

Devolution and Public Sector Governance: A Critical Reappraisal

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Perceived benefits from direct popular participation in public affairs have been grossly exaggerated, especially when viewed in the context of devolution and public governance in developing societies. The overblown assessment is due mainly to the fact that devolution has been viewed in terms largely of the direct and immediate benefits it bestows on the people of local communities, and that the net positive external and interaction effects of community activities on society as a whole have been largely ignored. A number of institutional factors further aggravate the adverse consequences of devolution on social welfare, foremost among them being the prevalence of corruption and the lack of managerial skills at the local level. While devolution is an essential ingredient of political reform, we should be cautious of its uncritical and loose implementation.

Introduction

In the course of the evolution of the “new public administration” over the past couple of decades, few ideas have gained more prominence than that of devolution. No other concept has sunk deeper into the collective mindset of academics concerned with public governance, nor has gained more acceptance among professional public sector administrators. Devolution has, for all intents and purposes, become a permanent fixture in today’s accepted model of public sector management among the developed countries and in most of the developing world.

The concept of devolution has great intellectual appeal. It is rooted in traditional western political philosophy which puts emphasis on the rights of the governed to take an active part in running their affairs. It is no surprise, therefore, that devolution in its present form had its early beginnings in western countries such as Great Britain, New Zealand and the United States. The idea later spread to countries in the developing world, most of which have long been exposed to western political, economic and social traditions. The Philippines is one of several developing countries in which the idea has taken a firm hold.

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It is surprising to note, however, that there has been little serious debate among Filipino scholars in the field of public governance about the relative merits of this doctrine as viewed in the context of Philippine society and culture. They all seem to speak with one voice in support of devolution, the commonly held assumption being that it is a requisite for good governance. Its popularity rests in no small measure on the romanticized notion that political and economic power belongs to the people.

The extant literature on the subject of devolution assesses its impact mainly in terms of the concerns of the people in the communities who are perceived to directly benefit from it. By contrast, this paper looks at devolution in the context of the social and economic benefits it bestows *on society as a whole*. Viewed from this wider perspective, some of the dysfunctions of devolution and governance strategies closely associated with it will hopefully come into clear view.

The Allure of Devolution

Devolution is the most salient aspect of the new orthodoxy of public sector governance. It is the process by which the responsibility for the allocation and use of public resources and the distribution of public services to the citizens is shifted from national to local government units and institutions. It is the natural consequence of the implementation of reforms in the political system, a change process which involves both the *decentralization* of governmental functions and the *empowerment* of the people to make the decisions that ultimately affect their economic and social well-being. These administrative reforms reflect a gradual shift from what has traditionally been termed public *administration* to what is now commonly known as public *management* as the underlying philosophy in running the affairs of the state. This transformation mirrors current trends in the corporate world. Devolution has been quite successful in the private sector and, as the argument goes, it is also likely to be successful in public sector governance.¹

A decentralized system of resource allocation and use in which the citizens themselves decide on matters that directly affect their lives is generally perceived to bring greater advantage to the people.² In traditional hierarchical bureaucratic structures, major allocation decisions are made at the top, and service delivery follows a "top down" flow from one administrative level to another. By contrast, in a decentralized system, resource allocation and service delivery are completely localized (Ellison 1998: 3).

There are very compelling arguments for decentralization in the public sector. Among the perceived advantages of a devolved system of governance are the following:

- Plans and programs can be custom-tailored to the specific needs of, and conditions obtaining in the community;
- Better coordination is achieved among the various organizations involved;
- More opportunities for experimentation and innovation in the choice of strategies and methods of program implementation become available;
- Greater motivation on the part of local-level administrators who have greater responsibilities for the programs under their supervision can be provided;
- Greater overall administrative efficiency is achieved due to the reduction of the workload of national level officials, who, after having been freed from operational responsibilities, can now focus on macro-strategy and policy matters; and
- Decisionmaking processes are considerably speeded up.³

A major argument for decentralization is to economize on the costs associated with the generation and transmission of information needed for effective governance. In a highly centralized structure, the informational basis for decisions is generated at the local levels and transmitted to the top where decisions are made. These decisions, along with relevant guidelines for implementation, are then transmitted to lower administrative levels. By devolving decisionmaking responsibilities to the local level, it is argued, the bulk of the cost of information is averted.

Cariño (1983) laments that certain biases of traditional policies (and policymakers) prevent the poor from gaining access to basic services. She sees in devolution a way by which the interests of the poor can be served with greater dispatch. To facilitate the effective distribution of society's resources among its less fortunate members, she suggests, among other things,

- that decisions be made at administrative levels as close as possible to the intended beneficiaries;⁴
- that decisions take into account the unique set of conditions that obtain in the locality; and

that decisions be made "by all persons to be affected, government and nongovernment, bureaucrats and clients and the public at large."

The direct involvement of the people on matters affecting their place in society is seen by most as an elemental force in political reform. For example, the EDSA "People's Power" revolution is considered to be the spark that brought about the downfall of the Marcos dictatorship and the birth of a new political order in the Philippines.⁵ Seen in its larger sociopolitical context, devolution is viewed as a powerful instrument for the full expression of the popular will and as a means by which to improve the social and material well-being of the citizenry.

Alternative Perspectives

While devolution does lead to the lessening of the costs of information needed for decisionmaking in the public sector, it entails additional costs of monitoring the activities of lower-level public officials. These costs may be expected to be quite substantial in view of the tendency of local administrators to behave opportunistically and pursue their own personal interests, along with those of their kin and associates, at the expense of the welfare of their constituencies. Information asymmetries between central and local public administrators and the tendency for the latter to render inaccurate or distorted reports make these monitoring activities necessary. Even if monitoring activities were set at their optimal levels,⁶ information asymmetries endure and the social costs arising from opportunistic behavior on the part of local administrators continue to be substantial.

The efficacy of devolution as a strategy for enhancing the well-being of society depends in large measure on existing social, economic and political realities. As Oyugi has noted about decentralization in Africa,

The literature on politics and governance in Africa tends to suggest that the hallmarks of good governance – namely, the rule of law; a fair and efficient system of justice; broad popular involvement in political, social, and economic processes; the capacity to manage development; and accountability and transparency in the management of public affairs – are still woefully wanting in many African countries (Oyugi 2000: vi).

Failure to take these and other institutional factors into account may lead to unexpected and unwelcome consequences. It is precisely this failure to take the relevant constraints into consideration that the success rate of devolution has been spotty at best.⁷ The well-documented difficulties encountered in the

country's efforts at devolving its health services illustrate this point quite forcefully.⁸

Differences in Values, Attitudes and Managerial Competencies

A major reason for the potential failure of devolution to achieve its intended results is the common observation that corruption, which is rampant in most developing societies, *is even more intense, relatively speaking, at the local level*. As Griffin (1981) has noted:

... in many countries, power at the local level is more concentrated, more elitist and applied more ruthlessly against the poor than at the center (cited in Turner and Hulme 1997: 172)."

This situation is no less true in the Philippines than it is in most other developing countries. Compared to their national counterparts, politicians, administrators and bureaucrats at the local level are less subject to close monitoring from their superiors, and are less visible to the media and cause-oriented organizations. Due to opportunistic behavior on their part, coupled with the indifference – or fear! – of those whom they are supposed to serve, it is reasonable to expect that the amount of public resources expropriated by these bureaucrats for their own personal use is larger (in relation to the amounts under their administrative responsibility) compared with their higher-level counterparts. Moreover, due to the close personal affinity between local administrators and many individual members of the community, cronyism is likely to be more rampant at this level than at the national level. In pursuit of their own interests, local officials typically manipulate the decisionmaking processes in their communities, often with the willing acquiescence of their constituencies.¹⁰

While the amounts involved in individual acts of chicanery and corruption at the local level are relatively small, these acts are perpetrated many times over in all parts of the country that the total amount involved can be staggering. If it is true that local officials are *relatively* more corrupt than national-level administrators, then devolution will result in a larger dissipation of public funds into unlawful uses. As a result, basic services will become less, not more accessible to the intended beneficiaries.¹¹

It is reasonable to expect that officials of nongovernmental organizations (NGO s) and local community organizations that are involved in the distribution of basic services are more dedicated to their work compared with government agencies. In some instances, however, these organizations serve as fiefdoms of

power-hungry and corrupt individuals who have little concern for the well-being of their members, much less of their clientele.

Another major reason for wastage and inefficiency at the local level is the professional incompetence of local administrators compared to their counterparts in the national government.¹² Because of limited access to relevant information and inadequate managerial skills among managers of regional, provincial and local government units, resources tend to be misused and the cost of basic services become unreasonably high.¹³ Due to poor logistics, timely delivery of the right amount of services to the correctly identified recipients is seldom achieved. Moreover, local project managers tend to focus exclusively on their specifically mandated administrative responsibilities and act independently of projects being undertaken elsewhere in the community. Because of this limited and narrow view, local service providers fail to capture the benefits of synergies arising from service complementarities. As a result, the welfare of the community is unwittingly compromised.¹⁴ I have argued elsewhere that the significant decline in the quality of instruction at the University of the Philippines is due in large measure to the devolution of many of its programs among several regional units where the level of academic and administrative competence is generally low (Poblador 1999).

Local executives are also known for their profligacy and display a penchant for expensive showcase projects that give tangible evidence of their "accomplishments" while in office. Most of these projects provide little or no direct benefits to the poor.

The State of Development of Social, Economic and Political Institutions

The success rate of experiments in devolution varies from country to country. As a general rule, devolution is more likely to be successful in highly developed societies than in less developed ones. This is so for a number of reasons.

The production and distribution of private goods is more efficient in the more developed economies because they have highly effective economic enterprises and institutions that constitute an efficient production and exchange system. This efficient market mechanism insures that economic resources are put to their best possible uses. Similarly, the production and distribution of public goods is equally effective in the more advanced societies because of the existence of highly developed and well endowed social and political institutions by which the people's will is effectively translated into appropriate actions and desired results. In developed societies, individual, community and societal concerns are more intimately and effectively intertwined due in large measure to a high

degree of factor mobility and highly effective communication systems. Because they are more closely interconnected, local communities in the advanced countries can better adapt to one another. The operation of the "unseen hands" of modern technology, a highly developed infrastructure, and an efficient network of social, economic and political institutions insures that addressing the concerns of local communities ultimately redounds to the well-being of society as a whole. What exists, in other words, is a self-organizing system in which small changes taking place at any one point and at any level are readily translated into changes elsewhere in the system. In the developed world, local interests are co-aligned with each other and with those of society as a whole. Here, devolution as a strategy for the delivery of public goods and basic services is an appropriate one.

The situation is quite the opposite in the developing world. In most less developed countries, social, economic and political institutions are at their early stages of development and are as yet unable to function efficiently. Communities are effectively isolated from one another, and development efforts exerted in any one of them have little spillover effects on the others. Local communities differ in their levels of economic and social well-being. They also differ widely in their value systems and in their ability to manage their own resources. Moreover, in many countries in the developing world, local communities and regions, many of which are defined along ethnic and linguistic lines, have very little sense of identification with society at large, and couldn't care less about how things are elsewhere in the larger socio-political system. In most of these countries, a decentralized system of public governance is highly unworkable.

The different communities and regions of less developed countries vary significantly in terms of level of development and resource endowments, and their needs for public goods and basic services vary substantially. Any system of public governance must treat these widely disparate political enclaves differently (that is, more resources should theoretically be allocated to the more needy ones) in order to achieve a semblance of optimality in the allocation of scarce resources. However, such a differential treatment is not politically feasible, and for obvious reasons. The common perception of equity requires an equi-proportionate (in relation to population), if not indeed an equal allocation of public goods among the many and disparate communities.

The economic rationale for a differential treatment of the diverse local political units of society can be explained with the help of the diagram shown below. In Figure 1, AA and BB are the marginal social benefit (MSB) curves of public expenditures in Communities A and B, respectively. To simplify matters, both communities are assumed to have equal populations, and that A is the poorer of the two. Following the usual equi-marginal condition for the optimal allocation of a given amount of resources (say, the government's budget for the year), Community A should be given an endowment of $0a_1$, and B should get $0b_1$. This insures that the benefit resulting from the last peso spent in Community A

(indicated by the segment na_1) is equal to the benefit arising from the last peso spent on Community B (fb_1).¹⁵ It can be seen that the required allocation for Community A is substantially larger than B's legitimate share. However, political expediency dictates that the central government reduces A's budget by a_2a_1 and increases that of B by an equal amount b_1b_2 to achieve an "equitable" allocation. This will result in equal allotments $0a_2$ and $0b_2$. Note, however, that the process of reallocation of community budgets has resulted in a net decline of the economic well-being of both communities *taken together* (or society as a whole) by the difference between the shaded areas mna_1a_2 and fgb_2b_1 . Under the assumed conditions, it is clear that only a strong centralized system of public governance can achieve an economically optimal allocation of public funds.

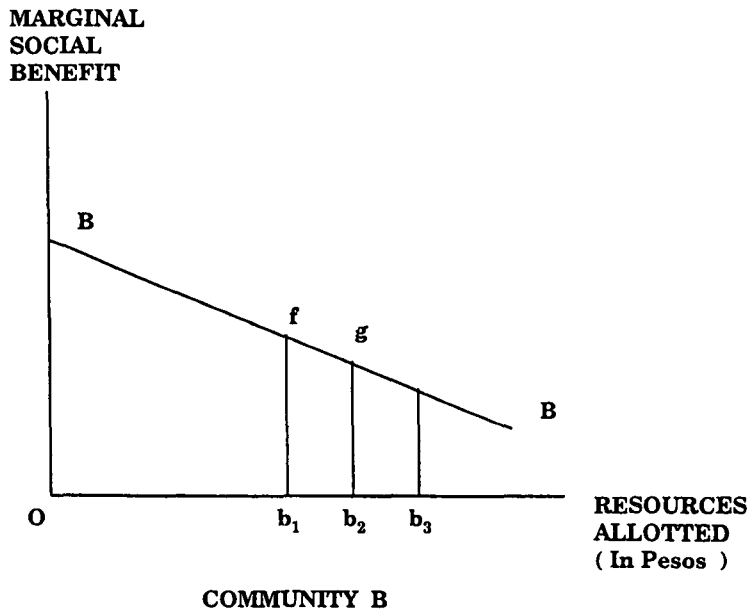
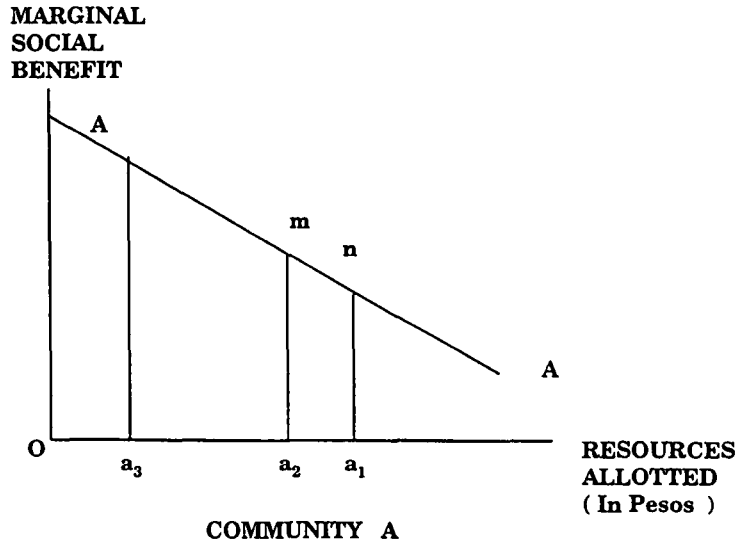
In the Philippines, public sector reform seems to have brought about just such a non-optimal situation. The Local Government Code of 1991, considered by many as "...the most radical and far-reaching policy that addresses the decades-old problem of an over-centralized politico-administrative system (Brillantes 1998b: 44)," provides, among other things, for an Internal Revenue Allotment (IRA) to cities, provinces and municipalities. By this provision, local political entities are allowed to retain a fixed percentage of their tax collections. This equi-proportionate (in relation to taxable income) retention of tax receipts means that the more affluent local governments units (LGUs) get the bigger slice of the budget cake. In Figure 1, this is shown by allocating $0b_3$ to the more economically developed Community B and $0a_3$ to the poorer Community A, a patently non-optimal allocation. Devolving economic and political power to the LGUs clearly entails a substantial price in terms of social welfare forgone.

This simple graphic illustration shows that a decentralized system of public governance is not compatible with the optimal allocation of resources in certain developing countries where existing institutional arrangements are far from ideal. This suggests that devolution cannot be regarded as a universal prescription for public sector reform. It should be applied discriminately and with extreme care.

Externalities and Interdependencies

A major flaw in the conceptualization and implementation of many devolution strategies is the notable neglect of externalities. This oversight follows from our earlier observation that current thinking on public sector governance looks almost exclusively at the direct and immediate benefits of public services to the local population, to the neglect of their indirect and longer-run effects on the larger body politic.

Figure 1. Welfare Effects of Different Patterns of Resource Allocation Between Two Communities



Externalities are the consequences, both harmful and beneficial, to the larger macro system of activities taking place at the micro (community) level. The potential impact of various economic activities on the physical environment are all too familiar for us to ignore. As one observer puts,

... if these development trends and phenomena are taking place at the expense of our environment and natural resources or for the benefit of a limited sector, (then they contradict) the intrinsic concept and value of development, (and are) inconsistent with what is globally considered as sustainable development (Padilla 1998: 83).

The long-run harm of certain community projects on the productive capability of the whole society is illustrated below. The curves AA and BB in Figure 2 are exactly the same ones shown in the preceding diagram. Suppose that the current levels of activity in the adjoining communities A and B are $0a_1$ and $0b_1$, respectively. An increase in the level of activity in Community B to $0b_2$ (say, arising from the expansion of its water management system) may cause serious long-run damage to the ecosystem and thus reduce the overall productivity of *both* communities. This is reflected in downward shift in the MSB curve of each community to A'A' and B'B', respectively, resulting in a decline in the two communities' combined economic well-being represented by the sum of the darkened areas between the two sets of curves. Unless the two communities coordinate closely with each other in planning out and implementing their activities, which is unlikely in practice, or unless the central government takes a strong hand in the decisionmaking process, such negative external effects will be ignored and society loses out in the process.

Quite frequently, certain activities implemented in one community will enhance the economic productivity of certain complementary activities being undertaken elsewhere.¹⁶ For example, if Community A embarks on an income-generating project such as the setting up of a cooperative to manufacture fertilizer from an abundant indigenous material, farmers in Community B will have access to cheaper inputs and their productivity is vastly improved. In Figure 3, curves AA and BB are the economic value added (EVA) curves of public projects being undertaken in communities A and B, respectively. The allocation of funds to the fertilizer project is reflected in a movement from $0a_1$ to $0a_2$, a move which will shift B's EVA curve to B'B'. As a result of the improvement in economic productivity of community B, it will enjoy additional economic well-being shown by the segment mn between the two EVA curves.

Figure 2. The External Effects of a Community Project

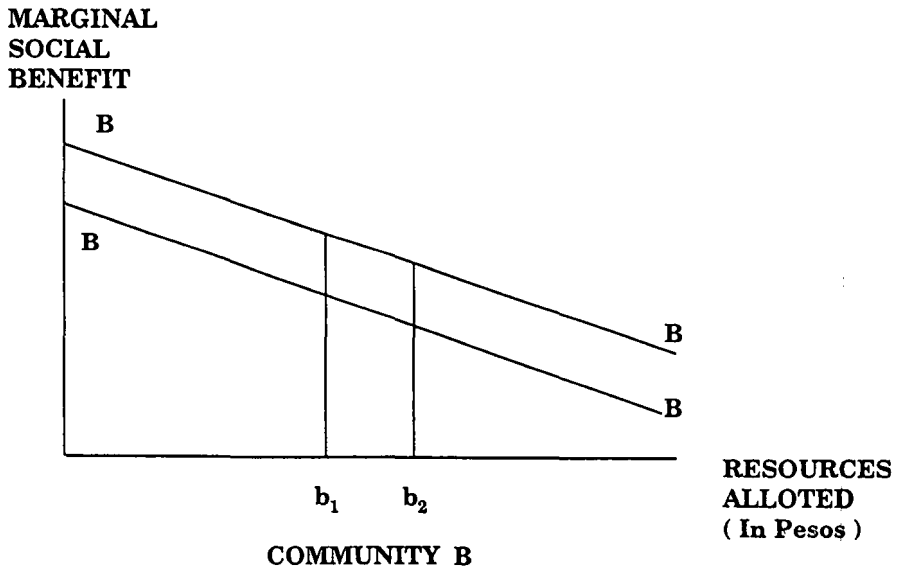
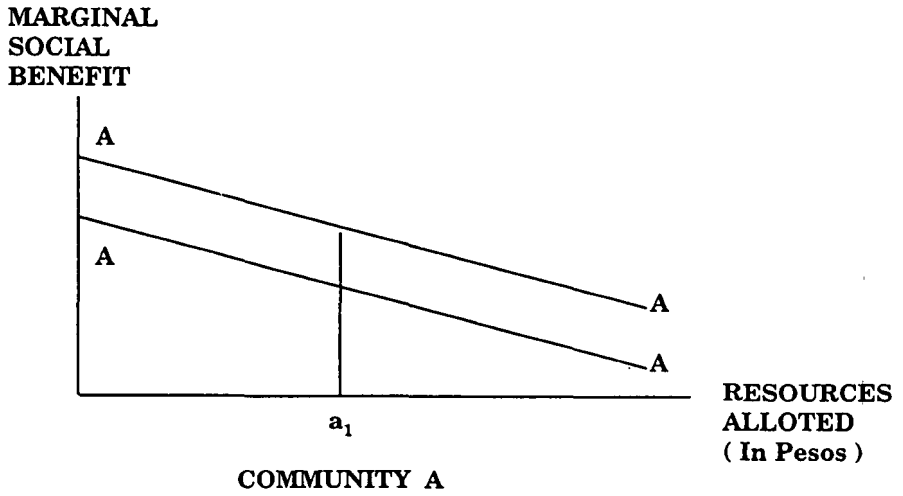
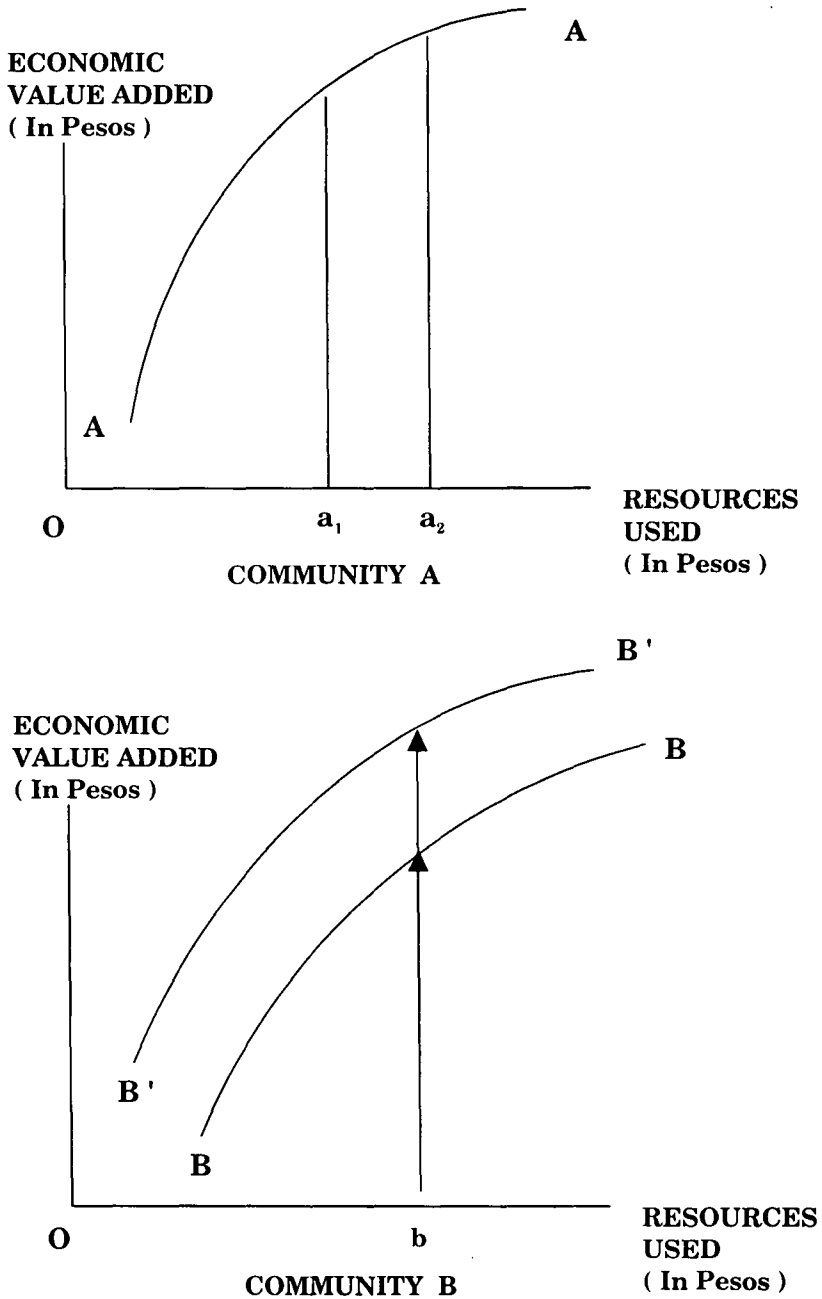


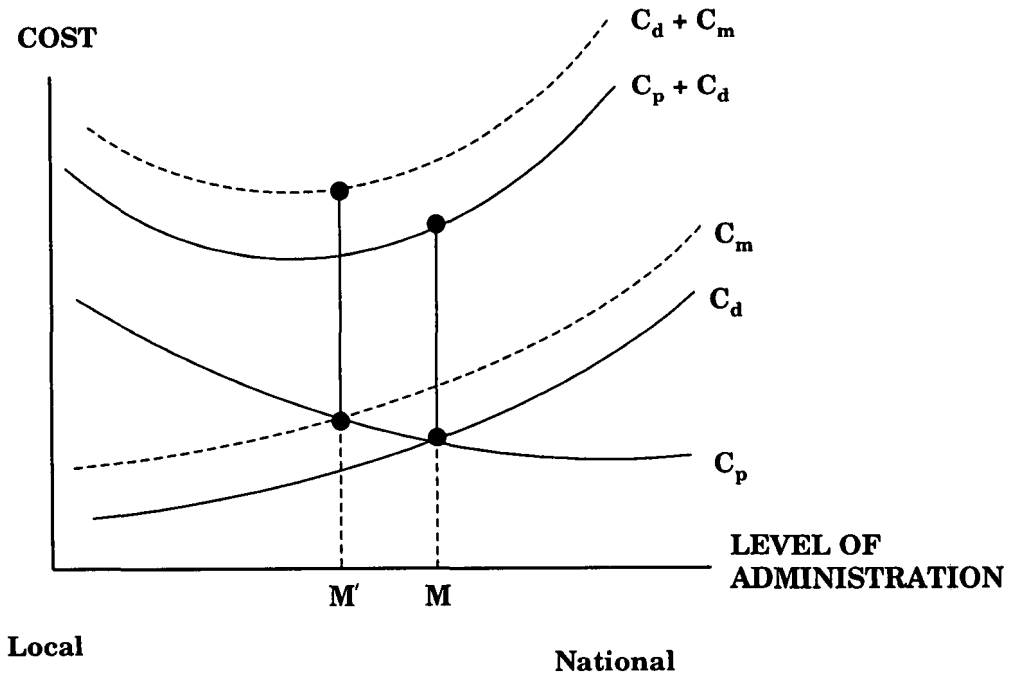
Figure 3. Interaction Effects Between Two Related Projects



The proposal to set up the fertilizer plant in Community A may be abandoned if it is found to be “unprofitable” to the community. However, if its positive impact on the other community is considered, the project may become viable. A significant number of projects that potentially benefit society as a whole may be overlooked if interdependencies such as the one just described are not factored into the local decisionmaking process. Left to themselves, local decision-makers are unable (or unwilling) to take these into account.

Figure 4. The Cost-Minimizing Level of Administration

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An argument that is frequently advanced in favor of centralization are the economies that are usually associated with large-scale production. This cost advantage of centralized production is however offset by the higher cost of distribution of the product or service in the outlying areas of the country. In Figure 4, C_p and C_d represent, respectively, the average production and distribution cost of a public good in relation to the level of centralization, or what

amounts to the same thing, the volume of output. If the objective is to minimize the total cost of producing and delivering a *given* quantity of the product or service, then the level of centralization must be set at point M. This means that the responsibility for producing and delivering the product should be assigned to a middle-level of administration, say, at the provincial or regional level.

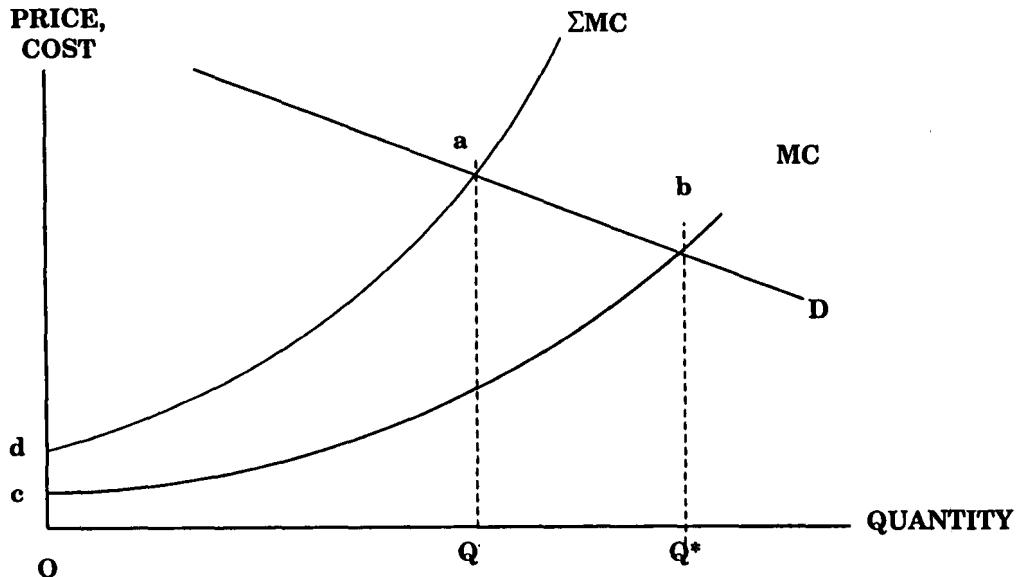
The cost-minimization model can be generalized to include other costs associated with centralization, such as the cost of maintaining a huge bureaucracy and the benefits foregone from decentralization.¹⁷

One obvious argument against a highly centralized system of public governance are the costs associated with *selective intervention* by the central authorities in the decisionmaking processes at lower levels of administration. These include not only the cost of gathering relevant information and the salaries paid to central bureaucrats who monitor local activities, but also the costs incurred by lower-level administrators in their attempt to influence the decisions made by the central government. In Figure 4, monitoring costs C_m are added to distribution costs, and are reflected in the upward-sloping cost curve $C_a + C_m$. With these costs factored into the analysis, the optimal level of centralization is M'. Avoiding the administrative costs associated with a highly centralized bureaucracy has been a major argument for devolution. A more thorough analysis of the costs and benefits of devolution must, however, consider all relevant costs, including social benefits foregone.

The major problem is not one of finding the optimal (i.e., cost-minimizing) level of centralization but one of determining the optimal (welfare-maximizing) level of output of public services. To maximize welfare, output should be set at that level where the cost of the last unit of the product or service is equal to the price that citizens are willing to pay for that unit rather than do away without it. In Figure 5, this condition is satisfied at output Q^* which corresponds to the intersection of the demand curve D and the marginal cost curve MC.¹⁸ Under the usual conditions that obtain in developing countries, this implies that the task for producing and delivering the product should be assigned to an entity at the national level. Any attempt to devolve this activity to a lower level of administration will lead to a decline in social welfare.

Let us suppose, for example, that the task is devolved to the provincial level. By plotting the *average* of the marginal costs of the different provinces at their respective levels of output against their combined output, we generate a quasi supply curve ΣMC . If the total output were set at Q' at which quantity supplied equals quantity demanded, the country as a whole will suffer a welfare loss equal to the shaded area abcd. Welfare loss will even be greater if output is extended beyond Q' .

Figure 5. Potential Welfare Loss from Devolution



Local Governments in the Global Context

The increasing pace of globalization of the world economy has made it imperative for developing countries like the Philippines to respond strategically to external developments. Just like national defense and foreign affairs, the strategic response to global developments is fundamentally a responsibility of the national government. However, many advocate a stronger role for local political entities (Brillantes 1998b). Indeed, the Local Government Code of 1991 encourages local governments to play an active role in the formulation and implementation of strategies intended to enhance the country's overall global competitiveness.

Our position on this matter is quite simple: What the country needs is a *unified strategic response to global challenges, not a plethora of individual local responses.*

In arguing for a greater role of local governments in facing up to the global challenge, a noted expert on LGUs observed that

... local governments in the Philippines have been properly equipped to face the challenge of globalization due to the enactment of a major national policy that guarantees their autonomy and drastically lessens their dependence upon the national government based in Manila (Brillantes1998b: 3).

It takes more than a legal code, however, to properly "equip" local governments in formulating and implementing effective global competitive strategies. To begin with, with few exceptions, local government authorities, business organizations and non-government organizations are not professionally trained and experienced enough in the arcane task of global competition to effectively outmaneuver their opposite numbers elsewhere in the world. The reservoir of relevant talent resides at the economic and political nerve centers of the country.

More significantly, in addressing global challenges, local governments tend to have only their narrow, parochial concerns in mind. They take into consideration neither the external effects of their decisions, nor possible interaction effects vis-à-vis the other communities in the country. Finally, such a strategy tends to pit one community against the others; successes in some are invariably realized at the expense of failures on the part of the others. In decisions made strictly at the local level, there is no assurance that society as a whole will experience a net gain.

Let us take a hypothetical example to illustrate our point. Suppose that a particular city was able to obtain funds from the Japanese government to modernize its port-handling facilities. These funds, conceivably, could have been allotted to another city which has earlier submitted a similar proposal in its bid to make its products more competitive in the world market. As far as the funding agency is concerned, its total budget allocation for the country is fixed. In zero-sum situations like this, what one city gains, another one loses. It is of course to be expected that the better-endowed communities, those with a surfeit of public and private resources, are in the better position to bid for big-ticket investment projects. These communities are not necessarily the ones which can contribute maximally to national development efforts.

In the port-development example just given, unless the relevant trade offs have been carefully calculated at the macro level, there is no assurance that the country as a whole will experience a net welfare gain. Moreover, the expansion of the port facilities in the city that successfully bid for the development funds may result in considerable damage to the environment. Only had these negative externalities been factored into the decision could the net impact on society be determined. On matters like these, the strong hand of a central authority is needed.

Conclusion

This essay is not intended to develop a case against devolution. On the contrary, its purpose is to look at the concept from a wider perspective and in the process place long overdue public sector reforms on a much more solid footing. We have argued that there are circumstances and situations under which certain forms of devolution may not be the appropriate strategy to enhance the social, economic and political welfare of the people. We noted that in presenting the case for devolution, its adherents have failed to discuss the concept in the context of the complex dynamics of the larger socio-economic system of which local communities are an integral part. They have failed to take into explicit account certain basic considerations. Foremost among these, to our minds, is the question of whose welfare are we really concerned with – that of the warm bodies that constitute the various communities, or that of society as a whole, to many a rather cold and abstract idea. By addressing this major point, all other important considerations follow, among them being:

- the possibility that the current system of resource allocation among the different regions and communities in the country fail to satisfy the Pareto optimality conditions;
- the possibility that actions taken in one community may have adverse (or, for that matter, advantageous) spillover effects on the larger social system;
- the possibility that by planning and implementing various activities in different communities at the national level, greater advantages are to be gained by society as a whole due to complementation;
- the possibility that by assigning the production and distribution of a public good to the central government, society may enjoy maximum welfare from the product due to economies of large-scale production; and
- the possibility that by formulating a single and comprehensive national global strategy rather than a profusion of local strategies, greater global competitiveness can be achieved.

For these reasons, many students of public governance are advocating a continuing important role for the central government in bringing about an effective co-alignment of the interests of local communities and those of society as a whole (Alfonso 1997; Esguerra 1997). They argue that the national government should provide the necessary policy guidelines for decision making at the local level to insure that choices made are consistent with the maximization of

national welfare. Among the different mechanism that may be considered are various methods of revenue sharing between the national government and local government units,¹⁹ direct bureaucratic controls, and joint undertakings between various levels of government.²⁰

Devolution is an idea whose time has come. Let us, however, implement it with extreme care and discretion and search for the forms and implementing strategies that insure that the attainment of goals in one sector or at one level of society does not frustrate the attainment of goals elsewhere in the larger system.

Endnotes

¹ Devolution in some business firms and not-for-profit organizations has been successful only because certain control and coordinating mechanisms are put in place to insure that the devolved units pursue not their own goals but those of the organization. Otherwise, the decentralization of functions and the empowerment of lower-level decisionmakers will frustrate not only the attainment of organizational goals but, ironically, those of the organizational members themselves.

² Oyugi (2000) observes that participation in decisionmaking by the intended beneficiaries of public services remains to be "a major missing link in the development process." He argues that in many situations, participation is more symbolic than real, one which is "... manipulated or controlled" and is "... intended to ratify, rather than influence" official behavior. According to him, a critical element that is absent in the process is real power sharing between the citizens and the bureaucrats: "Where the (power) relationship (between the people and the administrators) is characterized by imbalance, the more powerful actor will arrogate unto himself as much power as he can possibly muster." (p. ix).

³ For an extensive discussion of the perceived benefits from devolution, see Brillantes (1998a); Ellison (1998); and Tanzi (1996).

⁴ A more credible prescription is to place decisionmaking responsibility *at the lowest level where the relevant knowledge is lodged*.

⁵ See, for example, Bautista (1986).

⁶ The level of expenditure on monitoring E_m is optimized where dB/dE_m is equal to unity. B here is the estimated peso value of the social benefits realized from monitoring activities.

⁷ By success is often meant the degree to which certain *strictly local* goals and objectives have been met. When viewed in the larger societal context, a somewhat different assessment may be required.

⁸ For a discussion of the problems and difficulties faced by the country's devolved health services, see Esguerra (1997). Feedback from the field is discussed in the May 1-15 and December 16-30, 1994 issues, of *Health Alert*. See Anonymous (1994); Victoriano (1994).

⁹ For a similar view, see Prud'homme (1995) and Tanzi (1994, 1996).

¹⁰ The subversion of community sentiments by local officials, elected or otherwise, is perpetuated by the traditional patron-peon relationship that prevails in most Philippine communities to this very day.

¹¹ For a discussion of resource diversion in government, business firms and other types of organizations, see Jensen and Meckling (1976); Brenton and Wintrobe (1982); and Hoenack (1983).

¹² Bautista and others have noted quite correctly that the successful implementation of the Minimum Basic Needs (MBN) initiative of the government depends in large measure on effective leadership at the local level. The success stories documented in the January-April 1999 issue of this *Journal* and elsewhere are very likely to be the exceptions rather than the rule, however. See Bautista (1999).

¹³ Examples of poor budgeting practices of local administrators are described in Rutheford (1996), pp. 4-5.

¹⁴ This goes to show that there is a need to bundle complementary services in order to maximize benefits. The delivery of bundled services by just one or two local agencies is ideal but administratively unfeasible. One possibility is to create a "virtual organization" consisting of several closely inter-linked agencies acting in unison.

¹⁵ This condition follows from the attempt to maximize the objective function

$$W = f(a_i), \quad i = 1, 2, \dots, n \quad (1)$$

where W represents society's welfare, and a_i is the level of public expenditure in community (or activity) i . This attempt to maximize social welfare is subject to the condition that the entire budget for the period, B , is completely exhausted, that is,

$$B = B(a_i) = \sum a_i \quad (2)$$

By combining equations (1) and (2) into a single Lagrange expression,

$$h(a_i, \lambda) = f(a_i) + \lambda B(a_i) \quad (3)$$

setting its partials with respect to a_i equal to zero, and simultaneously solving the resulting set of n partial derivatives, we obtain the familiar first-order condition for the budget-constrained optimization model:

$$\delta f / \delta a_i = \delta f / \delta a_j \quad \text{for all } i \neq j.$$

¹⁶ In the social welfare function, any two activities are mutually complementary if

$$\partial^2 W / \partial a_i \partial a_j \geq 0 \quad \text{for all } i \neq j.$$

This means that an increase in an activity will increase the welfare derived from another, and vice versa.

¹⁷ In this rendering of benefit-cost analysis, the benefits from centralization are treated as costs averted, and the benefits foregone from decentralization are regarded as costs incurred.

¹⁸ To reflect externalities, social costs and benefits should be factored into the MC curve. Thus, if there are significant negative external effects associated with the activity, the MC curve should be drawn at a higher level, and the socially desirable quantity of output should be smaller.

¹⁹ Alternative mechanisms for revenue sharing are discussed by Shah (1994).

²⁰ A good example of joint endeavors between the national and local government units are integrated area development projects, a number of which are described by Cariño (1997).

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