

## Decentralization and its Role in Enhancing the Economic Power of Local Government

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**Abstract:** Power distribution process from the central government to local governments results in the distribution of economic power, as well. This in turn leads to the reduction of the central government's economic dominance over the local states. This approach realizes the local governments' decisions regarding the selection of the type of economic products and the way to produce and distribute them (with respect to natural and human powers). And, this makes the key role of people in economic and survival issues clearer and ends in economic independence and production increase. Production increase provides the opportunity for trade growth at local, regional, and national levels and leads to economic dynamicity, growth, and development. Such economic policies can lead to the objectives like increasing people welfare, the economic growth of local governments, and finally economic growth of central government. This paper is aimed to examine decentralization process and power distribution from the central government to the local ones in form of enhancing its economic efficiency. Research method is of descriptive-analytical type and library references were used in parallel with the theoretical principles of economics and political geography. This study tries to present a new approach for the role of decentralization in enhancing economic power. Results of the study indicate that decentralization and power distribution from the central government to the local ones first leads to the increase of economic power of the local government and finally the central government's.

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**Key words:** decentralization, central government, economic power, local government

### Introduction

Local government is conceptually an official-political structure emerged as a result of the process of political power spatial distribution by the central government. That is to say, the process resulting in the matter that the execution and monitoring the local affairs in form of the central government's general policies to be relegated to public institutions and organizations (like councils, associations, civil organs, judgment organs, and sages) as well as governmental authorities and officials (like governorship, sheriff, and governmental offices) (Hafeznia, 2009:36). This accompanies a type of delegation, in fact, a type of power decentralization and "decentralization will have positive effect on reducing the government's inefficiency via making government and people close (Mo'alemi, 2010: 111). Compared to central government having more limited knowledge of the areas, local ones have not only more comprehensive and accurate information but also involved in the issues more concretely (*ibid*:112). Accordingly, delegating the authority of public goods accommodation to the local governments can bring about higher welfare for the society. On the other hand, the limited number of specialized forces in local government which is one of the main issues of decentralization can reduce the local governments' recognition and evaluation of

people's demands and tastes. Hence, the accommodation of general goods must be delegated to central government and the administration of decentralization policy not only does not increase society's welfare but also prevents from the appropriate policies of the central government in some cases (*ibid*:121).

In extensive systems, if a structure is built regarding "local democracy" and the relationships between central organization and provinces or areas are modified and/or in fact down-stream areas' authorities are enhanced in different decision makings, then a type of non-centralized extensive governmental political management system is formed (Hafeznia et al, 2010:51). Now, if democratic systems are not well-established in different areas of a country so that the democracy level in central government is higher than the local governments, then local governments cannot properly distinguish the society's consumptive taste. As a result, as the central government's recognition function is close to this taste, preparing general consumptive goods by the central government enhances the society's welfare level more. Therefore, we must not expect that executing decentralization policy to have its own appropriate function (Mo'alemi, 2010:122).

Today, in addition to other government's functions, this is its "economic function" to be

explained based on economic terms. The government's economic role goes beyond just accomplishing military objectives and the system's survival and domestic order depends on the economic role and the government's legitimacy source (Vefagh.co.ir....2008:1). Today, the attempt to reach a better status in global economy is a key part in development campaign. International work division is the creator of a hierarchy or basis for improving welfare. The discussion of welfare improvement is developed in terms of relative advantage theory; namely, any country which takes its best function as the pivot will gain the best results. The most productive activity of any country is the activity which fits better with the resources and agents existing in that country (hawzah.net ...2004:1). Absolutely, any development and growth is emanated from paying attention to domestic investment and economic growth through enriching local resources. Economic statistics show that the increasing growth of the products of local economy leads to market prosperity, economic competition, and social welfare. Any investment in this sector can improve economic competitions and the level of employment (jafarimahmood.blogfa.com...2010:1). During the past years, there has been an apparent trend of delegating cost allocation and increasing incomes to different governmental levels at global level. Several reasons may underlie the trend including: political changes to establish a government with higher cooperation and democracy levels, improving the extent of political leaders' responsiveness to people, establishing further connection between the quality and quantity and composition of goods and products produced with the superiority of their stakeholders, and the existence of corruption at regional level must not be ignored. Secondly, regional governments have not mostly been able to develop modern and transparent management systems (like methods of financial control, reporting, and costs plans evaluation). Thirdly, compatible legal and geographical area using maximum efficiency is not always resulted from the lack of decentralization (system.parsiblog.com....2005:1).

Now, regarding the abovementioned, the present study is aimed to study the advantages and disadvantages of decentralization and power distribution from the central government to lower levels including the local government especially in terms of economic considerations. Methodology of the study is of descriptive-analytical type and library and website references which had higher credit were used. It must be noted that by decentralization we mean central government's power division and delegation to local public organizations and agencies as well as local governmental authorities.

### **Decentralization Policy from the Economic View**

Today, there is an increasing tendency toward decentralization across the world. One of the most important reasons underlying the issue is that many countries apply this policy as a method to improve the performance of public sector. So, it is expected that such policies lead to objectives like increasing society's welfare, enhancing economic efficiency, and finally economic growth. This is because local governments know their people well due to closer proximity to the residents (Moa'lemi, 2010:105). Generally, decentralization policy has three different aspects: first, political decentralization, second, financial decentralization, and third, official decentralization. The first means the direct selection of local political authorities by local people which may not be done completely and if local governments have no control over their resources and/or have no political freedom, then the democratic selection of the local officials is senseless. Financial decentralization is defined as freedom in earning and expending income in a special area by the local government of the area. On the other hand, official decentralization means relative freedom in setting objectives, providing resources and administering and executing general policies. In sum, executing decentralization policies successfully requires the existence of foregrounds. Indeed, delegating the authorities from central level to local requires the provision of certain levels of capabilities and efficacy in each local government to realize the residents' demands (Moa'lemi, 2010:106).

From the view of public sector economy, decentralization is the most important approach for reforming the internal decision making system of the government. A variety of costs and advantages regarding decentralization and delegation to lower layers of the government are discussed each of which has a special status in various areas of the world regarding decentralization structure and level. In the last decade, many developed and developing countries have tended to decentralization policies and have implemented decentralization in one way or another. The increasing attention to the decentralization discussion can be sought in some reasons (hadizamani.com...2007:1):

- The origin of decentralization developing countries can be searched in the unsuccessful experience of the centralized world powers during the last two decades.

- Decentralization can be effective via transferring power to the lower levels of the government to reduce the central government's dominance over national economy.

- The increasing tendency of people toward establishing democracy in the developing countries has intensified decentralization policies.

Generally, decentralization “is the delegation of authorities regarding decision making planning and/or management from the central governments’ officials to local officials.” (*ibid*:1)

Governments with lower efficient and capable levels have lower performance regarding the execution of decentralization, because delegating authorities to local governments not only does not improve people’s welfare but also the weak performance of these governments will result in wasting the resources and finally reduction of the society’s welfare. Accordingly, local governments must enhance their capabilities in terms of meritocracy structures and the employment of specialized manpower so as to be able to achieve higher levels of performance. Moreover, it must be noted that increasing local governments’ capabilities without paying attention to the efficiency issue cannot realize the society’s demands. In fact, although then the local governments will take numerous actions to enhance society’s welfare, the actions will not be in parallel with the people’s demands.

Accordingly, moving toward increasing the efficiency by developing democracy and reinforcing the systems for achieving information itself can play a critical role in enhancing society’s welfare. So, achieving higher level of competency together with creating opportunities to increase the local governments’ efficiency can enhance decentralization performance up to the level expected (Moa’lemi, 2010:110).

The relationship between decentralization and efficiency is first discussed by Tibut. Under an expression “voting by feet”, he argued that local governments can better realized the people’s demands and views and will allot more efficient resources compared to the central government. From his point of view, when people have complete reflation, they will be deployed in an area where their preferences and demands are best met based on expense-tax basket. On the other hand, the reflation indicates that demander (household) will buy from the most inexpensive supplier (hadizamani.com, 2007:1).

#### **Role of Decentralization in Preventing Economic Corruption**

Corruption and fighting it is the major problem of many countries these days. The most important reasons for economic corruption in public sector are related to the government guardianship in economy and include commercial limitations, industrial subsidies, controlling prices, multiple exchange rates,

low payments in governmental services, and natural reservoirs like oil. Economic corruption leads to the reduction of investment, the slowness of economic growth, and finally non-realization of economic development objectives in country and consequently tax incomes decrease and the quality of economic infrastructures and public services decrease. The most critical policies of fighting economic corruption and economic reforms include the establishment of organs for the same regard, increasing payments of public sector, reducing the size of government in economy, accurate auditing, the independency of mass media, independency of judicial system, citizens’ participation, decentralization, and modifying society’s culture which can create dynamicity in the country’s economy and finally lead to the growth and development of national economy. Economic corruption has turned out to be one of the main problems of developing countries, government interference with economic activities leads to the matter that it plays the role of manufacturer or supplier of the industrial goods in most cases. The government allot high subsidies to industrial and agricultural activities and renting can have high profits. Obviously, the further the government interferes with production and distribution affairs, the further the corruption demand will be (*ibid*:1).

#### **The Advantages of Decentralization from Economic View**

a) Enhancing efficiency: is one of the most important advantages of decentralization which is based on “diversity hypothesis” and/or “decentralization hypothesis”. b) Reducing inefficiency: decentralization can be taken as a limitation on the behavior of governments maximizing budget, while vertical and horizontal competitions between different levels in the governments acting so leads to their budget distribution and consequently limits public sector. Accordingly, decentralization can prevent from too much goods and service supply and result in the reduction of inefficiency in public sector (hadizamani.com...2007:1).

#### **Enhancing Productivity**

Economic theory and practice show that ownership is the main factor motivating economic performance. One of the main reasons underlying the failure of communistic economy is the nationalization of private assets and destruction of the producer’s motivation (globalization.ir...2012:1).

Since decentralization indicates the transfer of responsibilities from central government to local governments via establishing responsiveness, then not only it creates motivation for local government to consider the preferences of the residences of different areas but also it leads to innovations and creativity in

producing public goods and services at regional level. and, as a result, the general costs of production and consequently the prices reduce and the quality of production increases (compared to centralized mode where a single method is used for public goods and services) (hadizamani.com...2007:1).

#### **Reducing Costs**

Decentralization leads to the reduction of bureaucratic hierarchy. Materially, the affairs in each area are usually managed with respect to the possibilities and meeting a part of other local requirements and plans are organized by taking local possibilities into account. Hence, by consuming, the central government's budget is significantly reduced, because undertaking local affairs is to cost of central government and leaving such affairs will reduce the expenses of central system. In addition, evidently, it will have no costs for local systems. So, reducing costs can lead to production efficiency and finally to economic growth increase.

#### **The Possibility for Reducing Bribery, Financial Corruption, and Renting**

As mentioned earlier, there are different discussions regarding the relationship between decentralization and the possibility of increasing or decreasing bribery and financial corruption. Generally, what can be perceived from these discussions is that on one hand in case any exclusive power and authority exists, bribery and financial corruption will increase at the central government level, and on the other as the politics' responsiveness to the public increases, this possibility decreases. Hence, decentralization can lead to the reduction of bribery and financial corruption (*ibid*).

The stakeholders' access to economic rent is mediated by government. Generally, governments are the enormous foci of allocating and distributing rents in a society both actively and potentially. They can provide the opportunity for renting via different ways. The great part of rent sources is created and distributed in the market via government's intervention in the market. These interventions can provide the scene for renting in different ways including taxes on market voluntary trade-offs, controlling and exploiting natural resources, direct government's entrance into production, interfering in prices system, implementing price limitations on and disrupting relative prices, interfering in labor, exchange and credit market via determining payment rate and the rate of exchange and bank profit, employing commercial limitations in form of tariff and non-tariff restraints, endowing subsidies in different forms like production and consumption subsidies, creating exclusive conditions and preventing from competition, endowing a variety of

business licenses and a variety of other interferences (donya-e-qtasad.com...2010:1).

#### **Decentralization Cost**

Beside the advantages, there are also disadvantages regarding the execution of decentralization policies. Accordingly, decentralization costs can be examined from two views: first, costs resulted from decentralization level related to the inaccurate distinction of the level or exceeding the level; the second is the structural costs of decentralization which are due to the lack fitness between decentralization structure and political, economic, and cultural structures of a society (*ibid*).

#### **Costs related to Decentralization Level**

##### **Income Gap Increase**

Based on the studies done in this regard, delegating the duty of income distribution to local governments brings about problems, because firstly poverty generally heightens more in rich areas compared to the poor areas. As a result, the reduction of income gap by local governments does not require the same attempt, and as a result delegating the issue to local governments will not be fair. Secondly, re-distribution of the income by local governments automatically results in failure (hadizamani.com...2007:1).

##### **Endangering Macro Economic Stability**

Delegating the duty of establishing sustainability to local governments will lead to failure for some reasons: first, the influence of local governments on macro economic variables including national demand, global prices and budget control will be really weak due to the weakness of some national governments. Second, the effect of macroeconomic control is mostly out of the legal jurisdiction of the local governments and imposes many costs on them. Third, even delegating a part of stabilization policies to local governments can lead to the failure of the central government's policies. This is because it is possible that the local governments' financial policies flow against the policies of the central government (*ibid*).

##### **Market Failure**

In general, in some cases, delegating authority to local officials will fail. Cases like the existence of external positive and negative effects, providing pure public goods, savings resulted from the scale and inability of private sector in providing financial resources in macro economic plan and also high-risk activities are among the situations finally end into the market failure (*ibid*).

#### **Costs related to Decentralization Structure**

##### **Weakness in Allocation Efficiency**

In general, one of the advantages of decentralization is the improvement of resource allocation based on satisfying the demands of people

in a society. Yet, the discussion is theoretically based on financial feudalism which is barely true with developing countries. This because on one hand alternatively the main problem of these countries is not the accurate recognition of people's priorities, rather - due to the existence of weak economic structures - even local governments cannot meet even the areas. Moreover, voters cannot reflect their completely known needs and obvious priorities via election (hadizamani.com...2007:1).

#### **The Limitation of Manpower**

If local governments do not have enough and specialized manpower, we cannot expect that decentralization accomplish its goal. This is because the success of decentralization approach requires having enough and specialized manpower. So, it can be said that central government has further occupational and payment opportunities compared to local governments to employ manpower with higher quality (Sameti et al, 2006:1).

The economic power of the government is related to the capacity and ability of the government to determine and change the society's economic conditions and controlling the economic life of people. In societies relying on governmental economies and authoritarian political systems, this control is direct and mostly very intensive. If in societies relying on open economic system and parliament democracy, this control is indirect and relatively limited. In these societies, the governments' economic control is mainly practiced via formulating regulatory and directive rules and policies (*ibid*:1).

#### **Decentralization in Iran**

Based on reports of the parliament research center, in an analytical report as "increasing the authorities of provinces in decision making on local policies", decentralization is evaluated as a positive action. Also, in this analytical report as "establishing local government and also separate local parliament in each province", it is recommended as a solution which can bring about decentralization of central government's duties. Extending the authorities of local governments means that for example "central government" and "national parliament" merely legislate a budget as civil plans budget in Ilam Province rather than spending their time and energy for examining the priority of developing irrigation plans or construction of rural roads or for instance equipping hospitals in this province, and then delegates decision making on the details of allocating the budget to local government and probably the local parliament of Ilam Province. Also, a framework (both based on political economy's theoretical principles and the successful experience of tens of countries delegated extensive authorities to local governments

and municipals) can make great contributions to optimally allocate public budget in different areas of the country and bring about further public satisfaction of citizens and in particular in smaller and less developed provinces (khabarfars.com...2012:1).

Iran's economic movement toward development in recent years taken a developing trend, despite many problems has naturally intensified some economic difficulties and crime. This trend – despite being uncontrollable – is hard to be solved due to the complexity of the subject. And, any ignorance and political destructive movements can shaken and ruin the weak roots of the economic system of Iran. Executing principle 44 of constitution is the beginning of a new evolution in privatizing and the improvement and increase of country's production. The new evolution can be the origin of developing activities for enhancing economic system efficiency which can also have positive effect on the efficiency and productivity of national economy, enhance expectation, remain macroeconomic variables, and be the main factor in preventing from and reducing economic corruption. Private sector and cooperative in 2007 had good economic dynamicity by implementing decentralization principle in the economy by the government (confbank.um.ac.ir...2008.ir). To enhance national economy efficiency, there is no way except delegating the national investment management and centrality to private sector and protecting open and competitive economy; the objective on which whole general policies of principle 44 are focused (walkinocomy.mihanblog.com...2011:1).

From a historical point in Iran, establishing non-centralized system thinking has got started since constitutionalism. In post-revolution years, council was taken as management tool in local and regional affairs, and discussed as a suitable scene for decentralization. In the first development plans of Iran, decentralization was less taken into account but in the second one it was taken into account more seriously so that based on Note 2 of the plan, the government was required to determine each province annual budget from national incomes and current and civil budgets and present it to the parliament attached to the government's budget act. This subject was proceeded in the third and fourth development plans, as well (hadizamani.com...2007:1).

In the decentralized system, local affairs are managed rather by organizations or associations where their individuals are chosen by the locals. In this method, each local government has special budget, formations, duties, and regulations for itself. However, the limits of authorities previously set by legislative or specified in the text of constitution and in case of any ambiguity central government will

clarify it by issuing its approval. In such a system, all official regulations and place and decisions made on all residents will be approved by formal and legal associations. In such a system, local governments and their employees follow local regimes and the central power monitors them and their individuals. The character of federalism is the political decentralization and formation of independent political units in a certain local area. Integrating federalism into economy produced expression "economic federalism" in the political and economic literature of our country monitors the formation of independent economic areas proportionate to the abilities and potentials existing in the provinces of Iran. So, the regionalism economy plan, implementing federalism is only in the realm of economy and centralization in managing political, cultural, and defensive domains are still like before (tabnak.ir...2012:1).

#### **Role of Government in Economic Development**

Today, it is widely accepted that the existence of efficient and effective government is critically important for the realization of social and economic development. Yet, it is also accepted that such government must play its role as the partner and supplier of these facilities rather than as leader and manager. That is, the government must complete the market activity rather than replacing it. Hence, three main duties can be mentioned for the government: 1- war responsibility 2- protecting the country's security and the third, since domestic peace and political survival mostly depends on economic conditions, governments and authorities are responsible for economic evolution, as well. This duty in summarized in terms of three roles allocation, stabilization and distribution each of which is explained here:

Provision process or public goods through which total resources are divided into public and private goods and also a combination of public goods are selected is one the government's roles which can be called allocation role.

Distributive role means the government's movement toward establishing fair income distribution. Also, government's interference in terms of stabilization role also means that the economic systems periodically suffer from inflation, unemployment, lack of development, and the governments interfere in economy for removing inflation and unemployment and attempt to accomplish better and more rational development (hawzah.net ...2004:1).

#### **Role of Government's Size on Economic Performance**

Studying the effect of government's size on total economic performance and growth is important and

in this regard various theories are developed. A view point is that larger government's size is harmful for production efficiency and economic growth. This is because firstly government's performances are mostly managed and executed inefficiently; secondly, modifying different governmental systems affect the country's economy negatively; and thirdly, most financial and monetary policies tend to deviate economic motivations and reducing the efficiency level. Contrary to this view point is that some believe that government has a sensitive role in economic development stages and argue that larger government's size is similar to a strong motor of an economic development because firstly leading the government is essential in accordance with the conflicts in private sector. Secondly, preventing from being exploited by aliens is among the vital affairs which are not possible without the government. Protecting the increase of profitable investment and providing an effective social leadership for development and growth is not possible without the government's presence (ensani.ir...2007:1).

#### **Governments' Economic Interference**

Regarding economic interference, governments can be divided into an extensive spectrum which are started from classical government and ended in centralized planning government.

The government's economic activities are done in terms of three levels including central government, general government, and public sector.

##### **1- Central Government**

A country's central government political dominance over the whole realm of the country is extensive. The central government can impose tax on all domestic and international units having economic activity in the country. The central government is responsible for the general interests of the society including national defense, relationship with other countries, public order and security, and optimized performance of the country's social and economic system. In addition, it may spend for providing healthcare and education services mainly done for the households and have transfer payments to the institutional units at other levels of the government. Also, it executes financial policies on anti-inflation or inflation pressures in the economy whose policymaking body can formulate and implement policies for national interests. In most countries, central government is the largest and most complicated governmental level. This is generally formed by a combination of a central group of organizations and ministries establishing a single active unit in addition to active units under the dominance of the central government – which have a separate legal sign and enough authority to form extra governmental units (vista.ir...2012:1). Most

countries delegate duties like defense, foreign affairs, foreign trade and monitoring of migration to the central government. On the other hand, services like defending domestic order and security, firefighting, healthcare, transportation, and some public services are usually undertaken by municipalities in areas and cities. There is not the same pattern for other duties. In addition, the legal framework of these duties is not clear, and differences are seen in formulating policies, financing, and allocating. Regarding the decentralization of social costs, there are considerable differences among countries. Duties related to social provision are generally undertaken by the central government. This is because they require regulations which must be practiced at all national levels. That is to say, providing services like unemployment and old age aids are usually done regionally. Regarding education, the conventional pattern of delegating duties is the delegation of public primary and secondary levels to local governments (municipals) and secondary level to state governments. However, in some countries, education at all levels is on the government's charge. Even in countries where their costs are spent in decentralized form, central government again plays the main role in determining regulations, standards, and financing educational plans. Regarding healthcare services, local governments are mostly responsible for providing prevention and care services (system.parsiblog.com....2005:1).

## 2- General Government

General government includes all governmental units and non-market non-profit institutions controlled and generally financed by governmental units yet not general or pseudo-general companies. Depending on the legal and official arrangements, there might be more than one governmental level inside a country. In the financial statistical system of the government, three levels are considered: central, statewide (provincial or regional) and local. All countries do not have the three. Some have just central or the central with a lower level. Some also may have more than three levels which all different units must be grouped in one of the three levels. In addition to government levels, social services bank – due to its role in financial policy – is taken as a separate sub-section of the general government. Central government was explained in previous section. Now, two other sub-sections of the general government are explained.

### a) Statewide or Provincial or Regional

A state, province or zone is the greatest geographical unit based on which a country may be divided for political or executive purposes. Legal, judicial, and executive dominance of a statewide government is extensive on all the areas of that state

which usually have many districts. Yet, it does not include other states. Statewide government has usually financial independence for taxing the resident or active units in economic fields in the area under its dominance. Also, the government must be able to acquire the ownership of assets, capital increase, creating debts as well as spending and distinguishing taxes and other incomes which it has earned based on its policies. Also, this government must be able to assign its employees independent from the external official control. Major ministries and organizations of the statewide government make a single unit in the same way as the main body of the central government. In addition, there might be active institutes under the dominance of the statewide government with separate legal identity and adequate independence. Based on this definition, there is no provincial government in the country but governorships act in provinces as the representatives of the central government.

### b) Local Government

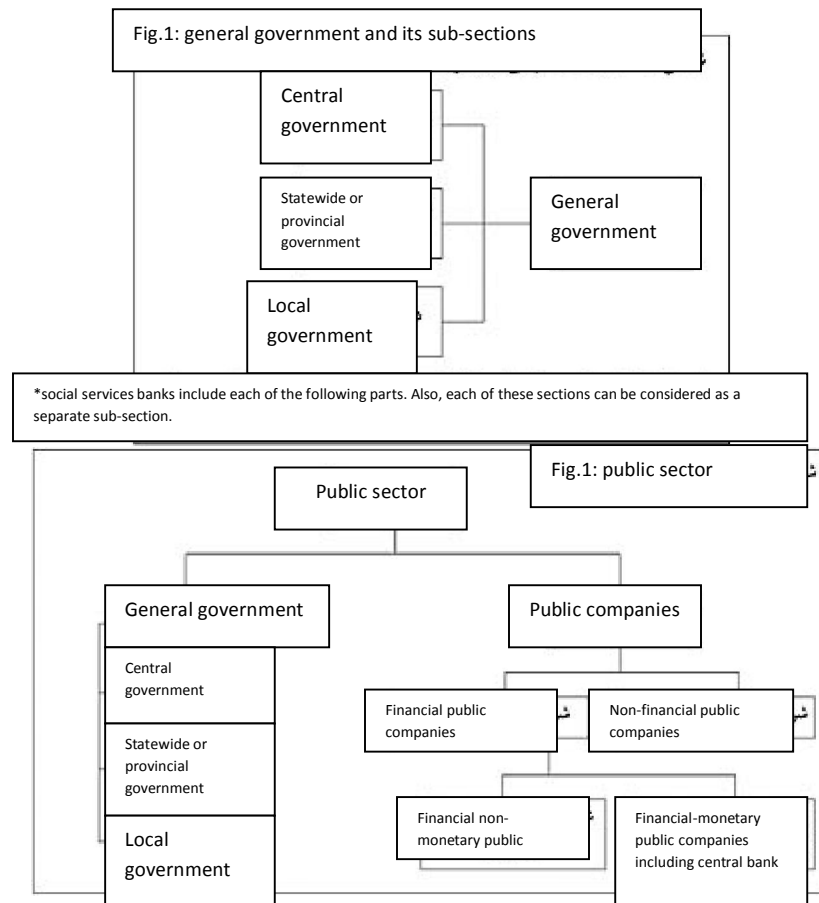
The legal, juridical, and executive units of local government are divided into smaller geographical areas (like city or province) which are differentiated for political and official purposes. The domain of local government dominance is less than central and statewide government. Also, they mostly depend on the higher order governments financial aids and may sometimes act as the agent of central or statewide government. The local governments must have autonomy over their assets, capital increase, and receiving loans. Also, they must be independent regarding how to spend, and to assign their employees. Local government statistics may include a wide spectrum of governmental units (such as area, province, city, town, and district). Based on the definition, local government in Iran includes municipalities (vista.ir...2012:1). Model (1) illustrates government's economic activities at different levels.

### Conclusion

The legal, juridical, and executive units of local government are divided into smaller geographical areas (like city or province). The domain of local government dominance is less than central and statewide government. . Also, they mostly depend on the higher order governments financial aids and may sometimes act as the agent of central or statewide government. The local governments must have autonomy over their assets, capital increase, and receiving loans. Also, they must be independent regarding how to spend, and to assign their employees. Local government statistics may include a wide spectrum of governmental units (such as area, province, city, town, and district). Based on the definition, local government in Iran includes municipalities (donya-e-eqtesad.com...2007:1). To

accomplish these purposes, one of the followings is done: power division from the central level to local governments. Namely, the functions of the central government are delegated to local governments. Amongst the roles is the government's economic function. The present study has demonstrated that this issue has both advantages and disadvantages. Yet as seen its advantages and benefits are considerably more than its disadvantages. And, based on

experiences, these threats can also be turned out to opportunities via further studies and explorations. Hence, it can be said that decentralization acts as a powerful tool for enhancing the efficiency of public sector. So, one of the main reasons underlying the justification of decentralization trend in the world is that executing such policies can lead to the objectives like enhancing welfare, efficiency, and finally economic growth.



Source: (donya-e-eqtasad.com...2007:1)

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