

## **SURVEY OF LITERATURE ON FISCAL DECENTRALISATION AS A SUSTAINABLE LOCAL DEVELOPMENT TOOL IN GHANA**

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### **ABSTRACT**

This study reviews literature on fiscal decentralisation and links it to local development concept in Ghana. However, particular reference was placed on Ghana as a country and how her decentralisation and fiscal decentralisation concept is practiced. The study made use of secondary data / materials from different writers in the field of decentralisation, fiscal decentralisation and development. Also included is literature from local and local level development literature. Theories such as decentralisation, intergovernmental fiscal allocation (fiscal decentralisation) have been explained in this study. Literature has been reviewed on the concept of decentralisation, concept of local level development and the intergovernmental fiscal allocation, which spell out the main arguments advanced towards revenue collection from local level and its expenditure. Conceptual / theoretical framework has been developed to explain the relationship between the various concepts.

**Keywords:** Decentralisation, Fiscal Decentralisation, Sustainable, local, Development, Ghana.

### **INTRODUCTION**

Decentralisation has gained prominence as an expressed goal or as an actual programmatic pursuit in the context of or as a consequence of two prominent movements affecting the African state (Ndegwa, 2002:1). These two areas are: the structural adjustment programmes that sought to reform the public sector starting in the 1980s while the other is the ongoing transition toward more democratic and competitive politics that started in the 1990s.

Programmes linked to decentralisation, on the other hand, have been embarked in many African countries to strengthen the role of regional and local government in development (World Bank, 1996). Increased fiscal decentralisation is expected to allow public goods and services to be provided at the level and costs desired by local communities and to enhance citizen participation in government (Bahl, 1999). According to Ebel and Yilmaz (2002) the shift from central to local governance, thus decentralisation, has resulted in a shift of focus. To them, the concept of requirements for achieving the development objectives is changing and many countries around the world are now implementing fiscal decentralisation reforms.

The reason is that decentralisation will enhance the chances of development at the community and village levels of society. Ikeanyionwu (2001) notes that the practice of decentralised system has made many local and regional governments to become responsible for development activities in their jurisdiction based on local needs, priorities and resources. In this direction, decentralisation is therefore regarded as a critical mechanism for aligning public expenditures

to local priorities, for improving management incentives and for improving accountability to users close to the point of service delivery.

Yaw-Nsiah (1997:12) defines fiscal decentralisation as the transfer to sub-national governments of the power to mobilise, allocate and manage financial resources according to locally determined priorities. Fiscal decentralisation (which includes externally and internally generated sources of revenues) has therefore become the main issue in the decentralisation process in many developing countries. It has been considered crucial for the effectiveness of the decentralised institutions, without which the local governments cannot achieve the desired developmental goals at the local level. Thus, the absence of fiscal decentralisation implies the decentralised institutions would not have the financial means to implement projects. Bahl and Linn (1992:368) argue that fiscal decentralisation has the tendency to increase the satisfaction with government services by local people.

Fiscal decentralisation has an added advantage in revenue mobilisation effort. The advantage is that it gives the local people, through their District Assembly, the chance to mobilise internally generated revenues such as rates, fines, fees, land and licenses. The District Assembly, being familiar with its local economy will be in the best position to mobilise internally generated revenues in the fast-growing parts of their economic base. Through this, the local administration will comparatively mobilise more financial resources at less cost than the Central government. However, the implementation of fiscal decentralisation brings up the following questions: to what extent should the local government be allowed to exercise their right to mobilise financial resources. Should they be allowed to mobilise the financial resources internally and also be in charge of its expenditure or what? What framework should the central government put in place to ensure an efficient and effective fiscal decentralisation process?

The practice of fiscal decentralisation cannot do away with a structure to address the fundamental problem of allocating expenditure and revenue responsibilities among levels of government known as Intergovernmental fiscal relations. For example, Bahl and Linn (1992: 82) argue that the central government can, if it wishes, allow regional and local authorities a greater role in regional policy and yet still retain control of the pattern of expenditure by making inter-government grants to regional and local authorities.

Intergovernmental fiscal relations and fiscal decentralisation together deal with how public expenditure is organized between these different levels of government and how it is financed. Fiscal decentralisation thus constitutes the public finance dimension of decentralisation, defining how and in what way expenditures and revenues are organized between and across different levels of government in the national polity. However, the precise nature of intergovernmental fiscal relations and fiscal decentralisation policy in any given country varies depending on how sub-national government and administration is organised.

Ghana's decentralisation process provides a framework for a system of locally-controlled development and planning. By this process, District Assemblies were established and charged as the local planning authorities with responsibility for the overall development and governance of their district of jurisdiction. This model (please refer to Figure 1) of decentralisation places the District Assemblies in the heart of service delivery, development and democracy at the local levels.

## **DECENTRALISATION**

Over the past few decades, decentralisation has been championed within the development circles and many developing countries have embraced the concept of decentralisation, though its application and what it entails differs from country to country. Specifically, it can be said that decentralisation became an important policy objective since the 1970s and 1980s as governments in developing countries sought to create more socially equitable pattern of economic growth and to meet the basic needs of the poor.

Many countries are decentralizing fiscal, political and administrative responsibilities to lower-level governments, the private sector and non governmental organisations. Political and administrative decentralisation has not happened in vacuum. A lot of factors have served as impetus or deriving forces for the ever increasing choice of decentralisation concept. Some of the factors include:

1. The size of the country;
2. Diversity and the history of a country;
3. The trend towards more democratically elected government;
4. The challenges of information technology making the traditional bureaucratic hierarchies less compelling;
5. Urbanization, education and economic development are all increasing both the demand for local services and the capacity to administer them locally; and
6. The trend towards market economies and the rethinking of government roles.

The trend towards centralisation, authoritarianism and homogenization are reversed. On the other hand, the chaos and complexity theory about states that the analogy to be explored for human society is that not centralisation but decentralisation to ensure harmonized local behaviour.

Decentralisation has received a lot of challenge. Studies have made it clear that many developing countries are reluctant to decentralise due to fear in the areas of weak systems, poor information, unlimited needs, weak capacity administrative diseconomies and above all decentralised budget responsibility would lead to loss of expenditure control.

## **DEFINITIONS AND TYPES OF DECENTRALISATION**

Decentralisation is broadly defined to include the transfer of authority from central to local governments and the management arrangements that relocate responsibilities away from the centre. Decentralisation can be envisaged as “the transfer of authority on a geographic basis whether by de-concentration of administrative authority to field units of the same department or level of government or by political devolution of authority to local government units, or by delegation to special statutory bodies” (United Nations, 1996)

Decentralisation refers to “the transfer of political power, decision making capacity and resources from central to sub-national levels of government” (Walker, 2002: 63). Rondinelli (1989: 33) defines decentralisation as “the transfer of the responsibility for planning, management and the raising and allocation of resources from the central government and its agencies to field units of government agencies, subordinate units or levels of government, semi-autonomous public authorities or corporations, area-wide, regional or functional authorities, or nongovernmental private or voluntary

organisations”. Decentralisation, according to the writer was classified into four: namely de-concentration, delegation, devolution and privatization.

While some researchers accept and agree to only three types of decentralisation, others support the idea that decentralisation can be categorized into four main types. World Bank (1999) identifies four standard types of decentralisation. These are:

1. Decentralisation; meaning the dispersion of responsibilities within a central government for example to a regional branch office;
2. Delegation; this is a step further on decentralisation. With this, local governments or agencies act as agents for the central governments, executing certain functions on its behalf;
3. Devolution therefore does not only give local governments the power to function as agents of the central government but also the power to decide on what to do; and
4. Privatisation or deregulation; involves the transfer of responsibility to non-governmental organisation on the private sector. This item has really created controversy among researchers. It is important to stress on the fact that in practice decentralisation varies from country to country and that the practice of decentralisation has been a mix of the various types identified above.

#### **THEORETICAL JUSTIFICATION OF DECENTRALISATION**

A lot of arguments were developed for the use / application of decentralisation concept in governance. For the purpose of this research, the author adopted two main theoretical justifications for the widely acceptance and application of the concept of decentralisation in governance. These two main justifications leveled for the use of decentralisation have been explained in full below. These are the economic and non-economic justification.

Economic justification of decentralisation can be categorised into two: welfare economics and the institutional economics. Welfare economics support the total welfare of the society. The main argument is that total welfare can be increased by following local preferences instead of applying a “one size fits all” approach which usually goes along with centralisation. The question which usually comes up with this kind of argument is: What is social welfare and how can social welfare be maximized? Welfare analysis can be considered to be a systematic method of evaluating economic implication of alternative allocations. It answers the following questions;

- a. Is a given resources allocation efficient?
- b. Who gains and who loses under various resource allocations?
- c. By how much?

Therefore, it can be seen that welfare economics is a methodological approach to assess resource allocation and establish criteria for government intervention. Welfare economics use the perspective and techniques of microeconomics; which is better achieved from a decentralised system. However, they can be aggregated to make macroeconomic conclusions. Because different “optimal” states may exist in an economy in terms of the allocation of resources, welfare economics seeks the state that will create the highest overall level of social welfare.

Institutional economics argues from efficiency issues of the various levels of government and the relations between them. North (1993) defines the new institutional economics as an attempt to incorporate a theory of institution into economics. World Bank (1999) argues that the institutional economics camp draws on the efficiency and therefore argues with the view of drawing public attention to the need of championing efficiency in the delivery of public services. The efficiency should apply to all levels of government as well as the relations between them. The economic justification of decentralisation argues from maximum welfare and efficiency. Maximum welfare is in the sense that if local people are actively involved (through decentralisation) they can include their needs in the plans and that will create sense of ownership on their side.

Institutional efficiency is maximized with the assumption that people are more willing to pay taxes if they receive services that they value. The challenges here have been outlined in the following questions below:

- a. What services do the local people value?
- b. How do we determine those services? and
- c. Who determines those services?

Decentralisation ensures the maximum participation of the local people in the development process as it is supported by the statement that development is for the people, by the people and with the people and therefore people are in the centre of any development project (Conyers & Hills, 1984). Alternatively decentralisation can be of great advantage as it may be accompanied by an increase in tax effort and less resistance to your charges.

The main arguments under non-economic justification for decentralisation are decentralisation from the grassroots perspective. Decentralisation from grassroots perspective / bottom up approach to fiscal decentralisation from the “bottom-up” generally stresses political values. These political values can be seen from improved governance, thus, local responsiveness and political participation, coupled with a locative efficiency by improving welfare.

Central Government may decentralise (top-down) to make their life easier by shifting what is known as deficit (or at least some of the political pressures resulting from deficits) downwards. On the other hand, the Central Government, for the purposes of effective and efficient resource allocation, may adopt this method as spear head the process. With this, the Central Government may delegate some powers to a local government.

Though naturally, decentralisation has attracted a lot of favourable arguments within the intellectual circles it is bedeviled with some counter arguments. For example, Rondinelli et al, (1984) argue that the argument in favour of decentralisation is usually a priori rationalization based on plausibility.

## **DECENTRALISATION PRACTICE IN GHANA**

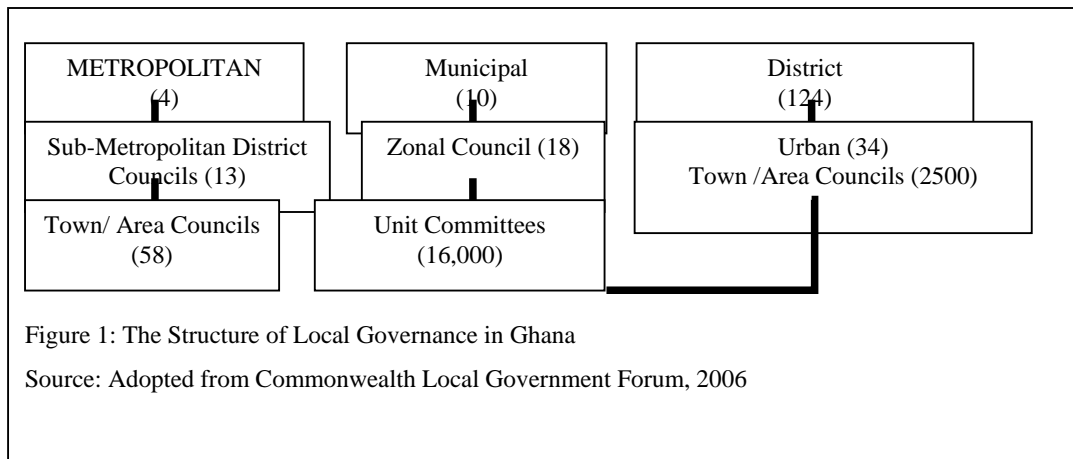
Goel (2010) looked at decentralisation in three main areas. These are administrative, Democratic and Financial (Fiscal decentralisation). Administrative decentralisation is basically about the structure of the local government. For example, Ghana’s local government system consists of a regional coordinating council, a four-tier metropolitan and a three-tier municipal / District Assembly structure. Metropolitan Assemblies have population of over 250,000, Municipal over 95,000 and District with over 75,000.

Assembly, henceforth District Assembly has the responsibility for the overall development of the District. District Assemblies therefore have legislative and executive functions and they formulate and implement a medium term development plan and budget, both subject to the central government (Goel, 2010).

The District Assemblies, on the other hand, have the overall responsibility over the operation of all development agencies in the District including the central government ministries, departments and agencies and non-governmental organisations. They execute this responsibility through the following means; coordinating, integration and harmonization of activities of all development agencies and won governmental organisations.

Grass-roots level administration consists of two sub District structure. These are Town / Area Councils and Units Committees (UC). Town / Area Councils and Units Committees perform special duties delegated to them by the assemblies. Crawford (2005) further stated that the main function of the unit committees were to link remote rural locations at the grass-roots to the District level whereas the District Assemblies links the grass-roots to the central government. The Urban / Town / Zonal / Area Councils are also expected to implement their own development projects based on the funds allocated to them as stipulated by LI 1589. Thus, there are clear lines of reporting and communication, which are expected to result in high standards in both the implementation of development plans and accountability in the utilization of development funds.

Democratic decentralisation focuses on the election of executive for the District Assemblies with particular reference to Ghana. Elections to local governments are paid by the Central Government and managed by the Electoral Commission. District Assemblies have 70 percent of the membership elected. The president on the other hand in consultation with local interest groups appoints the remaining 30 percent. The election positions available are; the District Chief Executive (DCEs) and the councils. DCEs are mainly in charge of the day-to-day.



Fiscal decentralisation in Ghana relates to the most common theoretical rationale for decentralisation; which is to attain allocation efficiency among different local preferences for public goods and services (Musgrave, 1959; Oates, 1972). Financial responsibility is the core component of decentralisation. If decentralised units are to carry out their responsibility effectively, they must have adequate level of revenues – raised locally and/or transferred from the central government – as well as the authority to make decisions about expenditures. This process of distribution of public finance and responsibilities to the various levels government is usually referred as fiscal decentralisation.

The emphasis of fiscal decentralisation is to strengthen sub-national (local government) finances and thus their capacity to provide public goods and services. The idea is to give local governments some revenue powers and expenditure responsibility and allow them to decide on the level and structure of their expenditure budgets. In this way, the local people will be able to articulate their needs and preferences and participate in governing their affairs. Fiscal decentralisation as a means of achieving local development is based on two main arguments namely economic efficiency and local revenue mobilization (Bahl & Linn, 1992; Oates, 1993).

Local governments were introduced in Ghana as a result of colonization and development assistance requirements. The earliest attempts at local administration during the colonial era were with the native authorities, which centered on a chief or some unit of local royalty, which was not well defined. These native authorities were not democratically elected but handpicked to represent the interests of the British Colonial Government as well as to administer law and order (Inanga & Osei-Wusu, 2004). According to them subsequent steps towards decentralisation were purposely for administrative and control purposes. These, among others include, the Municipal Ordinance of 1859, which led to the creation of municipalities in the coastal towns of the Gold Coast, as Ghana was then known.

Over the years, various attempts have been made to establish decentralisation in Ghana. After independence the Local Government Act, Act 54 of 1961 was enacted. The features of these efforts include a central government body, which dealt with national issues and the local authorities as central government agencies. Decision making at the local level, however, took much time because most issues had to be referred to the ministerial levels. The effects are the stifling of local autonomy, democratisation, economic development and self-determination.

Some challenges to the earlier efforts in decentralizing the machinery of government from the centre to the local levels included the lack of personnel with professional skill and expertise as well as financial resources to meet obligations. These factors, among others such as the increased demand for infrastructure and services, necessitated the institutioning of the current decentralisation policy. The economic policies adopted in Ghana during the 1980s focused mainly on an aggressive programme of stabilisation and economic liberalisation. The main features include, first, the Economic Recovery Programme (ERP) and the Structural Adjustment Programme (SAP). These programme emphasized a private sector-led growth with limited role of governments.

The other issue was the creation of a market friendly environment. In the decade that followed, annual GDP growth averaged 5 per cent and physical and social infrastructure was rehabilitated. However, the role of the public sector in development seems to have been ignored as at 1988. There were thus, increased economic and political pressures to decentralise the functions of government (Inanga & Osei-Wusu, 2004). There five main implementation aspects in Ghana's decentralisation policy are political, administrative, planning and programme implementation, management of public / private partnerships and fiscal decentralisation. Most of these policy aspects have experienced tremendous strides. This includes the formation of local government institutions that have been empowered to exercise deliberative, legislative and executive functions at the sub-national level of governments.

In Ghana, there are three levels of government, namely, the National, Regional and the Metropolitan / Municipal or District levels. The sub-national government structure comprises ten Regional Coordinating Councils, 170 Metropolitan / Municipal / District Assemblies (MMDAs) and Town / Area Councils and Unit Committees. Main features of the current decentralisation programme, which has implications for the management of finances, include:

- a. the composition of the District Assemblies: appointed and elected members;
- b. re-demarcation of Districts to create more manageable and viable local government units and District Assemblies as non-partisan local government bodies;

- c. empowerment of District Assemblies as the legislative, administrative, development planning, service delivery, budgeting, and rating authorities; to promote participatory decision-making and implementation;
- d. establishment of a National Development Planning Commission to co-ordinate decentralised development planning;
- e. the non-partisanship of the District Assembly to promote consensus building though functioning in a politicized environment;
- f. the capacity for bottom-up planning and the effective resourcing of such plans;
- g. transfer of responsibility for 86 statutory functions of state to local government bodies with jurisdiction over demarcated geographical areas;
- h. restructuring of resource allocation and establishment of resource sharing between central and local governments; and
- i. Redefinition of the roles, functions and structures of government institutions at the national (policy formulation), regional (co-ordination) and local levels (implementation).

Section 240 (2c) of the Local Government Act, 1993 (Act 462) and the constitution of the Republic of Ghana (1992), Section 245b provides that each local government unit shall have a sound financial base with adequate and reliable sources of revenue. Despite this requirement the Metropolitan, Municipal and District (MMDAs) have a limited number of sources of revenue for carrying out their activities, which include the District Assembly Common Fund (DACF), grants, transfers, cede revenues and external credits, land rates and minerals royalties and other internally generated revenue (IGR). The sixth schedule of Act 462 lists the revenue sources of local government bodies to include entertainment duty, casino revenue, betting tax, business registration charges, gambling tax, rates and levies, fees, licenses, as well as taxes chargeable on the income of certain categories of self-employed persons. There are also miscellaneous receipts such as stool land revenue, fees for dislodging of latrines, collection of sand and stones and others.

However, the internally generated revenues do not yield much revenue, not even for the recurrent expenditure and so most Districts depend entirely on the DACF and other grants from the Central government. This study delves deep into the issues of the internally generated revenues for the District Assemblies.

According to Ayee (1996), Ghana's approach to decentralisation appears to be a system of devolution which involves the transfer of power to District Assemblies with absolute autonomy and responsibility to determine the level of services required, the best methods to ensure their provision and the sources and types of funds to finance them.

### **FISCAL DECENTRALISATION**

Decentralisation holds great promise for improving the development objective of public service delivery, but the outcomes depend on its design and the institutional arrangements governing its implementation. Now, the concept of requirements for achieving development objectives is changing and many countries around the world are now implementing fiscal decentralisation reforms.

Greater fiscal decentralisation is expected to allow public goods and services to be provided at the level and costs desired by the local communities and promote citizen participation to increase government accountability. These fiscal



decentralisation efforts typically begin with a fundamental review of allocation responsibilities for expenditures and revenues by level of government. Rationalising these responsibilities, combined with establishing an inter-governmental transfer programme, is the first step towards creating a fiscal structure that can enable governments to properly fulfill their stabilisation, distribution and allocation functions (Shah, 1994).

Fiscal decentralisation is also called central-local (or inter-governmental) fiscal relations by European writers and fiscal federation by American writers. Therefore, the terms are used interchangeably. Inter-governmental fiscal relations, according to Shah (1994), focus on the fundamental problem of allocating expenditure and revenue responsibilities among levels of government. It also refers to the devolution of authority for public finances and the delivery of governments services from the national to sub-national levels (Tanzi, 1996). The conceptual framework of fiscal decentralisation is well established, drawing largely on the contributions by Stigler (1957), Musgrave (1959), Oates (1972) and Brennan and Buchanan (1980). The core logic is based on the following: if growth and poverty issues are to be taken into account, one should be concerned about efficiency-supplying services up to the point at which, at the margin, the welfare benefit to society matches its cost (cited in Ebel & Yilmaz, 2002).

Fiscal decentralisation is an issue of considerable practical importance facing many developing economies and has been championed by international bodies such as the World Bank and the Organisation for Economic Cooperation and Development (World Bank, 2003).

The two basic interrelated themes under the inter-governmental fiscal relations are; the distribution of revenue mobilization and expenditure under the centralized / decentralisation alternatives (the assignment problem of “who collects and gets what”). Another is the degree of financial autonomy of local governments versus dependence on central transfers. The distribution of revenue sources and expenditure responsibilities between different levels of government is such that local public expenditures tend to exceed own-source revenues (also referred to as Internally Generated Revenues).

Local governments have no option than to heavily depend on Central Government transfers; thus limiting their degree of financial autonomy. Financial autonomy can be defined as the ability of government units to finance own expenditures from own revenues. Fiscal imbalances do not necessarily indicate an inappropriate allocation of governmental responsibilities and powers. It is important to note that the appropriate delegation of revenue authority to local government will depend, to some extent, on the assignment of expenditure responsibilities.

By description, fiscal decentralisation comprises the financial aspects of devolution to regional and local government. Fiscal decentralisation has been broken into two issues. The first is the spending responsibility and revenue sources between levels of government (national, regional and local). The second deals with the amount of discretion given to both regional and local governments to determine their expenditures and revenues; both in aggregate and details (Davey, 2003).

Davey (2003) developed criteria for measuring the actual power and responsibility of horizontal (regional and local government) exercise. These are:

1. What range of public services they finance;

2. Whether their revenues are commensurate with these responsibilities;
3. How much real choices they have in allocating their budget to individual services; and
4. Whether they can determine the rates of their taxes and charges (both allowing them to vary their level of spending and making them answerable to the payers). In this section the term local government was used to describe both upper (regional, country, District) and lower (city, municipal, settlement) tiers of self-government.

Vo (2008) perceives fiscal decentralisation as devolution of authority to sub-national levels of government. The four interrelated fiscal issues among levels of government are:

1. Expenditure decisions;
2. Taxing and revenue- raising powers;
3. Sub-national borrowings; and
4. Intergovernmental fiscal transfers. The explanations to these four points have been provided under the sub-heading captioned practical issues in fiscal decentralisation.
- 5.

### **REVENUE AND EXPENDITURE RESPONSIBILITIES OF GOVERNMENTS**

The discussion here was made with particular attention to developing countries. Local government spending trends to be directed on services such as primary public goods and basic health care, whereas the central government has significant expenditures in such areas as defense and security, transport and communications infrastructure, public administration. It therefore, follows from the argument that, if it is accepted, that the national government has primary responsibility for horizontal fiscal equalization, economic stabilisation and management, as well as, significant expenditure responsibilities in such areas as major economic infrastructure, it follows that the centre should exercise control over the most important (lucrative) and flexible, as well as the main redistribute tax sources.

World Bank (1988) and Bahl & Linn (1983) have argued along the lines of what the local government should do. The arguments dwelled on the grounds of efficiency and states that for the sake of efficiency, District Assemblies should distinguish between services based on some characteristics. These characteristics are: (i) pure public goods- which should be financed by user charges, and (ii) externalities – financed by intergovernmental transfers.

Gandhi (1983) puts a challenge to this simplified classification of services. Gandhi argues the simplification of the classification has resulted in conflicts in its application. For example, clean water supply can be a public utility which has significant externalities. Public utility includes services such as national defense, mosquito abatement, pollution control, disease control etc. The common characteristics of these services are that once they are made available, separation of those who have paid from those who have not paid is impossible and any number of people can consume the same good at the same time without diminishing the amount of goods available for anyone else to consume.

The transfers from higher to lower levels of government are often a significant source of local finances. Local resource mobilization may either expand or contract in response to the transfer. In the former case, the transfer can be termed “simulative”, whilst in the latter local governments cut back on local revenue raising and substitute the central transfer (Bahl et al., 1984). The objective of central transfers should be to allow recipient local governments to fulfill their

expenditure functions, while encouraging their own fiscal efforts as far as possible and ensuring an equitable distribution of public service provision throughout the country.

There are a number of empirically testable hypotheses concerning how the aggregate level of revenues generated might be influenced by the structure of government, in particular, when spending and taxation decisions are made on a decentralised basis. Yet there is very little in terms of rigorous quantitative evidence.

Brennan and Buchanan (1980) put forth the view, by analogy with the convention theory of monopoly in the private sector that a monolithic (i.e. centralized) government will systematically seek to maximize tax revenue. This led them to the proposition that the size of the public sector varies inversely with the extent of decentralisation. From the perspective of the above mentioned authors, (which is obviously somewhat different than the present one), decentralisation is endorsed as a means of constraining total public resource mobilization.

The degree of fiscal decentralisation affects public finance through the following avenues (Marlow, 1989):

1. Decentralisation increases competition in the public sector, leading to a relatively lower tax burden- i.e. given mobility of residents and capital in pursuit of fiscal gains, the greater the numbers of alternative tax jurisdictions, the less likely that 'excessive taxes will be levied;
2. Conversely, centralisation restricts the ability of states to compete (as in (i) since a growing national share of total government money weakens the relative significance of local governments; and
3. Centralisation may generate a greater reliance on inflationary finance given that only the national government is able to print money.

Oates (1985) argued that decentralisation would tend to increase total public resource mobilization. An empirical investigation conducted by Oates (1972) for 42 countries reveals a strong and statically significant negative association. The study was done by regressing tax revenue (size of public sector) on a fiscal centralisation ratio (central revenue as proportion of the total). In another study, Oates (1985) explored the question again for 43 countries (18 industrial and 25 developing). The results proved that for the entire sample, the rank correlation between the size of the public sector and the extent of centralisation is strong and significantly negative. Meaning a relatively decentralised public sector is typically large.

## **SPENDING RESPONSIBILITIES BETWEEN LEVELS OF GOVERNMENT**

In most countries local governments are responsible for what are often called "communal services": local roads and lighting, water supply and sanitation, waste management, parks and sports facilities, cemeteries, social housing. Three tier government system: central, state and local as in federal states creates a challenge. The main challenge in this area lies in "to what extent should the state or the local government be involved or responsibility for the provision of certain facilities includes education, health and social assets."

Practically, Davey (2003) identifies three opinions. First is the state funding the whole service from its budget and the second funding responsibility splitted between local and the central government. This option may be by function. For example, the state paying for secondary education, hospitals, social benefits and local government for basic education, primary health care and social service. Or it can be by cost factor (for example, the state providing professional salaries

while local government pays all other operating costs). The third option is the case where the local governments meet all cost except central provision.

On the other hand, fiscal decentralisation, which begin with the review of the expenditure and revenue responsibilities of level of government is expected to allow public goods and services to be provided at the level and cost desired by local communities and to enhance citizen participation in government.

### **FISCAL DECENTRALISATION AND THE THEORY OF REVENUE ASSIGNMENT**

There is no generally accepted framework globally on revenue assignment between different levels of government. Different countries practice different systems in its assignment between different levels of government.

The theory of revenue assignment, according to Bordignon and Ambrosanro (2006), is concerned with the optimal determination of the vertical structure of taxation and tries to answer questions such as which level of government ought to choose the taxes to be imposed at any level? And which one should define both the tax base and the tax rates? Finally, it also includes which one should enforce and administer the various tax tools. Furthermore, the authors identify two broad extreme arguments on the development of revenue assignment for the various levels of government. These are the traditional normative approach and the public choice approach.

The Traditional Normative Approach, was the first ever argument and was developed and championed by early writers such as Musgrave and Oates. The theory identifies three distinct fiscal functions of every government. These are resource allocation, income redistribution and macroeconomic stabilisation (Musgrave, 1983). To share the three functions, Musgrave (1983) and Oates (1999) argue in favour of the central government to be in charge of the function of income redistribution and macroeconomic stabilisation whereas the local governments handle the resource allocation fiscal function. The argument in support for the allocation above between the central and local government is that because of spill-over effects which would be difficult to internalise at local level, the responsibility. Income redistribution and macroeconomic stabilisation should be assigned to central government, whereas resource allocation could be performed by all levels of government including the local government. The basis for this argument was on the assumption that optimal revenue assignment is strictly related to the normative optimal assignment of expenditure functions to levels of governments. The traditional normative approach provided some guidelines for the setting of sub-national taxes. These guidelines were developed on efficiency grounds for local development. These are:

1. Local government should levy taxes on relative immobile assets such as land, buildings etc in order to prevent tax competition and revenue losses;
2. Levy taxes on bases evenly distributed among jurisdictions in order to prevent horizontal fiscal imbalance; and
3. They should levy taxes whose yield is relatively stable in real terms to ensure expenditure planning (Bordignon & Ambrosanio, 2006).

The central government, on the other hand, was therefore charged with the collection of income taxes in the areas of individual progressive income taxes, corporate income taxes etc. since they presents themselves or enjoys the relative advantage over other types of taxes as the best instrument to achieve the main fiscal objectives of the central government.

It was therefore argued that the central government can catalyse her main objective of macroeconomic stability and income redistribution of attention is placed on this type of income related taxes. The traditional normative approach places much attention on the economic theory of revenue assignment.

Traditional normative theory has suffered a lot of attacks mainly from the camp of Brennan-Buchanan approach. The critics point the approach, first of all, is fundamental wrong since it was developed on the premise that governments are benevolent or social welfare maximising entities, which in real case is not. The traditional approach practically did not consider the forces of political power exercise and bargaining which usually comes along with revenue assignment with different levels of government. Also, the traditional normative approach is a purely normative theory which provides weak / poor explanation of revenue assignment and expenditure across central and local government, as we observe in the real world.

Lastly, the traditional normative approach was criticised to be purely an academic or theoretical approach which is likely to face a lot of challenges when applied to real life situation, thus cannot stand the test of time. Local governments in reality are concerned with income redistribution, for instance, in education and health care sectors and rather make less use of benefits taxes as the theory indicates. The shortfalls in the traditional normative approached led to the birth of Brennan-Buchanan approach.

Brennan–Buchanan Approach was developed to fill the gaps identified within the application of the traditional normative approach. Put differently, the Brennan-Buchanan approach hinges upon a completely alternative view of government and therefore leads to a completely alternative view of the optimal revenue assignment (Bordignon & Ambrosanio, 2006).

Unlike the traditional normative approach, this approach acknowledges that fact that governments are not benevolent and that even in countries where democracy is well developed, effective controls on politicians are poor. The approach considers that fact:

1. The only way politicians can maximize total revenue from the private sector is through tax (revenue mobilization); and
2. that large amount of revenue through tax, maximise the spending powers of politicians and bureaucrats.

To achieve these two broad goals; the following strategies need to be adopted. The first strategy is choosing broad tax bases with the aim of minimising tax evasion and tax erosion and the second is imposing higher rates on less elastic bases. Brennan-Buchanan approach was used to describe the contemporary roles most central government play in any economy. According to the authors, the central government uses their powers and authority to control revenue assignment. The approach also creates some sort of competition among the local government.

The competition created serves the following advantages. It serves as one of the forces restraining tax design and budget size. The argument here is that substantial local government taxes should be levied or imposed on mobile factors which has the ability to trigger completion to limit the rapaciousness of levitation. Completion again brings about efficiency, just as competition in the private sector, is accompanied with efficiency. Completion will therefore reduce the monopoly powers of governmental units. However, just like the traditional normative approach, Brennan and Buchanan’s approach also dwells on or was developed on based on economic efficiency rationale. Some of the criticisms the approach faced

were: The approach was too rigid on central government's role in taxation. It painted governments as Leviathan; thus the name the Leviathan model, however, in practice governments are less monopolist than the approach claim, and

The competition created by this model among local government can be dangerous, since it has the high capacity of introducing serious allocative distortions. This allocation distortion can lead to an erosion of the tax base.

### **OPTIONS FOR CENTRAL - LOCAL GOVERNMENT FISCAL TRANSFERS**

Questions which usually follow local government fiscal transfers such as ways of arranging fiscal resource transfers from central to local government, how efficient horizontal allocation mechanism should be and how should the central government grant (fiscal) resources be allocated among local governments (who gets what and what should be the basis to judge who gets what)? These questions though look very simple and easy on paper, however, faces a lot of challenges in its implementation / application. The practice of fiscal decentralisation carries along with its own expected benefits. Fiscal decentralisation if addressed properly will create a stable, equitable and efficient horizontal allocation mechanism. However irrespective of the method / approach used, some local government will receive more grant than others. Some of the options available for horizontal allocation mechanisms are: the per capita transfer funding, the ad hoc approach and the formula-base allocation mechanism / approach.

Per capita transfer funding (commonly referred to as the straightforward horizontal allocation mechanism) distributes the total pool of intergovernmental grants available in a country proportionally among all local governments based on the number of people that resides in each local government area. This system looks too simple and tempting to use due to its simplicity making it attractive. One may ask, is it very easy to estimate the number of people within each local government especially, within this current era of huge rural-urban migration? How effective will the calculation be? So in effect, this system sound perfect academically but will face huge application problem since it ignores vital information which are necessary in allocating revenues among local governments, With this method, in place, each local government will receive the same amount of per capital transfer funding. This method practically does not meet efficiency and equity criteria (Boex and Martinez-Vazquez, 2005). Furthermore, in reality, intergovernmental grants are rarely allocated strictly to per capital basis.

By ad hoc approach, horizontal allocation of grants to local governments is done through negotiation or through the fall on the discretion of fiscal policy experts and practitioners. Just as the per capital basis approach discussed above, the ad-hoc approach has suffered a lot of challenges. Bahl (1999) considers this method inherently central, which is against the decentralisation concept this fiscal decentralisation follows. Grant disbursements to local governments that are negotiated (as part of central government's budget formation process) are inherently more centralizing than formal-based grants. Politicians (governments) will wield their influence to the benefit of their constituents. It also has the potential that give cabinet officials or members of parliament an opportunity to "sell" favours to local officials. This approach also goes with high chance of introducing corruption in the process of horizontal allocation of grants.

Lastly, the formula-base allocation mechanism / approach have been the most widely accepted approach for horizontal allocation mechanism. It also does not ensue that the allocation of resources is objective, fair, efficient or stable. Because of this, the formula-base allocation approach does not have a globally accepted format. The formula can be changed anytime when it is considered appropriate to make it more responsive to fairness, equity objective and stable (Boex and

Martinez-Vazquez, 2005). In many countries, the central government has the discretion to unilateral change the factors included in the allocation formula and change their relative weights from year to year, giving the central government de facto control to alter the effective distribution of grant resources as it sees fit. Unnecessary manipulation by central governmental officials to affect the outcome of the formula has been the most common challenge to this approach. This is done through the manipulation of data used to compute the allocation factors. A classical example was the case of Russia's equalization fund during the mid 1990s (Boex and Martinez-Vazquez, 2001).

Now the question to address is that irrespective of the approach one adopts, what will determine the horizontal allocation of intergovernmental grants? In countries that rely on a sound formula-based transfer system such as the United States of America, the form of the horizontal allocation mechanism is very often a function of the ultimate policy objectives pursued by the central government.

### **PRACTICAL ISSUES IN FISCAL DECENTRALISATION**

A lot has been written to describe fiscal decentralisation theory in this chapter. The study considered this particular section important in the sense that theory is developed from observations of phenomena in question. World Bank (2003:3) identifies four main practical issues that concern fiscally decentralised systems. The assignment of responsibility for the provision of services across different tiers of government, the assignment of revenue-raising powers, intergovernmental fiscal transfers and lastly the sub-national borrowing.

The assignment of responsibility for service provision option argues that every multi-tiered fiscal system has responsibility for the provision of a particular type of service. This service is usually assigned across different tiers of government. The assignment of services takes two forms. These are "unique" and / or "shared" Service provision is termed "unique" if for example one particular level of government is made to finance or provide a particular type of service. Example, provision defense (National Security) has always been the responsibility of the central government. "Shared" across levels of government, is considered or applied on instance such as education; which is jointly provided by national government and sub-national (local) governments. One common concern which has created hot debate on the assignment of responsibility for service provision has been identified as follows. The extent of assignment among various tiers of government and the composition of assignment (Vo, 2008). Of equal importance is the legal issue pertaining to the assignment of responsibility for service provision.

All the challenges outlined above have attracted attention of international bodies. The concerns have highlighted the following issues. Should the assignment of spending responsibilities (within and between various levels of government) be constitutionally codified? Or should the assignment be merely the outcome of the practice and fiscal competition? These are some of the main challenges with respect to the practice of service provision responsibility.

The assignment of revenue-raising powers has attracted hot debate within the international circles. The word "power(s)" used in this context involves two main elements (Vo, 2008). These are identified as powers to:

- a. The legal authority to raise particular types of revenue, thus, constitutional question; and
- b. The decision by various levels of government as to whether or not to exercise all, some or none, of their legally guaranteed powers to raise revenue.

However, there are some fundamental legal questions to be addressed. Revenue assignment can be unique. In this case, each level of government is assigned taxing powers that other levels of government do not have and that whether the assignment of revenue-raising powers should be codified in a fiscal constitution, or whether the composition of taxing powers across government levels should be the result of some of the process, such as competition within and between, different levels?

Assignment of revenue-can also be shared; thus taxing power is shared across different levels of government. Sharing takes the following forms; administrative or legislative, a strategy commonly referred to as “piggybacking” by Vo (2008). Administrative, in the sense that, the central government taxing authority collects tax on behalf of local government and legislatively, on the other hand, involves the case where local governments tax bases are defined in national government legislation. Revenue collected by central government from its tax bases may also be “shared” with the local government.

Intergovernmental financial transfers address issues of revenue assignment across the levels of government. It has been observed that this usually results in some level of mismatch between spending responsibilities and revenue-raising powers for local (sub-national) government. This challenge has resulted in the need for some form of fiscal transfer from one level to the other level of government; usually from the central to local (sub-national) government is needed to correct this abnormality. This challenge, is often referred, to as vertical fiscal imbalance. Vertical fiscal imbalance; which is defined as a mismatch between the revenue-raising powers and expenditure responsibilities of each level of government; where a shortfall in revenue for one level of government (typically the regional level) is made up by grants funded from the surplus revenue of the other (typically the central government)

This form of transfer has been named intergovernmental fiscal transfers. Fiscal transfers to correct vertical fiscal imbalance, also face design challenge. Related to the fundamental question of vertical fiscal imbalance is the issue of, how fiscal transfers should be designed? In this regard, the first-order issue concerns the share of general purpose (for unconditional or untied) transfers related to specific purpose (or conditional or tied) financial transfer.

Within these two broad types, there are some variations of types of grants. First, conditional grants can be subdivided into: (i) lump-sum grants and (ii) matching grants. For the first subdivision, a fixed sum of money is received and a recipient needs to spend money on designated areas. On the other hand, matching grants depend on a fiscal capacity of a jurisdiction to “match” funds transferred from high-tier government. It is to say, the amount of matching grants will depend on how much money local jurisdictions spend on a particular service. Second, unconditional grants can also be subdivided into two different types: (i) a lump sum and (ii) effort-related grants. While the first subtype is clear, the second requires the judgment from the national government about the “effort” of local governments in fiscal activities. The second-order issue concerns the question of whether intergovernmental transfers should be the subject of “fiscal equalization” across all governments for a given tier of politics (henceforth, “horizontal fiscal equalization”)

Sub-national or local government borrowings concentrate on access to financial market for local government, which has been a controversial issue especially in the literature relating to developing countries. The arguments which go in favour of central government borrowing vis-à-vis the local government has been that the local governments have poor



accounting and disclosure standards and rely heavily on the central government to avert debt crises, when there is a conflict of interest between lenders and borrowers (Ter-Minassian, 1996).

World Bank (2004) argues in favour of local governments borrowing with the following points. Local governments' investment expenditure entirely financed from current tax revenue is inappropriate for the equity reasons. Investment here is important here for the local governments in the sense that it will bring benefits for future generation. Also, through this, the local governments will be at least partially responsible for their spending. The second point is that the ever present mismatch between revenue and expenditure in most developing countries makes it relevant for local governments to borrow, and lastly political accountability is evident in the borrowings from local governments.

This point is in support of the first generation theory (Vo, 2008: 47), which associates the process of fiscal decentralisation with an enhancement in the overall degree of public sector responsiveness to a public demand and, ultimately, to an improvement in the economic efficiency of public economic activities by better linking resource allocation with public preferences. Furthermore, it was argued that in the absence of significant intervention from the national government, financial markets send a clear signal of local governments' performances by providing borrowings or block them from accessing the financial market. The first generation theory also suggests that local government should be given the space to manage and service their own debt, but in conjunction with transparent accounting arrangements for public sector finances (Vo, 2008).

Ter-Minassian (1996:156) in Vo (2008: 45) challenged the practice of local government borrowing. The question of the extent of the budget constraint to be imposed on local government by the national/ central government should be addressed. Should it be soft or hard budget constraint? A hard budget constraint means that the national/ central government will not bail out local government for excessive debt under any circumstances. In such a case, the market should be fully informed on the conditions in dealing with the local governments. The statement should carry the policy statement of no bailout for any local government by the central government under any condition. Additionally, the local governments have no incentives to borrow and fail to meet financial responsibility.

## **DEVELOPMENT AND LOCAL DEVELOPMENT**

Defining development is a particularly difficult issue as there is no universally agreed definition. The different definitions and uses of the concept reflect varying disciplinary biases, distinctive paradigms, and ideological disputes. Generally, the type of definition used is often a function of the socio-economic, political and educational background of the author.

In the 1950s and the early 1960s development was only seen in economic terms. The degree of development was most often measured in terms of national income. However, by the mid of 1960 people were beginning to question the economic concept of development. Its critics argue that this concept had many problems, which are basically social and political and they include:

- The breakdown of traditional, social and political institutions, which in turn result in increase in crime, deprivation and inequality; and
- The problem relate to environment like pollution of land, water and the atmosphere; and the depletion of natural resources.

Dudley seers (1969: 72) in expressing concern about this concept of development wrote: The questions to ask about a country's development are therefore:

- a) What has been happening to poverty?
- b) What has been happening to unemployment?
- c) What has been happening to inequality?

If all the three have declined from high level, then beyond doubt this has been a period of development for the country concerned. If some or all three have been going worse it would be strange to call the results development even if per capital income doubled. These concerns raised about the economic concept of development led to the welfare of mankind in the 1970s.

This new concept sees development as a state of human well being rather than as a state of the national economy. This new thinking was first expressed in a statement known as the Cocoyoc Declaration (1974). It was adopted by participants at a seminar in Cocoyoc city in Mexico organized by United Nations council of trade and development, a United Nations environmental programme (UNEP). The declaration states our first concern is to redefine the whole concept of development. This is not to develop things but to develop man. Human beings have basic needs such as food, shelter, clothing, education etc, therefore any process of growth that does not lead to their fulfillment or even led to worse, disrupt them is a travesty of the idea of development. So therefore, development consists of economic growth, equity, poverty reduction, employment generation, improved housing, gender empowerment, elimination of all forms of discrimination, freedom, justice and maintaining a healthy environment (Mensah, 2005)

This concept of human centered development concerns itself with distribution of the benefit of development, that is, the benefit of development be equitably distributed. This concept of development is further advanced to be what came to be known as the "third system project" developed by international foundation for development alternatives (AFDA) in Nyon, Switzerland. The third system took an innovative study by recognizing the different scales at which development occurs, thus local, national or global. Of these, local space was regarded as the most significant base for development deeply rooted in the maxim that "development is lived by people, where they live, work, play and die." The primary community, therefore, whether geographical or organizational is the immediate space within which personal and societal development first and best interact (Adarkwa and Diaw, 1999: 52). This underpinned the concept of local development. The desire for human development that ensures reduced poverty, access to the minimum basic needs of life is the goal in every society. In the traditional Ghanaian society, even at the community level, a strong desire for development, for the individual and the community has always been set as goals of life. At the community level, development is seen as the availability of good educational infrastructure, good roads, and access to services like potable water, electricity and health facilities among others.

### **LOCAL LEVEL DEVELOPMENT**

There is no agreement on what the term local implies. However, Uphoff (1986:10-12) has identified ten levels of decision making activities ranging from international level to the level of individual level decision makers. Within this range, Uphoff distinguishes three different local levels which are nested within one another. These local levels are: locality level, community level and group level (Andoh, 1967: 8). With this differentiation, attempts have been made at

explaining what the term local connotes. Uphoff (1992: 15) sees the term as referring to “a geographical area composed of a group of local government authorities that generally share an economic base and are close together enough to allow residents to commutes between them for employment, recreational and retail shopping.” Furthermore, “local” is “where people have some possibility of personal acquaintance, and usually some experience of working together.

Fekade (1994: 7) broaden the knowledge that “local” refers to “a spatial delineation of a limited size in which its inhabitants share similar problems treats and constraints and resources. Inhabitants are routinely interlinked by common identity (language, history, culture, physical patterns such as settlement, roads, shared service centres) and commonly shared needs and appreciation of problems in a mobilisable potential.” From these interpretations, the term “local space” for the purposes of this study is defined as an area made up of fairly cohesive and bounded by social units (that is communities), which has some established patterns of communication, economic exchange and social interrelationships, with some perceptions of common interest and some capacity for collective action.

By this definition, the districts in Ghana are considered as local level space. This is premised on the observation that people within the districts have some acquaintance with each other directly or indirectly through intermarriage, trading relations, religious festivals or participation in local government activities.

From the above definition of the terms ‘locals’ and ‘development’, local level development is therefore defined as a process of change that enables people in a particular locality to take charge of their own destinies so as to realise their full potential. This form of development requires the use of social, economic, technological and institutional process to build in the people the confidence, skills, assets and freedom necessary to achieve their development aspirations. This is considered as development from below, attained principally through the efforts of the people themselves and not as a result of goodwill gestures of those who have excessive monopoly of decision making powers and resources. This is the basis of community involvement.

Inherent in this definition is the “defining trait of the new development paradigm that development must be human-centered, coming from within, rather than imposed from outside.” Local level development, as rightly noted by Fekade (1994:46), is associated with the following attributes. These emanates from within a community/ locality, meeting of the basic needs of the population, environmental sustainable, culturally specific, access to resources and opportunity to employ one’s energy and accommodates external (i.e., non local intervention in the internally induced) process.

## **CONCEPTUAL/ THEORETICAL FRAMEWORK FOR LOCAL GOVERNMENT FINANCE SYSTEM IN GHANA**

The study was done from two main theoretical/ conceptual strands. These are the decentralisation concept; which is practiced in the form of District Assembly concept (Metropolitan, Municipal and District) in Ghana and the theory of intergovernmental fiscal relation; which spells out the fiscal policies for the District Assemblies in Ghana. These (concept/ theory) have been explained in details in the early pages of this chapter.

However, particular attention was placed on the theory of fiscal decentralisation, which spells or describes out the financial systems of the District Assemblies and the fiscal relations between the central government of Ghana and the local governments (Metropolitan, Municipal and District Assemblies).

In Ghana, it has been realized that the issue of fiscal decentralisation is one of the main causes of the failure of successive local government systems in the country (Asibuo and Nsarkoh, 1994: 32; Kessey, 1995: 25, Bandie, 2005: iv). Greater fiscal decentralisation is expected to allow public goods and services to be provided at the level and costs desired by the local communities and promote citizen participation to increase government accountability. For the purpose of the study, fiscal decentralisation is defined as the devolution of a certain degree of revenue- raising authority and transfer of funds and economic Programme to local institution (Haque, 1997: viii). Until recently most developing countries practiced decentralisation which did well in the transfer of responsibility to the local government units without the corresponding means (fiscal decentralisation).

These fiscal decentralisation efforts typically begin with a fundamental review of allocation responsibilities for expenditures and revenues by level of government. Rationalizing these responsibilities, combined with establishing an intergovernmental transfer Programme, is the first step towards creating a fiscal structure that can enable governments to properly fulfill their stabilisation, distribution and allocation functions (Shah, 1994).

Internally generated revenue can therefore be sub-divided into rates, royalties, fees and fines, licenses, rents and investment. Mobilisation and utilisation challenges of financial resources at the local level has been described by Mensah (2005) as one of the major challenges militating against the smooth implementation of District Medium Term Development Plans at the local level. This problem has affected local level development and led to widespread poverty in the districts.

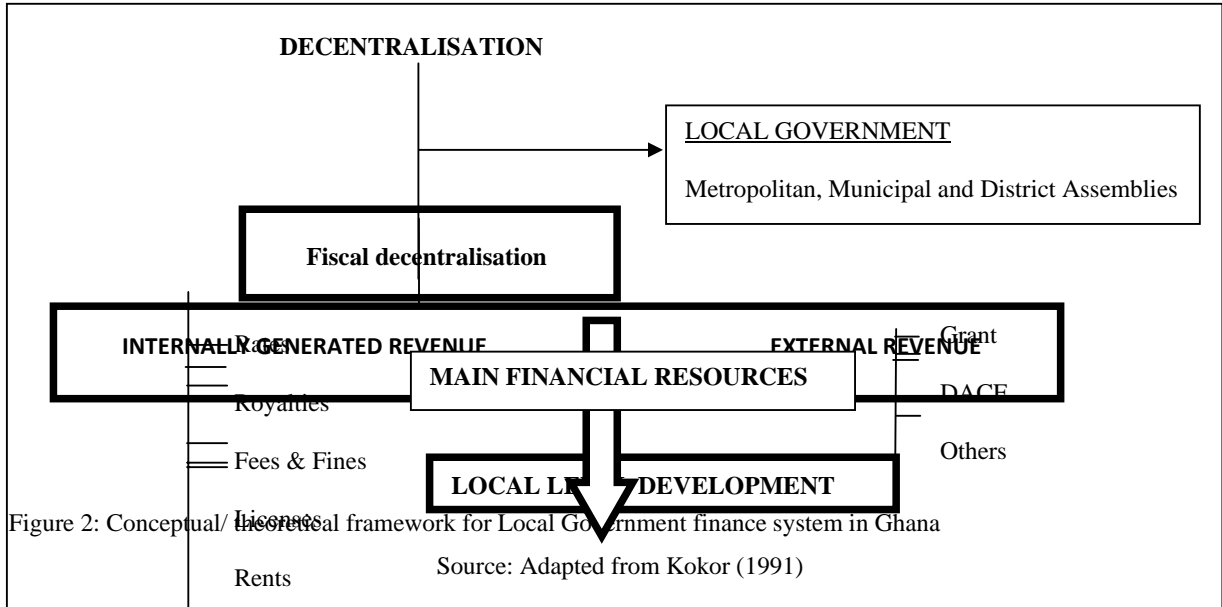


Figure 3: Map of Ghana Showing Boundary Countries  
Source: Adopted from Google Map, 2012

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