



DECENTRALIZATION IN COLOMBIA: RECENT CHANGES AND MAIN CHALLENGES¹

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INTRODUCTION

"Colombia is a legally organized social state under the form of a unitary, decentralized Republic with autonomous regional entities...." (article 1, 1991 Constitution)

Since the early eighties, a deep institutional crisis developed in Colombia as new types of delinquency and violence began to flourish in several regions while corruption permeated through the entire state. This crisis, together with slow growth, called for changes in economic and political institutions. A dramatic structural reform was set in motion in the late eighties and early nineties, including the expedition of a new Constitution in 1991.

As in the case of many other countries, the reform package was the result of a consensus that the inward oriented model prevalent until 1989 had to be abandoned if the country was to improve its growth performance. It seemed necessary to change the approach to state intervention, increasing the role played by market forces and

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exposing the economy to foreign competition and externalities. A key element was trade liberalization, complemented by labor and financial reforms. In the last two years, proposals for social and environmental reforms started to come into the picture as the concepts of equity, quality of human capital and sustainable development permeated long-run economic policy thinking.

On the other hand, since the late seventies, there has been growing recognition that decentralization could be a crucial step towards rebuilding confidence and credibility in institutions. Under this view, the practice of self-government is perceived as the best way to strengthen democracy, while improving the efficiency and efficacy of state intervention. Though during the eighties important steps were taken in that direction through political reforms² and decentralizing fiscal policies, it was with the 1991 Constitution that this intention gained impulse and legitimacy.

Though the Constitution is quite specific regarding some aspects of decentralization, it left a wide open space for developing further legislation and many possibilities for altering institutional and territorial organization. One of the important challenges faced by government and Congress during the Gaviria administration was to begin to build the legal framework under which the decentralization process would be carried out. This task is far from complete.

² Such as the establishment of popular elections for mayors in 1986. Before, mayors were appointed by governors who, in turn, were appointed by the President until 1991.

The main purpose of this paper is to provide some critical comments and reflections about the recent decentralization process. To a great extent, the paper is based on recent work made under different scopes and frameworks [mainly Presencia (1994), Wiesner (1992, 1994), Rojas (1993), Fainboim et.al. (1994) and Sánchez and Gutiérrez (1994)]. It is an attempt to organize the main ideas in a coherent way and analyze them critically in order to derive policy conclusions and provide insights for future research.

The paper is divided in three sections. In the first a series of conceptual and methodological issues is presented. In the second the main features of the recent process are described. The third one points out the problems that may arise from it. Finally, some recommendations and new avenues of research are suggested.

I. DECENTRALIZATION: WHAT IS IT? WHAT FOR?

A. The concept of decentralization

When inquiring into the area implied by the title of this paper, one has to face the problem of specifying what is meant by decentralization. As pointed out by many analysts, the concept is quite ambiguous. Firstly, decentralization can be horizontal or vertical, within governmental structures, or it can be to the markets and deregulation. An example of horizontal decentralization is central bank independence. Vertical decentralization can be

"upward" or "downward". In upward processes, decision-making is transferred to supra-national levels. Such is the case of trade policies under free trade agreements. Our interest is related to the more traditional concept of downward vertical decentralization.

Secondly, it is important to distinguish between decentralization of resources and of functions and authority regarding expenditure and other fiscal matters. Of course, there can be an infinite number of combinations between these two. Thirdly, there are three different concepts often used under the name of decentralization: deconcentration, delegation and devolution. As shown in Chart 1, only devolution refers to true decentralization of decision-making. This concept is close to Heins' (1971) definition: "a process under which decisions about scope are made at the central level, but decisions about the design of activity are made at lower levels ... involves programs under which funds are acquired by the federal government and turned over to lower levels for disposition" ³.

[INSERT CHART 1]

³ The concept of decentralization varies depending on the political system in reference. In a unitary republic like Colombia, decentralization is similar to the process undergone by business firms: the larger organization confines itself to setting broad goals, while giving authority over specifics to ingredient units under a well-defined set of rewards and punishments. In federal systems, decentralization involves sovereign units. The nature of rewards and punishments is different; the federal government can offer carrots, but it cannot compel the tax-expenditure performance consistent with the notion of decentralization already mentioned.

CHART 1. TYPES OF DECENTRALIZATION

: Decocentration: redistribution of functions within a central government level. It could mean :
: physical or regional deconcentration to another branch-office or city. There is hardly any real :
: decentralization of decision-making authority. :
: :
: :
: Delegation: Some discretionary power is delegated by the central government to subnationals levels.:
: :
: :
: Devolution: delegation of full decision-making authority to the lower levels of government. This :
: devolution may involve the capacity to establish new taxes, to borrow and to freely use unmatched :
: transfers and grants. :

Source: Wiesner (1994)

B. How to measure decentralization

If it is difficult to define, it is even more difficult to measure. Regarding fiscal decentralization, four indexes are commonly used [Wiesner (1994), FIEL (1994)]: i) local relative to central taxes; ii) local relative to central expenditures; iii) transfers relative to own revenue; (iv) transfers relative to central level revenues.

The problem with these ratios, even if constructed with reliable data, is that they do not reflect crucial aspects of regulation, finance, administration, autonomy, reporting, accountability and control [Levin (1990)]. Conclusions about the real quality of decentralization and its implications for governance and resource allocation cannot be derived from statistical analyses alone. For instance, a country where more than 50% of taxes are levied and expenditures performed locally is not necessarily very decentralized, if decision making is centralized. In this paper we try to complement statistical information with a description of the institutional and legal framework under which the process has taken place and with views expressed by social and political scientists.

C. The problem and objectives of decentralization

In the past few years the case for decentralization has been build on the grounds of achieving two different (but complementary) objectives: improvement in resource allocation and enhancement of

governance, both geared towards fostering economic and social development. Behind the arguments in favour of decentralization lies the premise that decentralized decision-making enhances the effectiveness with which governments perform their duties, as they become more "accountable" for their actions. Quoting Bird (1993), "the ultimate objective ... is to improve the quality of local decision-making on fiscal and political issues. To achieve this end it is indispensable that the prices of local public goods and services be "right", in the sense of making local governments accountable to their citizens for the actions they undertake, to the extent those citizens finance those actions, and to tax-payers in general, to the extent the finance comes from transfers."

The point of departure of much of the research has been the "Tiebout (1956) model", the purest version of which states that under a decentralized system with perfect mobility of consumers, households seek the residence that provides a fiscal "bundle" that approximates more closely to their demands for local services. That is, "people vote with their feet". Under these premises, competition among local governments that offer "fiscal bundles" leads to a Pareto optimal solution, similar to the private-market solution.

Though the pure version of the model has received many criticisms in view of its unrealistic assumptions, its main insights are considered valid: competition for resources and the provision of public goods and services does encourage some responsiveness to

consumer tastes and exert pressure on local officials to "seek out reasonably cost-effective techniques of production" [Oates (1981)]. Based upon the validity of this statement, the "problem of fiscal decentralization" is to search for the proper location by level of government of taxes, transfers, expenditures, functions and regulations that maximizes local government efficiency [Wiesner (1994)]. It is a problem belonging more to "economic geography" - defined by Krugman (1991) as the "location of production in space"- than to any other field in economics.

As recent experiences in Argentina and Spain show [Pastor (1993), Perry and Herrera (1994)], fiscal decentralization or fiscal federalism have been consolidated through a process of learning by doing. In systems based on the principle of federalism, due to recent threats posed by a competitive global environment and the need to find solutions for sustainable development, there is a tendency to adopt more centralized frameworks in certain areas⁴. Less developed countries where the decentralization process is at an early stage have to be aware of these tendencies; otherwise, they might construct what others are dismantling.

Though decentralization is a concept that evolves as economic and political reality change, some lessons from experience should be taken into account when analyzing fledgling processes like the

⁴ Environmental policy, health care and education in the case of the US.

Colombian. The following are some of the most important findings of the literature on the subject:

1. In order to maximize potential benefits, local taxes and revenues must be an important source of income at lower levels of government. Therefore, a necessary condition for decentralization to be successful is a significant degree of tax policy autonomy⁵.

2. With disparities in regional income, transfers may be necessary from the point of view of equity and sustainable development.

3. If ill-designed,³ grants can be costly in terms of efficiency and stability. In the first place, empirical studies indicate that unconditional grants have a "flypaper effect"⁶; lump-sum aid seems to be more stimulative of expenditure than what is predicted by traditional consumer-theory models. Additionally, grants tend to be spent rather than passed on to constituents via local tax cuts.

Several theories of "fiscal illusion" have been proposed to explain this effect. The intuition behind them is that grants reduce the "perceived" marginal cost of producing public goods and services; an aid program that leaves community resources unchanged will still increase recipient government expenditures. Another view

⁵ This does not mean that taxes have to be administered by local authorities. Some types of taxes are better administered at the central level.

⁶ That is, "money sticks where it hits".

is what has been coined the "Leviathan argument": public officials are able to exploit asymmetric information and access to the legislative process in pursuit of their own goals, at the expense of those of the electorate. They do not return a substantial part of grants to citizens via tax cuts, even though the citizenry would prefer tax relief to expenditure expansion.⁷

4. A different strand of studies suggests that grants have been accompanied by tax "apathy" at the local level. If grants stimulate apathy and aid from the central government takes the form of earmarked grants, accountability and institutions may suffer, reversing the process; the sub-national unit becomes more accountable to the central level than to the taxpayer or voter.

5. Decentralization implies costs, particularly in the first stages, while institutions and agents adapt to the new rules. Local corruption usually occurs at the beginning of the process. This effect tends to disappear as control institutions are created (or old ones restructured) and the public reacts to bad administration. Also, during the learning process the central government may transfer resources while it continues to perform tasks that are no longer its responsibility, creating overall fiscal imbalances.

⁷ Other mechanisms leading to the flypaper effect arise from the behaviour of groups lobbying for increased spending. Additionally, some argue that the effect does not stem from the pervasive behaviour of governments, but rather from their efficiency in responding to citizens demands [Quigley and Smolensky (1992)]: grants are not passed on to constituents via tax cuts because negotiating changes in tax rates is costly and takes time.

This leads us to a final issue worth commenting, the speed at which the process should be carried out. Some argue that decision making should not be decentralized until local governments are prepared to be autonomous. Others believe that the alleged inefficiency cannot be proved until regions are given a chance. It may well be the case that gradualism is not the most effective way to diminish costs; it is just a mechanism to transfer them to the future. Costs are diminished if the process is well designed and coordinated with other policies and reforms. As with trade liberalization, fears are greater than faith, and once the process takes off one may be surprised that efficiency and creativity are better than expected.

II. CHARACTERIZATION OF THE RECENT PROCESS*

A. Historical background

Since the independence from Spain in 1819, the political and administrative organization of the Colombian state has suffered several reforms. During its first 60 years, there was a strong debate between federalists and centralists regarding the way in which power should be distributed among levels of government. The 1858 Constitution created a federal regime that lasted until 1886. Under it, intermediate level governments not only had total fiscal

* Sections II and III draw heavily on Presencia (1994), where historical references are provided.

autonomy, but their own income⁹ -which represented on average more than 50% of central government resources (Table 1)-, had to be partially transferred to the central government. Decentralization was thus "upward". Though this system provided the basis upon which the present state was built, the fiscal crisis of the 1880's¹⁰ forced a complete reversal of decentralization.

[INSERT TABLE 1]

In 1886, after a civil war between regions, a new Constitution was issued, transforming the regime into a centralized system. State intervention was geared towards recovering national unity, modernization and solving the fiscal crisis. Local powers were abolished and regions were divided in departamentos (departments); rents from alcohol and tobacco monopolies, an important source of income for the provincias, were nationalized; taxes that belonged to sub-national levels were transferred to the central government. Between 1887-90 and 1905-09, the share of departments' revenue in central budget income decreased from 26.7% to 14.4%.

This Constitution ruled until 1991, building a long tradition of centralized power and decision making. While centralization of the political, military, legislative and judicial systems remained stable throughout the years, the fiscal system suffered many

⁹ Mainly from the collection of property taxes.

¹⁰ Concentrated at the central level and in half of the Provincias and produced by a downturn in exports and economic activity and an increase in the service of public foreign debt.

TABLE 1. SHARE OF REGIONAL REVENUE IN TOTAL GOVERNMENT REVENUE (%)

Year		
1851-4	Budget revenue (a)	44.7
1855-8	" "	72.2
1871-5	" "	47.5
1881-3	" "	66.0
1887-90	" "	26.7
1905-9	" "	14.4
1929	Own revenue (b)	91.0
1945	" "	89.0
1967	Current income (c)	44.3
1978	" "	33.5
1980	" "	35.3
1985	" "	33.3
1990	" "	28.7
1991	" "	45.2

(a) Departments only

(b) Does not include transfers

(c) Includes rents on alcohol beverages at the dept. level and contributions at the local level

Source: Ocampo (1984) and Presencia (1984)

changes. By means of constitutional amendments and changes in legislation, it was possible to adapt the Constitution to the fluctuating economic and political reality of the times, which sometimes called for some fiscal decentralization.

Between 1890 and the end of the 1920's, in spite of the fact that the number of departments was increased under the regime of general Reyes (1905-1910) in order to divide and further reduce their political power, there was a period of fiscal and administrative decentralization that could be characterized as a process of delegation of functions and transfer of resources. The sub-national share in total government revenue increased, especially in the case of municipalities. This resulted from a strong recovery stimulated by booming exports and of measures that returned some tax revenue and administration to regional governments and increased transfers of revenues from tariffs on foreign trade to departments¹¹.

These were years in which public investment in transport infrastructure, particularly in railroads, was very dynamic. As from 1920, investments delegated to departments and municipalities started to be financed mainly with foreign credit. By the time of the world crisis in 1930, regional foreign debt was almost the same as that of the central government. Due to growing fiscal imbalances

¹¹ 25% of customs revenues were transferred to regions [Betancur (1994)].

at the regional level, mistrust in sub-national public administration started to grow at the central level.

In 1936, following the "keynesian revolution", central state intervention was strengthened through a constitutional reform aimed at providing the government with instruments to regulate the economy and foster development. Budgetary, fiscal and institutional reforms were carried out in order to guarantee that the government could comply with its functions. Fiscal reform was geared towards increasing the elasticity of the central tax system without modifying tax structures at the regional level [Ferreira and Valenzuela (1993)]. This structure prevailed until the late 1960's. Regarding administrative measures, in the Presidency of Lopez Pumarejo in the mid 1930's many central government institutions were created in order to execute functions at the regional level¹². This centralization process lasted until the middle of the 1970's.

In 1966 a special mission, directed by Richard Musgrave, was created to study the situation of public finances. It concluded that it was necessary to increase the supply of basic services and suggested that this should be done by departments. In order to finance such programs, it proposed an increase in property taxes and the transfer of its revenue to departments. Since then, the need for decentralization started to permeate the country.

¹² Examples are INSFOPAL, a fund to finance and promote investment in local infrastructure, and the Caja Agraria, a bank for the agricultural sector.

In 1968 important reforms were carried out that, though having increased income received by sub-national levels, were centralist in nature. The "Situado Fiscal" was created as a mandatory transfer of a portion of central government income to departments and the capital district. These resources, which were to finance health and education, were administered by central government officials that operated at the regional level. Similarly, sales tax revenue was shared with municipalities to finance primary social services; these transfers were reduced in the early 70's in order to finance the nationalization of secondary education, completed in 1981.

By the mid 70's growing demand for these services generated a crisis that called for new decentralization measures. In 1975 President López proposed a constitutional reform geared towards administrative decentralization and strengthening the capacity of municipalities to provide those services; the Supreme Court did not approve the reform. The period between 1967 and 1980 could thus be characterized as one of fiscal and administrative deconcentration rather than delegation or devolution. The recent drive started in the eighties. This process, in turn, could be divided in two: 1980-1991 and as from 1991, after the new Constitution was issued.

B. The first stage of fiscal decentralization: 1982-1991

During the early stages of the process, the main goal was to achieve fiscal independence among different levels of government,

while protecting the budget balance at the central level [Rojas and Campbell (1994)]. Those were the main recommendations of a highly influential report produced at the end of 1980 by The Commission on Intergovernmental Relations, headed by Richard Bird.

During the administration of President Betancur (1982-1986), important measures were taken in that direction (Chart 2). Many believe they represent the most aggressive decentralization effort of the century. Law 14 of 1983 restructured regional tax structures and Law 12 of 1986 redistributed functions among levels of government and strengthened the transfer system. With respect to political decentralization, the highlight was the establishment of popular elections for mayors (Legislative Act 1 of 1986).

[INSERT CHART 2]

Tax bases and rates and most technical and operational issues were previously established by law, with practically no intervention by the legislative branch of lower levels of government¹³. Law 14 introduced certain autonomy in this sense, permitting lower levels to define rates and exemption mechanisms within limits set by law. Though the 1991 Constitution introduced changes to the legal framework, the present distribution of taxes is still regulated by Law 14 (Chart 3). Central government collects and administers income and value-added taxes, tax on fuel consumption and all taxes levied on foreign trade. Departments collect and administer taxes on consumption of beer, alcoholic beverages and tobacco, and until

¹³ Department assemblies and municipal councils, respectively.

CHART 2. MAIN DECENTRALIZING REFORMS DURING THE 1980-1991 PERIOD

	Main Objectives	Instruments/ Mechanisms	Distribution of functions among levels of government	Target sectors of reworked credit and transfers.	Criteria for resource distribution among levels of government.
Law 38 of 1981	Incorporate sub national levels in the elaboration of the National Development Plan.	Creates planning committees at the Department level.			
Law 14 of 1983	Strengthen sub national tax income revenue sources.	At the department level it introduced changes in bases and tariff-rates for taxes on cigarette and alcoholic beverages. The same was done for municipal taxes such as gross-income-tax on industry and commerce and property tax. New taxes were created.	Municipalities were authorized to impose a tax on motor vehicle mobilization and were forced to keep updated cadasters.		80% of new tax revenue should be dedicated to finance investment.
Law 76 of 1986	Increase sub national governments' participation in the design of the National Development Plan and the budgetary process.	CORPES are created.	CORPES are made responsible for the following functions: 1) Coordination of central government entities with sub national ones. 2) regional planning. 3) Coparticipation in the design and distribution of central financing and cofinancing resources destined to sub national governments. Departments are made respon- sible for coordinating CORPES and municipalities and for technical assistance and supervision of the latter regarding the use of such resources.		
Legislative Act 1 of 1986	Political decentralization.	Establishes popular election of Mayors and opens the door to democratic participation in local public administra- tive issues.			
Law 12 of 1986	Increase transfers of sales tax revenue to municipalities and delegate functions to sub national levels regarding the provision of basic public services.	Departments had the responsi- bility to distribute resources among municipalities.			Resources were distributed in proportion to the population of each jurisdic- tion and its corresponding local fiscal effort measured according to the collection of property tax.

Cont. CHART 2.

Decree 77 (Law 12 of 1987)	Regulate administrative decentralization. The dis- tribution of functions among levels of government is summarized in the following columns.	Departments: 1. Control and follow-up of the utilization by local levels of central transfers established in Law 12. 2. Health: provide secondary and third level health-care services and guarantee provision of primary services at municipal level. Provide technical assistance to local levels in this area. 3. Education and infrastructure responsible for the provision of these services at the local level. 4. Agricultural sector: coordination, follow-up and evaluation of local government's technical assistance programs.	Municipalities: 1. Water and sanitation. 2. Urban and rural infrastructure (mainly roads, transport terminals, electricity, marketplaces and recreational facilities). 3. Technical assistance to the agricultural sector. 4. Low income housing.		
Law 29 of 1989	Decentralize education administration.				
Law 57 of 1989	Create a credit financing and cofinancing system to foster investment projects at lower levels of government.	Creates FIDOCETER, a financial institute similar to a development bank.		Infrastructure for water sanitation, electricity, roads, telephone, educa- tion, health and other local and regional projects.	
Law 10 of 1990	Reorganize the national health system. Change the formula for distribution of transfers dedicated to health.		Priorities and criteria for distribution are set by central government. Departments administer and channel the resources and municipalities are final recipients.	At least 50% of transfers should go to finance primary health services at local levels. The rest should cover other health services, according to priorities and percentages set by the Ministry of Health.	Population covered by public health services. Socioeconomic status of munici- pality (according to special indexes).

Source: Ferreira and Valenzuela (1993) and Fainboin, et. al. (1994)

1991 had the monopoly of alcohol production. They also collect taxes on motor vehicle registration and on lotteries.¹⁴ Finally, municipalities collect property taxes, a tax on gross income on industry and commerce and taxes on motor vehicle mobilization. According to Law 14, this distribution is based upon two criteria: economies of scale in tax administration, and capacity to control collection. Under this criteria, the nation should collect taxes on factors of production that are mobile across regions.

[INSERT CHART 3]

Law 12 and complementary regulations (i.e. Decree 77 of 1987) redistributed and delegated functions and resources among levels of government. It increased transfers of VAT to municipalities¹⁵ and modified the geographical distribution criteria, creating incentives for local fiscal effort. The central government was given the discretion to reform, merge or liquidate institutions previously responsible for providing such services and the responsibility of formulating policy and providing assistance to lower levels regarding delegated functions. Finally, Decree 77 established co-financing as the mechanism through which the central

¹⁴ These revenues are central government revenues temporarily given to departments. This led to confusion with respect to their administration [Ferreira and Valenzuela (1993)].

¹⁵ The share of municipalities in total central VAT revenue was increased gradually to 45%, with a preferential share to those with less than 100.000 inhabitants.

CHART 3. SHARES IN TOTAL TAX INCOME BY LEVEL OF GOVERNMENT (1991)

	Municipal:	Department	Central (1)	Earmarking
Foreign trade	:	:	19.4%	:
Income tax	:	:	48.6%	23% (24.5% in 1996) of current income earned by the central government must be transferred directly to states and districts and spent in health and education, while
Sales tax	:	:	23.5%	15% (22% in year 2001) must be transferred to municipalities and must be spent in social investment. That is, 38% (45% in year 2001) of total central government revenues is earmarked.
Motor fuel taxes	(2)	:	6.9%	:
Beer Consumption	:	29.2%	:	8% must be dedicated to health programs. 0.5% to road construction
Liquors	:	35.1%	:	100% must be dedicated to health programs
Tobacco	:	15.3%	:	:
Business and commerce gross income tax	43.8%	:	:	:
Property tax	32.5%	:	:	Between 15% and 25.9% must be dedicated to finance Environmental Corporations
Property tax surcharges	:	:	:	Instead of the rates shown above, municipalities can impose a surcharge on property tax rates 1.5/00-2.5/00 over property value, for the same purpose.
Motor vehicle mobilization	6%	:	:	Between 0-10% of state vehicle taxes dedicated to finance Environmental Corporations. 80% must be dedicated to investment projects
Other taxes	17.7%	:	1.6%	:
Total tax revenue	100%	100%	100%	:
Approximate share of earmarked revenue in total tax income	Between 4.8% and 10%	Between 40% and 60%	Minimum: 38% (45% in year 2001)	:

(1) 1992

(2) Cali and Medellin impose motor fuel surcharges to finance transport projects

Source: Banco de la República

government could participate in the funding and implementation of projects assigned to municipalities and departments¹⁶.

It was assumed that with this legal framework each level of government would be capable of paying for its responsibilities, either out of its own revenue sources, or through financing and higher transfers [Rojas (1993)]. The reform was mainly geared towards strengthening municipal governments, viewed as the best place to articulate state functions to citizen life and constituent's demands. The role of departments changed shortly after Law 12 was issued, as Law 76 of the same year created the CORPES (Chart 2) as main regional planning entities, the first attempt to decentralize economic planning.

Up to this point, the process could be characterized as one of increased delegation of functions and resource decentralization, particularly in favour of municipalities, together with a slight increase in fiscal autonomy at lower levels of government. During the Barco administration other pieces of legislation came into place. Law 29 of 1989 delegated to Mayors the responsibility to appoint teachers and administer school payrolls and other expenses, though the resources to finance wages and social security expenses were provided by the central government. Law 57 of 1989 created FINDETER, a bank devoted to financing investment in urban

¹⁶ In the majority of cases, financing through this system required matching of resources.

infrastructure at the regional level. This law has been important in the development of the whole process for two reasons:

1. Poverty reduction programs were put high on the list of priorities of the Barco administration¹⁷. As Rojas and Campbell (1994) thoroughly explain, these programs were planned, executed, and controlled by the central government. The need to coordinate poverty reduction programs with decentralization and to create a unified system of targeting became evident. Through matching credit financing, FINDETER was one of the first instruments used for spending coordination between different levels of government in order to achieve the desired social policy goals.

2. It was an effective instrument to rationalize financing and a source of technical assistance to lower levels of government.

Finally, through Law 10 of 1990 the national health system was restructured, delegating functions and responsibilities. The central government was made responsible for designing policies, for transferring resources to sub-national levels, and for overall coordination and supervision of the latter. The nation was given the monopoly over lotteries and gambling activities, the rents from which should be dedicated to finance health programs and should be administered through a fund called ECOSALUD. Departments and municipalities were made responsible for executing those programs -

¹⁷ Barco's government plan was called "War on Poverty".

directly or through contracts with the private sector-, and for creating funds to administer all resources dedicated to health. The Fondo Nacional Hospitalario (a centralized fund similar to FINDETER), which provided highly conditional co-financing and financing in this area, was put in charge of supervising and providing technical assistance to these funds. The formulas for the Situado Fiscal were modified; not only did transfers increase in order to finance health programs, they were earmarked as well.

To sum up, at the beginning of the process there was no control on the use of transfers. At the end of the decade a few cases of corruption and waste and increased indebtedness induced some central government intervention. Central funding institutions such as Fondo Nacional Hospitalario, FINDETER and others¹⁸, started to play an important role; besides providing assistance to lower levels, financing started to be increasingly conditional upon the fulfillment of requirements regarding the methodologies and administration of the projects presented by regional governments. Thus, at the end of this first stage, the central government started to interfere heavily in regional administration and decision making, reversing the autonomy gained at the beginning.

¹⁸ The most important central funding institutions were Fondo DRI (fund for rural development), PNR (a special program created by the Barco administration to assist regions with high levels of poverty and violence), INURBE (to finance low income housing) and Fondo de Caminos Vecinales (to finance roads in the rural sector).

C. Decentralization in and after the 1991 Constitution

In 1990 a new impulse was given to the process. The development plan of the Gaviria administration, "La Revolución Pacífica"¹⁹, gave priority to decentralization as a complement to the rest of the reforms. Hence, ten years after the Bird report, the government commissioned another study to suggest how decentralization should be oriented²⁰. Additionally, a major political reform process took off at the end of 1990 with the call for an election to conform an assembly that was to write a new Constitution.

Both the Constitution and the laws, decrees, and bills that developed its principles and mandates, introduced important changes in the framework ruling decentralization. This stage of the process has involved at least four different but strongly related areas: (i) territorial and political organization; (ii) distribution of functions and responsibilities; (iii) distribution of resources; (iv) economic planning, budgetary and fiscal control processes.

1. The constitutional reform

The first article of the Constitution introduces the concept of a unitary, decentralized republic. The most important principles or mandates of the Constitution regarding decentralization are:

¹⁹ The Peaceful Revolution.

²⁰ The final report of this mission is in Wiesner (1992).

a. It established popular elections for governors.

b. It opened the possibility to create new territorial entities such as Regions (groups of departments), Provinces (groups of municipalities), Special Districts, Metropolitan Areas and Indian Territories, among others. All should be autonomous under certain limits and governed by their own authorities.²¹ It also allowed the conformation of regional entities such as the existing CORPES, that could play an important role regarding planning and coordination between intermediate and local governments.

c. The Constitution itself introduced a general framework regarding the intergovernmental functional structure (Charts 4A and 4B), and more specific mandates regarding fiscal matters such as:

i) Greater fiscal autonomy: the new Constitution goes beyond Law 14 and gives regional authorities the right to administer and create taxes so as to comply with their functions; it states that in peacetime only the legislative branches can create or modify taxes; it prohibits the law to impose surcharges or exemptions over territorial taxes²² or to transfer revenues to the central government. It also establishes that income from the exploitation

²¹ The Constitution established that a law should be enacted (Ley Orgánica de Ordenamiento Territorial, LOT) to design and regulate their political organization.

²² With the exception of municipal property taxes, where the law can mandate that a portion be dedicated to finance local environmental projects.

of monopolies that are the property of regional governments cannot be appropriated by central authorities. Finally, it mandates that property taxes can only be imposed by local governments.

ii) Intergovernmental transfers: new rules were introduced regarding the distribution of transfers to regions and the geographical distribution of royalties from natural resource exploitation. The Constitution widens the base for calculating the Situado Fiscal, which can only be dedicated to finance education and health investment programs²³ and should be distributed geographically according to fixed percentages (Chart 4).

As far as transfers to municipalities are concerned, it established that resources have to be devoted to social investment²⁴. In 1994 approximately 15% of central government current income should be transferred to municipalities, and by 2001 this share should have increased to 22%. More important, the Constitution introduces the principle of balance between functions and resources, stating that no new responsibilities can be delegated without previous assignment of resources to finance them. Finally, it states that royalties from the exploitation of non-renewable resources must be transferred entirely to subnational governments.

²³ Nursery, primary and secondary schooling and all three levels of health assistance.

²⁴ Though the concept is not entirely clear in the Constitution, it establishes that the social function of the state is to provide or guarantee education, health, water and sanitation.

[INSERT CHARTS 4A AND 4B]

d. Regarding planning and budget processes, it established that Congress must regulate the way in which regional plans and budgets should be coordinated with national ones, through two laws (Orgánica de Planeación -LOP- and Orgánica de Presupuesto -LOPRE-). It also states that the legislative branches of the respective levels will design the framework regarding budget and planning processes. In what appears as a contradiction, it states that the LOPRE should determine the mechanisms by which regional governments budgets should be programmed, approved, changed and executed.

e. As far as fiscal control is concerned, the Constitution gives the Contraloría General de la Nación -central government auditor-, the power to intervene in sub-national affairs by determining the methods for fiscal control at regional levels and by exerting direct control on lower levels of government. The Constitution creates the Contador General de la República (national accounting director) who shall harmonize all fiscal accounting systems.

To summarize, the 1991 Constitution, while legitimizing the decentralization process, still gives the central government a great amount of power to determine fiscal and administrative affairs at lower levels of government.

CHART 4a. TRANSFERS TO DEPARTMENTS AND SPECIAL DISTRICTS-SITUADO FISCAL
 (Formulae for geographical distribution)

15%	85%
To be distributed in equal parts among all the states and districts in the Country	Variable share which should guarantee enough resources (adding up the 15% of the previous column) to cover the same health and educational services produced the year before, under conditions of administrative efficiency (1).
	Portion to be distributed according to the following criteria: . Potential population (2) of the state . Fiscal effort (share of own resources in total state income)

(1) See Annex 1 for the definition of this term

(2) See Annex 1 for the definition of this term

Source: Colombian National Constitution and Law 60 of 1993

CHART 4b. TRANSFER TO DEPARTMENTS AND SPECIAL DISTRICTS-SITUADO FISCAL
(Formulae for sectorial distribution)

:	:	:	:
:	:	:	: At least 50% for basic health services. :
: Minimum share	: 20%	:	: This function and these resources must :
: for health	:	:	: be transferred to local governments :
:	:	:	: gradually while they get prepared to :
:	:	:	: manage them adequately. :
:	:	:	----- :
:	:	:	:
:	:	:	: At least 5% for prevention programs :
:	:	:	:
-----	-----	-----	-----
: Minimum share	: 60%	:	:
: for education	:	:	:
-----	-----	-----	-----
:	:	:	:
: Remaining	: 20%	:	: To be distributed at discretion between :
: share	:	:	: health and education according to :
:	:	:	: development plans and priorities. :
-----	-----	-----	-----

Source: Colombian National Constitution and Law 60 of 1993

2. Legal developments after the 1991 Constitution

Since 1992, both the legislative and executive branches have been active developing the general principles and mandates of the new Constitution. According to Presencia (1994), during the past two legislative periods (July 1992-June 1993 and July 1993-June 1994) more than 48 bills and laws which develop aspects related to decentralization have been discussed or approved.

The legal framework is far from complete and is still subject to changes and corrections. In particular, four pieces of legislation that can be crucial to determine the final shape of this process have not been discussed or approved: (i) the bill for the LOT; (ii) the bill that develops the principles and limits for the fiscal autonomy of lower levels of government; (iii) the bill for the LOPRE; (iv) the bill that creates the national accounting office.

Despite not having guidelines in these areas, the Gaviria administration legislated extensively regarding the assignment of functions and resources between levels of government.

a. The transfer system: Law 60 of 1993 is summarized in Charts 4-6. It regulates responsibilities and transfers to finance social investment programs; it introduces specific formulae and criteria to distribute central income among territorial entities and designs

a framework geared at controlling that those resources are spent according to these rules and to constitutional mandates.

[INSERT CHARTS 5A, 5B AND 6]

Regarding the Situado Fiscal, it establishes that the share of these grants should increase from 23% of central government current income in 1994 to 24.5% as from 1996, and creates mechanisms to gradually transfer responsibilities to departments, and from these to local levels, so that no responsibilities should be transferred if lower levels are not prepared to assume them. The National Planning Department (DNP) is to administer and control the distribution of transfers, and CONPES²⁵ is to define if departments are prepared to assume the delegated functions. With respect to transfers to municipalities, it further develops the distribution formulae, giving priority to those with less than 50,000 inhabitants and to Indian territories (Chart 5). These formulae tie the amount to be distributed to population, needs²⁶, fiscal effort and efficiency in spending. Summing up these two transfer "pipelines", in 1994 approximately 38% of central government current income must be distributed to the sub-national level, and by 2001 this share should have increased to at least 46%.

b. **The co-financing (matching grant) system:** To complement transfers, the Gaviria administration proposed the creation of a co-financing funds system, following the experience of FINDETER and

²⁵ Consejo Nacional de Política Económica y Social.

²⁶ Using an indicator of unmet basic needs (Annex 1).

CHART 5A. TRANSFERS TO MUNICIPALITIES
 (Formulae for geographical distribution)

X%	INDIAN TERRITORIES (The share is determined by a certain amount of per capita income)
5%	MUNICIPALITIES WITH LESS THAN 50.000 INHABITANTS
1.5%	MUNICIPALITIES ON MAGDALENA RIVER
0.1%	FEDERACION COLOMBIANA DE MUNICIPIOS
60%	20% ACCORDING TO POPULATION WITH UNMET BASIC NEEDS (UBN)
	40% ACCORDING TO RELATIVE POVERTY INDEXES
(93.4-X) %	22% POPULATION/TOTAL NATIONAL POPULATION
	6% ACCORDING TO FISCAL EFFICIENCY
	6% ACCORDING TO ADMINISTRATIVE EFFICIENCY IN PUBLIC SERVICES SUPPLY
	6% ACCORDING TO THE EVOLUTION OF AN INDICATOR OF QUALITY OF LIFE

Source: Law 60 of 1993 and Annex I

CHART 5B. TRANSFERS TO MUNICIPALITIES
(Formulae for sectorial distribution)

: Education	30%	:
: Health	25%	:
: Water and sanitation	20%	:
: Culture and recreation	5%	:
: Discretionary	20%	:

Source: Law 60 of 1993 and Annex 1

Chart 6. Redistribution of functions under Law 60 of 1993-Social sectors

Sector	Central Level	Department level	Municipal Level
General Role	<ul style="list-style-type: none"> -Formulates policy -Allocates resources from Situado Fiscal and transfers -Administers co-financing funds -Advises territorial entities -Evaluates services provided 	<ul style="list-style-type: none"> -Plans, administers and coordinates social services -Distributes resources among municipalities -Provides financial support and advice to municipalities 	<ul style="list-style-type: none"> -Provides basic services: health and education at the first level, drinking water, basic sanitation, housing and others indicated by law
Education	<ul style="list-style-type: none"> -Ceases to be responsible for administrative matters related to national educators -Determines pay according to the law -Conducts follow-up and service evaluation 	<ul style="list-style-type: none"> -Plans, administers and coordinates educational services -Manages and trains educators in accordance with legislation -Gradually turns over functions to municipalities -Manages co-financing funds for municipalities (with local resources) 	<ul style="list-style-type: none"> -Administers pre-school, elementary and secondary education according to the terms of departmental turn-over -Makes necessary investments in facilities equipment and maintenance of educational centers
Health	<ul style="list-style-type: none"> -Promotes and coordinates national campaigns and programs for basic health and sanitation -Performs all other functions established by Law 10 of 1990 	<ul style="list-style-type: none"> -Services are provided through regional, specialized and school hospitals -Undertakes campaigns in coordination with or on behalf of the central level -Performs all other functions established in Law 10 of 1990 	<ul style="list-style-type: none"> -Promotes prevention treatment and rehabilitation of patients in the first degree -Provides medical services through local hospitals, health clinics and through activities related to environmental sanitation
Housing	<ul style="list-style-type: none"> -Provides technical support to local entities -Ceases to undertake construction programs -Provides subsidies to support municipal programs 		<ul style="list-style-type: none"> -Defines regulation for urban development -Promotes and participates in social housing projects -Provides housing subsidies to the neediest
Basic Sanitation	<ul style="list-style-type: none"> -Undertakes technical assistance programs for territorial entities -Co-finances and provides credit 		<ul style="list-style-type: none"> -Provides services (directly or indirectly through contracts with private sector) -Undertakes projects for construction and expansion of water and sewage -Guarantees the provision of basic rural sanitation services, urban cleanup, and sanitation of slaughter houses and food markets.

others. Decrees 2132 of 1992 and 206 of 1993 create this system, the only channel through which the central government can assign funds (other than transfers) to finance projects at lower levels of government. The system consists of matching grants; financing requires a minimum share of regional resources. The use of co-financing is restricted to capital investment, as long as it represents less than 10% of current income at the regional level.

Four funds constitute this system: for inter-municipal road system infrastructure; for municipal transport infrastructure; for social investment projects and for rural areas. It abolished many funds previously created, such as the Fondo Nacional Hospitalario. As from August 1994, these funds were put together with parallel grant programs in the President's Office into a single network called "Red de solidaridad social", which at present has not been fully organized. These new arrangements could make resource allocation more centralized, in contrast with the original idea.

c. Law 141 of 1993: the regional distribution of royalties::

The rules for the distribution of royalties from oil exploitation are summarized in Table 2. More than 68% of resources must be kept by producing or transporting regions; the rest must be administered by a national fund (NRF), to be redistributed across the country.

[INSERT TABLE 2]

TABLE 2. DISTRIBUTION OF ROYALTIES

	When production is less than 20 T8D	When production is greater than 20 T8D
Producing departments	47.5	47.5
Producing municipalities	25.0	12.5
Municipalities located in sea or river ports where oil is shipped	8.0	8.0
National Royalties Fund (NRF)	19.5	32

Distribution of NRF resources		
Energy Projects	15	
Environmental and other specific projects:	12.625	
Corporación Río Grande de la Magdalena	10.0	
Current expenses NRF	0.25	
Remaining Portion:	51.875	
Mining projects	20.0	
Environmental projects	20.0	
Other local or regional projects	59.0	

Source: Law 141 of 1994

To conclude this section, one could characterize the last stage of the process as one with more potential autonomy regarding own tax policies, significantly more transfers to lower levels of government, but less autonomy in planning and decision making.

III. PROBLEMS AND CHALLENGES

According to the analysis presented in the first section and having offered a summary of the process in Colombia, the next step is to ask whether the present design is adequate so as to achieve the expected goals. The answer seems to be negative. There are problems regarding both the consistency of the package and the design of functional and fiscal relationships which can make the process more costly in the short-run, and less beneficial in the long-run.

These problems could be grouped into two broad categories: lack of a clear and stable legal framework and a fiscal revenue system that propitiates low saving rates and fiscal deficits, and that can become an important source of inefficient resource allocation.

A. The legal framework

1. Specific laws have been approved before more general ones have been discussed. For instance, fiscal and planning functions were distributed among levels of government while the definitive territorial organization was not known or the general planning and

budgetary processes defined²⁷. Tariff rates for certain local taxes have been determined, while a general law that defines the regime under which local fiscal autonomy can be practiced does not exist.

2. There is inconsistency between many of the bills and laws that regulate the process, with respect both to the criteria for distribution of functions and resources and to policy guidelines. In part this is due to the fact that bills and laws have been discussed separately, within distinct contexts, and presented by various government departments, serving different purposes. For example, while during the 1993-94 legislative period the LOT bill was drafted by a commission created for that purpose, the Ministry of Government was presenting bills on the administrative and political regime of departments, districts, metropolitan areas and municipalities. A few of the latter were passed by Congress while the former was not. Simultaneously, the environmental agencies, the ministries of health, transportation and education and DNP were legislating separately, with different points of view.²⁸

²⁷ The general law on economic planning, Law 152 of 1994, was passed only in mid 1994. LOT and LOPRE are yet to be approved.

²⁸ For instance, while Law 60 (designed by DNP) delegates functions and decentralizes resources for health programs, Law 100 (designed by the Ministry of Health), creates a national health-care system similar to that proposed by President Clinton, which centralizes policy decisions. The law that creates the Ministry of the Environment decentralizes some aspects of policy to Corporaciones Autónomas, the jurisdiction of which overlaps with departments and other administrative entities such as the CORPES.

To sum up, decentralization is still a moving target. It is not clear what responsibilities will remain in the central government. The potential consequences are unstable legal frameworks, lack of credibility and weakening of institutions. There is the need to appoint and prepare an institution at the central level responsible for coordinating the legal process, for unifying criteria and for designing a strategy of technical assistance to lower levels. Of course, the pace of fiscal decentralization is different from the speed at which institutions develop. Though the Constitution created a number of mechanisms for democratic participation, many years and educational efforts are needed to develop a participative political culture, particularly in remote areas. Without these, it is difficult to strengthen accountability. This is especially worrisome in regions rich in natural resources, where local officials will soon have to administer huge amounts of money.

B. Intergovernmental fiscal and administrative relationships

The second group of problems is related to specific details of the intricate design of intergovernmental relationships. This system seems to have three disadvantages: (i) no incentives for increased tax effort; (ii) excessive share of transfers and non-tax income in regional income; (iii) the formulas for transfers and distribution of royalties and the earmarking of taxes and transfers can lead to long-term inefficiencies. All of these may lead to fiscal

imbalances at the regional level, to extreme budget inflexibility and to a bias towards more public spending and lower savings.

1. Low fiscal effort and excessive amount of transfers

Until the beginning of the present decade regional governments were far from being fiscally independent, and the increase in own tax effort at sub-national levels was meaningless, despite the initial positive effects of Law 14 of 1983 at the municipal level. As a percentage of GDP, tax revenue at the municipal level increased, while the corresponding share at the department level fell (Table 3). Adding up the two levels, this share slightly increased, from 2.3% in 1980 to 2.6% in 1991. Measured as a percentage of total expenditure, however, between 1980 and 1991 own tax income decreased in municipalities and remained constant in departments (Table 4). That is, though fiscal effort slightly increased at the local level, expenditures rose faster.

[INSERT TABLES 3 AND 4]

On the other hand, due to the reform in the grants system introduced by Law 12 and to the dynamism of mining activities, since 1986 both the amount of transfers to local levels and the revenues from non-tax sources significantly increased (Tables 3-6). Between 1980 and 1991 the share of received transfers in GDP rose from 2.1% to 2.5% in departments, and from 0.6% to 1.3% in municipalities. Similarly, the share of revenue from non-tax sources increased from 1.3% to 2.3% in municipalities. As a

TABLE 3: REVENUE AND EXPENDITURE BY LEVELS OF GOVERNMENT (% of GDP)

	Central (1)			Department (2)			Municipal (3)		
	1980	1985	1991	1980	1985	1991	1980	1985	1991
Taxes	10.69	11.04	11.37	1.59	1.67	1.55	0.72	0.90	1.02
Non-tax revenue	2.98	5.15	7.52	1.19	1.10	1.00	1.26	1.74	2.30
Transfers	1.64	1.09	2.23	2.14	2.58	2.46	0.56	0.71	1.34
Capital income	2.26	1.48	0.79	0.08	0.08	0.06	0.10	0.03	0.17
Total income	17.56	18.76	21.91	5.00	5.44	5.07	2.63	3.38	4.83
Current expenditure	3.99	4.13	3.76	3.03	3.53	3.09	1.17	1.42	1.54
Other expenditure	1.51	0.54	0.58	0.01	0.02	0.02	0.07	-0.06	-0.23
Transfers	6.15	7.50	8.64	0.75	0.69	0.56	0.22	0.21	0.29
To central government				0.05	0.05	0.03	0.02	0.03	0.02
To states	2.10	2.55	2.41				0.01	0.01	0.01
To municipalities	0.51	0.65	1.27	0.04	0.03	0.03			
Other	3.54	4.30	4.95	0.65	0.62	0.50	0.19	0.17	0.27
Interest payments	1.18	2.48	2.89	0.06	0.11	0.18	0.21	0.62	0.96
Capital expenditure	7.10	7.86	5.35	0.71	0.81	1.11	1.21	2.04	2.92
Total expenditure	19.93	22.51	21.21	4.56	5.16	4.96	2.88	4.22	5.49
Deficit (-) Surplus (+)	-2.36	-3.75	0.70	0.44	0.28	0.11	-0.25	-0.85	-0.67
Total (1+2+3)									
Income	25.20	27.57	31.81						
Expenditure	27.36	31.90	31.67						
Deficit (-) Surplus (+)	-2.17	-4.32	0.14						

Source: Sánchez and Gutiérrez (1994)

TABLE 4. DEPARTMENTS AND MUNICIPALITIES INCOME *
(As percentage of their total expenditures)

Departments	1980					1985					1991				
	Taxes	Non-tax	Subtotal	Transfers	Total	Taxes	Non-tax	Subtotal	Transfers	Total	Taxes	Non-tax	Subtotal	Transfers	Total
1	18	19	36	69	105	19	20	38	68	106	20	15	35	62	97
2	20	25	45	57	102	21	17	37	59	97	20	20	41	69	110
3	29	31	61	47	108	29	25	54	56	109	25	24	49	48	98
4	29	27	56	48	104	24	20	44	46	90	27	16	44	55	98
5	30	31	61	42	103	32	25	57	49	106	31	28	60	49	108
Int. + comis.	25	4	28	69	98	20	5	25	59	84	18	8	26	61	87
Total**	26	27	53	51	104	25	22	47	54	101	25	21	47	55	102

Municipal	1980					1985					1991				
	Taxes	Non-tax	Subtotal	Transfers	Total	Taxes	Non-tax	Subtotal	Transfers	Total	Taxes	Non-tax	Subtotal	Transfers	Total
1	23	11	34	54	88	18	11	29	55	84	13	3	16	67	83
2	26	23	49	51	100	21	16	37	56	93	19	13	32	76	108
3	38	26	64	47	111	30	28	58	43	100	20	18	39	69	108
4	32	43	75	22	97	28	34	62	22	84	20	33	53	36	88
5	41	47	87	24	111	29	42	71	19	90	25	42	66	36	102
Int. + comis.	15	5	20	94	114	15	2	17	98	115	3	6	9	58	68
Bogota D.C.	16	40	56	16	73	14	44	58	15	73	14	43	57	11	68
TOTAL**	33	35	68	34	102	27	31	57	32	89	20	27	47	50	97

* Group 1 = highest proportion of poor people in total population.

Group 5 = lowest proportion of poor people in total population (according to unmet basic needs-UBN).

** Excludes Intendencias and Comisarias and Bogotá D.C.

Source: Authors calculations based on Banco de la República and Sánchez and Gutiérrez (1994).

percentage of expenditures, between 1980 and 1991 the share of transfers increased at both levels, while the share of non-tax income decreased (Table 4), despite the fact that income from royalties rose sharply (Table 5). Therefore, a result of the first decentralization stage is that fiscal dependency substantially increased at lower levels of government. The share of own tax income in municipal income decreased from 60.8% in 1980 to 51.9% in 1991, while at the department level it fell from 31.8% to 30.6%. From the point of view of central government finances, these changes implied that the share of transfers in total tax income increased from 39.9% in 1980 to 66.3% in 1992 (Table 6).

[INSERT TABLES 5 AND 6]

Some international comparisons are presented in Graphs 1-3 and Tables 7 and 8. It can be seen that Colombia's regional tax effort is low, even when compared to other Latin-American countries like Brazil and Argentina. While the share of regional taxes in total public revenue is larger than 20% in many OECD countries, in Colombia it has never reached that figure. With the exception of Brazil and Spain, fiscal dependency in Colombia could be one of the largest in the world.

[INSERT GRAPHS 1-3 AND TABLES 7 AND 8]

With the new Constitution and Law 60, the share of transfers in total revenue and expenditures will rise in the future. According to official projections, by 2000 these transfers may reach 50% of central government income, 7% of GDP and more than 60% of regional current revenue (Graphs 4-6 and Table 9). These numbers are huge,

TABLE 5. ROYALTIES AS % OF TOTAL (TAX + NON TAX) REVENUE

	Municipalities	Departments
1980	2.5	1.7
1981	2.5	2.2
1982	3.3	5.6
1983	3.8	6.4
1984	4.5	6.7
1985	6.1	7.9
1986	8.8	13.6
1987	10.5	17.0
1988	9.3	15.4
1989	12.0	22.9
1990	14.4	30.2

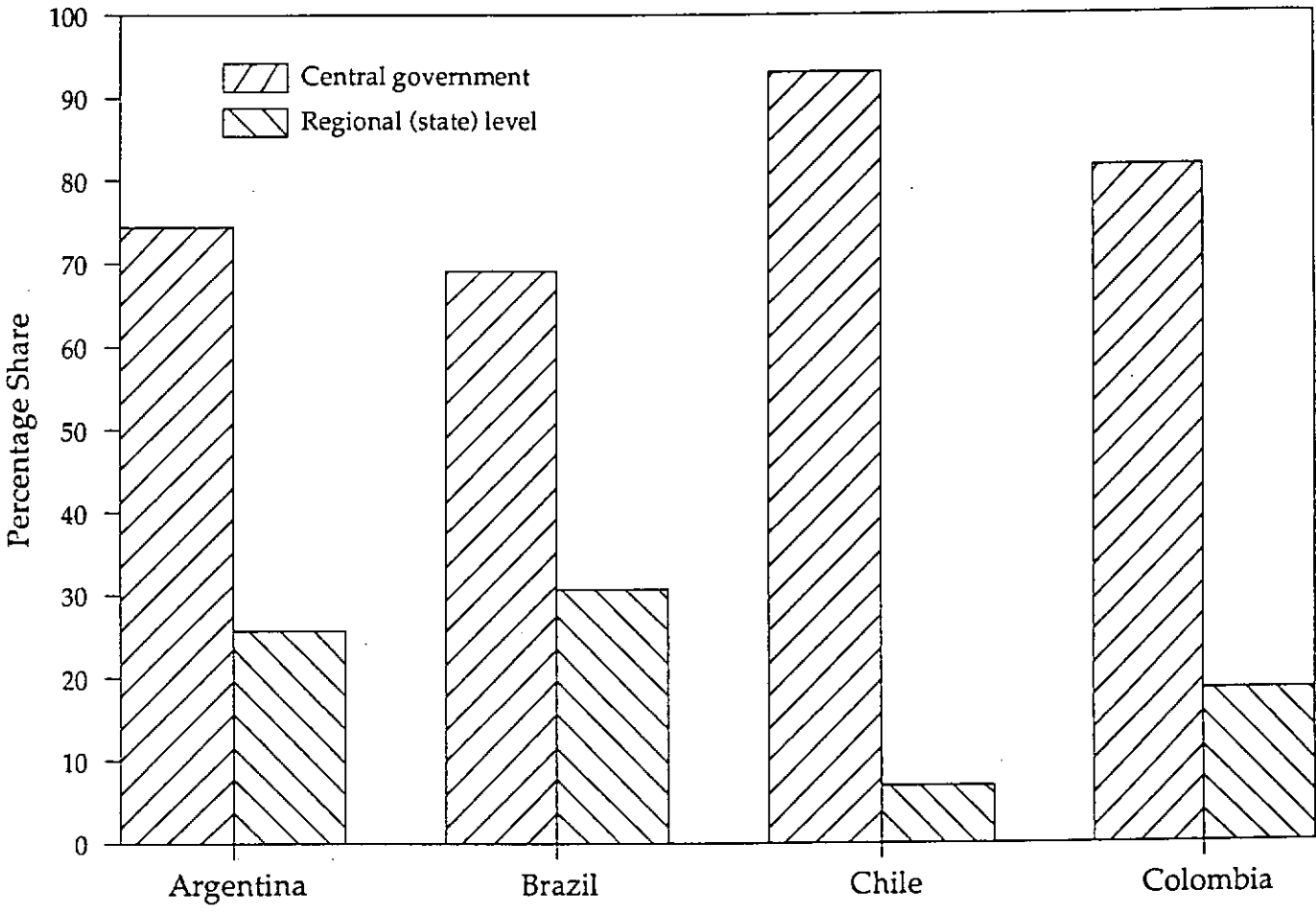
Source: Banco de la República.

TABLE 6. CENTRAL GOVERNMENT TRANSFERS
(As % of Central Government revenue)

1980	39.9
1981	45.9
1982	47.7
1983	56.2
1984	75.3
1985	55.3
1986	48.6
1987	45.4
1988	40.3
1989	44.8
1990	42.4
1991	53.2
1992	66.3

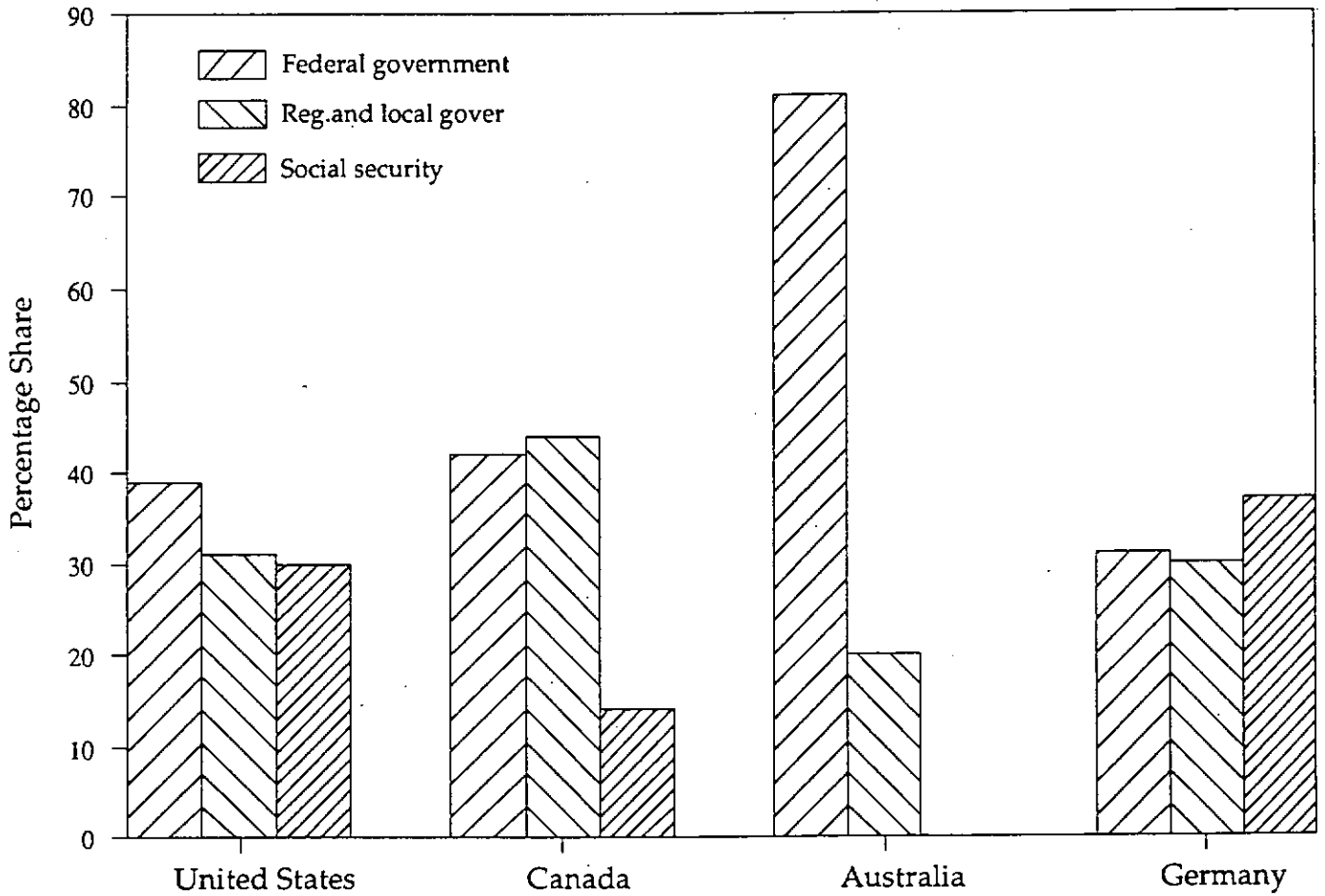
Source: Informe Financiero Anual 1992,
Contraloría General de la República.

Graph 1
Tax revenue share by level of government 1992



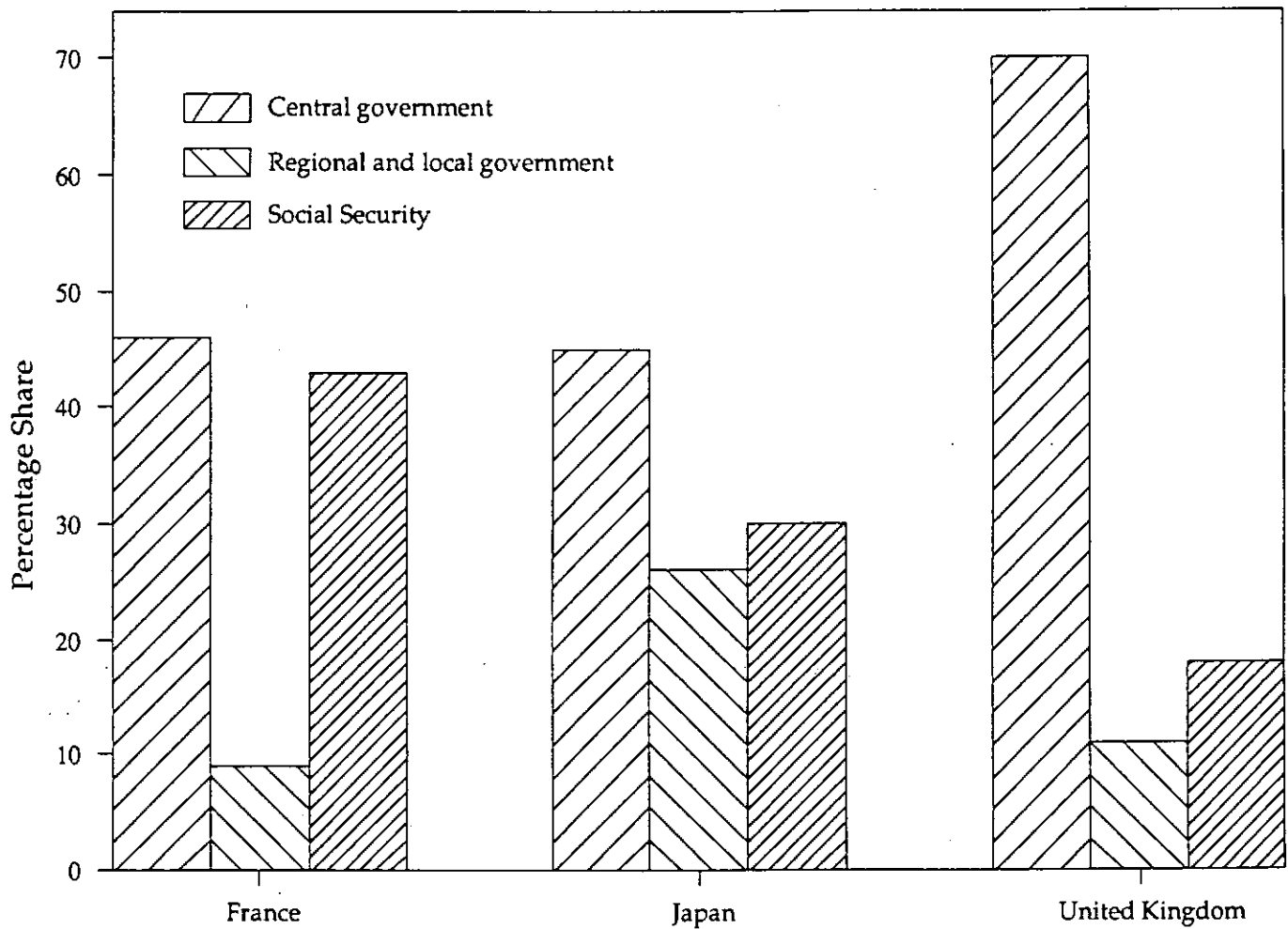
Source: Wiesner (1994).

Graph 2
Tax revenue share by level of government
system 1986 (Federal)



Source: Wiesner (1994).

Graph 3
Tax revenue share by level of government
System 1986 (Unitary)



Source: Wiesner (1994).

TABLE 7: DESCENTRALIZATION INDICATORS*

Country		Expenditure as:		Transfers as (%) of GDP	% of taxes locally collected	Transfers as % of total revenue:	
		% of GDP	% of overall public expenditure			regional/provincial	local
Colombia	1980	5,7	34,4	2,9	21,8	51,0	
	1993p	7,0	41,3	4,1	17,8	50,5	
Bolivia	1986	1,5	11,9	0,0	15,1	1,9	
	1991	1,9	11,4	0,2	7,3	12,9	
Brazil	1982	11,4	31,1	3,0	23,1	18,4	66,7
	1991	18,6	46,8	5,8	35,0	20,5	62,6
Chile	1983	0,6	8,5	1,1	4,2	39,5	
	1991	2,7	15,0	2,0	3,0	43,6	
France	1983	8,5	17,2	3,2	22,0	41,0	
	1992	9,5	18,6	3,4	9,7	36,8	
Spain	1981	4,4	14,0	0,6	11,1	71,9	6,0
	1990	14,6	35,7	7,6	13,3	74,2	34,9
US	1984	16,9	47,6	5,2	33,4	20,9	38,3
	1991	18,8	50,3	5,8	34,2	21,4	37,2

* Refers to state and local governments and entities, composed as follows:

Colombia: Capital district, 25 district agencies, 32 state governments, 276 state agencies, 32 regional social security institutions, 1008 municipalities, 68 municipal agencies, 21 municipal social security foundations and institutions.

Bolivia: 9 states, 9 regional development corporations and 9 state capitals.

Brazil: 26 state and 4974 municipal governments and Federal government.

Chile: 325 municipalities.

France: 22 regions, 96 states, approximately 36000 communities and local government agencies.

Spain: 17 autonomous communities, approximately 8000 municipalities and local authorities.

US: 50 states, 4 states unable to provide social security services, 44 state workers compensation systems, approximately 68465 counties, municipalities and other local governments and 14721 school districts.

Source: Fainboim, et.al. (1994).

TABLE 8. TAX REVENUE SHARES BY GOVERNMENT LEVEL

	1975			1986		
	FEDERAL (National)	REGIONAL (State+Local)	SOCIAL SECURITY	FEDERAL (National)	REGIONAL (State+Local)	SOCIAL SECURITY
OECD Federal						
United States	43	32	25	39	31	30
Canada	48	43	10	42	44	14
Australia	79	20		81	20	
Germany	34	31	33	31	30	37
OECD Unitary						
France	50	8	41	46	9	43
Japan	45	26	29	45	26	30
United Kingdom	71	11	17	70	11	18
LATIN AMERICA	1970		1992			
Argentina	74	26	74.4	25.6		
Brazil	74.7	25.3	69.2	30.8		
Chile	95.6	4.4	93.3	6.9		
Colombia	82.2	17.9	81.6	18.4		

Source: Wiesner (1994)

even when compared with more decentralized systems. In turn, until 1989 co-financing resources represented a small fraction of total income at the sub-national level²⁹. This situation changed with the reform of the 1990's, which is projected to determine transfers in the equivalent of more than 0.7% of GDP in 1995.

[INSERT GRAPHS 4-6 AND TABLE 9]

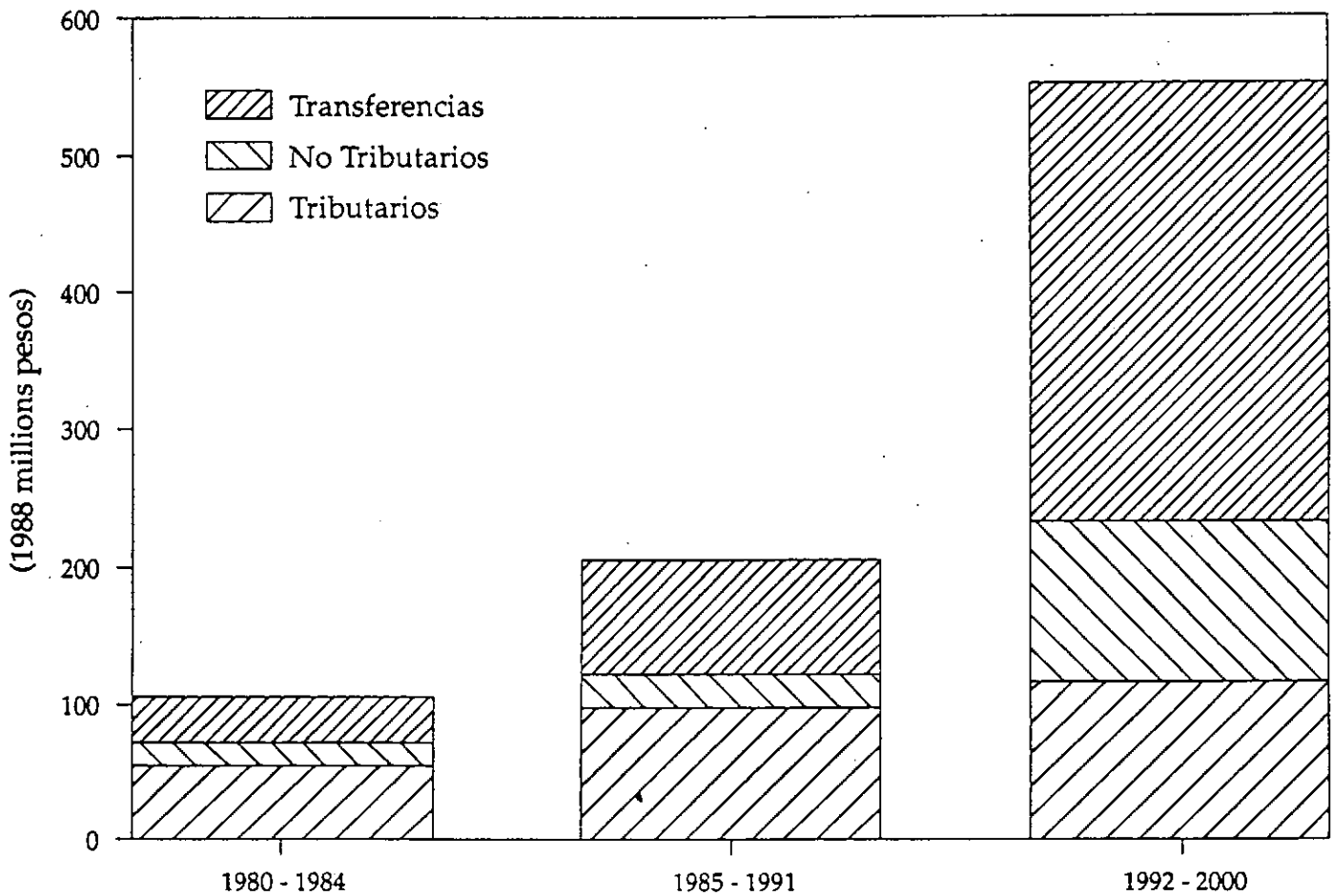
The results of the first stage of decentralization offer evidence of severe fiscal problems, situation that developed as a result of: i) excessive increase in transfers and other non-tax sources such as royalties, which produced both fiscal apathy³⁰ and flypaper effects; ii) ineffective requirements of fiscal effort as prerequisite for transfers from central government; iii) political accountability did not develop.

It is fair to conclude that it has been the case that the higher the grants from the central government to the regional level, the lower the taxing effort of the latter. The formulas introduced in Law 12 to stimulate own tax effort were ineffective, and the slightly greater autonomy introduced by Law 14 has not been enough to change the revenue structure of lower levels of government. In our view, however, the main reasons that explain poor regional tax effort are the increase in transfers and, to a lesser extent, of other non-tax income such as royalties. With few exceptions

²⁹ Since 1989, 70% of granted credit has been allocated to the five or six largest cities in the country.

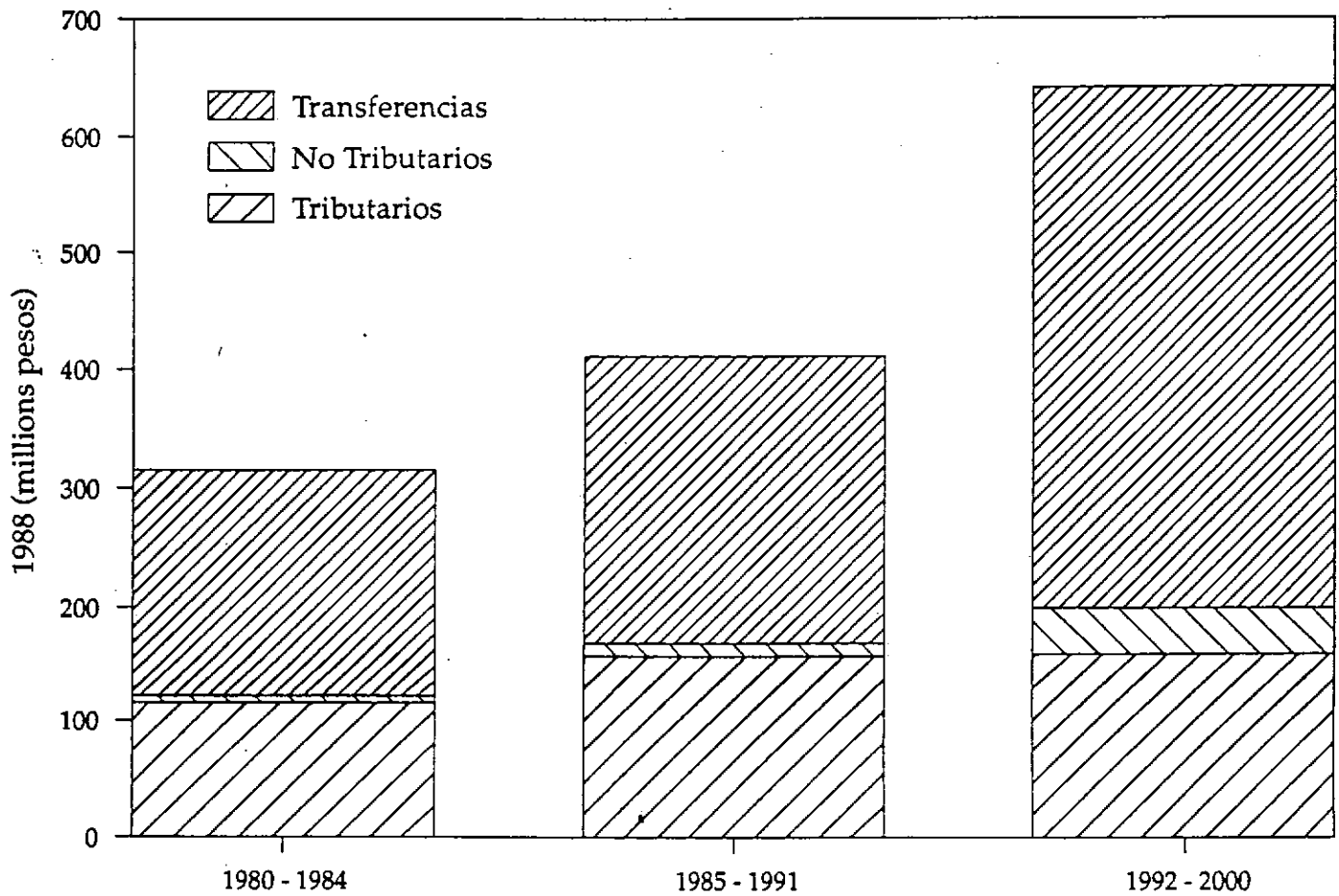
³⁰ In Annex 2 we provide econometric evidence on the subject.

Graph 4
Current Income Sources of Municipalities 1980-2000
(Yearly average)



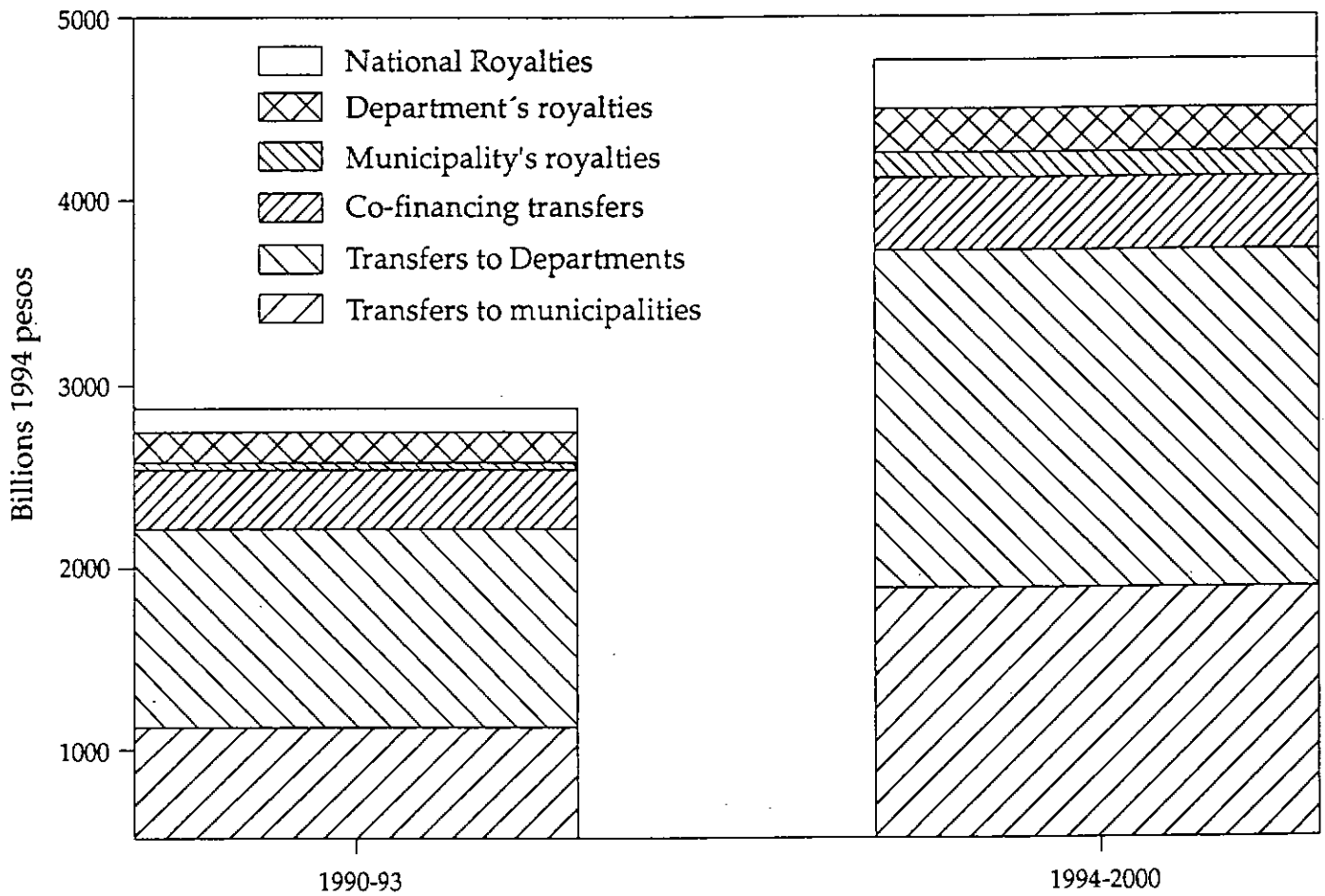
Source: DNP-UDT.

Graph 5
Current Income Sources of Departments 1980-2000
(Yearly average)



Source: DNP-UDT.

Graph 6
Income from transfers and royalties of lower levels of government
(Yearly average)



Source: DNP-UDT.

TABLE 9. TRANSFERS AND REGIONAL REVENUE*

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
1. Transfers to municipalities	1.01	1.12	1.44	1.60	1.66	1.81	1.92	2.05	2.23	2.35	2.47
2. "Situado Fiscal"	2.05	2.06	2.22	2.56	2.83	2.82	2.77	2.79	2.87	2.88	2.88
3. Co-Financing	0.67	0.69	0.69	0.56	0.68	0.71	0.67	0.61	0.58	0.54	0.51
4. Royalties to municipalities	0.12	0.09	0.08	0.08	0.17	0.21	0.25	0.23	0.21	0.19	0.18
5. Royalties to departments	0.44	0.31	0.31	0.32	0.31	0.38	0.44	0.42	0.39	0.36	0.33
6. National Royalty Fund	0.38	0.27	0.23	0.21	0.21	0.22	0.37	0.54	0.52	0.48	0.44
7. Total transfers and royalties	4.67	4.54	4.98	5.33	5.86	6.16	6.41	6.65	6.79	6.80	6.80
8. "Situado Fiscal"	21.07	18.48	19.07	22.97	24.60	25.47	24.50	24.50	24.50	24.50	24.50
9. Transfers to municipalities	10.39	10.03	12.42	14.37	15.00	16.00	17.00	18.00	19.00	20.00	21.00
10. Co-Financing	6.86	6.22	5.95	4.51	5.30	5.76	5.40	4.94	4.53	4.25	3.99
11. Total transfers	38.32	34.73	37.44	41.85	44.90	47.23	46.90	47.44	48.03	48.75	49.49
12. Transfers, Royalties and local revenue	75.35	75.57	71.95	65.64	65.48	68.11	68.43	67.98	66.20	65.20	64.31

* (1)-(7) as % of GDP; (8)-(12) as % of government current revenue

Source: DNP - ODT

(Medellín and Cali are notable ones), regions have achieved financial sufficiency without facing the costs of imposing higher taxes. As the revenue projections suggest, this situation is likely to worsen in the future; there are great chances that the changes in legislation after 1991 will accentuate the observed problems, due to the greater fiscal dependency they create.

2. Problems with intergovernmental transfers and grants

In addition to the previous problems, there is consensus among analysts that the current grant system has serious drawbacks.

a) During the first stage of decentralization there was overlapping of functions and confusion about distribution of responsibilities, as the central government continued to perform tasks such as investment in infrastructure for public education at the municipal level. Though some of these problems have been corrected, there is still a great deal of confusion regarding responsibilities for fiscal control, supervision, project evaluation and so on.

b) The link between expenditure decisions and budget restrictions is too loose. The system stimulates the provision of services beyond the point where costs equal benefits. Besides flypaper effects, the distribution of functions leads to situations in which the spending decisions are taken in one level, while the financing

decisions are taken at another.³¹ Additionally, the formulas in Law 60 and Law 141 are so complicated (Annex 1) and difficult to measure, that few local governments will be able to accurately predict their future income from transfers so as to incorporate this information in their planned budgets and development programs.

c) Though the transfer system introduced in 1991 has several advantages -i.e., introducing automaticity in the estimation of the amount of grants to be received by each regional authority-, the distribution rules, by being too specific and rigid, could lead to inefficiencies. The allocation formula in Law 60 favours four or five sparsely-populated departments. Though they are poor regions, there are doubts whether their share in total transfers correspond to their absorptive capacity. Particularly worrying are the low shares of Bogotá and Antioquia, with more than 8 million people.

d) It is not clear whether the indicator that measures "needs" will capture real necessities, particularly in the health sector. The combination of Law 100 of 1993 -which reformed the national health system- and Law 60, could lead to excess demand for services in certain regions and excess resources in others. Law 100 establishes that the state will guarantee equal health services to every family. It is quite obvious that the demand will be located in the

³¹ For example, while teachers are selected and contracted by mayors since 1988, departments pay for their salaries.

relatively rich regions, while Law 60 gives them proportionally less resources for health programs.³²

e) The present earmarking rules introduce inconvenient budget rigidities and may generate inefficiencies³³. Additionally, by being too rigid, the distribution formulae may produce "gaming" response from local governments aiming to maximize receipts.

f) Education and health are tied to taxes very sensitive to the business cycle (income and sales), while more stable ones (property) are used for environmental protection and other projects.

C. Some additional policy recommendations

1. Decentralize true decision making once and for all, making earmarking rules and transfer distribution formulae more flexible, while at the same time imposing strict rules regarding limits to local and regional indebtedness and fiscal deficits.

³² These allocation inefficiencies could be even worse in the case of royalties. For example, according to Law 141, a large portion of revenue will have to be divided among a number of small municipalities across the Magdalena river, and be dedicated to solve water contamination problems, while contamination of the river starts in Bogotá, city with a small share in these resources.

³³ Approximately 60% of total tax and non-tax revenue has to be dedicated to health and education, and 10% to environmental protection.

2. As suggested by Presencia (1994) and Rojas and Campbell (1994), the laws on participatory mechanisms and institutions must be coordinated with the decentralization package, defining limits in regard to the participatory channels in the co-financing and planning systems.

3. Impose upper limits for the growth of transfers and grants received by local and regional governments. These limits could be defined according to criteria such as regional GDP growth.

4. To continuously evaluate the quality of indicators in the distribution formulas, it is necessary to implement an information system allowing regional governments and constituents ready access to data on their performance and on income prospects. In order to diminish the "learning costs", institutional efforts geared to train regional officials and to strengthen their administrative capacity must be coordinated and rationalized. Though important steps have been taken in this direction³⁴, at present there are about 15 training programs, financed either by non-governmental agencies, by multilateral credit organizations or by the central government. These projects follow different methods, contributing to the institutional chaos.

5. Design a clear and aggressive strategy towards increasing local and regional tax effort through measures such as tying royalties

³⁴ Through the PDI (Plan de Desarrollo Institucional).

and grants to regional fiscal effort, and modernizing regional tax structures. Inefficient and "medieval" taxes (cattle slaughtering) and inequitable and distortionary ones (on gross income of industry and commerce) should be abolished, while more modern and efficient ones should be introduced (i.e. environmental control taxes). International technical cooperation programs could be implemented at local levels for this purpose. When possible, transfers should be substituted by regional government's surcharges on taxes that belong to central government, introducing tax sharing schemes. VAT tax, for example, could be partially shared by central and local governments³⁵, while keeping central administration to minimize collection costs. To maintain progressivity in the local tax structure, income tax could be shared with the central government. Local levels should have the autonomy to impose surcharges, with limits fixed by law. Finally, education and health should be partially financed with stable sources, particularly in a nationalized health system, were social security and unemployment contributions are also affected by the business cycle.

³⁵ A legal initiative was presented in Congress by the previous government but was not approved.

ANNEX 1

I. DISTRIBUTION FORMULA FOR "SITUADO FISCAL"

$$SF_i = SF^T \times \{0.15 \times (POP_i / POP^T) + 0.25 \times [(AP^{ed}_i + AP^{he}_i) / AP^{tot}_i] + 0.35 \times [(PP^{ed}_i + PP^{he}_i) / PP^{tot}] + 0.15 \times EF_i + 0.1 \times EA_i\}$$

where:

SF_i = Situado fiscal received by department or district i.

SF^T = Situado fiscal to be distributed among all departments and districts.

POP_i = Beneficiary population of the situado fiscal.

POP^T = Total (national) population.

AP^{ed}_i = School-age population (5-17) registered with the government sector of department i.

AP^{he}_i = Population with unmet needs (UBN) currently serviced by the health sector of department i.

AP^{tot}_i = Sum of target populations for health and education in department i.

PP^{ed}_i = School-age population for department i, estimated as the population between 5 and 17 years minus the registered population in the government and private sectors.

PP^{he}_i = Indigent population in need of health services in department i, estimated as the population with UBN minus first-time users of medical services.

PP^{tot} = Sum of potential populations for health and education in all departments and districts.

EF_i = Fiscal efficiency, measured by standardized local resources (tax revenue, fees, penalties, income and property contributions except financial revenue) as a % of the Situado Fiscal received by department i.

EA_i = Administrative efficiency, measured as the rate of an efficiency indicator in health and education divided by the standardized costs for administrative officials in centralized and decentralized education and health services in department i . The efficiency indicator is built with the health coverage index and the rate of the population in school.

II. DISTRIBUTION FORMULA FOR TRANSFERS TO MUNICIPALITIES

$$TRA_i = TRA^T \times \{0.4 \times (PO_i^{UBN} / PO_T^{UBN}) + 0.2 \times X_i^{UBN} + 0.2 \times (PO_i / PO_T) + 0.07 \times EF_i + 0.07 \times EA_i + 0.06 \times DELTA_i^{UBN}\}$$

where:

TRA_i = Transfers received by municipality i .

TRA^T = Transfers to be received by all municipalities.

PO_i^{UBN} = Population in municipality i with UBN.

PO_T^{UBN} = National population with UBN.

X_i^{UBN} = Index of UBN for municipality i .

EF_i = Fiscal effort, defined as the relationship between standardized tax revenue and transfers received by municipality i .

EA_i = Administrative efficiency, defined as the standard rate of the number of people receiving basic services (water, sewage and electricity) and per capita expenditures in personal services for municipality i .

PO_i = Population of municipality i .

PO_T = National population.

$DELTA_i^{UBN}$ = Difference (standardized) between the last two indices of UBN. For the first years of application of the formula, the indices of 1973 and 1985 will be used.

Source: Law 60 of 1993 and Rojas and Campbell (1994)

ANNEX 2

Fiscal apathy can be empirically tested. We address this issue by constructing panel data - a combination of time series and cross-sectional data- in the following form:

$$(1) \quad Y_{it} = X_{it} \cdot b + U_{it} \quad i = 1, \dots, N; \quad t = 1, \dots, T$$

where N is the number of cross sections (jurisdictions), T is the length of the time series for each cross section (12 years, 1980 to 1991) and U is the error term. The dependent variable, Y, refers to efforts to generate own revenue. We are considering only one independent variable, X, transfers from the central government.

We tested the hypothesis of fiscal apathy using two definitions of Y and X, and three levels of aggregation, as follows:

a) Fiscal effort was proxied with: (i) Eff1, the ratio of nominal regional tax revenue to regional GDP;³⁶ (ii) Eff2, the ratio of tax revenue to total revenue (tax + non-tax + transfers).

b) The explanatory variable was proxied in two ways: (i) Tra1 is total real transfers; (ii) Tra2 is nominal per capita transfers.

c) We estimated the model for data referring to the intermediate government level (24 departments³⁷), to the local level (municipalities of the 24 departments), and aggregate data for 24 departments at the intermediate and municipal level.

In all, 12 estimations were performed. Under the null hypothesis that there is apathy, b is expected to be negative. Table 10 summarizes the results of estimating (1) using the method suggested in Fuller and Battese (1974).³⁸

³⁶ There is Eff1mu for municipalities, Eff1de for departments and Eff1tot for the aggregate of both. The same holds true for all other definitions of Y and X.

³⁷ Before the 1991 Constitution, there were departments and several "intendencias and comisariás". The latter have been grouped as one and considered as an additional department.

³⁸ Method consisting of generalized least squares (GLS) with an error structure of the form

$$U_{it} = V_i + e_t + n_{it}$$

[INSERT TABLE 10]

According to our estimates, at the department and at the aggregate levels there is evidence of fiscal apathy, regardless of the definition of "own effort" and of "transfers". At the municipal level the evidence is not as conclusive, but it is certainly not the case that $b > 0$.³⁹

in which the right hand side terms are independently distributed, with zero mean and positive variances. That is, each error term depends on the cross-section, on time and on the "intersection" of the cross-section and time.

³⁹ There are two possible explanations for the result at the municipal level: i) since the late eighties, the institute in charge of the cadastral base has broadened it by valuating properties more accurately. While in the eighties only 30% of market value was registered, in 1992 this percentage increased to 70 [Correa (1993)]. This effort does not have anything to do with local tax effort. ii) after a long depression, construction has experienced a tremendous recovery, which has increased property tax income. The model we estimate does not capture these effects.

TABLE 10. ECONOMETRIC RESULTS OF ESTIMATING (1)

Dep. Var.	Indep. Var.	b	T statistic
Eff1 to	Tra1 to	<0	-1.48
Eff1 de	Tra1 de	<0	-4.51
Eff1 mu	Tra1 mu	>0	3.84
Eff1 to	Tra2 to	<0	-6.17
Eff1 de	Tra2 de	<0	-6.41
Eff1 mu	Tra2 mu	<0	-0.87
Eff2 to	Tra1 to	<0	-7.75
Eff2 de	Tra1 de	<0	-8.53
Eff2 mu	Tra1 mu	<0	-1.68
Eff2 to	Tra2 to	<0	-8.20
Eff2 de	Tra2 de	<0	-8.19
Eff2 mu	Tra2 mu	<0	-4.49

Source: Authors estimates

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TABLE 11. RESOURCES FOR LOCAL GOVERNMENT SPENDING (per capita)

Groups	Own source 1990	Mandated 1994
1	17.034	52.525
2	17.782	62.035
3	14.546	34.679
4	15.445	42.579

Source: DNP- Rojas and Campbell (1994)

Note: Group 1: Casanare, Cartagena, Chocó, Guainía, Santa Marta, Vaupes.

Group 2: Amazonas, Arauca, Bolívar, Boyacá, Caquetá, Cauca, Cesar, Córdoba, Guaviare, Guajira, Magdalena, Mariño, Putumayo, Sucre, Vichada.

Group 3: Santafé de Bogotá D.C., Caldas, Quindío, Risaralda, Valle.

Group 4: Antioquia, Atlántico, Cundinamarca, Huila, Meta, N. Santander, San Andrés, Santander, Tolima.