



# Local government and local utilities: a crucial link for promoting growth

Giorgio Brosio  
University' di Torino

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## A missing link in developing countries

- Prevailing separation in the literature between local/decentralized government and local utilities.
  - Although there are exceptions (for example, Herrera and Post , 2014 on contradiction between decentralization and “insulating” reforms).
- Also separation in the formulation of budget documents.
- And in the public speech.

## Also frequently missing partners

- Local public utilities play a reduced role in developing countries.
  - Public transport is generally missing.
  - Two main sectors are water (and sanitation) and electricity.
  - Local utilities in both sectors operate mostly at the distribution level, with no producing capacity.
  - Water used to be quite centralized before the 1990's
  - and it has been decentralized, privatized or moved (“insulated”) to the intermediate level (basin's and other).

Financial/economic constraints matter: with weak capital markets, local governments do not have the financial strength to finance huge capital projects, such as power plants, dams and aqueducts.

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## Local focus on development

- Prevails on improving directly the standard of living and on redistribution policies
- Is also reflected in other features of central and local government sector;
  - Weigh on educational, rather than health spending (not to say of welfare);
  - Use of local energy utilities for raising revenue (in addition to connection to national grid).
  - Creation of local firms (not utilities) operating in the market sector dictated by creation of jobs.
- However, this latter effort was and is strongly discouraged by IFIs, because of:
  - Fear of emersion of a soft budget constraint.
  - “Ideology”: proper role of government is to provide public services.
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## Fear of emersion of a soft budget constraint

- Market preserving federalism, or Federalism Chinese style (reference is to Qian and Weingast et al.).
- In no country subnational government has played such a big role in development (and growth has never been so rapid and protracted) as in China.
- Risks of failure have been controlled by the operation of a few rules.

# Market preserving federalism



- Main rules to our purposes:
  - the central government has the authority to police the common market (level playing field).
  - Subnational governments have to face a hard budget constraint.
- Other rules:
  - subnational governments have primary responsibility over economy in their jurisdictions.
  - Rules and allocation of responsibilities are durable.

# Market preserving federalism replicability

- Not easy outside China. Because of:
- big size of Chinese sub-national governments;
- shift from a planned to a market economy, with previous existence of SOEs, whose shifting to local level induced ignition of growth;
- devolution of banks, local promotion of foreign trade, *etc.*

Without effective rules and these other conditions, locally promoted growth and decentralization become a “Tragic brilliance mechanism”.

# Ideology": proper role of government is to provide public services: the water war in Cochabamba

- Very well known-case. Originated world-wide movement against privatization of basic services.
- The story is worth of recounting, but not for ideological purposes.
- The municipality of Cochabamba decided, under the impulse of WB and other, to privatize its water utility (SEMAPA) in 1999.
- Only one bid was made, an American (Betchel) lead consortium, won. It took over immediately and in early 2000 raised prices on average by 50 %.





## Water war in Cochabamba

- Riots ensued, with at least one fatality among demonstrators.
- Betchel gave up. SEMAPA came back.
- The Bolivian government passed a new law, introducing a new institutional framework for the provision of water including a dedicated Ministry of Water, substantial funds for water projects, and an all-inclusive organization and legal framework.
- The law has not yet been fully implemented.
- SEMAPA shows very unsatisfactory levels of performance: more than 40% of households are not connected and have to pay huge price for delivery.

# Proper role of government is to provide public services

- I have no general suggestion for water-provision, with however a preference for public provision.
- Water is (and will become even more) expensive and is a hugely capital intensive sector.
- Solving the “insulation” problem is crucial. Local governments need to properly govern their local utilities.
- This does not mean local regulation, however.

## Let's come back to Cochabamba and to its development

- The main municipal tax source is the property tax.
- However, 40 per cent of properties are not registered.
- Tax experts say that it is because of problems with registry and cadaster. Very partially true.
- People are ready to pay, but can't. Basic services, water included, are not provided. The municipality can't ask the tax.
- Without adequate revenue it cannot provide basic inputs for development, such as infrastructure.
- Moreover, informal housing accrues to informality, weighing negatively on growth.
- Proper working of local utilities is a factor of general growth.