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Adjusting Fiscal Decentralization Programs to Improve Service Results in Bulgaria and Romania

Procedural and Institutional Change: Four Perspectives from Abroad

Fiscal decentralization programs are works in progress, and expenditure roles often need to be adjusted to improve service delivery. The Balkan countries of Romania and Bulgaria, both needed for accession to the European Union in 2007, must demonstrate positive results from their fiscal decentralization programs in the social services area. Focusing on social service delivery, this paper explores how the design of fiscal decentralization programs, in the form of assigning intergovernmental expenditure roles and responsibilities, affects service performance. The authors conclude that fiscal decentralization requires the proper assignment of authority to match expenditure responsibilities and the policy and administrative capacity to carry them out.

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Spurred by some combination of political expediency, interest in obtaining international donor financing, and internally perceived needs to increase the efficiency of resource use, many countries have embarked on fiscal decentralization (FD) programs. These programs typically implement legislative mandates to devolve revenue and expenditure powers to subnational governments. This often includes the expansion of authority to borrow in credit markets for infrastructure finance, which increases local fiscal autonomy. Fiscal decentralization has been pursued in a variety of contexts by radically different kinds of regimes, but the overall objective is roughly the same: to facilitate improved local financing of current and capital investment needs consistent with their assigned functional and service responsibilities. It is expected that such programs will lead to greater political accountability and fiscal responsibility in the process.

Countries that have embarked on FD programs find that they are works in progress; in no country is the process of FD "finished." Assignments of intergovernmental roles and responsibilities must be constantly adjusted to take account of changing fiscal and political realities; fiscal incentives and revenue-sharing or transfer mechanisms also need to be constantly reviewed. To ensure that fiscal controls are in place and link fiscal authority with service responsibility, governments typically assign expenditure responsibilities before revenues. It is often forgotten that this is a trial-and-error institutional process guided by economic principles and institutional logic. Thus, the form that FD programs take and their evolution in each country are conditioned by the effects that FD has had in the past and by the evolution of economic and political forces in each country where FD is being attempted. The unfinished nature of FD in any country also reflects the fact that the design of FD involves balancing conflicting objectives—typically efficiency and responsiveness—and that these objectives receive different priorities as government regimes and public opinion change over time.

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Centralization/decentralization does not exist along a single continuum. There are many aspects of a country's fiscal affairs that can be more or less decentralized. Because fiscal affairs can be divided into many activities, centralization/decentralization takes place along a number of continua. Often, it is not possible to say that one country is more decentralized than another because the two may be decentralized on some dimensions but not on others. For example, in our study of Romania and Bulgaria, the level of decentralization varies by type of social service.

One may compare the decentralization of limited fiscal dimensions, such as expenditures at the local

level versus the central level, leading to the conclusion, for example, that country A has a more decentralized approach to providing primary education than country B. However, one may be hard-pressed to say that overall fiscal affairs in country A are more decentralized than they are in country B. For example, even if expenditures are larger at the local level in country A, local governments in country B may have larger shares of own-source revenue, enabling them to finance more programs and projects. Thus, case studies cannot deal with simple yes/no answers except on narrowly defined subdimensions of fiscal organization. There is no single model of fiscal decentralization or set of measures that can be applied across the board to all countries (Guess, Loehr, and Martinez-Vazquez 1997, 13).

Research Objectives

With these general observations and caveats, the purpose of this paper is twofold. First, it attempts to measure and compare the efficiency and effectiveness of three social service programs in the context of two Balkan countries. Efficiency is measured by unit cost and economy of scale; effectiveness refers to service quality, cost-effectiveness, and coverage of eligible clients or users. Second, it attempts to link differences in efficiency and effectiveness with differential role and responsibility assignments to governmental institutions in both countries. Accepted expenditure rules assign spheres of responsibility through laws or constitutions: central government (e.g., defense, fiscal policy), state governments (e.g., roads and secondary hospitals) and local governments (e.g., sanitation, lighting, and schools). Concurrent intergovernmental obligations are also created for such areas as health, education, and social assistance. Assignment rules also recognize the stages of service delivery: regulation, financing, and implementation (Mendoza and Martinez-Vazquez 2000, 139).

An important problem with the expenditure assignment literature is that the rules are overly broad and static. The rules do not indicate how and when to assign management authority and financial responsibility for each type of program. This can weaken the efficiency and effectiveness of service delivery. As Mendoza and Martinez-Vazquez note, "formal expenditure assignments can never be explicit enough to cover all contingencies" (2000, 166). Nevertheless, countries implementing FD programs must make ad hoc adjustments in expenditure assignments in order to deal with responsibility and financing gaps. Some countries do not adjust assignments because they lack empirically tested theoretical guidance. Other countries adjust incrementally without clear guidance. The result can be an opaque financial constitution consisting of an inefficient cobweb of revenue-expenditure equalization and joint public spending that results in insufficient services. This gives FD a bad name. The question is whether there are more dynamic guides that can clarify expenditure responsibilities and allow for improved adjustments during the fiscal decentralization process.

Based on a review of three services in two countries, we had two research expectations. First, we expected to find that social service efficiency and effectiveness problems could be identified and explained by ill-defined central regulatory norms (too narrow/too broad, too intrusive/not enough) and operational responsibilities (too much/too little). Second, we expected to find that assignments resulting in central normative control of programs would lead to greater emphasis on efficiency than effectiveness, whereas greater devolution of normative controls and enforcement would lead to greater attention to effectiveness than efficiency. Normative controls refer to service standards and budget-management rules that are set and enforced by independent, staff-level units. Such controls are often ill defined and riddled by conflicts of interest with service operations.

Bulgaria and Romania were selected because they were both slated for entry into the European Union (EU) in 2007, and both had been undertaking programmatic reforms in decentralization, social services, and social protection in order to meet the EU standards. Consistent with the expectations and illustrated by the health care sector in both countries, the first research hypothesis is as follows:

> **H_1:** Normative centralization without sufficient operational decentralization leads to more service efficiency than effectiveness. When the wrong quality standard-of-care norms are centralized and forced on lower-tier units that lack operational authority, one can expect services to be efficient in a narrow unit-cost sense but not user friendly in that many clients are served poorly or not at all.

For example, during the 1990s, hospital "rationalization" in Bulgaria focused on consolidating or closing inefficient hospitals without consideration of their social functions in serving remote and poor municipalities (Balabanova, Tsolov, and Delcheva 2005, 23–29). Ineffective secondary and tertiary services (e.g., the absence of nursing homes or rehab centers) led to high levels of hospital stays. This gave the appearance of high health care service provision that could be made more efficient by the simplistic approach of cutting beds and doctors (35–36). The approach has penalized users of secondary and tertiary services (reduced quality and effectiveness) while the economies of scale achieved from the consolidation of other units have not increased the efficiency of health care either. Paradoxically, rationalization through the

reduction of beds has increased patient waiting lists and jeopardized the Ministry of Health's hospital accreditation norms (37). The second hypothesis is as follows:

> **H_2:** Operational decentralization without sufficient normative centralization leads to service effectiveness with lower efficiency. When norm-making and enforcement are left to lower-tier units, excessive discretion exercised by the wrong tier of responsibility can lead to inefficient results.

For example, to preserve service quality and coverage of patients, during the 1990s, Bulgarian local government decision makers avoided hard choices about needed internal reforms of hospital operations, such as closures, cutbacks, and consolidations. Some of these had to be made but were not. A possible improvement would have been to decentralize the operational responsibility for planning and to leave the allocation of public finance to districts on the basis of clear quality and equity standards (Balabanova, Tsolov, and Delcheva 2005, 38). Despite some evidence to support our thesis in the social protection area, it cannot be said that the two hypotheses are fully confirmed. Given the importance of refining the expenditure-assignment literature, further research is warranted.

Expenditure-Assignment Criteria

The rationale for FD programs is that they provide improved resource allocation and therefore improved efficiency. Improved efficiency is usually defined as getting greater consumer (taxpayer) welfare from fixed resources. It can be subdivided into technical (least unit cost) and allocative (effectiveness and coverage) efficiency (World Bank 1995, 29–30). Welfare can be used here as a synonym for value for money and services with reasonable unit costs and effective coverage of target population needs. Welfare should also include equity considerations. This is the classic local effect described by Musgrave (1959) and Oates (1972), and it is the main impact sought by FD programs. Efficiency gains rest on the presumption that local governments are much better at identifying and fulfilling the needs of households because they are closer to them and mobilizing and using local resources to pay for goods and services having purely local impacts (Peterson 1996). When locally provided goods and services "spill over" to the wider community, the case for FD is weakened (Bird 1994), but it is not destroyed unless benefits spill over evenly to the entire nation.

An important element that is often forgotten in FD design is that the costs of local goods and services should be borne by the beneficiaries in order to reap maximum efficiency gains. When FD is implemented and services do not achieve efficiency gains, there is a case against the decentralization of particular services and a strong argument for the readjustment and redefinition of the FD program. In this article, we attempt to distinguish technical efficiency from allocative effectiveness resulting from program design and implementation.

The efficiency and effectiveness gains from FD programs depend on proper intergovernmental assignments of revenues, expenditure, and program or service authority. To the extent that core social services have high unit costs and low coverage ratios, there may be design problems with an FD program. Intergovernmental roles and responsibilities may need to be reallocated and reassigned in an attempt to increase efficiency gains in the social services.

The economic rationale for the assignment of fiscal functions to different levels of government is largely spatial (Musgrave and Musgrave 1989, 446). For transitional countries, economic rules must be tempered by the realities of institutional capacity constraints. Stable fiscal policies benefit the nation as one spatial unit, and therefore the normative and operational functions are assigned to central governments (455). Similarly, income, employment, and resource differences among regions and localities require that financing and regulation of distributive programs be centralized in higher tiers of government (454). This means that revenue and expenditure assignments for social assistance programs should be normatively and financially centralized and operationally *deconcentrated* (Rondinelli 1990) to lower-tier units of the central government. Conversely, responsibilities for allocative programs such as social goods and services can be precisely assigned to benefit regions with accountability for effective and efficient delivery (Musgrave and Musgrave 1989, 449). The literature provides three criteria for general expenditure assignment.

First, fiscal decentralization requires the devolution of service responsibilities to local governments, along with sufficient revenue and expenditure authority. The devolution of authority to mobilize revenues is critical to local fiscal autonomy. Because service performance is a function of current and capital expenditures, it is critical that local governments be able to plan and finance their infrastructure needs. Without own-source revenues to cover current and capital needs, the reform is not actually decentralization but merely the "deconcentration" of responsibilities from the center (Rondinelli 1990). But the expenditure responsibilities must be assigned first on a trial basis.

Local governments must be able not only to mobilize their own-source revenue but also to allocate it to local needs as well. They should be able to set the bases and rates, perform collections, and apply the funds to their own budgets. Local governments should

have the authority to determine the composition of their own budgets. For example, raising local revenues that must be spent on central mandates would defeat the purpose of fiscal decentralization. Thus, on the revenue side, local governments should have full authority over property taxes and service fees, whereas provincial governments should be able to levy and collect sales taxes, and central governments should have full authority over income taxes. Normal tax-sharing and piggyback arrangements among tiers of government are required adjustments to make the system work. Failure to assign according to economic efficiency criteria can threaten the results of FD programs. Local governments in developing and transitional countries have varying amounts of authority to perform these tasks. How much is required for effectiveness? This depends on the type of service or program. For allocative programs—such as social goods and services, for which program beneficiaries are regional or local—costs should be shared across as many jurisdictions as possible and services decentralized (Musgrave and Musgrave 1989, 446). This means that in order to achieve the best social service performance, to the extent that it is feasible, normative authority should be centralized and separated from operations, whereas the financing and management of operations should be decentralized.

Second, the assignment of service responsibilities should be targeted to local area needs. With responsibility for assigned services lie accountability and incentives to be more responsive. Services should be provided at minimal unit cost to service jurisdictions (i.e., they should be efficient) and cover target populations (i.e., they should be effective). The economic assignment of intergovernmental roles and responsibilities is critical for fiscal decentralization. Revenue and expenditure assignments should be based on the need to reduce beneficiary spillovers and take advantage of scale economies.

Assignments should meet economic efficiency criteria that ensure responsiveness to properly sized pools of beneficiary needs. For instance, the assignment of intercity highway authority to local governments could produce duplication and high transaction costs as cities try to coordinate routes and maintenance activities. Rather, the intercity road function should be assigned to the provincial level to reduce costs and maximize beneficiary service. Mixed assignments of authority for financing and maintenance are often suboptimal. Local governments with responsibility for maintenance but not construction have every incentive to skimp on maintenance, knowing that the central authorities will replace the facility in the future, so that budget savings can be reprogrammed to other local needs now. To ensure the sustainability of capital investments, governments need to match public investment responsibilities with beneficiaries and with operations and maintenance responsibilities (Guess, Loehr, and Martinez-Vazquez 1997, 18).

Because balanced assignments of fiscal authority and management responsibility are rare, what is the threshold? When are the assignments so badly made that they threaten the goals of FD programs? Institutional and management incentives are often ignored in program design. For optimal service responsiveness and efficiency, assignments need to target beneficiaries and provide incentives for management accountability. The use of contractual quid pro quo mechanisms can provide managerial flexibility and authority to shift resources in order to meet norms and ensure accountability for results (Schiavo-Campo and Tommasi 1999, 358).

Third, service performance should meet minimum national standards. Even in the most decentralized countries (e.g., Brazil), local governments have centrally mandated tasks that they must perform in accordance with national norms. Some central controls must be maintained to ensure fiscal responsibility and service standards. In Central and Eastern Europe, EU norms for public health, water quality, and roads are probably the most important at this stage of transition. Without mandates, local governments under partisan influence often allocate funds to projects that will ensure their reelection (e.g., new buildings and works) but do not necessarily meet community needs (e.g., proper maintenance and operations). Remediation may require the recentralization of services or tighter regulatory enforcement from the center, together with the reallocation of financing responsibilities. Fiscal authority and program or service responsibilities need to be matched.

Local governments are obliged to perform some centrally mandated functions, but they must be provided sufficient financing through central transfers, subsidies, or devolved financing sources to cover mandated expenditures. Otherwise, intrusive central service mandates could threaten local fiscal autonomy. So, local governments with high levels of central mandates may receive high levels of earmarked transfers to cover their expenses. Conversely, central mandates must be based on appropriate service norms and quality standards. The norms should make sense practically from a service-development perspective. The question, then, is under what conditions should devolved services be recentralized to ensure compliance with national norms? Also, when should national norms be revised to ensure that devolved authority is being properly used? Regular assessments of program performance are critical for regulatory design decisions. In the intergovernmental relations context, service efficiency and accountability for results are best achieved if the normative or rule-setting function is independent of operations (Reagan 1987, 180). This means that

regulatory enforcement for stabilization, allocation, and distribution functions and their corresponding programs should be independent of operations. They could be centralized and executed by a staff unit at the same tier of government.

Assigning Expenditure Roles in Practice

The literature provides textbook rules and criteria with which central and local policy makers in Central and Eastern Europe have long been familiar. With all three rules, the practical question is, how much or how little? Policy makers agree on balanced assignments, but this has little practical value in certain contexts. There is no definitive prescription setting out the functions that should be assigned to local governments (World Bank 1995, 78), nor is there much guidance on defining activities within those functions as part of FD programs. Few policy makers would proceed with FD knowing that balance is required when the risks of failing to achieve that mythical level of balance are great. To improve FD policy making and to lower decision risks, tested policy lessons are needed to reveal the implications of efficiency/effectiveness trade-offs. Rules and mechanisms to guide policy makers should be based on comparative field studies.

How transitional and developing countries operationalize the three rules assists in gauging FD progress. In applying them, regimes typically have to make adjustments. Countries implementing FD programs have to redefine revenue and expenditure responsibilities in order to improve efficiency (reduced unit costs and increased economies of scale) and effectiveness (value for money, service performance). Policy makers need to weigh the benefits of local government autonomy with the need for optimal service delivery. In some cases, this may mean recentralizing particular programs or services (as will be noted later for Bulgarian social protection). The decision to decentralize should be guided by expected results, not only democratic ideology.

It has been documented in many countries that local governments can achieve fiscal autonomy and still not provide efficient services. In Brazil, for example, operational expenditure authority was devolved to local governments without corresponding requirements to mobilize revenue or comply with national spending norms. The result has been poor services and periodic threats to macroeconomic stabilization (*The Economist* 2004, 37). Failure to properly assign responsibilities in FD programs results in services that often fail to meet national norms, have excessively high unit costs, and do not cover target population needs. The key, then, is to assign revenue and expenditure responsibilities to encourage as much local service efficiency and effectiveness as possible. Viewed this way, the achievement of the latter for allocative and distributive programs may not be consistent with the ideal of maximum decentralization. Additionally, governments implementing FD programs do not assess or redefine roles and responsibilities, often because they lack sound guidance on what will happen to the services.

From this brief review, it is evident that the literature on expenditure assignments to increase the effectiveness of decentralization is sound in theory but leads to problems in practice. Despite the rigor of the theories and soundness of the literature (see, e.g., Joumard and Konsgrud 2003; Wurzel 1999), countries in most regions with FD programs experience problems with unclear assignments, the dichotomy between construction investment and maintenance responsibility, and unfunded mandates (Mendoza and Martinez-Vazquez 2000, 151).

Some of the problems are institutional in that, regardless of assignments, each tier blames the other for gaps in financing and responsibility. But the rest result from the generality of the recommendations produced—the balance between efficiency and responsiveness (unit cost and service quality). Other problems relate to legal instability—the fiscal laws change all the time, and this affects service delivery. Perhaps no more concrete management guidance can be given, and policy makers must accept enigmatic and almost Delphic advice. Additionally, it could then be argued that this problem rests with risk-evading policy makers and not the literature. The question is how the effectiveness of FD programs can be improved by more precise, practical advice from the literature.

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As noted, fiscal decentralization programs are works in progress. The financial and institutional framework (in the form of laws and regulations) provides a guide for sequential implementation of the FD program and intergovernmental performance of expenditure functions. The implementing sequence and functional assignments have to be constantly adjusted to suit political realities. Some guidance exists for sequential implementation (Guess 2005). Developed countries often have the institutional strength or positive redundancy to pursue FD simultaneously on

several fronts. In poorer countries, not every activity can be implemented at once, and programs typically follow a phased set of sequential activities. By contrast, the literature on expenditure role adjustments provides little guidance and leaves policy makers to work out the practicalities by trial and error in the quest for efficiency and effectiveness. Ultimately, this may not be a bad thing, as overscripted advice is just as pernicious to practitioners. Nevertheless, the purpose here is to refine the advice, make FD decisions less politically risky, and encourage FD programs to go forward.

There are other reasons for service inefficiency and ineffectiveness beyond the inappropriate assignment of intergovernmental roles. For example, the failure of political leaders to provide voters with their best judgments leads to piecemeal, partial, and incoherent reforms at the national level and in sectoral programs. Lack of technical capacity on the part of public sector officials and weak state institutions are two other factors. That is, deficiencies in public administration structure and workflow processes impede program performance. It can be said, however, that the misallocation of roles and responsibilities exacerbates these factors (e.g., without defined management responsibility and sufficient fiscal and authority, officials lack incentive to acquire or use new skills). Weak state institutions are often the product of official (elected and appointed) indifference and lack of will (or courage of convictions). Poor performance of administrative and policy activities related to programs is often a problem of incentives derived from irrational or inconsistent role and responsibility assignments. Lack of fiscal authority or management responsibility acts as a disincentive and weakens government performance.

The solution is the proper reallocation of roles and responsibilities to shift institutional incentives. The absence of state reform is often the product of a calculus that to do anything on structural or functional reform risks making things worse, which increases political costs for particular decision makers and their current regimes. Our premise is that, despite other influences, precise and practical guidance on how to assign expenditure responsibility is a powerful influence on FD program performance. Failure to provide these prescriptions has led to gaps in service financing and responsibility, which weakens service efficiency and effectiveness.

Comparing International Programs: Expectations and Findings

Using secondary data, we tested the "expenditure role allocation" thesis using the comparative case method. The "matched-case" method of comparison used by Xavier (1998) for the comparison of Malaysian and Australian budget reforms is useful for our purposes. We used that method to select countries in one region having similar social services programs under similar conditions. Classification of the similarities permits us to hold constant the key factor expected to influence service results—here, the definition of expenditure roles. This reduces the problem of multiple causation that otherwise besets comparative analysis. With appropriately matched cases, we then looked for maximum variation in the dependent variable (service performance) attributable to the independent variable (expenditure role definition and assignments). The question is whether in similar cases (Balkan countries), role variation explains service performance differences. If so, based on partial generalizations (Lijphart 1975, 172–73) derived from this method, what criteria or rules can be developed to guide more precise role allocation and definition?

As indicated earlier, the two-country Balkan study asks two questions: (1) Did the FD programs misallocate expenditure roles? (2) How did they lead to inefficient and ineffective social services? For instance, health care services in Bulgaria were found to be both inefficient and ineffective (see table 1).

It is generally believed that such problems can be cured by increased decentralization. But the design and enforcement of norms often need to be centralized (or performed independently of program operations), with operational responsibilities decentralized. This general rule ensures that authority and responsibility match. Whether the program is allocative, distributive, or undertaken for stabilization, the authority to raise and spend funds should correspond to responsibility and accountability for service performance. Expenditure and revenue assignments that incorporate incentives to manage for results should work best. In practice, it is hard to assign roles and responsibilities consistent with this rule. This paper is a preliminary effort to link role and responsibility assignments to better service performance through lessons from a two-country comparison.

Social Service Performance Results in Both Countries

The progress of FD programs in both countries is summarized in table 2. Basic secondary data on local governments and social services in both countries is presented in table 1. It is hard to develop a single rating or index to gauge service performance based on multiple measures with incomplete data. Indicators range from good to bad on particular measures, so aggregating all of them into one rating could be misleading. It is also hard to assess sectoral performance when the sectors are in flux (i.e., design and implementation transition). All three have been the targets of reform advice by external donors and internal

Table 1 Basic Data on Local Governments and Social Services in Bulgaria and Romania

Measure	Bulgaria	Romania
Population	7.9 million	22.3 million
Municipalities	262 *obchtina*	2,951 (93 *municipii*, 172 *orase*, and 2,686 *communes*)
Counties	28 *oblasts*	42 *judets*
Population/municipal government	28,275	6,784
Health service efficiency	Low: • Fiscal recentralization under the National Health Insurance Fund to 76% fund, 24% local government • National Health Insurance Fund to cover 50% of health care financing • Current-capital portion not established, leaving free-rider problem.	Low: • Physicians per 1,000 population = 1.8 • Hospital beds per 1,000 population = 7.4 • Occupancy rate = 78.6% • Average length of stay = 10.1 days • Health expenditures as a share of GDP = 3.8% • Total expenditures as a share of GDP = 4.6% • Public expenditures increased 29.0% from 1995 to 2000 • Sources of finance: 77% statutory insurance, 23% state budget (mostly central government or health fund—99%) • Infant mortality rate per 1,000 population = 18.6 • Investments financed by Ministry of Health budget
Health service effectiveness	Low: • Polio immunization rate dropped from 99% in 1989 to 94% in 1999 • Bed occupancy rate = 67% • Average hospital stay = 11.9 days • Infant mortality rate per 1,000 population = 13.3	Low: • Centralized health fund financing • Polio immunization rate increased from 89% in 1989 to 96.3% in 1999 • Need results budget format (now economic and administrative categories) • Most allocations to hospital outpatient (70%) • Primary care-family doctors only 7.3%
Education service efficiency	Low: • Real 2002 expenditures as a share of 1990 levels = 40.3% • Growing reliance on local government financing, up to 38.5% • 10% of total public expenditures in 2002 • Science quality below international mean: 545 to 518 (1995–99) • Student–teacher ration too low at 11.2 • Secondary teachers and schools increased as the number of students enrolled declined (high unit costs) • Payments to keep redundant schools open • Low teacher pay • Poor student results • Centralized management controls teacher and principal decisions • Low student–teacher ratio is deceptive—low enrollments lower ratio	Adequate: • Local governments financially responsible for all pre-university education • Real expenditures as a share of 1990 levels: 128.9% • 3.1% of GDP (2000) (dropped 8.4% 1995–2000)

Table 1 Continued

Measure	Bulgaria	Romania
Education service effectiveness	Low: • Centralized management • Decentralized financing • Too many schools, too much staff • Declining rural enrollments, poor teacher salaries, lack of materials (supply constraint) • Turkish families hold kids back (demand constraint)	Low: • Wide gap between rich and poor schools on capital facilities repair, rehabilitation, and the overall quality of education.
Social protection efficiency	Low: • Before shift to 75% central financing in 2002 and 100% in 2003, central transfers were underestimated and local governments could not mobilize required shares	Low: • Expenditures 9.9% of GDP in 2000 (increased 6.2% 1995–2000) • Local government responsibility for Minimum Income Guarantee and heating payments • Central government financing through earmarked equalization grant to *judets* • *Judets* distribute funds to local governments on the basis of the number of approved eligible beneficiaries reported by mayor • About 25% must come from local government budgets to support Minimum Income Guarantee program
Social protection effectiveness	Good: • Adequacy ratio of Guaranteed Minimum Income (ratio received by poor to prebenefit consumption) = 93.7% • Guaranteed Minimum Income and energy subsidies are pro-poor—35% of total expenditures in 2002 • 80% receive at least one benefit • 55% of all social protection expenditures are for old-age pensions • Poverty headcount after benefits = 12% • Poverty rate without social protection benefits = 18% or higher • Performance improved by centralizing financing (e.g., energy subsidies fully paid without delays to eligible)	Adequate: • Program coverage of Minimum Income Guarantee needs • 65%–81% underfunded mandate • Major drops in poverty rates, gaps and severity as a result of Minimum Income Guarantee/heating subsidies

Sources: World Bank (2002a, 2002b, 2002c); DFID (2004).

Table 2 Comparative Fiscal Decentralization Data

Measure	Bulgaria	Romania
Local government share of own-source revenues	15.0%	19.6%
Local share of total public expenditures	17.0% (1998)	18.7%
Direct local government debt as a share of total public debt	0.01%	1.0%
Indirect local public debt as a share of total public debt	—	38.0%
Local capital expenditure as a share of total local public expenditure	5.0% (of total revenue by law)	11.4%
Local authority to hire/fire employees without central government approval	No	No
Real GDP in 2000 as a share of 1990 GDP	82.1%	82. .9%
Local authority to borrow without Ministry of Finance approval	Yes	No (2004)
Separate commercial account for short-term local government loans possible	No	Yes
Social welfare payments financed by local own-source revenues	0% (Reduced to 0% in 2003 from 50% in 2002; program is now 100% centrally financed)	25.0% (75% centrally financed)
Separate commercial bank accounts for long-term loans possible	No	Yes
Number of local governments accessing credit market (bank loans and bonds)	2	29
Standard & Poor's rating (September 2004)	BBB–	BB+
Local government multiyear budgeting system	No	Yes
Devolution of authority to plan, budget, and finance capital investments	No	Yes

Sources: Dexia (2000); World Bank (2002a, 2002b, 2002c); Mayorga (2003).

experts. The results of particular pieces of advice or program efforts are hard to attribute or measure. Despite the preliminary and judgmental element involved, we attempted to do so for all three sectors and to draw conclusions about the design of FD programs.

Health

Performance results measured by the efficiency and effectiveness of the Romanian program have been weak. But the data are also weak. What is known is that health care expenditures are only 4.6 percent of gross domestic product (GDP), which is lower than other countries in the region with social insurance schemes. Some efficiency indicators have improved. For example, statutory insurance as a percentage of total health care financing rose from 0 percent in 1997 to 77 percent in 2000. This is attributable to the introduction of health insurance and not the design of any FD program. The average length of hospital stay decreased from 10.1 days to 8.8 days during the same period (World Bank 2002b, 92). But it is not clear who is staying less—live-in patients or those in dire need of care. In addition, major capital investments are mandated for local government hospitals that cannot finance them. The Ministry of Health retains responsibility for local health care capital financing despite a legal mandate to decentralize hospital ownership (World Bank 2002b, 95).

Despite improvements, comparative effectiveness measures remain low. World Health Organization data indicate that Romanian male life expectancy is still the lowest in Central and Eastern Europe—65.3 years in 1997 and 67.8 years in 2000—and the infant mortality rate is still the highest in the region—22 percent in 1997 and 18.6 percent in 2002 (World Bank 2002b, 93). Recognizing that these data include the former Soviet republics of Russia, Moldova, and Ukraine, which lower the average, the Romanian figures are still low. Romanian polio immunization rates increased from 89.4 percent in 1989 to 96.3 percent in 2000) (World Bank 2002b, 50), but this merely brings the rate up to regional levels. Finally, sectoral resources are allocated against recent trends in use. Most resources are allocated to hospitals (67 percent), with fewer devoted to specialized outpatient and primary treatment (28 percent). It appears that users increasingly seek primary care over hospital stays (World Bank 2002b, 91), whereas insurance providers prefer hospital use. The Romanian model consists of centralized financing and norms, little local management authority, and difficulty in linking health results to expenditures because budgets are still classified by economic and administrative categories. Most allocations are still for hospital outpatient care (70 percent), with little for primary care (family doctors).

Evidence of reform notwithstanding, the Bulgarian health care system has also achieved poor performance

results. Even though the rate fell from 15.2 days in 1990 to 11.5 days in 2000, Bulgaria still has one of the highest average hospital length of stays in Central and Eastern Europe (Stayko et al. 2003, 60). The 11.9-day length of stay in 1999 was still twice that of the European average and one and a half time that of the Czech Republic (World Bank 2002a, 129). Bulgaria also has one of the lowest hospital bed occupancy rates, falling from 85.7 percent in 1990 to 66.3 percent in 2000). By contrast, Croatia has a 9.2-day average length of stay and 96.3 percent occupancy rate (Stayko et al. 2003, 60).

Life expectancy and measles immunization rates in Bulgaria are also down. As of 2000, in contrast with Hungary, which has immunized 100 percent of its population against measles, and Romania, which has immunized 97 percent, Bulgaria has immunized only 90 percent of its much smaller population (Stayko et al. 2003, 59). The experience also demonstrates a methodological problem—when adjustments are made in the implementation of an FD program or social services subprograms, it is difficult to attribute any performance results to one model. In health care, Bulgaria has shifted from centralized to decentralized and now to a shared-duty model (central financing and norms and decentralized management). Yet indicators are still low: Average polio-immunization rates are dropping (to 67 percent), and average hospital stays are increasing (to 11.5 days), probably more so for the poor. But the accumulated effects of structural, management, and financing reforms may improve health care performance measures in the near future.

Thus, in the health sector, both countries currently suffer from poor performance. In Bulgaria, norms for the rationalization of facilities through closure and consolidation reduced unit costs but jeopardized accreditation by reducing overall service quality without really reducing total expenditures for the sector. Conversely, decentralization to increase local operational responsibilities allowed local officials to avoid hard choices on hospital reforms. In Romania, the evolution of the health care system toward a decentralized market solution providing quality care has been slow. Patients in both systems are suffering the consequences.

Education

In Bulgaria, both the efficiency and effectiveness of educational expenditures have been weak (see table 3). Student–teacher ratios have been low—lower than in the United States or United Kingdom, largely because of declining enrollments. The efficiency of expenditures is constrained by central norms and restrictions on local government budget management. Consequently, funds cannot be transferred or reprogrammed—for example, from savings on staff reductions to operations and maintenance. This leads to inefficiency in that funds are misallocated among the inputs needed to increase learning. Most resources are spent on teacher (and administrative) salaries and little on classroom materials, supplies, or maintenance. As Mendoza and Martinez-Vazquez (2000) note for Mexico, efficiency and performance could be improved if more funds were dedicated to inputs other than salaries. The effectiveness of both Bulgarian and Romanian educational expenditures is measurable by student test scores. Though the science and math test scores of both countries were poor, Bulgarian scores were above the mean in 1995 (545 and 527 compared to the mean of 518 and 521) but had dropped below the mean by 1999. In 2001, the Task Force on International Mathematics and Science Scores international measure of science and math knowledge indicated that Romania was still far below the mean of 521 in both fields, at 472 for both. By 2001, scores in both countries had dropped below the mean for science and mathematics (World Bank 2002a, 111).

A new EU/World Bank–financed program delegates budget management authority to Bulgarian local schools. It allows school managers to manage budgets flexibly and retain savings from funding shifts, including staffing cuts (World Bank 2002a, 114). If this attempt at operational and financial decentralization is applied nationally with permanent institutional changes, the effects on both efficiency and effectiveness should be positive.

In Romania, educational performance for facilities repair and replacement vary substantially across local governments. Capital expenditures per school vary from $231 in Salaj to $15,498 in Bucharest (DFID 2004, 31). This reflects the growing gap between rich and poor schools (32). In many cases, new capital investments result from inadequate historical spending on repairs and maintenance. In general, local governments do not engage in multiyear planning and budgeting for school investments and maintenance. Schools have limited involvement in capital investment decision making (27). Decisions to repair, replace, or rehabilitate are not made on the basis of regular facilities condition inventories. At the same time, local governments spend for current repairs, but not within the framework of a rehabilitation and replacement schedule (35). School officials often have little interest or expertise in financial management decisions; projects are planned and executed by local governments, with little consideration of cost savings or economies of scale (38). Without local school involvement in fiscal decision making, educational decentralization cannot really happen. It is estimated that about 6,000 schools are still in need of urgent rehabilitation (13).

Social Protection

As table 3 indicates, although the efficiency of Bulgarian social protection policies is low, the effectiveness of

Table 3 Bulgaria and Romania: Service Efficiency and Effectiveness

Country	Health	Education	Social Protection
Bulgaria	• Evolution from centralized to decentralized and health care fund financing • Management control of staffing and salaries remains centralized	• Local government responsibility for current financing • Central responsibilities for capital investments and staffing and salaries	• 50% cost share required of local governments changed to 0% in 2003 • Program is now 100% centrally funded • Allocation criteria are clear • Decentralized operational capacity and authority
Efficiency	Low	Low	Low
Effectiveness	Low	Low	Good
Romania	• Evolution from centralized to decentralized and health care fund financing • Staffing and salary authority remain centralized	• Decentralized responsibilities for both current and capital expenditures • Centralized authority for staffing and salaries	• Evolution from centralized program to means-tested social assistance benefit and Minimum Income Guarantee • Program requires 25% local government cost share • Criteria are unclear • Local government administrative capacity in social assistance area is weak
Efficiency	Low	Adequate	Low
Effectiveness	Low	Low	Adequate

the overall program has been relatively high. The implication is that if efficiency constraints can be identified and eliminated, effectiveness will improve even more. There have been serious efficiency constraints in the social assistance subprogram for Guaranteed Minimum Income. About 16 percent of all social benefits are paid in cash because of intergovernmental fiscal constraints on local governments (World Bank 2002a, 168). The Guaranteed Minimum Income program is the main social safety net, and about 86 percent of the benefits are provided in kind. But the goods provided are inferior, poorly targeted to the poor, and provided irregularly because of past local government cost-sharing constraints (World Bank 2002a, 169).

In the past, fiscal transfers from the Ministry of Finance were earmarked for social assistance payments on a 50 percent cost-sharing basis. Given the fiscal weakness of many local governments, especially poorer ones, many could not come up with the 50 percent, which reduced program outlays and results (World Bank 2002a, 166). The intergovernmental financing mechanism was weak, leading to underfunding of more rural and poorer local governments, which produced irregularly paid benefits as the local governments scrambled to meet salaries and other local requirements first (World Bank 2002a, 165). The Bulgarian government identified the problem and changed the funding mechanism to 75 percent central/25 percent local (similar to Romania). The earlier fiscal recentralization was modeled on the success of the energy-subsidy program in getting full payments disbursed to recipients (World Bank 2002a, 167). In 2003, the government fully centralized social assistance financing and normative responsibility in the Ministry of Labor and Social Protection. This should improve the coverage and efficiency of in-kind benefits for the Guaranteed Minimum Income program.

Despite past financing constraints, program effectiveness has been good. Though it cannot be said that either the level of decentralization or the social protection program independently affect the poverty rate, they are important influences. For example, it is estimated that the poverty rate would be 18 percent higher without the social protection program (World Bank 2002a, 146). Because of payouts by this program, the poverty headcount was reduced from 29.9 percent in 1995 to 11.7 percent in 2001. From 1995 to 2001, targeting improved from 26.9 percent to 53.1 percent, coverage from 11 percent to 31 percent, and adequacy (the ratio of benefits to prebenefit consumption) from 33 percent to 93.7 percent (World Bank 2002a, 168).

Romania began socioeconomic reforms after Bulgaria, so progress was delayed. Because of delayed privatization and hard budget constraints, about 41 percent of the people lived below the poverty line in 1999. By 2001, this figure had dropped to 29.6 percent as a result of economic growth and the effects of social protection policies (World Bank 2002c, 1). Though the Romanian social protection program has been inefficiently designed and administered, performance results and coverage have ranged from adequate to quite good. This suggests that money is being wasted

to achieve relatively good results. Greater efficiencies could produce even better results. Positive results from the 2002 Minimum Income Guarantee program suggest that social assistance benefits will reduce the poverty rate by 18 percent, the poverty gap by 36 percent, and poverty severity by 52 percent (World Bank 2002b, 114).

As indicated, the major program inefficiency has been in local government financing incentives and local council implementation capacity. Central transfers are mandated expenditures that do not ensure proper incentives for implementation. As in Bulgaria, the 25 percent matching requirement is hard to meet for many poorer Romanian local governments, and accordingly, outlays are less than budgeted amounts. Oversight of local government performance is the responsibility of the deconcentrated line offices of the Ministry of Labor and Social Solidarity in each *judet* (county) (World Bank 2002b, 116). Local governments often lack the administrative capabilities to administer and manage the social assistance program (World Bank 2002b, 127). Only about 5 percent of local government city halls granted the means-tested social assistance benefit in 1999. Full program coverage for eligible poor recipients would require scaling up operations by 360 percent to 480 percent (World Bank 2002b, 125). To improve efficiency, funding should be centralized (as in Bulgaria, with 100 percent central financing), local governments should be given greater discretion and capacity-building support, and criteria for allocation of transfers from *judets* to municipal councils should be clarified.

Recommended Fiscal Decentralization Program Adjustments

Intergovernmental roles and responsibilities affect policy making and implementation in both intended and unintended ways. Changes in intergovernmental roles modify authority and responsibility relationships vertically between tiers of government and horizontally across institutions that are responsible for particular program areas. Given the complexity of interlocking impacts, many of the results are unintended and unforeseeable. In the cases presented here, authority and responsibility assignments affect the performance of all three social programs. The effects of role assignments cascading between institutions and institutional layers are complex and nonlinear. But variation in program performance between the two countries is not that great—they all are relatively poor performers.

Intergovernmental roles and responsibilities affect policy making and implementation in both intended and unintended ways. Changes in intergovernmental roles modify authority and responsibility relationships vertically between tiers of government and horizontally across institutions responsible for particular program areas.

To summarize, table 3 indicates that the efficiency and effectiveness of the three social programs have been relatively low. Health services in both countries are neither efficient nor effective. The only service differences found were that the social protection programs in Bulgaria are more effective than those in Romania, and Romania's educational program is slightly more efficient than Bulgaria's. This is hardly enough variation to allow broad generalization or confident institutional and policy recommendations. Nevertheless, given the evident allocation problems in assigning authority and responsibilities for each program, it should be asked, what adjustments could be made to improve their performance? Are there other, more important factors that work in conjunction with role and responsibility assignments to affect implementation progress? It is evident that all three programs have evolved institutionally over the past 12 years. Some responsibilities have been centralized, and others have been decentralized. What differences have these changes made?

The difficulty of developing conclusions and lessons is the dependent variable: the lack of variation in service performance across services. The institutional changes for decentralization have not produced major changes in service efficiency or effectiveness. Social services under the Soviet or state planning system were likely more effective but not very efficient. Despite the reforms of the 1990s through the present, these services are still not very efficient or effective. Partly, this may be attributable to the fact that some of the institutional changes have had little to do with decentralization objectives. It is thus hard to draw program design lessons unless performance differences occur and can be attributable to differences in role and responsibility assignments. Despite these limitations, several conclusions can be noted that should be scrutinized and tested by further research.

First, as indicated in table 3, education is characterized in both countries by fiscal and management centralization. Local school managers (or local government overseers) have little authority over recurrent expenditures, such as staffing, salaries, or program operations. This removes most of the school-level incentives for improved service delivery. The unsurprising results are low efficiency and effectiveness in both countries—varied in that Romanian educational performance is only slightly better or more adequate than Bulgaria's. The tentative conclusion here is that management authority over staffing

and salaries should be decentralized along with financing.

Second, health care in both countries has evolved from state centralization to fiscal decentralization and health fund financing. Program responsibilities have also been decentralized without any analysis of the norms that need to be enforced. This has allowed local managers to avoid choices needed to improve performance, such as consolidation and cutback of facilities without jeopardizing certification by the Ministry of Health. Decisions on the control of staffing and salaries remain centralized in both countries. But devolution of authority without ensuring that basic norms are enforced leads to inefficient and ineffective services. Management authority in both countries should not be further decentralized without consensus on core norms or standards of quality health care.

Third, social assistance in Bulgaria is now characterized at the center by centralized financing, clear norms, and allocation criteria. At the local administrative or program level, there are sufficient management authority and technical capacity. Given this reasonable split of authority and responsibility assignments, one would expect better results. In fact, that has been the case. The Bulgarian local government cost share was decreased from 25 percent in 2002 to 0 percent in 2003, with corresponding increases in effectiveness (program coverage). In Romania, the local match is only 25 percent, but this incentive has been outweighed by a lack of local government management capacity in social assistance and a lack of clear funding-allocation criteria between counties and cities. Thus, the tentative lesson is that funding (recurrent at least) should be centralized, and management authority should be devolved to local officials with high capacity (normative and fiscal centralization and operational decentralization).

For fiscal decentralization programs as a whole, adjustments should likely be made in all services that are consistent with these lessons in order to improve both the efficiency and effectiveness of results. Conversely, failure to design fiscal decentralization programs according to these tentative conclusions can jeopardize many of the benefits of devolving authority, responsibility, and accountability to local governments. The research problem is made more difficult by the problem of comparing the progress of FD programs in the first place. This is true in the Balkans. It is even more problematic in Latin America and Asia. Political and fiscal variables interact with intergovernmental institutions that, combined with often missing data, render even the best policy comparisons tentative.

In conclusion, based on evidence of program performance problems across the three social services in these two Balkan countries of Eastern Europe, expenditure assignments should be adjusted for at least social protection. Accepted general rules are largely static, encouraging balance between efficiency and responsiveness criteria. In response, Bulgaria and Romania have made few adjustments to their FD programs, and services have suffered. Based on identified expenditure role misallocations in social protection, it is recommended that Romania and Bulgaria do the following:

- Assign the authority to design and enforce performance norms to the central government. Ensure the separation of normative and regulatory authority from program operations. In addition, policy makers should analyze the link between norm content and service trade-offs and between responsiveness and efficiency. For example, the norm of health care rationalization through consolidation and cutbacks of beds and doctors for efficiency and unit-cost considerations must also consider the consequences for EU accreditation, which focuses on quality and service effectiveness. Neither country has assigned roles and responsibilities in health care that are consistent with these principles. This may be attributable to the powerful competing interest groups in the health area.
- Assign operational responsibility to local governments to the extent possible in order to match managerial discretion with accountability and responsibility requirements. This means shifting toward a highly flexible and centralized model of FD. Local responsibility for services should include the authority to raise funds and manage budgets (e.g., salaries and operations and maintenance). Capital finance responsibilities should remain centralized for smaller and less creditworthy cities. Capital financing authority (e.g., borrowing authority) should be assigned to local governments to allow revenue mobilization and fiscal accountability consistent with program responsibilities (e.g., school facilities). Romania has made greater progress in assigning operational roles and responsibilities for education than Bulgaria.

For FD policy makers, the results suggest that revenue and expenditure assignments should be regularly reviewed to ensure that they correspond to each type of functional program (e.g., social assistance as a distributive program). Revenue and expenditure assignments based on comparative analyses can optimize program performance by indicating which norms and operational responsibilities should be centralized, decentralized, or mixed across tiers of government. The cases here suggest that performance differences are the result of ill-defined and poorly assigned and reassigned responsibilities. Although these problems persist in the allocative programs (i.e., health and education), they have been reduced in the distributive area by redefining revenue and expenditure responsibilities (i.e., social protection in Bulgaria). Improved assignments can also reduce mismatches of authority and responsibility, encourage local revenue mobilization,

and ensure compliance with the regulatory norms of allocative programs.

Despite the limited results of this study, the lessons for social protection programs should be applicable to other countries in southeastern Europe and the Balkans, such as Albania and Macedonia. It is hoped that future research can identify more precise combinations of norms and regulations and operational requirements by service type that can be translated into performance-driven assignments of expenditure and revenue roles. Such guidance is now missing from the literature. Though trial-and-error adjustments may be "rational" in policy theory, clients suffer, needs are ignored, and funds are wasted in the learning process. Research could point, for example, to how much expenditure authority should be provided to county or municipal line health officials when certain regulatory norms are not in place at the center. This could lead to more thorough FD program analysis and improved ex ante impact data before decisions are made on intergovernmental role assignments.

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