

# Sub-Federal Governance and Global Harmonisation of Policies: Some Issues for Consideration\*

Murali Kallummal and Smitha Francis♦

## Introduction

Globalisation and decentralisation may sound contradictory to one another, as they convey two different focal points for economic policy making. But the most successful countries of tomorrow would be those which are able to craft development models that finely coordinate these two diverging focal points. In a dynamic world, there is no single successful development model. As the internationalisation of economic interactions increase at an ever accelerating pace, it is the need of national governments and local stakeholders to evolve governance structures which integrate local decision making processes into their national policy making systems in development-oriented strategic ways.

Some of the important channels through which the latter takes place are political decentralization, administrative decentralization and fiscal decentralization, which can occur in four major forms viz., devolution, delegation, deconcentration and divestment. While each of these would require equal and at times disproportionate treatment according to the ground realities in various country contexts, in most cases political and fiscal decentralisation take the forefront. But, among these two, in most countries, it has been found that political decentralisation has been occurring faster than fiscal decentralisation,<sup>1</sup> resulting in a lack of financial autonomy at the sub-national levels. While total financial independence of sub-national governments may not be a viable proposition, experiences of different countries support the

---

\* An earlier version of this paper appeared in *Trade Wind*, Department of Commerce, Newman College, Thodupuzha, Kerala, India, in December 2004.

♦ The authors are Consultant, Centre for WTO Studies, Indian Institute of Foreign Trade, New Delhi, and Senior Economist, Economic Research Foundation, New Delhi, respectively. The views expressed in this paper are the authors' and are independent of the organisations they represent.

<sup>1</sup> In 1999, 96 out of 127 (76%) countries were politically decentralized, while only 52 of the 127 countries (41%) had fiscal decentralization. Countries with higher development (income) were found to have had both fiscal and political decentralization. The two regions which topped the list were the US and Western Europe. See Work, Robertson, 2002. "Overview of Decentralization Worldwide". 2nd International Conference on Decentralization. Manila.

idea of increasing the stake of local players in both financial and decision making processes in a manner that leads to the appropriation of the development process from below.

The emerging challenges are multiple for developing countries like India, where a vast majority of regions remain backward and a significant share of population live in remote villages dependent on subsistent farming. It has been observed that their regional economic concerns become un/under represented in national priorities owing to various weaknesses in the structure and form of governance, which may not have been structured to adequately take account of the varying development priorities and socio-political interest conflicts at the regional and local levels. In the Indian case, one of the various manifestations of this is reflected in the ever increasing statehood demands emerging from across the nation.

As increasing economic globalisation is leading to a convergence of various countries' policies at the national level, a critical question is what will be the space to address regional developmental concerns within nations? What are the processes by which harmonisation of economic policymaking occurs at the global level and what are its implications for regional concerns? Are we in the developing world prepared for this change in governance which is catching up rapidly from the top? What are the areas which require attention in the immediate future and in the years to come? These are some issues which we attempt to address in this short paper. This is a snapshot of some of the aspects related to these issues, which of course need to be widely debated to assimilate divergent views and already available experiences, to work out alternative ways of tackling the emerging challenges.

### **Global Commitments, Harmonisation of Rule Making and Implementation**

Since the 1980s, there has been a paradigm shift in the understanding of economic development and growth, as neo-liberal economic policies emphasising market-oriented and trade-led economic growth undermined the old welfare economy understanding of economic development. It is increasingly evident that the emergence of this paradigm globally has been reflective of the economic interests of the various dominant powers within the prevailing international geopolitical power structure. This has increasingly led to a process of harmonisation of rules governing economic policymaking at the global level.

This trend towards policy harmonisation may be described to have two distinct phases. The first phase is when the rules and disciplines are being formulated and conceived, and the second phase is when these rules become obligations on the part of members through specific treaties and agreements. The rule-making exercise at the international level is going on under the auspices of various institutions such as the World Trade Organization (WTO) and the International Monetary Fund (IMF). It is also being carried out in various other multilateral institutions like the World Intellectual Property Organisation (WIPO), International Standards Organisation (ISO), Bank for

International Settlements (BIS), Basel Committee on Banking Supervision, UNCTAD, WHO, ILO, etc. Both these parallel processes are equally significant.

While the latter phase or the implementation phase may appear to be the critical one in the context of deriving the flexibilities necessary to address local developmental challenges, it is important to recognise that it is equally crucial to incorporate governance principles for including local decision making processes in the first phase of rule-making itself. This is due to the fact that within the neoliberal paradigm, the harmonisation of rules that these various international agreements implies, leads to a substantial reduction in flexibilities to apply not only traditional “welfare-driven” macroeconomic policies (of exchange rate, money supply and fiscal policies) to counter economic instability, but also nation states’ ability to carry forward certain regenerative and redistributive developmental policies at the national and sub-national levels.

In a large developing country context, the inflexibilities in trade and investment policies arise due to the nature of market access (trade liberalisation) and national treatment commitments under the WTO and other trade-related specific obligations under TRIPs (intellectual property), TRIMs (investment), etc. as well as due to trade facilitation issues. These commitments are more rigorous than the obligations under other multilateral bodies owing to two factors.

Firstly, the WTO covers activities of all sectors from the point of view of trade. Further, these are bound by legal contracts. In the area of trade, the landmark turning point emerged from the eighth round of the GATT (General Agreement on Tariffs and Trade) negotiations during 1986 to 1994, which culminated in the Marrakech Agreements, bringing in all previously uncovered areas under multilateral disciplines within the WTO. Thus, apart from manufactured goods, trade in agriculture and services have come under these disciplines and additionally, non-trade issues like investment, competition, government procurement and intellectual property rights have also become integral parts of the overall agreement.

Secondly, the lack of flexibility is exacerbated by the fact that all member countries of the WTO are obliged to carry forward and implement the consensus-based final outcomes of all its agreements, and cannot agree to implement only some agreements. The implication of this all inclusive “single undertaking” approach adopted by the WTO can lead to serious inflexibilities with regard to national policies. This is all the more so especially when development is increasingly considered as a function of trade under the shift to market-oriented economic growth paradigm. The implementation of various commitments are further limited by the inter linkages which WTO has devised with other multilateral bodies like IMF, ILO, WIPO, etc.

The single undertaking regime under the overall umbrella of the WTO would thus have an interventionist role in every walk of life. These external interventions are justified only to the extent that they help correct domestic irregularities. However, evidence drawn from past

experiences quite clearly points to limited benefits to be derived from these external interventions. But, even the limited potential for economic benefits from globalisation are also being undermined by the unequal capacities of developing countries and LDCs and the geopolitical interests of developed countries. These imbalances are “systemic” reflecting the historical evolution of these global institutional structures and the limited capabilities of countries given that there are already too many international obligations to meet.

Under the prevailing dominant market-driven economic growth paradigm, harmonization pressures are also occurring at another level. Typically, neoliberal macroeconomic policies and liberalisation have also been the focal point of the conditions put forward for gaining access to external finance for developing countries, either directly imposed by the international financial institutions (IFIs), or through its impact on the ‘success’ of the country’s economic performance in the perception of foreign investors/creditors. Thus, in several instances, developing countries have had to follow one-size-fits-all prescriptions of macroeconomic ‘stabilization’ and ‘adjustment’ as well as undertake significant trade and investment liberalisation, under the conditionalities attached to obtaining both new financial assistance and debt relief from bilateral or multilateral donors, since despite the graduation from Structural Adjustment Policies (SAPs) to Poverty Reduction Strategies (PRSs), economic policy conditionalities attached to external aid continue to be based on neoliberalism.<sup>2,3</sup> Further, with the Millennium Development Goal of halving extreme income poverty by 2015 reflecting the consensus of the international development community that poverty reduction is of overriding importance, national poverty reduction strategies, and Poverty Reduction Strategy Papers (PRSPs) in particular, have become the primary vehicle for focusing national policies on reducing poverty.<sup>4</sup>

Meanwhile, the delivery of WTO technical assistance meant for assisting developing and least-developed countries and transition economies to adjust to WTO rules and disciplines and implement obligations, is also increasingly designed around these same national poverty reduction

---

<sup>2</sup> In fact, by insisting that the borrowers carry out drastic liberalisation in their trade and investment regimes in order to be eligible for financial assistance, the donor conditionalities often pre-empt the "Special and Differential Treatment" (S&DT) that the WTO offers the poor nations.

<sup>3</sup> In the recent past, social and political unrest in some debt-ridden countries, primarily caused by conditionalities-imposed economic hardships, has come to be seen by the World Bank and the IMF as derailing the ‘hard-won’ financial stability in those countries; and have therefore allowed some flexibility in the reform measures demanded of these countries. However, it is indeed ironic that the multilateral bodies, which link up their aid and debt relief packages also to democracy-linked electoral reforms in some debtor countries, ignore the fact that such popular protests are indeed indicators of political participation by the affected populations in these countries.

<sup>4</sup> See Terry McKinley, 2002. “Economic Policies for Growth and Poverty Reduction: PRSPs, Neoliberal Conditionalities and Post-Consensus Alternatives”. Paper presented at the IDEAs International Conference on The Economics of New Imperialism, JNU, New Delhi, 22-24 January, 2004. [www.networkideas.org](http://www.networkideas.org)

strategies. The Strategy for WTO Technical Cooperation for Capacity Building, Growth and Integration endorsed by the Doha Declaration has been to mainstream trade into national plans for economic development and strategies for poverty reduction.<sup>5</sup> The emphasis is on coordinating the delivery of technical assistance programs with bilateral donors and the OECD Development Assistance Committee (OECD-DAC) and other multilateral and regional intergovernmental institutions.

This assumes more significance in the context of the growing integration of global donor programmes with country strategies and programmes to be found in the recent efforts towards aid harmonization and alignment within the broader development agenda of recipient countries. As part of the follow-up to the Monterrey Conference on Financing for Development (February 2002), the international development community have committed at the High-Level Forum on Harmonization in Rome (February 2003) to align their development assistance with partner country strategies, harmonize donor policies and procedures, and implement principles of good practice in development cooperation, in order to make international aid more effective. The High-Level Forum comprises of a wide range of multilateral/bilateral donors such as the World Bank, 23 members of the OECD-DAC (bilateral donors and the EU), four regional development banks (African, Asian, European and Inter-American development banks), IMF, the UN Group, etc.

A progress report shows that on alignment, as of October 2004, 43 countries had prepared poverty reduction strategies (PRSs), and many other low- and middle-income countries had “nationally owned” development strategies and that there is a promising trend toward increased donor alignment behind these country strategies. Although still small on harmonization, donors have made a start in using simplified procedures and practices, joint analytical work, enhanced focus on delivery of development results, delegated cooperation, common procurement and financial management procedures, and common arrangements for sector wide approaches and budget support. It is reported that more donors are using budget financing to provide overall support for country strategies and programmes at the national and sectoral levels. There has been a surge in interest in sector-wide approaches (SWAs) to align around sectoral priorities, and a growing number of these include use of countries’ existing frameworks for channelling and accounting for funds.<sup>6</sup> There is agreement that a comprehensive solution needs borrowing countries to set out a clear results-based development agenda that frames the specific contributions they seek from donors.

---

<sup>5</sup> See paragraph 38 in Doha Declaration.

<sup>6</sup> See Harmonization, Alignment, Results: Report on Progress, Challenges and Opportunities. The OECD-DAC Working Party on Aid Effectiveness. [www.aidharmonisation.org](http://www.aidharmonisation.org)

While harmonization of donor policies will help eliminate a lot of repetitive analyses, time and money for the different donor agencies and aid recipient countries, it is evident that within this framework, donor alignment behind country strategies (which are all influenced by the harmonisation pressures in macroeconomic and market-oriented policymaking described above) emphasizes greatly increased reliance on borrowers' own administrative systems. It is also important to note that such donor financing of budgets has specific implications under the current 'fiscal disciplining' regimes being propagated by the Bretton Woods Institutions (BWIs). Therefore, sub-federal priorities should be woven into country policy and investment priorities and in the preparation of medium-term frameworks that link country priorities to budget decisions, in a flexible manner.

In the WTO negotiations context, it is also important to note that apart from the policy conditionalities of the Fund, the Bank and other multilateral and bilateral donors, the rules and agreements that are formulated by international organisations such as the ILO, WIPO, UN bodies, World Customs Union (WCU), International Council for Standards (ICS), Bank for International Settlements (BIS), Basel Committee on Banking Supervision, etc. have a bearing on the WTO negotiations as the agreements reached in each of these bodies, with a mandate for rule-making in specific areas, are often taken on board at the negotiations on the relevant WTO agreements and become the template for negotiations.

Similarly, another process through which harmonization of policies comes about in a creeping manner is through regional or bilateral investment treaties (BITs) and bilateral or regional free trade agreements (FTAs). In cases, where developing countries carry out liberalization under such preferential agreements that is greater than what their multilateral commitments mandate, this could potentially become the benchmark for extending liberalisation at the most-favoured-nation (MFN) level in ongoing/future multilateral negotiations.

Unfortunately, it is often the case that developing countries are made to realise the import of the various legally binding agreements that they have signed up at other multilateral or bilateral fora, only when they are at the WTO negotiations, when cited by member/s on the other side of the negotiating table. This reduces the flexibility in bargaining before it becomes binding and harmonised at the multilateral level. Therefore, it is imperative that developing countries abandon the casual and individualistic approach which is often adopted by their representatives at these bodies and identify and understand the links carefully, analyze the implications of the undertakings they sign up separately under these or other similar international legal bodies in a broader developmental and strategic framework. It is crucial that national policy bodies which enter these international rulemaking processes and negotiations have a strategic vision and exercise their rights to ensure that ample policymaking flexibility is retained for ensuring the democratic rights of local stakeholders.

This is even more significant today as most developing and less developed countries have already missed the opportunity in the first phase of rulemaking. Indeed, while developed countries across Europe and the Americas were actively negotiating some of the most intricate processes of harmonisation of rules at the

multilateral level in the WTO, they had already carried out decentralisation within their nations.<sup>7</sup> But, in the case of developing countries, too much focus on international obligations with very little understanding and reforms at the domestic level is a factor which may not only derail the whole process, but also threatens to undermine whatever development has been achieved so far.

These different levels of harmonisation of economic policies under trade-led and market-driven policies therefore pose new challenges for the smallest administrative sub-federal unit in developing countries. But, how do you meet the challenges emerging from the harmonisation of international rules and policies, when such local understandings are not accounted-for or discounted-for in the international rule-making phase? The primary blame of course lies with nation states and their centralised policy formulations.

### **Indian Experiments with Devolution**

Decentralization and thereby empowering the local bodies was a vision which the Indian democracy visualized in the 1980s. However, it was only since 1991 following the 73rd amendment that the smallest unit in Indian federalism - the “gram panchayat”, has been sought to be empowered. This has been primarily done to devolve the space for economic development policies so that these bodies are capable of responding to the challenges faced by the local communities, which are vital for the survival of federalism in India. The original intention in 1991 was primarily to address the lack of healthy administrative interventions by the Centre and States owing to geographical distance and growing corruption in allocation of funds, which made the distribution of central and state welfare funds ineffective. However, today, the guardians of Indian federalism face a new enemy in the form of globalization, which is squeezing the space for intervention in developmental policies. The most obvious structural changes happening today is the harmonisation of global rules and policies unleashed by international organizations like the IMF and the WTO, as described above.

Neo-liberal economic policies supporting liberalisation and export-led growth have been the driving force in India over the last decade and more. These called for substantial domestic reforms to take account of the changing “rules” at the multilateral level, owing to India’s commitments in

---

<sup>7</sup> In the United States, the Reagan administration (early 1980s) had come into office in the wake of twenty years of enormous expansion in highly centralised federal assistance grants. The administration went in for simplification of this grant system by consolidating the number of grants into revised block grant programmes and gave State governments and Counties greater policy discretion and administrative flexibility – most notable of it was in the form of designating state governments as the recipients of funding for all the block grants. The Reagan administration thus began the process of devolution in the US way back in the 1980s. By the 1990s, this became the fundamental tenet of the federal policy towards distressed regions as well as aid to lower-income individuals. Federal policies towards economic and community development demonstrated a continuation of federal programmes and funding strategies, but essentially authorized States and Counties to determine how to best use federal resources.

the Uruguay Round of GATT. Some movement in this direction can be seen in the form of administrative reforms necessary to facilitate the introduction of the new economic policies, mainly at the national level. However, owing to the different management capacities of the political, executive and legislative branches of government and also due to a lack of political will, reforms lag behind in terms of deeper administrative and fiscal reforms required at the sub-federal level. Sub-federal structures have remained almost unchanged even though the political and administrative realities have undergone remarkable change under the new fiscal “disciplining” regime of neoliberal economic policies and attempts towards global harmonisation of rules.

How we address this problem of international obligations on rules, while taking account of local realities and challenges for development in a representative manner, is emerging as a big challenge. One may look at existing examples of “Panchayat Raj” in India to find some answers and compare the same with some existing examples in the developed world. Two such cases find prominence among the many experiments in India: the “People’s Plan” in Kerala; and the “IT revolution” carried out in the state of Andhra Pradesh.

The experiment in Kerala, wherein decentralized planning was carried out by mapping local resources and linking them with investment and other activities to promote development, can be said to have achieved a moderate beginning.<sup>8</sup> However, such measures would need to be institutionalized with proper checks and balances and two-way exchange of inputs, to achieve the common goal of development.

While the People’s Plan has achieved some good to begin with, what the IT revolution in Andhra achieved can only be measured in the form of capital drain. The case of Andhra Pradesh clearly highlights that the expansion of computer networks can never take the place of “effective administrative reforms”. What is of concern is the capital-intensive nature of the efforts to decentralise the decision-making process seen in both the Indian cases discussed above. While the realities stay as they are, such efforts are trivialised by the claims made on connectivity and computerisation, which lead to capital goods imports and fail in solving the real issues of welfare and development directly.

---

<sup>8</sup> January 16, 2004, Kerala scored another first in the InfoTech age. The Vellanad panchayat in the outskirts of Thiruvananthapuram (state capital) kick-started e-governance in the state, and became the first fully computerised village panchayat in the country. The panchayat has set up computerised counters offering services like registration of births and deaths, issuance of certificates and payment of bills. Officials said plan project monitoring, accounts management and revenue management have been brought under the programme. Vellanad has also become the first village panchayat in India to have a full-fledged geographic information system, a citizen database linking the electoral roll, ration card and property ownership, as well as a management information system. The project was undertaken by the Information Kerala Mission set up by the state government to promote e-governance in the state. What it offers in terms of the interventions in actual development is something which needs to be seen, as none of the elements of planning and economic information are taken up under these projects.

Two distinctly important messages emerge from these two approaches towards decentralisation carried out in these southern Indian states: First, e-solutions have to be representative of the development needs of the people; and secondly, local understandings need to be aggregated and incorporated into the planning and policy formulation process. There is a need to generate deeper “administrative awareness” on the relevant issues from a welfare perspective. Priorities are important, but these have to come from the bottom. What should have been attempted is to develop structures which provide a space for these tiny building blocks of Indian democracy in the national policy formulations. But, even now, understanding on this lowest administrative unit is minimal across the various Indian states and hence the real concerns from the local levels are inadequately represented in the policies and plan documents at the State and Central levels.

In this context, it is important to recognise that while the macro picture and macro statistics are important for international comparisons, the realities and challenges for development planning would need to be drawn from local statistical assimilations. It is here that India (as other developing countries) would need to put a substantial energy in the coming years. The existence of India as a free and federal structure would have to be addressed by building better systems of governance, which would address the interface of international harmonisation of rules with that of aggregated local understanding on development needs. It would mean that in the given global environment, governance is the system of values, policies and institutions by which a society organizes collective decision-making and actions related to political, economic as well as socio-cultural and environmental affairs.

One important and powerful tool can be “direct democracy” which fulfils two important functions in the whole decision-making process, which are vital for the political system: political communication and political socialisation. However, this method cannot be applied in the Indian context owing to various limitations regarding applicability.

Decentralisation brings decision-making closer to the people and therefore yields programmes and services that better address local needs. Bringing stakeholders together to define priorities for projects and programmes will increase appropriation of the development strategy by the people for whom it is intended for,<sup>9</sup> which in turn promotes sustainability of the development path adopted. Supporting open dialogue and participation between the local governments and civil society can ensure improved self-reliance. Empowering and supporting the under-privileged helps to improve their economic conditions and make progress in alleviating widespread poverty. Encouraging a

---

<sup>9</sup> This is quite different from the “ownership” of PRSPs imposed from above.

culture of participatory democracy will also assist in ensuring the accountability of elected government officials.

### **A Lesson from the Masters of the Art: What Do We Need to Adopt?**

In this context, it is crucial to examine whether sub-federal governments are in a position to finance and deliver the necessary economic and developmental programs at the regional and local levels. How effective have been the developed countries in managing this challenge? The re-engineering which happened in the case of the Food Stamp Program (welfare scheme for the poor) in the United States reveal one of the unique ways by which the growing demands of multilateral harmonisation of rules is being overcome there.

A study done last year in the United States by the Economic Research Services titled Food Assistance and Nutrition Research Report Number 17, suggest that “Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA)” witnessed a substantial re-engineering of the way food aid is distributed at the sub-federal level. From a period when federal grants on welfare programmes were targeted, today most of the grants by the federal government to States and Counties are in the form of “Block Grants” (which does not suggest any specific purpose). Such Block Grants give greater flexibility to States to administer their programs in ways that meet their unique local needs.<sup>10</sup> All States undertook at least one "re-engineering" activity in their Food Stamp Programs (FSPs) as a result of PRWORA. In addition, 35 States had implemented changes in 3 or more re-engineering categories, while 24 States had planned changes for fiscal year (FY) 2000 in 2 or more categories.

PRWORA dramatically changed the systems that provide cash assistance and food stamps to low-income Americans. Along with mandatory changes in food stamp eligibility, States were given greater flexibility to administer their programs to meet their unique needs. What the American system is achieving through these efforts is to de-link federal commitments from specific programmes at the national level which come under the scanner of multilateral undertakings, while providing the necessary flexibility to States to address their poverty-related and developmental concerns at the ground level. Whether this re-engineering of FSP is to beat the harmonisation of global rules and increased multilateral commitments and how they actual achieve it would need a deeper analysis. But certainly, it offers an outstanding example of how the American federal finances are being re-engineered to address the challenges of globalisation.

---

<sup>10</sup> USDA, 2002. “Re-Engineering the Welfare System– A Study of Administrative Changes to the Food Stamp Program”. Economic Research Service, Food Assistance and Nutrition Research Report, Number 17, pp. 1 – 98.

Such de-linking of federal and sub-federal finances has provided developed countries with substantial flexibility in carrying forward many of the so-called WTO non-compatible state supports, while continuing to meet their WTO commitments. At the same time, it is interesting to note that there is also resistance to the increasing pressures of harmonisation on governmental policymaking space emerging from the developed countries in different forms.<sup>11</sup>

## **To Conclude**

In this short paper, we attempted to provide a brief overview of the implications of the global harmonisation of rules and economic policies for developing countries. The increased globalisation of production and financial structures, which is driving the attempts towards policy harmonisation in several sectors mostly for the benefit of multinational and national corporations, is eroding the policy space of national governments in addressing domestic priorities and internal dynamics. Therefore, strategic vision by national policymaking agencies (supported by local activism) is required to keep national level commitments sufficiently flexible to take care of domestic development priorities.

In this context, it becomes necessary to evolve systemic development-oriented governance structures to safeguard the welfare interests of societies at the national and sub-national levels. Given that the stakes are much higher than in a protected regime, in order to ensure the former, it is essential that decentralisation is carried out in a meaningful manner, which would enable effective co-ordination and inputting of local policy needs into the national policymaking exercise. The fiscal decentralisation that is required to support the decentralized policymaking process will need to be flexible and dynamic.

Undertaking such a decentralised decision-making exercise will also highlight the emerging conflicts between local requirements and the international commitments that have been already agreed to by countries and underline the weaknesses of existing agreements. This should in fact pave the way for undertaking a complete review of existing agreements towards formulating more balanced global rules, provided the powerful in the global polity believe in true global welfare.

February 18, 2005.

---

<sup>11</sup> For instance, in the context of public services, the city of Geneva in Switzerland had declared itself to be a GATS-free zone.