for, subnational revenue development.

[47] Some examples are provided in Green (2005).

[48] This is discussed to varying degrees in Smoke and Lewis (1996), Litvack, Ahmad and Bird (1998), Burki, Perry and Dillinger (1999), Falleti (2005), Smoke (2006, 2007, 2010), Bahl and Martinez-Vazquez (2006), Ebel and Weist (2006), Shah and Thompson (2006), and Bahl and Bird (2008).

Even a well-designed subnational tax on a high-value base, for example, may not be productive unless sufficient care is given to how it is implemented—not only in technical but also in political and institutional terms. The central government must be willing to devolve the tax and develop reasonable systems and procedures for operating it. Subnational governments need to face incentives—from the central government and their constituents--to adopt the new taxes and develop the capacity to use them. Citizens and businesses must learn to pay new taxes, which they will resist doing unless they believe that subnational governments are being responsive and treating them fairly. None of these things happen quickly or easily in the context of many developing countries.

Decentralization (including local revenue) implementation has both national and local dimensions that can be developed in various ways. The conventional approach might be called the "framework" approach because it involves developing an intergovernmental framework—based on normative principles adapted to country context—by the central government and creating systems and procedures for its operation. Some awareness raising and training is involved, but the core expectation is that if correct incentives are built into the new system, relevant actors at all levels will adopt its provisions, including developing capacity. At the other extreme, the center pursues a managed process for implementing the subnational framework over time according to nationally determined rules. Decentralization is not fully automatic under this approach—it happens through a centrally managed process according to centrally determined criteria. I have elsewhere called these models the "sink or swim" and the "paternalistic" approaches.[49]

A pure framework approach is not appropriate for most developing countries. It can only work under certain conditions, including where central ministries face incentives to comply with decentralization mandates; a hard budget constraint is adopted to discipline subnational governments; subnational governments clearly understand what is expected of them and have adequate capacity and incentives to comply; and citizens see benefits of engaging with subnational governments and trying to hold them accountable. The management approach involves a more active role for central government in overseeing reform, but it is prone to move slowly and treat capable subnational governments too conservatively, hindering their ability to manage their fiscal affairs.[50]

The merits of a more strategic approach somewhere in between the two extremes—which recognizes key political and institutional constraints—are gradually being recognized. Such an approach might involve, for example, consultative mechanisms with actors critical for reform; asymmetric treatment of subnational governments to recognize their different characteristics (e.g. urban vs. rural) and capacities (fiscal and administrative); negotiated reform trajectories, such that subnational governments share some responsibility for agreeing to adopt particular reforms over a specific time frame; and performance based approaches to create incentives for reform. As certain steps are successful, more advanced stages of reform can be progressively undertaken.

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[49] See the discussion in Smoke (2008).
[50] See, for example Bahl and Smoke (2003), and Smoke (2007, 2010).

This type of implementation strategy is subject to risks. Assessments and negotiations involved could become politicized, and reforms might stall at an early stage. But this seems to be a danger with all decentralization reforms, and carefully crafted processes and accountability mechanisms could alleviate risks. The specific situation will also differ among countries that are at different stages of reform. Some countries already have a local revenue system that they are trying to improve. Others are transferring centralized revenues to local governments. Still others are creating new local revenues. Such differences in the nature of the system—along with political and institutional factors outlined above—should inform the strategy for a particular country.

It is also important to consider an implementation strategy from the perspective of a subnational government. Even capable ones must be strategic in adopting revenue reforms that require major increases in what residents pay and other behavioral changes. Simple and more politically acceptable reforms could be undertaken before complex or controversial ones, and revenue improvements could be tied to specific service improvements. For example, in places where movement to full property valuation is intended and current valuations are low, assessment ratios could be phased in and related to particular service improvements. Similarly, new user charges could move gradually towards cost recovery in order to avoid harsh equity effects, undesirable changes in service use, administrative and political resistance, etc. New systems and procedures could be tested through pilots, allowing for modifications before wider adoption.

Institutional innovations can be used to help overcome political connectivity constraints noted above. Adoption or tailoring of citizen engagement and oversight can facilitate public acceptance of local tax reforms, as some of the empirical work noted above suggests, and public education may improve citizen awareness and compliance. User committees for specific services have been used in some countries to connect citizens to subnational service delivery and associated revenue generation, although they can also be used to bypass subnational governments.[51] Working with community-based groups on service delivery and revenue generation for certain services, such as urban trash collection and maintenance of minor rural irrigation canals, can be productive and benefit subnational governments, the partner community groups and local residents. Small steps can change how subnational governments function as well as how citizens view them.

Some may argue that subnational revenue reforms in developing countries already bridge technical and political matters to some degree, and there is often an element of strategy as well. It is true that many technical aspects of revenue reform discussed above, such as more transparent and simplified property valuation, incrementally increasing assessment ratios or user charges over time, and the like, are in part a strategic response to political constraints on revenue administration and compliance, even if not explicitly portrayed as such. Many such reforms, however, are promoted unilaterally by a single agency, involve largely technical procedural changes, and fall short in incorporating features that could help to alleviate other constraints that hinder developing a relationship between local governments and taxpayers. Many strategic elements are also partial and ad hoc, focusing on one aspect of the local revenue system that may not be sustainably improvable without attention to other factors.

[51] See the discussion and examples in Manor (2004).

There is no magic formula for developing an implementation strategy, and the complexity of the context in which fiscal decentralization reforms occur necessitates finding a manageable approach. This means that not all considerations and constraints that one might wish to consider in a perfect world can be taken into account. There is likely, however, to be significant room for improvement over current practice. The goal is to better understand the opportunities for and constraints on a desired reform and the relevance of likely sources of support and opposition for how to approach implementation.

V. Using and Moving Beyond Mainstream Theory for More Effective Practice

Central governments in developing countries often do follow, at least to some extent, basic fiscal federalism principles in developing formal frameworks for subnational government revenues. There is, however, a tendency to limit revenue decentralization. Equally significant, frameworks are often general, leaving much room for detailed design of individual revenue sources to stray from principles. Perhaps most critical, even if design principles are closely followed, implementation can easily go off course.

Some deviations between subnational revenue theory and practice can be explained by the theory itself. There are, as noted above, tradeoffs among some principles. Other constraints on applying them—data scarcity, basic socioeconomic characteristics (e.g. economic base and poverty), heavy administrative demands of certain sources, capacity deficiencies, weak commitment, etc.—are recognized as factors underlying compromised design and lackluster implementation of subnational revenue reform. These are all valid explanations for divergence between theory and practice, but they do not do justice to the complexity or depth of the forces involved, some of which are a manifestation of more fundamental phenomena. Several additional factors contribute to the challenges of crafting, adopting and institutionalizing robust subnational revenue systems.

First, decentralization is rarely adopted primarily for the reasons considered desirable by democratization and fiscal federalism theories. Instead, it is often a response to crisis, demands from subnational governments, or shifts in political dynamics. The intention to decentralize may be genuine, or reform may be a superficial response to domestic and/or external pressures. Related concerns include whether reform is broadly supported and if its likely affects are understood. If adopted too quickly, there may not be a genuine consensus or sufficient appreciation of its political or fiscal implications. There is rarely anything that policy analysts can do to influence these underlying forces in dominate in the heat of the moment, but they can try to be more aware of the broader political context.

Second, if the decision and steps to decentralize did not involve consultations with the range of national agencies involved in reform design and implementation and they did not properly understand the reforms, they may develop concerns if they later feel threatened. These agencies shape reform details, and they may have diverse views on decentralization and face conflicting incentives to support or undermine it, either overtly through how they define systems and procedures or more informally through how they implement reform. Poor coordination of the actors in this competitive policy development and support structure environment—and its common reinforcement in aid dependent countries by international development agencies—can lead to policy inconsistencies and limit the effectiveness of subnational reforms, including revenue generation.

Third, local political realities can severely constrain implementation of even a well-designed intergovernmental fiscal system endorsed by national legislators and administrators. The form of local elections and non-electoral accountability mechanisms; the nature the local economy and social relations and associated power dynamics and informal non-democratic practices (clientelism, patronage, etc.); the strength and characteristics of civil society; and other diverse contextual factors affect whether subnational governance mechanisms can have their intended effects broadly or in a particular jurisdiction. Taxpayer compliance is substantially predicated on whether local citizen-voters believe that they are being treated fairly and receiving public services commensurate with the contribution to the public purse being requested of them.

Fourth, capacity issues are critical at both central and subnational levels. This is widely accepted and capacity building is a key component of reform, but it often fails to target the full range of relevant actors and is designed in a traditional way that is increasingly considered insufficient. On the first point, capacity building tends to focus on technical/ managerial staff and the mechanics of new systems and procedures, with limited attention to improving the nature and quality of interactions among actors—levels of government and subnational actors (elected officials, bureaucrats and citizens)—whose cooperation is required for successful reform. On the second point, capacity building often involves classroom training that does not adequately prepare recipients for using new skills on the ground. There is an increasing recognition of the need for on-the-job, on-site capacity building that better supports and institutionalizes new ways of doing business.

Finally, there is a growing recognition of limited attention to implementation strategies. Mainstream approaches tend to be built around defining technical reforms, with more ad hoc consideration of political economy and practical factors. In the case of revenue reforms, there may not be enough consideration of their relationship with other elements of the fiscal system much less the broader environment. Decentralization that is too rapid may overwhelm subnational absorptive capacity and threaten central bureaucratic tolerance, while unduly slow reform will disillusion proponents and reinforce centralist practices. Various elements of strategic implementation have been proposed, such as the use of asymmetry, negotiated reforms, performance incentives, demand driven capacity building, innovative subnational civic engagement, etc. An appropriate strategy may incorporate some or all of these, but it must be crafted in the context of a particular country, and at the subnational level in the context of local conditions.

Given the diversity of context and experience among developing countries, it is not sensible to generalize about how to approach the theory-practice gap beyond a few basic points. Considering all of the diverse forces and the many ways they could interact to shape appropriate decentralization and subnational revenue reform may even seem overwhelming. The dynamics are multi-dimensional, and it is a challenge even to identify them, much less to appreciate their effects and know what to do about them.

At the same time, an exhaustive analysis is not necessary to improve on the status quo. The basic theory remains a useful starting point, but effective policy development and implementation require interpreting it in context and looking beyond it. Policy analysts need to understand more fully the actors and factors that support and challenge reform and the relative power of each. At the national level this can facilitate the crafting of more workable reforms. It is also essential, however, to assess subnational political and civil society characteristics and dynamics, what they imply for the types of reforms that can be effectively pursued, and the best ways to make progress. It will often be more productive to engage in asymmetric and/or modest reforms that move the system in the right direction and build a foundation for future action rather than to pursue more comprehensive reforms that have little chance of taking root.

In the final analysis, there is considerable justification and scope for trying to build more robust theory to incorporate neglected factors and relationships that are known to be important for decentralization and subnational revenue generation. In the interim, more can be done to understand relevant national and subnational political and bureaucratic dynamics and to consider what these imply for pragmatic, strategic and productive subnational revenue reform. Better systematic analysis and documentation of individual cases would help scholars and practitioners to construct a better analytical framework.

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