CCI Research Agenda
February 2022

I Theme Two **I**

Decentralized Governance

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## The Future of Development

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Empowering new cities with better governance to lift tens of millions of people out of poverty.

The Charter Cities Institute is a non-profit organization dedicated to building the ecosystem for charter cities by:

-Creating legal, regulatory, and planning frameworks;
-Advising and convening key stakeholders including governments, new city developers, and multilateral institutions;
-Influencing the global agenda through research, engagement, and partnerships.
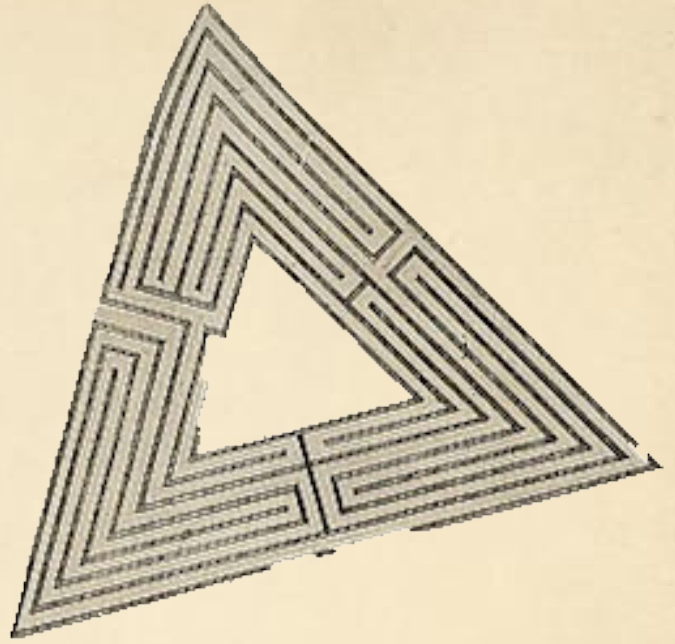
The Decline of the Central State

Over the past three decades, decentralized (or devolved) governance has become a popular policy to address issues of transparency, administrative efficiency, and political legitimacy across the world. Both academics and the World Bank have advocated for and helped implement decentralization projects in almost every country. This reflects a departure from the prevailing "strong state as centralized state" intuition, in which centralized, top-down governance was believed by scholars and policymakers to be a more effective administrative system (Faguet et al., 2014). In theory, centralized states can more swiftly and uniformly implement policies, coordinate resources, and manage populations. However, in practice,

many contemporary states struggled to establish effective centralized control, which has forced policymakers to reconsider their assumptions.

An alternative is decentralization. This refers to the full or partial transfer of power, responsibilities, and resources from higher-level government bodies (such as the national government) to lower-level entities, including regional governments, civil society, and private firms. Decentralization may take place in various aspects of governance (Cheema & Rondinelli, 2007). Administrative decentralization refers to the delegation of policy administration and central bureaucracy staffing to lower-level agencies. Fiscal decentralization refers to the granting of relative autonomy in raising and allocating public revenue. Political decentralization, which we argue constitutes the most substantial form of decentralization, refers to the shifting of legislative powers and policy decision-making to lower-level units. Since the 1990s, almost every country in the world has engaged in some form of decentralization (Manor, 1999).

This is not to say that decentralization advocates eschew the central state completely. Rather, they argue that too much centralization can inhibit effective governance and reliable public services delivery, and that centralization faces some innate deficiencies that are hard to overcome. As such, much of the "decentralization agenda" has focused on identifying the domains in which devolving power makes the most sense.
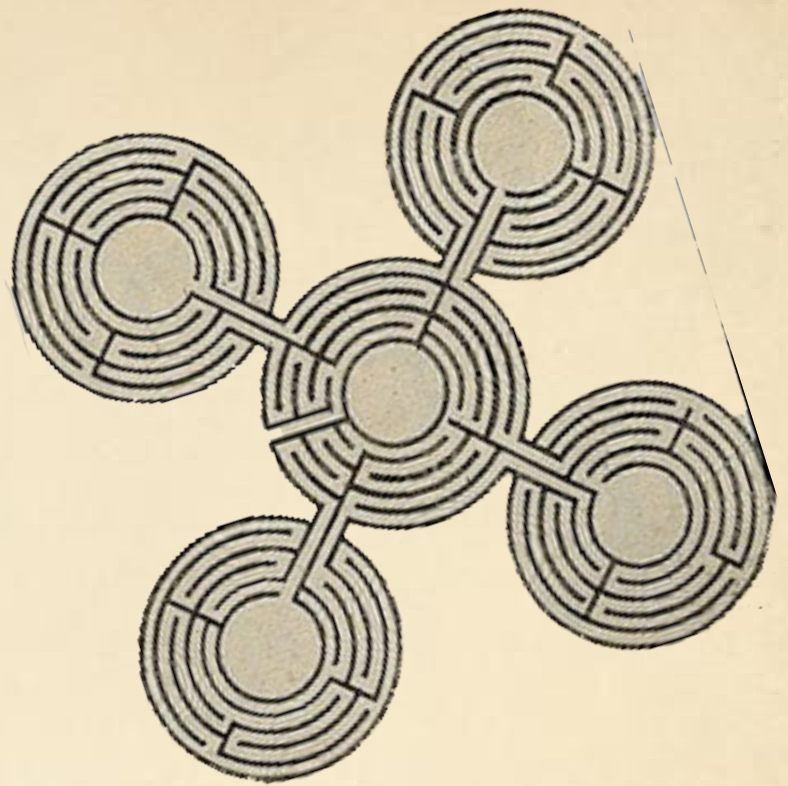
Decentralization and Better Governance

Decentralization promises to solve a number of issues inherent to over-centralization. As critics argue, centralization produces distant bureaucracies that are less accountable to local preferences. This can generate three problems. The first is a problem of information asymmetry. Due to a physical and cultural distance, central bureaucracies acting in good faith may find it difficult to effectively understand local preferences and deliver demanded public goods. Second, central governments may face administrative burdens to effective governance. Unlike local governments, higher-level politicians must balance the needs of a more diverse constituency. This democratic balancing of preferences

inadvertently introduces inefficiencies. Central government decisions, by virtue of their vertical structure, must also pass through various points of policy vetoes.

The third issue is one of state legitimacy and corruption. Faguet et al. (2015) highlight that many developing countries were formed by forcing distinct ethnic and religious groups into artificial political boundaries. While this trajectory established de jure institutional cohesion, it did not form a corresponding national consciousness. When compared to more homogenous states, citizens in heterogenous and fractionalized states tend to lack trust in the national government, which is oftentimes dominated by a singular ethnic group. As a consequence, these countries can settle into an equilibrium in which minority groups avoid formal politics by relying on traditional and rival (often kin-based) political institutions. At the top, it incentivizes the dominant political group to ignore minority groups.

Implicit in these three issues are problems of accountability and transparency (Bardhan, 2002). By focusing decision-making at the national-level, the government is less responsive to the people. In contrast, decentralization brings power closer to local groups and increases the accountability of political leaders in various policy domains. While not definitive, a vast body of empirical evidence suggests that experiments in decentralization have indeed led to improvements in governance. Grossman (2019) catalogues research showing that bureaucrats selected via local elections—as opposed to top-down political appoint-ments—tend to be less corrupt and better at delivering public goods. Interestingly, this may be true even if decentralization doesn't entail elections (Baldwin, 2019). Magaloni et al. (2019) find that communities ruled by indigenous, non-democratic institutions in Oaxaca were better at providing public goods, constraining corruption, and encouraging civic participation than comparable communities ruled by elected, national political parties.

Likewise, some evidence, albeit mixed, suggests that decentralization can minimize ethnic tensions that arise from social fractionalization. Bazzi and Gudgeon (2021) exploited a national policy in Indonesia that redrew subnational political boundaries. They find that redistricting along group lines, in which specific ethnic groups gained greater self-rule, reduced conflict. Correspondingly, districts that became more heterogeneous saw a rise in conflict.

Another advantage of decentralization is policy experimentation. In decentralized political settings, subnational governments are responsible for setting policies within their political boundaries. This gives rise to a richer policy environment, in which different administrative units pursue divergent policies to address similar problems. Policymakers can then incorporate lessons from the experiences of others and adopt successful solutions. In essence, local governments function as smaller-scale "laboratories" to test policies before implementing them more broadly. These governments also engage in a form

of "competitive governance," in which they must enact better policies to attract residents (and ergo, tax revenue). However, while there is a large body of theoretical research that models this dynamic (Oates, 1999; Cai & Treisman, 2009; Strumpf, 2002; Cheng & Li, 2019; Callander & Harsted, 2015), there is relatively less empirical research establishing a causal link.

The principal empirical case demonstrating policy experimentation is China. Chinese authoritarianism encompasses top-down control by the ruling Communist Party paired with officially-sanctioned, devolved local authority, which includes local elections—a system characterized as "authoritarianism 2.0" (Mertha, 2009). Provincial leaders are given the freedom to pursue their own policies and are rewarded by the national government if they achieve nationally-set goals. However, some evidence suggests that while the Chinese model improved policies in productive growth-oriented sectors, it was not effective in improving social goods provision like healthcare (Heilmann, 2008). Similar out comes have been observed in other authoritarian settings, such as Ethiopia (Kosec & Mogues, 2020), which illustrates the importance of institutional context when undertaking decentralization.

Decentralization, however, does not always lead to better governance. While it does bring power closer to the ground, it also exposes policymaking to local elite capture and bureaucratic inefficiency. For instance, Argentina excessively concentrates power to provinces, which are able to ex-tract rents from the federal government (Faguet, 2011). Similarly, excessively decentralized political systems may find it harder to address negative social externalities (e.g., pollution, inter-region transit, etc), since local governments are either unwilling to internalize the costs or wary of free-riding by other jurisdictions (Strumpf, 2002). Local governments also lack the economies of scale of large centralized bureaucracies, which can raise transaction costs and hinder the delivery of certain public goods (Bardhan, 2002). With respect to ethnic tension, while decentralization may discourage conflict by conceding some power to restive groups, it may also empower them to pursue greater autonomy or even secession (Christia, 2019). These discrepancies suggest that the success of decentralization is conditional on institutional and cultural context.
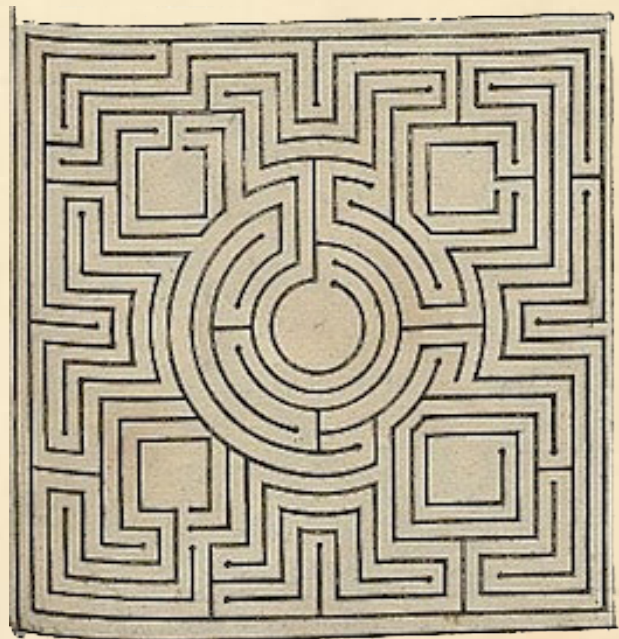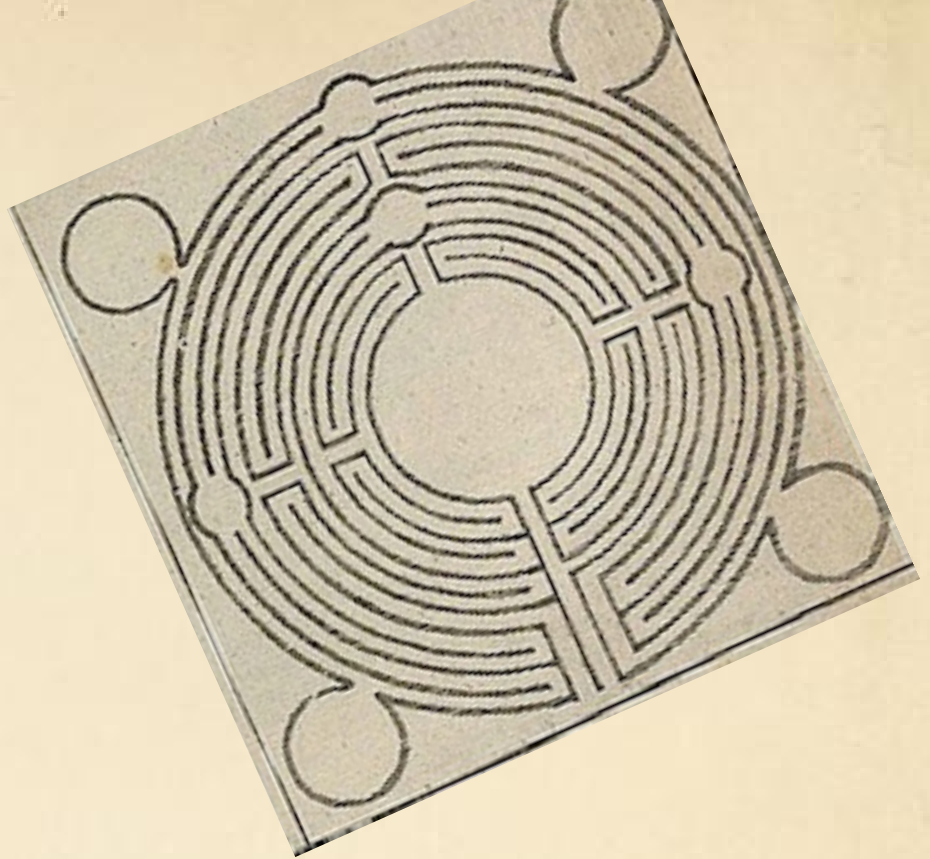
Further Research

How does decentralization relate to charter cities? Charter cities are in essence a special case of decentralization: "special jurisdiction decentralization." It proposes to devolve powers and resources typically held by the national government down to special jurisdiction cities. In doing so, these cities and their hosts can ideally realize many of the advantages theoretically associated with political, fiscal, and administrative decentralization. For instance, charter cities provide a fertile landscape for host countries to experiment with new policies. This could help developing countries avoid the pitfalls of "one-size-fits-all" policies imported from the West by testing and modifying solutions before national implementation. Arguably, this was the approach taken by China in the 1980s, in which they tested Western economic liberalization—with some noted Chinese characteristics—in Shenzhen before expanding it nationally.

Yet, many open questions remain in the intersection between decentralization, charter cities, and economic growth. The first is an issue of generalizability. China offers the best model for decentralization via special jurisdictions, but the Chinese

experience is also unusual. It would be erroneous to assume its model can be perfectly replicated in other developing countries, which have lower state capacity and more fractionalized societies. Indeed, the most universal finding in the decentralization literature is that institutional and social context matters to the success of decentralization. This opens up a research agenda of translation: how do we replicate, even partially, Chinese "special jurisdiction decentralization" elsewhere?

Another question is that of appropriation. Most decentralization experiments are national, but "special jurisdiction decentralization" can create attractive opportunities for state capture. We see this, for example, in China's expanding authority in Hong Kong. Charter cities advocates are therefore very interested in structuring incentives to discourage takeovers. Understanding how to do this is less clear. Part of the answer may lie in historical analysis. For instance, what political and economic tools did historical European city-states use to defend themselves? Another path is examining state capture in other contexts and generalizing them up. For instance, recent studies have characterized the relationship between changing state capacity and the incentive for national governments to re-centralize (Martinez-Bravo & Miquel, 2017; Bo et al., 2019). Can charter cities' institutions be structured to condition this dynamic?

Charter cities implementers must also be careful that powers are not decentralized too much. If structured inappropriately, charter cities may generate negative externalities that are hard for the national government to curb. This includes environmental damage, crime, and the establishment of tax havens.

Given these issues, the Charter Cities Institute is interested in understanding (1) how can decentralization help charter cities be governed effectively, (2) can special jurisdiction decentralization turn charter cities into agents of structural transformation, and (3) how should we structure the relationship between charter cities and their host governments to maximize mutual benefit and minimize conflict? These questions will frame our efforts to study decentralization, but they cannot be themselves studied due to empirical limitations (e.g., lack of data, endogeneity, small sample sizes, etc). Instead, we aim to better understand the causes and effects of decentralization, particularly decentralization implemented at the municipal level.

Examples of Research Questions:
-How do special jurisdiction cities (e.g., Brasilia, Washington DC, Tokyo, New Delhi, Abuja) govern differently than traditional municipalities?
-How efficient is the competitive governance "market" for residents?
-What role should the central government play in maximizing the benefits of subnational policy experimentation?
-How do different governments decide if they should incorporate successful policies from other regions?
-What parts of China's "special jurisdiction decentralization" have been successfully replicated elsewhere in the Global South? Which aspects have failed to replicate?

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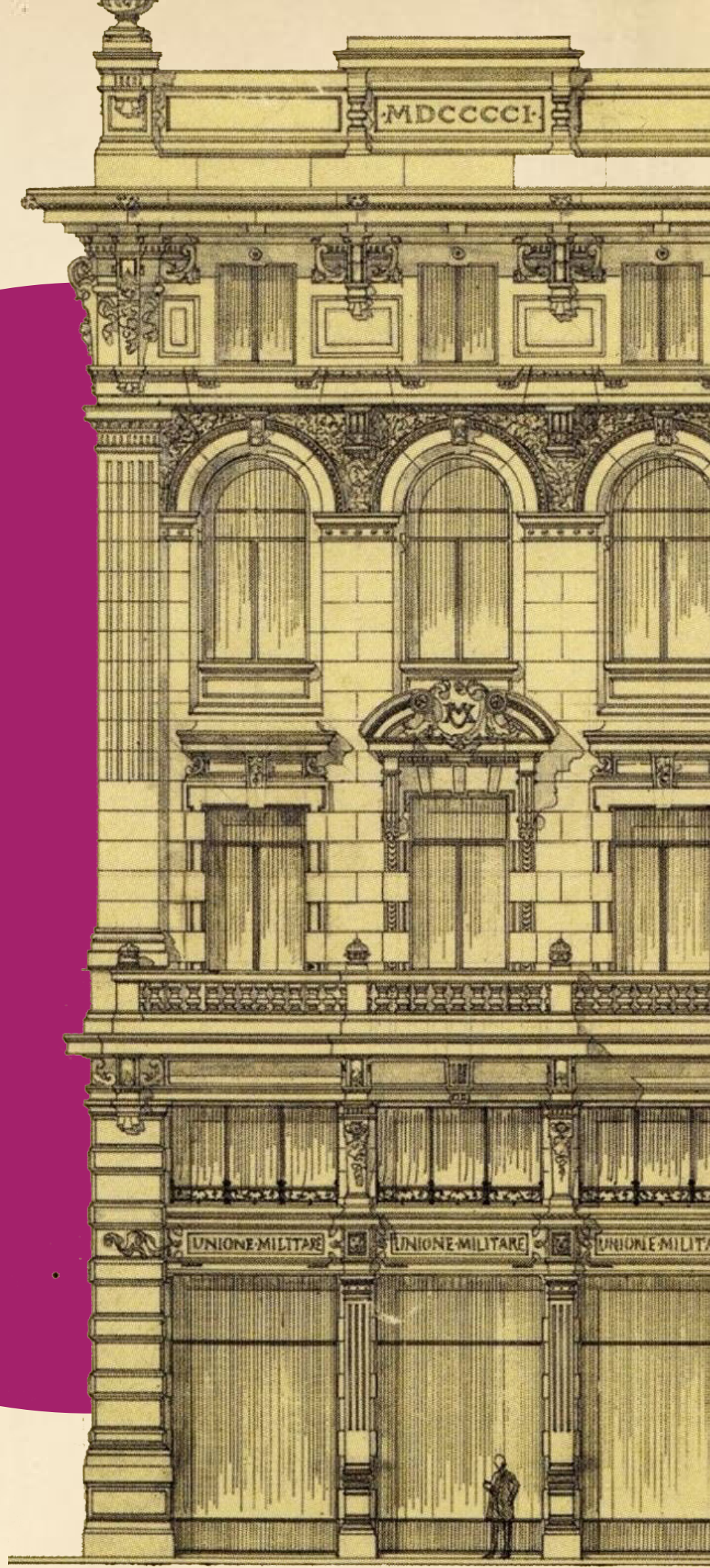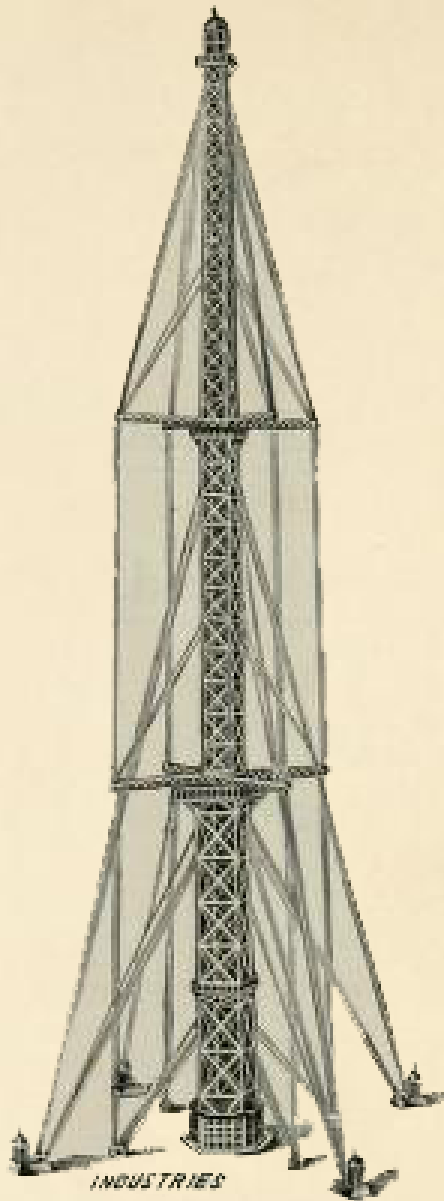
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