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Multi-level governance and subnational finance in Asia and the Pacific

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Multi-level governance and subnational finance in Asia and the Pacific

Regional analysis based on the 3rd edition of the World Observatory on Subnational Government Finance and Investment

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Abbreviations and acronyms

ADB	Asian Development Bank
BLGF	Bureau of Local Government Finance
CCMC	Crisis Management Centre
CDC	Communicable Disease Committee
CEB	Council of Europe Development Bank
CFE	OECD Centre for Entrepreneurship, SMEs, Regions and Cities
CIT	Corporate income tax
COFOG	Classification of the Functions of Government
CWA	Central West Asia
DAU	*Dana Alokasi Umum* – General Allocation Fund
FED	Federal country
FRL	Fiscal responsibility laws
GDP	Gross Domestic Product
GIZ	German Corporation for International Cooperation
GLDF	General Local Development Fund
JPY	Japanese yen
Lao PDR	Lao People's Democratic Republic
LAT	Local Allocation Tax Grant
LATAM	Latin America
LDC	Least Developed Country
LDF	Local Development Fund
LGFA	Local Government Funding Agency
LGFV	Local Government Financing Vehicles
MEAE	French Ministry of Europe and Foreign Affairs
NTA	National Tax Allotment
OECD	Organisation for Economic Co-operation and Development
PFM	Public financial management
PIT	Personal income tax
PPP	Public-private partnership
PPP	Purchasing power parity

RAI	Regional Autonomy Index
SA	South Asia
SDGs	Sustainable Development Goals
SEA	Southeast Asia
SGLG	Seal of Good Local Governance
SNG	Subnational government
SNG-WOFI	World Observatory on Subnational Government Finance and Investment
SOE	State-owned enterprise
TAO	Tamboon Administrative Organisation
UCLG	United Cities and Local Governments
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNIT	Unitary country
USD	United States dollar
UWA	Unweighted average
VAT	Value-added tax

Executive summary

Asia and the Pacific[1] is rapidly transforming. Over recent years, many countries in the region have achieved high levels of economic development and improvements in well-being. In the 10 years to 2020, average GDP growth in the region was 4.3%, well above the global average of 2.4%. This economic growth has been accompanied by rapid urbanisation and a decrease in poverty in some countries. Since the Sustainable Development Goals (SDGs) were adopted in 2015, an estimated 143 million fewer people across the 26 countries in Asia and the Pacific studied in this report are living on less than USD 3.20 per day (very close to the poverty line).

Yet there is still a long way to go to improve living standards, and current crises are creating new challenges. While some progress has been made, many countries in the region are still underdeveloped and the region is not on track to achieve any of the 17 SDGs by 2030. Although some countries already have high levels of development, the region is home to some of the world's least developed countries and there are often important disparities within countries, particularly between urban and rural areas, in access to infrastructure and services. On top of these challenges, many countries in the region also face significant risks relating to climate change and the Russian invasion of Ukraine[2], and the subsequent food and energy crises.

Development of the region has been accompanied by decentralisation processes and territorial reforms. Over the past four decades, many countries in the region have undergone reforms to adjust their institutional, territorial, multi-level governance and public management frameworks, reconfiguring the authority and functions of subnational governments (SNGs). Many of these reforms are still ongoing. Of recent and current reforms, at least ten countries were identified to have undertaken municipal amalgamations, five have implemented municipal partitions and four have recognised villages as self-governing entities. In addition, ten countries were identified to be reforming their fiscal frameworks or updating their public financial management regulations. Green budgeting and participatory budgeting practices are also emerging in the region.

Decentralisation processes have not been fully realised in some countries. Competencies are often not clearly defined across levels of government, leading to overlaps in responsibilities. In addition, the process of devolution of new competencies has often not been accompanied by an equivalent transfer of resources, in particular of own-source revenues. One indication of this is that a higher proportion of total public expenditure is undertaken by subnational governments (29%) than the proportion of total public tax revenue they receive (20%). This can increase the risk of unfunded or underfunded mandates. Mechanisms to promote coordination between the central and subnational governments, such as intergovernmental forums and dialogue platforms, are also often inadequate, or unavailable, and the use

[1] This report covers 26 countries across Central Asia, East Asia, South Asia, Southeast Asia, Western Asia and the Pacific. The report refers to these regions collectively as "Asia and the Pacific".

[2] *The OECD Council condemns the large scale aggression by Russia against Ukraine in the strongest possible terms as a clear violation of international law and a serious threat to the rules-based international order* (Statement of OECD Council on the Russian aggression against Ukraine, available on the OECD website)

of horizontal cooperation, particularly among municipalities, is low. These factors can affect policy coherence and limit effective decision-making.

Asia and the Pacific has the most subnational governments of any world region. Across the 26 countries in this study, there are 467 000 regional, intermediate and municipal governments, which represents 67% of the total number of subnational governments included in the *World Observatory on Subnational Government Finance and Investment*. There is a high diversity among these governments and many asymmetric decentralisation arrangements within countries. In addition, 12 out of 26 countries in the region have sub-municipal governments, which are much more frequent than in other world regions.

Today, subnational governments are key economic and social actors in Asia and the Pacific, with expenditure and revenue higher than the world average. They account for 29.1% of total government expenditure, representing 8.8% of GDP on average, above world averages (21.5% and 8.3%), and they account for 35% of revenue, representing 8.5% of GDP on average, also above the world averages (25.9% and 8.0%). These averages hide significant variations across countries. For example, in the People's Republic of China, subnational governments are responsible for 60% of total public expenditure, while in Azerbaijan they are only responsible for 10%.

High levels of subnational government expenditure and revenue do not necessarily indicate high subnational fiscal autonomy, meaning that potential benefits from fiscal autonomy are not always realised. Fiscal autonomy can improve the quality and efficiency of spending, promote fiscal responsibility, increase accountability to citizens and help improve access to external financing. Yet, in several countries in the region, subnational governments have limited autonomy over public spending, with decision-making remaining quite centralised. In at least four countries, subnational governments are required to submit their budget, or part of their budget, for approval by central government. In many countries, a large part of subnational government expenditure is defined through earmarked grants and transfers, giving subnational governments limited spending autonomy. However, achieving benefits from fiscal autonomy also requires developing human and financial capacity at the subnational level.

Subnational governments in Asia and the Pacific provide many essential public services and infrastructure to support economic development and well-being. Over a fifth of subnational expenditure in Asia and the Pacific goes towards education (24.4%, 2.4% of GDP), another fifth to the administration, development and management of general public services[3] (22.3%, 2.4% of GDP) and just under a fifth to economic affairs (17.5%, 2.1% of GDP). The next highest expenditure areas are healthcare, social protection, and housing and community amenities, each representing around a tenth of subnational government expenditure (around 1% of GDP). Subnational public investment is equivalent to 2% of GDP, similar to the OECD average, and well above the world average (1.5%).

Subnational governments in Asia and the Pacific are slightly less reliant on grants than in OECD countries and more reliant on tax revenues. Grants are the primary source of subnational government revenue in Asia and the Pacific (48% of revenue), slightly below the global and OECD averages (52% and 53%). By contrast, subnational government tax revenue is high (40%), although a significant proportion of this tax revenue is shared, and own-source taxes remains limited. For example, the collection of property taxes by subnational governments is low compared to the OECD average (25.9% of revenue vs 36.4% in the OECD). Similarly, the collection of user charges and fees is also low (7.3% of revenue vs 11.2% in the OECD). Revenues from financial and physical assets (3.3% of revenue) is however above the OECD average (1.9%).

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[3] The category "General public services" includes the expenditures related to the administration, development, and management of general public services. This covers executive and legislative organs, financial and fiscal affairs, external affairs; foreign economic aid; general services; basic research; R&D related to general public services; general public services n.e.c.; public debt transactions; and transfers of a general character between different levels of government (OECD, 2018[76]).

Although subnational governments are responsible for an important proportion of public investment in the region, compared to OECD countries, they often have lower levels of debt and more limited access to external finance. Subnational governments in Asia and the Pacific account for 38% of total public investment compared to 47% for OECD countries. In terms of GDP, they are responsible for a similar level of public investment to the OECD average (i.e. 2% of GDP), yet subnational borrowing only represents 6% of GDP (for the 16 countries with data available), half of the OECD average. This indicates a larger role of other funding sources (e.g., capital grants, taxes, etc.) to pay for investments. Furthermore, while subnational debt is relatively high in four countries (above 150% of annual SNG revenue), subnational debt is relatively low in nine of the 16 countries where data was available (below 20% of annual SNG revenue). This is partly related to central government controls on borrowing and other fiscal rules.

The COVID-19 crisis appears to have had a stronger impact on subnational governments in Asia and the Pacific than other world regions, but it also highlighted their important role. Between 2019 and 2020, subnational governments tax revenue and user charges declined, and expenditure increased, although there was large variance (in countries with data available) compared to the world averages. Subnational investment also increased overall, driven by large increases in two countries (e.g., New Zealand and Thailand), with the median country increasing by 4.8% (out of seven countries with data available). Despite increases in subsidies and transfers from central governments, the pandemic has squeezed subnational fiscal space. In addition, rising inflation, the food and energy crises, and higher borrowing costs will put further pressure on subnational finances, at a time when investment is needed to support inclusive and green development.

Key data

COUNTRIES IN THE SAMPLE

Federal countries	5	Australia; India; Malaysia; Nepal; Pakistan
Unitary countries	21	Armenia; Azerbaijan; Bangladesh; Bhutan; Cambodia; People's Republic of China; Georgia; Indonesia; Japan; Kazakhstan; Republic of Korea; Kyrgyz Republic; Lao PDR; Mongolia; New Zealand; Philippines; Sri Lanka; Tajikistan; Thailand; Uzbekistan; Viet Nam

SUBNATIONAL GOVERNMENT STRUCTURES

	Number	Average number of inhabitants	Average area (km²)
Regional level governments	627	7 751 698	90 598
Intermediary level governments	4 960		
Municipal level governments	461 457	56 600	1 118
All subnational governments	467 044		

Countries identified to have implemented amalgamation policies	10
Countries identified to have undertaken municipal partitions	5
Countries identified with forms of asymmetric decentralization	13
Countries with sub-municipal entities	12
Regional Authority Index (change from 1950 to 2018, average)	+6.5p

SUBNATIONAL GOVERNMENT EXPENDITURE AND REVENUE

	% GDP (UWA)			% of total government in category (UWA)			% of total SNG expenditure or revenue (UWA)		
	Sample	OECD	WORLD	Sample	OECD	WORLD	Sample	OECD	WORLD
Subnational Expenditure by Economic Classification									
Subnational expenditure (total)	8.8%	14.1%	8.3%	29.1%	29.6%	21.5%	100%	100%	100%
Staff expenditure	2.5%	5.2%	3.1%	31.9%	46.9%	32.2%	31.2%	36.7%	34.4%
Direct investment	2.0%	1.8%	1.4%	37.8%	46.7%	39.5%	20.7%	15.6%	18.8%
Intermediate consumption	1.9%	3.0%	1.8%	37.3%	47.0%	35.8%	23.2%	22.9%	19.5%
Subsidies and other current transfers	1.3%	1.7%	1.2%	41.5%	32.3%	25.8%	15.4%	10.6%	9.3%
Current social expenditure	1.0%	1.9%	1.1%	11.0%	10.5%	9.9%	5.3%	10.5%	6.4%
Capital transfers	0.3%	0.3%	0.3%	10.3%	29.3%	23.7%	1.3%	1.9%	2.5%
Financial charges	0.2%	0.2%	0.2%	6.9%	12.9%	7.9%	0.7%	1.3%	1.2%
Other current expenditure	0.1%	0.1%	0.2%	7.3%	40.5%	39.7%	1.5%	0.5%	2.6%
Subnational Expenditure by Functional Classification									
Education	2.4%	3.0%	2.2%	48% [2]	48.6%		24.4%	21.8%	20.2%
General public services	1.7%	1.8%	1.6%	19% [2]	21.4%		19.9%	14.9%	23.4%
Economic affairs incl. transport	2.1%	1.7%	1.4%	24% [2]	33.9%		17.5%	14.2%	15.5%
Housing and community amenities	0.9%	0.5%	0.6%	69% [2]	75.3%		10.8%	4.9%	8.1%
Health	1.1%	2.1%	1.3%	25% [2]	25.9%		8.5%	12.0%	10.4%
Social protection	1.1%	2.8%	1.5%	8% [2]	13.6%		8.0%	17.4%	10.7%
Recreation, culture and religion	0.3%	0.7%	0.4%	46% [2]	59.2%		4.3%	6.8%	4.7%
Environmental protection	0.3%	0.5%	0.3%	52% [2]	66.3%		3.8%	5.3%	4.6%
Public order and safety	0.4%	0.4%	0.3%	13% [2]	23.3%		2.6%	2.8%	2.3%
Defence	0.0%	0.0%	0.0%	1% [2]	0.4%		0.1%	0.1%	0.1%
Subnational Revenue by Classification									
Subnational revenue (total)	8.5%	13.9%	8.0%	35.0%	34.1%	25.6%	100%	100%	100%
Grants and subsidies	3.9%	7.0%	4.1%				48.2%	52.7%	51.5%
Tax revenue	3.2%	5.1%	2.9	20.0%	19.8%	14.2%	40.2%	33.5%	31.1%
including Property tax	0.7%	1.0%	0.7%	88.2%	88.4%	85.7%	25.9%	36.4%	8.2%
Tariffs and fees	0.6%	1.5%	0.7%				7.3%	11.2%	10.3%
Property income	0.6%	0.3%	0.2%				3.3%	1.9%	3.1%

SUBNATIONAL DEBT

Subnational debt (% of total public debt, UWA)[1]	7.4%	Subnational debt (% of GDP, UWA)	6.2%

FISCAL FRAMEWORKS AND PPPs

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Notes: UWA indicates unweighted average; All Asia and the Pacific countries with data available are included in the sample average; 1. Sample of 16 countries; 2. Sample of 12 countries; OECD average includes all OECD countries, including four from Asia and the Pacific: Australia, New Zealand, Japan and Republic of Korea. Source: Author's elaboration, based on data and country profiles from SNG-WOFI (OECD, 2019[1])

Key findings

Over the past four decades, subnational governments (SNGs) in Asia and the Pacific have become key economic actors due to various decentralisation processes and territorial reforms. These adjustments to institutional, territorial and multi-level governance frameworks have provided subnational governments with new responsibilities. Even though responsibilities are highly varied across countries, subnational governments now tend to play an important role in many policy areas crucial to economic development, well-being and the achievement of the sustainable development goals (SDGs), including in relation to education, economic affairs, water supply, sanitation, transportation and health care.

This study examines the territorial structure, multi-level governance mechanisms and subnational government finances across 26 countries in Asia and the Pacific based on an analysis of the 3rd edition of the World Observatory on Subnational Government Finance and Investment. The data gathered for the 26 countries in the region are vital for international organisations, central governments and subnational governments to assess the strengths and weaknesses of public finances. Nevertheless, in several countries, subnational finance data are either not collected, standardised, complete or regularly updated, and are hard to access or are not publicly available. As a result, some countries do not appear in certain graphs or calculations in this report, so the total number of countries in averages or medians is always specified.

Key findings of the report are outlined below.

Subnational government structures

Among the 26 countries in this study, 21 are unitary and 5 are federal states. However, the reality is more complex as some countries combine characteristics of both forms of government.

Asia and the Pacific has the most subnational governments of any world region. There are around 467 000 subnational governments across the 26 countries included in this study. These include 628 state or regional governments, 4 960 intermediary-level governments and around 461 000 municipal-level governments.

The size of regions and municipalities is highly varied across countries, with some countries having a highly fragmented municipal landscape. Of the 26 countries in the sample, 2 have one subnational level of government (i.e. municipality), 12 have two subnational levels (i.e. the local and the regional/state levels) and 12 have three levels of subnational government. Subnational government sizes range from over 490 000 inhabitants at a municipal level in the People's Republic of China to less than 1 000 people at a municipal level in Lao People's Democratic Republic (hereinafter ‘Lao PDR’). The region also has many countries with lower-level subnational entities (which exist in 12 countries), including sub-municipal governments that have no or limited autonomy, and small-size urban and rural governments.

Asymmetric decentralisation arrangements are commonplace. Of the five federal countries, four have a form of asymmetric federalism. Many unitary countries also have asymmetric arrangements for regional and local governments, especially for larger metropolitan and capital city areas. While adopting a diversity of structures can allow for differentiation and adaptation according to local characteristics and needs, in some cases asymmetric decentralisation can risk increasing administrative complexity.

Decentralisation reforms

Territorial structures are the result of decades of decentralisation, which has been a primary goal of reform agendas in many countries in Asia and the Pacific. Since the 1990s, many South Asian and Southeast Asian countries have seen decentralisation as a means of adopting new public management models, oriented towards more effective public policies and service delivery, which can contribute to economic competitiveness and respond to the challenges of urbanisation and growth. In Central and West Asia, decentralisation processes have been embedded in restructuring processes that followed the break-up of the Soviet Union in 1991.

Decentralisation processes in Asia and the Pacific have led to the strengthening of regional governance, and of regional level of administrations. Based on data from the Regional Authority Index (RAI), the power of regional authorities in Asia and the Pacific has doubled between 1950 and 2021 - the largest increase across different world regions.

However, in many countries, there are mismatches between the fiscal, political and administrative dimensions of decentralisation at regional and lower levels of governments. Misalignments between the decentralisation of responsibilities and fiscal resources are common, with a large number of functional assignments decentralised to SNGs, but inadequate revenue generating bases and fiscal transfers leading to fiscal imbalances. SNGs are hence faced with large number of unfunded or underfunded mandates. These can stem from or be aggravated by an unclear allocation of responsibilities, which can generate the perverse incentive of shifting costs to other levels of government and lead to policy duplication at different levels of government, to non-fulfilment of responsibilities and to an erosion of transparency and accountability. There is also a mismatch between decentralised functions and institutional arrangements and capacity. Due to weak institutional capacity, with inadequate and unskilled human resources, SNGs often struggle in mobilising finance to fund their mandates.

Many countries in the region have a dual system of territorial administration, with a mix of decentralised and deconcentrated entities at the subnational level. In many cases, a deconcentrated executive body, often at the regional level, is appointed by a central government (or an upper level of government), and a deliberative body is elected by the population (e.g. local council).

Territorial reforms

The average municipal size in countries in Asia and the Pacific is slightly larger than the OECD average. Countries across Asia and the Pacific had an average of 56 600 inhabitants per municipality in 2000 (versus 41 000 inhabitants in the OECD, and 5 172 in the European Union).

Changes in territorial organisation have occurred through two entirely different types of reforms: municipal amalgamation and municipal partition. At least 10 out of 26 countries throughout Asia and the Pacific have implemented amalgamation policies to gain from economies of scale as well as to improve efficiency and cost savings over the last 15 years. At least 5 out of 26 countries in Asia and the Pacific have implemented municipal partition at the subnational level, often responding to a wish to better cater for the needs of an increasingly large local population with specific policy preferences.

Inter-municipal co-operation is an alternate to amalgamation that is less frequent in Asia and the Pacific than in the OECD. This type of arrangement is more common between small-size subnational government units. It may be less common in Asia and the Pacific due to a lack of legal frameworks defining and structuring the functioning of these mechanisms. Apart from being less politically sensitive than amalgamation, inter-municipal co-operation mechanisms can offer other benefits: they are often used as a means to generate economies of scale, to improve the quality of public service delivery and to pool resources to access financing.

Vertical co-ordination mechanisms

Vertical co-ordination mechanisms across levels of government are often in place but the participation of subnational governments in decision-making processes appears to be relatively low in some countries. Regional governments tend not to be strongly involved in multi-level governance, have less consultation with the central government on a regular basis and do not appear to take part in constitutional and legal reforms.

The COVID-19 crisis resulted in the development or reactivation of vertical co-ordination mechanisms between the national and subnational levels in some countries. Some central governments were able to foster co-ordination by involving subnational governments and other stakeholders in the design and/or implementation of their policy responses to the crisis. Where such coordination and dialogue fora already existed (e.g. Thailand, People's Republic of China), they were able to respond more quickly to the crisis.

Fiscal decentralisation in Asia and the Pacific

Countries in Asia and the Pacific have, on average, higher subnational expenditure as a share of total public expenditure than other world regions. Subnational governments account on average for 29.1% of total public expenditure and 8.8% of GDP in Asia and the Pacific, compared with 21.5% and 8.3%, respectively, at global level.

Subnational government revenue accounts for 35.0% of total public revenue in Asia and the Pacific in 2020. This is well above the world average (25.6% of total public revenue) and the average for Latin America (21.6%), and slightly above the average for OECD countries (34.1%).

Subnational expenditure in the region represents 8.8% of GDP whereas subnational revenue amounts to 8.5% of GDP, although there is huge variance both across and within the region. The data indicate an average 0.3 percentage point deficit in the region, which is similar to the OECD and world averages. Subnational expenditure in the OECD and the world lies at 14.1% and 8.3% of GDP respectively on average while subnational revenue stands at 13.9% and 8.0%. The share of subnational government revenue in total public revenue is highest in countries from South Asia and Southeast Asia. It is lower in countries from Central and West Asia, on average.

However, expenditure and revenue ratios cannot be automatically interpreted as indicating the level of spending or revenue autonomy of subnational governments. In some cases, expenditures are delegated from the central government, making subnational governments act as "paying agents" of the central government, with little or no decision-making power. On the revenue side, subnational governments' autonomy over their tax revenue is relatively low in some countries, meaning that they have more limited ability to set their tax base and rates.

Subnational government expenditure

Over a fifth of subnational expenditure in Asia and the Pacific goes to education. Expenditure on education represents 24.4% of total subnational government expenditure, on average, and 2.4% of GDP. The second and third biggest categories of subnational expenditure by functional classification are administration, development and management of general public services[3] (19.9%, 1.7% of GDP) and economic affairs and transport (17.5%, 2.1% of GDP). It is followed by housing and community amenities (10.8%), health (8.5%), social protection (8.0%), and finally recreation, culture and religion (4.3%), environmental protection (3.8%) and defence, public order and safety (2.6%).

Subnational governments in Asia and the Pacific are typically responsible for a significant share of total public expenditure relating to the environment, housing, community and education. Across the 16 countries with data available, subnational governments are responsible for 68% of public spending on public housing and community expenditure, 48% on environmental protection, 47% on recreation, culture and religion, 48% on education, 32% on health, and 28% on economic affairs and transport.

Staff expenditure and intermediate consumption are the top two expenditure items of subnational governments in Asia and the Pacific. Staff expenditure is the most important expenditure item, accounting for 31.9% of expenditure, against 23.2% for intermediate consumption[4].

Subnational government public investment

Subnational governments in Asia and the Pacific dedicate a significant share of their spending to public investment. Subnational public investment represents 2% of GDP in Asia and the Pacific, which is the same as the OECD average (2% of GDP) but significantly more than the world average (1.4%). The share of total public investment undertaken by subnational governments in Asia and the Pacific (38%) is in line with the world average, but below the OECD average (47%).

However, there are strong disparities in the sample of countries, with half of the countries below the world average in terms of share of subnational investment in total public investment. This implies that even though much of the investment required to meet the SDGs is local, in some countries subnational governments have a low contribution to meeting the high investment needs.

Subnational governments in most countries in Asia and the Pacific have higher responsibilities for public investment than for other forms of public expenditure, in line with other world regions. On average, the 20 countries in Asia and the Pacific with data available are responsible for 38% of total public investment but only 29% of total public expenditure.

Subnational government revenue

Grants are the primary source of subnational government revenue in Asia and the Pacific, but reliance on grants is slightly lower than other world regions. Grants and subsidies represent 48.2% of subnational government revenue, while tax revenue represents 40.2% (which includes both shared and own-source taxes[5]). At the global level, grants and subsidies account for 51.5% of subnational government revenue (51.2% for Latin America and 53.5% for Europe and North America). Subnational government revenue in Asia and the Pacific is composed, to a lesser extent, of tariffs and user fees (7.3%), property income (3.3%) and other revenues, such as social contributions (1.0%).

Within Asia and the Pacific there is high variability in the proportion of revenue that comes from grants and subsidies. They account for more than 65% of revenue for subnational governments in Thailand, the Philippines, Georgia, Indonesia, Azerbaijan and Sri Lanka, but they represent 6% or less in Bangladesh and Pakistan. In these two countries, transfer systems tend to be quite unpredictable, without

[4] Intermediate consumption refers to goods and services that are consumed as inputs by a process of production, excluding fixed assets whose consumption is recorded as consumption of fixed capital.

[5] Note that there is a in lack of finer-grained data on the different categories of tax revenue in the National Accounts classification, which means analysing own-source tax revenues needs to be done on a country-by-country basis.

any equalisation component or performance-based mechanisms, and transfers tend to be at the discretion of the central government.

Although subnational tax revenues are higher in Asia and the Pacific than in the rest of the world, a higher proportion of taxes does not necessarily indicate higher fiscal autonomy as shared taxes are common in the region. Own-sources taxes are taxes for which subnational governments have a certain power to set rates and bases, while shared taxes are national taxes redistributed to subnational governments according to allocation criteria that are defined nationally with a wider or narrower margin of manoeuvre for subnational governments. Shared taxes make up the bulk of tax revenue in countries like the People's Republic of China, India, Kazakhstan, Thailand and Viet Nam. Unfortunately, there is limited internationally comparable data on the breakdown between own-source and shared taxes available.

Many countries in Asia and the Pacific are characterised by vertical fiscal imbalances, as indicated by the level of subnational expenditure and the level of subnational tax revenue. On average, in 2020, subnational tax revenue accounted for 20% of total public tax revenue, 35% of total government revenue and 29.1% of total public expenditure. In the OECD, these ratios are 19.8%, 33.9% and 29.6%, on average, respectively, while the global averages are 14.2%, 25.9% and 21.5%.

In many countries in Asia and the Pacific, subnational government revenue from property taxes – typically one of the main own-source revenues - is low. They account for 0.7% of GDP and 25.9% of subnational government tax revenue in 2020, below the average of OECD countries (1.0% and 36.4%, respectively). This means that despite the fact that the property tax is considered to be "the local tax by excellence" and is often the main own-source revenue for subnational governments, it remains largely untapped. Property tax reforms have become widespread in Asia and the Pacific to better exploit revenue from this source (e.g. People's Republic of China, the Philippines, Cambodia).

Subnational government borrowing and debt

Subnational government debt in Asia and the Pacific is similar to the global average but low compared to the OECD. On average, subnational debt in Asia and the Pacific accounts for 7.4% of total public debt, representing 6.1% of GDP. This is below the world average, which stands at 9.8% of total public debt (representing 7.9% of GDP), and the OECD average, (15% of total public debt, 13% of GDP). Data on subnational government debt is only available for 16 of the 24 countries studied.

Subnational government debt levels remained relatively stable between 2016 to 2020. Of the 12 countries with sufficient data available, subnational government debt as a percentage of GDP increased sharply in Australia, rising by 6.8 percentage points to 27% of GDP. In Kazakhstan, for example, the increase was small but notable, increasing by 0.6 percentage points of GDP, which represented a 60% increase. In Japan and the Republic of Korea, subnational government debt decreased by 2.4 and 1.3 percentage points of GDP, respectively.

Many subnational governments in Asia and the Pacific have lower levels of debt relative to their revenue than OECD countries. Eleven out of sixteen countries in Asia and the Pacific have subnational debt to annual revenue ratios below the Asia-Pacific and OECD average. Low subnational borrowing is often a reflection of low creditworthiness and fiscal controls.

Subnational governments in Asia and the Pacific often borrow through public financial institutions. A small number of subnational governments in Asia and the Pacific access finance through direct bond issuances. The issuance of bonds by subnational governments is less common than some OECD countries, particularly the United States. More often, subnational governments access finance through public financial institutions that are created by subnational governments or by a central government, which includes pooled financing mechanisms that pool borrowing needs of multiple subnational governments.

Fiscal frameworks and fiscal rules

Countries in Asia and the Pacific adopt a variety of controls and fiscal rules to manage subnational government debt. Measures regulating access to borrowing range from direct control by the central governments over subnational government finances, to fiscal rules (e.g., golden rules, balanced budget, etc.), to co-operative arrangements, and pure market discipline (e.g., requirements for municipal bond issuances). In four countries in the region, subnational governments are not permitted to borrow. In seven countries, subnational governments only take loans from public financial institutions. In OECD countries in the region (e.g., Australia, Japan, etc.), subnational government debt is more often controlled through market discipline rather than by direct control or fiscal rules set by the central government. In these countries, subnational governments are incentivised by markets to control their debt levels.

Only a few countries were identified to apply the golden rule that limits borrowing to investment. While the golden rule restricting borrowing to be used for investment purposes is common across OECD countries, it was identified in less than half of the countries in the region. In theory, this means that borrowing rules in many countries allow subnational governments to borrow to fund provincial or local budget deficits, or repay outstanding debts, which are sometimes not seen as an appropriate use of debt. However, explicit golden rules may not have been identified as borrowing is sometimes subject to direct controls by the central government, so explicit golden rules may not be explicit.

In 14 out of 26 countries regulations allow subnational governments to issue bonds; however, their use is not commonplace. This might be partly explained by the fact that in many countries subnational bond markets are not well developed. It could also be explained by strict controls and approval processes on subnational borrowing, insufficient creditworthiness and a lack of suitable investment projects.

Several countries are undertaking reforms to strengthen fiscal responsibility and improve fiscal relations among levels of government. Many countries in Asia and the Pacific have launched reforms to enhance fiscal responsibility across levels of government. Most countries have set up centralised or, more rarely, decentralised audit systems to oversee subnational government finances, although they are still lacking in some countries.

Public financial management

Several countries are undertaking reforms to improve the quality of public finance management as a crucial tool to extract greater benefits from decentralisation. Examples include the development of new centralised systems of public finance and data management (e.g. Thailand), or the establishment of specific institutions dedicated to monitoring and evaluation (e.g. Bhutan).

Priority-based and participatory budgetary practices by subnational governments are emerging across Asia and the Pacific. In at least five out of the 26 countries, some green budgeting practices were being applied at a subnational level (e.g. Cambodia, Indonesia, Nepal, India and the Philippines). Participatory budgeting is also emerging, with Indian subnational governments standing out.

Subnational governments in Asia and the Pacific often own and manage substantial asset portfolios, but limited comparable data is available on these assets. Subnational governments assets can provide an important source of revenue for subnational governments provided that strong regulatory, governance and institutional frameworks are put in place for assets to be managed effectively.

The number of subnational state-owned enterprises appears to be increasing in some countries in Asia and the Pacific. While, on average, there has been a decline in state-ownership over recent decades, SOEs (both national and subnational) continue to account for about 20% of investment and 5% of employment globally. Comparable data on the number of subnational SOEs remains limited.

Subnational public-private partnerships appear to be less common in Asia and the Pacific than in OECD countries. In seven countries studied, no use of PPPs by subnational governments was identified. In five other countries, such as Australia or the Philippines, the use of PPPs by subnational governments is frequent.

Most national governments (and some subnational governments) have established specialised PPP Units to support the development of PPP projects. PPPs require specialised expertise that is not always available within a subnational government but is essential to ensure benefits from PPPs are realised.

Policy opportunities

Based on these key findings, the report identifies 10 policy opportunities to better support effective multi-level governance and strengthen subnational government finances in Asia and the Pacific:

1. Ensure responsibilities are clearly defined across levels of government.
2. Enhance co-ordination mechanisms across levels of government (vertical) and support cross-jurisdictional co-operation (horizontal).
3. Make the most of inter-governmental transfer systems as a reliable source of revenue for subnational governments, including by carefully designing grants and equalisation arrangements to address disparities and promote tax and development efforts of subnational governments (e.g., performance-based grants, fiscal equalisation transfers).
4. Support subnational governments to secure a sufficient, stable and balanced basket of revenues, including by harnessing physical and financial assets, and further expanding own-source revenues such as property taxes.
5. Strengthen subnational expenditure autonomy to support the effective design and delivery of public services, enhance accountability and improve budget management, among other benefits.
6. Support the effective use of debt by subnational governments by adopting effective fiscal responsibility frameworks, building institutional capacity, exploring the use of financial intermediaries and ensuring availability of sufficient and stable funding sources.
7. Build the institutional capacity of subnational governments alongside the decentralisation of responsibilities, including relating to revenue collection, public expenditure, investment, asset management and debt management.
8. Enhance public financial management and public investment management, including by strengthening the link between planning, investment programmes and budgets to help deliver a pipeline of investable projects.
9. Support emerging practices of priority-based (e.g., green budgeting) and participatory budgeting practices to enhance local accountability and support prioritisation according to strategic objectives.
10. Improve collection and transparency of data on SNG finances to better support subnational governments' actions, in particular for data related to own-source revenue, assets and debt.

1 Introduction

Countries across Asia and the Pacific[6] are rapidly transforming. The 26 countries from Asia and the Pacific included in this study (see Box 3, page 18) represent 53% of the world's population, 21% of its land area and 40% of global GDP (Annex A). Over recent decades, many of these countries have achieved impressive levels of development. Their average annual GDP growth rate was 4.3% over the 10 years to 2020, with 9 of the 26 countries achieving a growth rate above 5% per annum – well above the global average of 2.4%. In 20 countries, this has been accompanied by high levels of population growth (average increase of 1.1% per annum in the five years to 2020) and, in 22 countries, by high growth rates of urbanisation (average urbanisation rate of 2% between 2019 and 2020). As of 2020, 44.6% percent of the population were living in urban areas in the sample countries, up from around 30% in 1980 (OECD, 2016[2]). The rapid transformation of the region has helped to lift millions of people out of poverty and improve wellbeing.

Yet there is still high variance in the level of economic and social development in the region. Across the countries studied, the average GDP per capita is around 16 000 USD in purchasing power parity terms (PPP)[7], ranging from 53 000 in Australia to 3 800 in Tajikistan (Annex A). The Human Development Index, which is a composite index of life expectancy, education and per capita income indicators, also varies significantly across countries. The region includes seven countries with 'very high' levels of development, such as Australia (8th in the world), and eight countries with only a 'medium' level of development on the index, such as Pakistan (154th in the world). Five of the countries studied are considered as 'least developed countries' (Bangladesh, Bhutan, Cambodia, Lao PDR and Nepal). The level of social and economic development is further characterised by strong disparities in access to services and infrastructure between urban and rural areas in many countries in the region (OECD, 2022[3]).

Many countries in Asia and the Pacific have a long way to go to ensure sustainable social, economic, and environmental development for their populations, as evidenced by their persistent gaps in meeting the sustainable development goals (SDGs). When the SDGs were adopted in 2015, more than 1.1 billion people in the region were living on less than USD 3.20 per day, very close to the poverty line (ADB, 2021[4]). Although by 2020, this number had decreased by 143 million in the region (Annex A), the region is not on track to achieve any of the 17 SDGs by 2030 (ESCAP, 2022[5]). Progress on achieving the SDGs has been unequal across countries, across territories within countries and across population groups. Furthermore, overall progress on the SDGs in Asia and the Pacific has slowed as the COVID-19 pandemic and climate change have exacerbated development challenges (ESCAP, 2022[5])

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[6] This report covers 26 countries across Central Asia, East Asia, South Asia, Southeast Asia, Western Asia and the Pacific. The report refers to these regions collectively as "Asia and the Pacific". See Box 3 for the list of countries.

[7] Purchasing power parity allows to equalise the purchasing power of different currencies, by eliminating the differences in price levels between countries.

Box 1. The role of subnational governments in meeting the SDGs

It is estimated that that 65% of the 169 targets underlying the 17 SDGs will not be reached without proper engagement of subnational governments and coordination with local and regional governments. Achieving the SDGs will hence depend on the progress made at the subnational level. In addition to SDG 11, which is dedicated to Sustainable Cities and Communities, subnational governments have an instrumental role to play in most SDGs given their mandates for public service delivery that are central to peoples' well-being, and being closer to people. SNGs are also responsible for almost 40% of total public investment globally and are responsible for a significant proportion of climate-significant expenditure (63% in the OECD). In recognition of this, many countries and institutions are supporting the "localisation" of the SDGs. These initiatives seek to support subnational governments in harnessing the SDGs to guide their development.

Sources: (OECD, 2020[6]; OECD, 2021[7])

As a result of the previous and current decentralisation processes, subnational governments (SNGs) in many countries in the region have an increasing role in policy making and public investment. Decentralisation has been one of the most prominent public reforms around the world over the last two decades, particularly in Asian countries (Chatry and Vincent, 2019[8]). Over this period, many countries have devolved a range of powers, competences, and resources to elected subnational governments, who have become responsible for the provision of services such as education, health, housing and transportation. This has resulted in an increase in public expenditure and investment undertaken by these SNGs. In 2020, in the 26 countries considered in this study, SNGs accounted on average for 29.1% of total public expenditure (above the global average) and 37.8% of total public investment, in line with the global average[8]. In parallel, several countries have also transferred authority and competences to non-elected, deconcentrated state administrations at the territorial level.

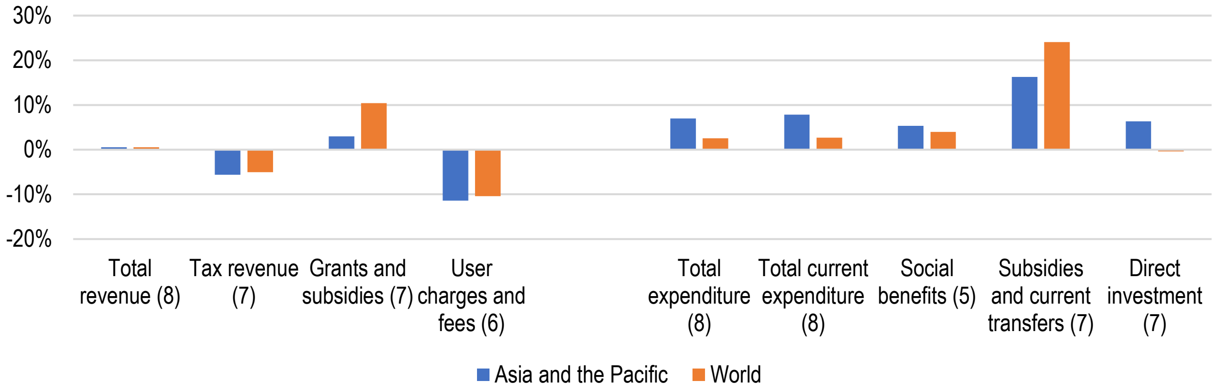
However, several bottlenecks to make the most of decentralisation remain. As decentralisation has led to increased responsibilities for subnational governments, these reforms need to be accompanied by fiscal decentralisation that provides sufficient and appropriate sources of revenues, over which SNGs may have some leeway, to avoid underfunded or unfunded mandates (Allain-Dupré, Chatry and Phung, 2021[9]). There is also a need to build capacities at subnational governments and enhance coordination and cooperation across levels of government to support effective public service delivery and investment (OECD, 2014[10]; Chatry and Vincent, 2019[8]; Allain-Dupré, Chatry and Phung, 2021[9]).

In the near future, subnational governments in Asia and the Pacific will need to overcome the challenges posed by the consecutive crises, in particular the global COVID-19 pandemic and the consequences of the Russian invasion of Ukraine. SNGs in the region appear to have been more strongly affected by the COVID-19 crisis than in other world regions. Between 2019 and 2020, subnational governments tax revenue declined (-5.6%, in real terms), user charges declined (-11.4%), expenditure increased (+7%) and investment increased (+6%) (Figure 1), which in all cases was a larger change than the world average (-5%, -10.4%,+2.6% and 0%, respectively). While this 'scissor effect' was offset in some countries by fiscal transfers (+3%), the average amount of support from central governments was lower than the world average (+10.4%). The high growth in subnational investment was driven by two countries in the sample that enacted stimulus packages early in the crisis, New Zealand (16.8% increase) and Thailand (13.9% increase). New Zealand implemented a range of stimulus packages from March 2020 to February 2022 (totalling 34% of its GDP) and Thailand introduced a large economic recovery package in

[8] Based on data from the SNG-WOFI, according to a sample of 135 countries across the world.

April 2020 (12% of GDP) (OECD/UCLG, 2022[11]). Fiscal and borrowing rules were often adjusted to allow subnational governments to borrow more to close the gap, leading to an increase in SNG debt (e.g. People's Republic of China, India, Japan, Republic of Korea). Furthermore, in some countries, SNGs have had to draw heavily on their reserve funds (e.g. Japan, Philippines).

Figure 1. Impact of COVID-19 crisis on subnational government revenues and expenses (% change 2019-2020)



Note: Numbers in brackets indicate the number of countries from the Asia and the Pacific region included in the unweighted average. For all indicators, Asia and the Pacific includes Australia, Georgia, Indonesia, Republic of Korea, New Zealand and Thailand. Malaysia is also included in total revenue, grants and subsidies, total expenditure, and total current expenditure, whereas Mongolia is included in total revenue, tax revenue, total expenditure, total current expenditure, social benefits, subsidies and current transfers, and direct investment. World averages include between 53 to 61 countries for each unweighted average. **Source**: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Recent shocks have reinforced the need to ensure that multi-level governance frameworks and subnational government structures are resilient. (OECD, 2022[12]; OECD, 2018[13]; ADB, 2022[14]). Although many national and subnational governments have responded strongly to these challenges, continual crises highlight the need to build resilience by strengthening SNG finances (e.g. through strengthening the fiscal health of subnational governments, promoting 'rainy day' funds) and reinforcing multi-level governance structures.

Subnational government structures and finances will also need to evolve to face future challenges, such as those posed by climate change. Subnational governments are often at the forefront of climate adaptation and mitigation, meaning that they need to have the fiscal space and institutional capacity to take climate adaptation and mitigation actions. In OECD countries, for example, they are responsible for 63% of climate-significant public expenditure and 69% of climate significant public investment (OECD, 2022[15]). Many countries in Asia and the Pacific are particularly prone to climate risks (OECD, 2016[2]). Asia suffers more disasters and associated deaths and economic losses than any other continent, with the risks compounded by the effects of climate change (ADB, 2021[16]).

Subnational governments also need to be prepared to face changes in their populations, which can affect future subnational government finances. Many countries in the region have had high levels of population growth in recent years, which requires higher expenditure and investment across many areas (e.g. education, infrastructure, etc.). In the five years to 2020, eighteen countries had an annual population growth rate above 1% per annum, and two countries had population growth above 2%. However, not all countries are growing. Over the same period, populations have decreased in two countries (Japan, Georgia). Most countries are also ageing, although many countries in the region still have a large youth population. The young-age dependency ratio, which is the ratio of young people (below 15) to the working age population (15-64), ranges from around 20% (Republic of Korea, Japan, Thailand, People's Republic of China) to over 50% (Tajikistan, Pakistan, Kyrgyz Republic, Lao PDR). The old-age dependency ratio, which is the ratio of people older than 64 to the working age population (15-64), ranges from 5% in Tajikistan to 50% Japan (Annex A).

Meeting the SDGs will require further supporting SNGs to effectively carry out their responsibilities. Development institutions and multi-lateral development banks are increasingly recognising the need to 'localise the SDGs' by expanding coordination mechanisms across levels of government and building subnational government capacity (ADB, 2021[4]; UCLG, 2019[17]), as well as by improving the enabling environment for regional and local governments (UCLG-ASPAC, Cities Alliance & UNDP, 2018[18]). Building robust SNG financial systems and well-developed, liquid domestic capital markets for these governments can help to accelerate the transformation needed to achieve the SDGs (UNCDF, 2022[19]).

Strengthening the ability of subnational governments to meet their future needs requires developing a detailed understanding of multi-level governance frameworks, subnational government structures and subnational finance. The responsibilities, and institutional arrangements of subnational governments are highly diverse across countries in Asia and the Pacific, reflecting a wide range of cultural, historical and political contexts. The World Observatory on Subnational Government Finance and Investment (SNG-WOFI, Box 2) has been harnessed for this report to help better understand SNG structures and finance, with a focus on ADB's developing members (which account for 22 out of the 26 countries covered). The SNG-WOFI has also served to highlight countries and sectors for which data on subnational finance is still incomplete or missing, which includes many islands in the Pacific region, and some countries in Asia (Box 3).

Box 2. OECD/UCLG World Observatory on Subnational Government Finance and Investment

The OECD-UCLG World Observatory on Subnational Government Finance and Investment (SNG-WOFI) is a joint endeavour led by the Organisation for Economic Co-operation and Development (OECD) and United Cities and Local Governments (UCLG). Its overall goal is to increase knowledge on multi-level governance and subnational finance around the globe by collecting and analysing standardised quantitative and qualitative information.

This initiative was supported by the French Development Agency (AFD), the Asian Development Bank (ADB), the Council of Europe Development Bank (CEB), the DeLoG Network, the German Corporation for International Cooperation (GIZ), the French Ministry of Europe and Foreign Affairs (MEAE), and the United Nations Capital Development Fund (UNCDF).

Now in its third edition (launched in October 2022), the SNG-WOFI is the largest international knowledge repository on subnational government structure and finance ever produced, covering 135 countries from seven world regions, including 26 ADB members. It provides, on one hand, systematic information on decentralisation processes, territorial reforms, the powers and responsibilities of subnational governments, fiscal decentralisation reforms and fiscal rules. On the other hand, it includes a unique database including data on subnational expenditure, investment, revenue and debt.

Note: For more information, you can visit : https://www.sng-wofi.org

Harnessing data from the SNG-WOFI, this report seeks to provide an overview of subnational government structures, reforms and finance in Asia and the Pacific. The report covers 26 countries from Central and West Asia, South Asia, Southeast Asia, East Asia and the Pacific (Box 3) and is structured in four main parts:

- **Chapter 1**, *this chapter*, provides an introduction to the report.
- **Chapter 2**, *Subnational government structures and reforms in Asia and the Pacific*, details subnational government structures and multi-level governance frameworks in Asia and the Pacific, indicating the current structure of subnational governments and recent trends.
- **Chapter 3**, *Subnational government finance in Asia and the Pacific,* details subnational government finances across Asia and the Pacific, detailing subnational government expenditure, investment, revenues, debt and assets, as well as highlighting fiscal frameworks and fiscal rules.
- **Chapter 4**, *Policy opportunities*, highlights some areas of opportunity to strengthen multi-level governance and subnational government finance in Asia and the Pacific.

Box 3. Countries from Asia and the Pacific studied in this report

This report is based on a sample of 26 countries from Asia and the Pacific. These countries represent 53% of the global population, 40% of global GDP and 21% of land surface area. There are over 450,000 subnational governments in the 26 countries studied in this report, which include:

- **Central and West Asia:** Armenia; Azerbaijan; Georgia; Kazakhstan; the Kyrgyz Republic; Pakistan; Tajikistan and Uzbekistan
- **South Asia:** Bangladesh; Bhutan; India; Nepal and Sri Lanka
- **Southeast Asia:** Lao People’s Democratic Republic (hereinafter Lao PDR); Indonesia; Malaysia; the Philippines; Thailand; and Viet Nam
- **East Asia:** Mongolia; the People's Republic of China; the Republic of Korea and Japan; and
- **Pacific:** Australia and New Zealand.

The report includes five least developed countries (Bangladesh, Bhutan, Cambodia, Lao PDR, Nepal) and four developed countries (Australia, Japan, Republic of Korea and New Zealand).

The selection of countries covered was based on the availability of information on multi-level governance structures and subnational finance that is available in the latest edition of the SNG-WOFI. Therefore, this report does not cover small pacific countries which are not included in the SNG-WOFI.

Note on subnational governments in small pacific countries:

According to the Commonwealth Local Government Forum there are over 900 local level government bodies across the developing countries in the Pacific. Of these, around 50 are urban and the remainder are rural or island based. There are around 7,000 elected and appointed councillors, or over 900 excluding those in Papua New Guinea. Additional information on subnational governments in these countries can be found through the Commonwealth Local Government Forum.

Note: Definitions of sub-regions (e.g. Central and West Asia) are adopted from the Asian Development Bank.
Sources: Commonwealth Local Government Forum, 2022, https://www.clgf.org.uk/regions/clgf-pacific/; Hassall, G., & Tipu, F. (2008). Local Government in the South Pacific Islands. Commonwealth Journal of Local Governance, (1), 7-29. https://doi.org/10.5130/cjlg.v1i0.766

2 Subnational government structures and reforms in Asia and the Pacific

Introduction

Subnational government in Asia and the Pacific have a high diversity of structures and responsibilities, which have changed over time through reform programmes. Subnational government structures are inherently linked to underlying geographic, historical and socio-political contexts of countries. These structures, which can be composed of one, two, three or more layers, have evolved through a variety of institutional and territorial reforms. Among diverse objectives, reforms may seek to reinforce multi-level governance mechanisms, improve local governance, achieve economies of scale or support better co-ordinating among and across levels of government. They can be accompanied by changes in territorial boundaries, funding and coordination structures, as well as changes to the allocation of responsibilities across layers of governments.

Subnational governments across Asia and the Pacific tend to play a key role in public services and infrastructure relating to the Sustainable Development Goals, such as education, health, transport and social protection. These responsibilities are often allocated at different levels, and sometimes include overlaps in responsibilities. Typically, state or regional governments are responsible for items such as secondary or higher education, spatial planning, health and social affairs, as per the states Australia or provinces in Cambodia (Table 1). Governments at an intermediary level, where they exist, have more specialised and limited responsibilities, as it is the case for secondary education, waste collection and public transport in Kazakhstan and Uzbekistan. In addition, intermediary governments are often tasked with assisting smaller municipalities. Municipal governments, on the other hand, are typically responsible for the direct provision of public services and infrastructure for the citizens. These might relate to local utility networks (water, sewerage, waste), local roads and social affairs (etc.), as in Japan and the Philippines.

Table 1. Example of responsibilities assigned to central and subnational governments across Asia and the Pacific

COFOG	Municipal level	Intermediate level	State or regional level	National level
General public service	Administrative and permit services Urban planning & management		Administrative and permit services Spatial planning	Foreign aid Research and development Fiscal management
Social protection	Support for vulnerable groups and homeless	Social and youth welfare	Employment services, training, and inclusion	Support for families, children, elderly disabled, veterans
Defence			Civil defence	Military
Public order and safety	Fire brigades		Regional police, civil protection	National police
Economic affairs (inc. Transport)	Local economic development, tourism, trade fairs. Local roads and public transport.	Secondary roads and public transport	Regional economic development and innovation Regional roads and public transport	National transport networks Agriculture, fishing and forestry Communications networks
Environmental protection	Green areas, local parks. Stormwater and sewerage Waste collection	Waste treatment	Parks and reserves	National parks
Housing and community amenities	Social housing Street lighting	Water supply	Social housing	
Health	Primary and preventive healthcare	Secondary hospitals	Secondary care and hospitals	Specialist hospitals
Recreation, culture and religion	Sport and cultural facilities		Culture, heritage and tourism	Broadcasting National sport
Education	Nursery schools, pre-elementary and primary schools	Secondary or specialised education	Secondary / professional training	Tertiary education

Note: Categories based on the Classification of the Functions of Government (COFOG)
Source: Author's elaboration, based on (OECD, 2019[1]) and the country profiles contained in SNG-WOFI

Subnational government structures

Irrespective of their form of state, subnational government structures in Asia and the Pacific are highly diverse

Most countries across Asia and the Pacific are unitary states. Among the 26 countries included in this study, 5 countries are federal and the remaining 21 countries are unitary states (Table 2). The federal countries are Australia, India, Malaysia, Nepal and Pakistan. Although the mere definition as a federal country necessarily implies a sizeable level of decentralisation, the reality is far more complex. For example, despite having enshrined the federal structure in its Constitution, Malaysia functions more closely to a unitary country as the central government concentrates many important powers, leaving relatively little room for manoeuvre to subnational governments (Ostwald, 2017[20]). Meanwhile, the People's Republic of China is a unitary country that appears highly decentralised on some metrics due to the high level of expenditure by subnational governments. Being classified as a federal or unitary country hence cannot be interpreted to be equivalent to a higher level of decentralisation.

Asia-Pacific has the most subnational governments of any world region. There are around 467 000 subnational governments across the 26 countries included in this study. These include 628 state or regional governments, 4 960 intermediary-level governments and around 467 000 municipal-level governments. State or regional governments represent only 0.1% out of all subnational governments whereas municipal governments account for 98.8%, and this is excluding sub-municipal layers of government. The proportion of state or regional governments is somewhat similar to Europe (0.4%) but in contrast to Africa (5.2%) and Euro-Asia (3.8%).

Table 2. State and subnational government organisation in selected countries in Asia and the Pacific

Country	Form of State	Regional or State	Intermediary	Municipal	Total
Armenia	Unitary			484	484
Australia	Federal	8		537	545
Azerbaijan	Unitary	1		1606	1,607
Bangladesh	Unitary	64	492	4894	5,450
Bhutan	Unitary	20		209	229
Cambodia	Unitary	25	203	1646	1,874
People's Republic of China	Unitary	31	333	2844	3,208
Georgia	Unitary	3		64	67
India	Federal	36		267428	267,464
Indonesia	Unitary	34	514	83813	84,361
Japan	Unitary	47		1747	1,794
Kazakhstan	Unitary	17	216	6938	7,171
Republic of Korea	Unitary	17		226	243
Kyrgyz Republic	Unitary	2	12	484	484
Lao PDR	Unitary	18	148	8,507	8,673
Malaysia	Federal	13		151	164
Mongolia	Unitary	22	339	1,710	2,071
Nepal	Federal	7		753	760
New Zealand	Unitary	11		67	78
Pakistan	Federal	4		12,369	12,373
Philippines	Unitary	82	1,634	42,046	43,762
Sri Lanka	Unitary	9		341	350
Tajikistan	Unitary	4	68	368	440
Thailand	Unitary	76		2,443	2,519
Uzbekistan	Unitary	14	294	9,168	9,476
Viet Nam	Unitary	63	707	10,614	11,384
TOTAL		**627**	**4,960**	**461,457**	**467,044**

Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Asia-Pacific has 67% of the total subnational governments across the 135 countries in the SNG-WOFI (Figure 2). Asia-Pacific is followed by Europe (14%), Euro-Asia (7%), North America (3%), Latin America (3%), Africa (3%) and Middle East and West Asia (0.3%). The proportion of subnational governments in the sample countries (67%) is even higher than the proportion of the global population represented in the sample (53%) and much higher than the total land area represented (24%).

Figure 2. Number of subnational governments by world region

Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

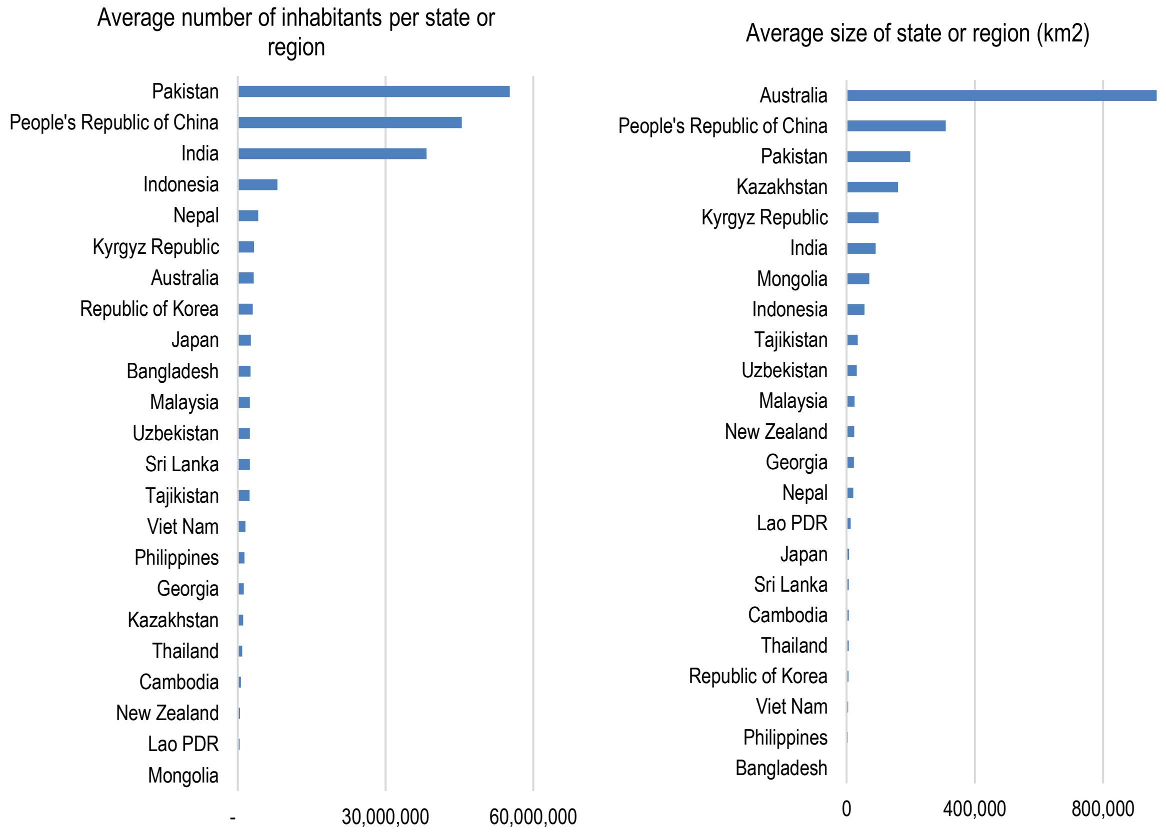
The number of SNGs is unevenly distributed among the 26 countries covered, as it is increased by India, Indonesia and the Philippines, which have very high numbers of subnational governments. India has almost 57% of all subnational governments in the sample, with over 267,000 municipal governments (villages and small towns (*panchayat)*). Indonesia and the Philippines also have many subnational governments, including many small and autonomous municipal authorities that fall within the SNG-WOFI definition of subnational governments.

Twelve of the twenty-six countries in the sample have three levels of subnational government. These include state or regional governments, an intermediate level, and municipalities. The People's Republic of China is an exception as only three tiers of subnational government are mentioned in the Constitution, while four layers exist in practice. All other (13) countries have two subnational government levels i.e. a municipal and a regional level. The only country in the sample with one single level of subnational government is Armenia (Table 2).

In the 24 countries that have a regional level of government (or state level in federal countries), there are 627 governments at this level (Table 2). This includes countries with an elected regional level covering the entire territory (e.g. in the Philippines, there are 82 provinces, with each province led by an elected governor and provincial council). It does not include countries where there is an outlier entity at regional level (e.g. the Nakhchivan Autonomous Republic in Azerbaijan).

The population and geographical area represented by regional and state governments varies significantly across the sample of countries (Figure 3). In the People's Republic of China, India and Pakistan, the average population for each state and region is over 35 million. In most of the other countries, regional and state governments represent an average population of between 1 and 4 million people (~15 countries). In Australia, the average geographic area covered by each state or territory is around 1 million square kilometres. In the People's Republic of China, it is around 309 000 square kilometres and in Pakistan, around 200 000 square kilometres. In most other countries, such as the Philippines, Sri Lanka or Bangladesh, the geographic area covered by state or regional governments is less than 10 000 square kilometres.

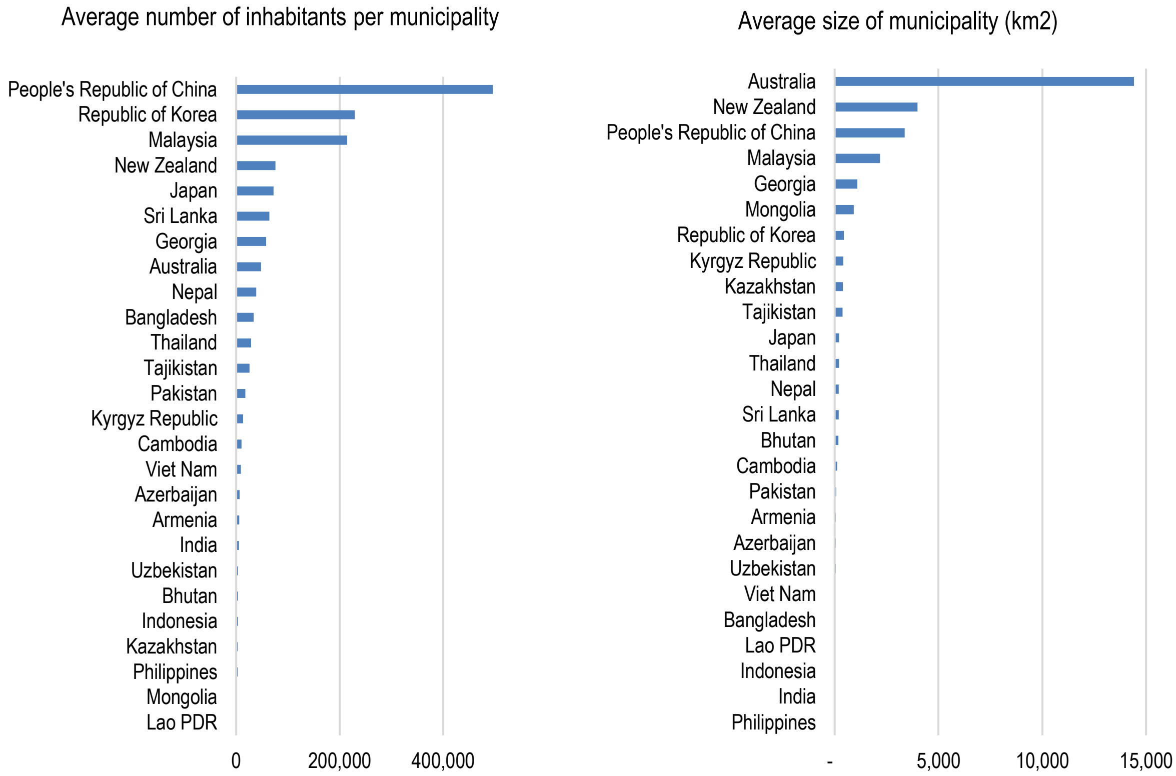
Figure 3. Population and geographic area represented by state and regional governments



Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Similar to the state and regional level, the population and geographic area represented by municipal governments is highly differentiated across countries (Figure 4). The average number of inhabitants per municipality in the Asia and the Pacific region is 56 600. This is substantially larger than the average for OECD countries, which stands at 41 000. It is worth noting that the highest value in the OECD average belongs to an Asian country, the Republic of Korea, with a national average of 229 000. The number of inhabitants per municipality is on average above 200 000 in the People's Republic of China, Republic of Korea and Malaysia. In the OECD, the average stands at 41 000, with the highest value being that of the Republic of Korea. In 10 of 28 countries in Asia and the Pacific, the number of inhabitants per municipality is between 15 000 and 80 000. In the remaining 12 countries, the number of inhabitants is below 12 000. The average geographic area of each municipality is also highly varied, with municipalities in Australia again being an outlier, covering an average of 14,416 square kilometres, which is larger than many regions in other countries. It is worth noting that there is a large difference between municipalities in Australia and that municipalities in metropolitan areas are much smaller. Most countries have municipalities that are smaller than 500 square kilometres (equivalent to two thirds of the size of Singapore) (Figure 4).

Figure 4. Population and geographic area represented by municipal governments



Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

The size of municipalities and regions, as well as the population living in them, are important considerations when looking to ensure that public goods and services are delivered efficiently. Indeed, municipalities with greater size and population may generate and can potentially benefit from economies of scale in their public service delivery. In places where the size and/or population of municipalities are low, seizing the gains of economies of scales may be achieved by undertaking territorial reforms, such as municipal amalgamation, or by strengthening horizontal or inter-municipal co-operation mechanisms (see Table 5).

Many countries in the region have a large number of sub-municipal entities

In several countries in Asia and the Pacific, there is also a large number of sub-municipal entities that can take various forms, either self-governing or not (Table 3). First, some countries have urban or rural settlements that are self-governing, and that constitute an extra layer of subnational government, in addition to cities and municipalities. These types of governments have general responsibilities, often in areas of local interest such as public order and maintenance, social waste collection and disposal, local health centres, and maintenance of local infrastructures or equipment. This is the case for example of *panchayat* in India, or *barangays* in the Philippines, whose responsibilities include agricultural support and maintenance of health centres and infrastructure. They are considered as subnational governments and are included in the total number of subnational governments in the country counted in the SNG-WOFI. On the other hand, there are countries with non self-governing sub-municipal localities, that are consequently not included in the total number of subnational governments in the SNG-WOFI. These sub-municipal localities may have no autonomy (civil parishes, community boards, settlements, etc.) as they depend on a given "mother" municipality[9] (Chatry and Vincent, 2019[8]). Finally, there are sub-municipal governments that may also be attached to a "mother" municipality, but have some autonomy, induced by their own elected representatives and budget. They can exist only on specific parts of the territory, such as the Tamboon Administrative Organisations (TAOs) in Thailand. TAOs exist mostly in rural areas and act as enablers of greater citizen participation.

Table 3. Examples of sub-municipal entities and small municipal governments in Asia and the Pacific

	Sub-municipal localities with no autonomy	Sub-municipal entities with limited autonomy	Small urban or rural municipalities
Main characteristics	*Administrative entities with no self-governing powers, and that are supervised by a given municipality*	*Entities with some degree of autonomy (elected representatives, own budget and staff) and attached to a given municipality*	*Autonomous self-governing entities with their own budgets and democratic representation*
Included in the total number of SNGs in the SNG-WOFI?	*No*	*No*	*Yes*
Examples	*Armenia (bnakavayrer)* *Georgia (administrative districts)* *Tajikistan (mahalla/guzar)* *Republic of Korea (eup, dong and myeon)* *Bhutan (chewogs and class "B" municipalities)* *Japan (ku)*	*Thailand (Tamboon Administrative Organisations)* *New Zealand (community and local boards)*	*India (panchayat),* *Philippines (barangays)* *Indonesia (keluraban)* *Kazakhstan (aul)* *Uzbekistan (mahalla)* *People's Republic of China (townships) – not counted in the number of SNGs*

Note: This table is not entirely comprehensive but rather selects several instances from a sample of countries with available data.
Source: Authors' elaboration based on SNG-WOFI country profiles

Asymmetric decentralisation arrangements are common in Asia and the Pacific

Asymmetric subnational governments structures, also known as asymmetric decentralisation, are common in Asia and the Pacific and can take various forms. Asymmetric decentralisation refers to the differentiated assignment of expenditure or revenue responsibilities across SNGs at the same level of administration. This may be due to their status (e.g. capital cities), their size or other reasons. As a result, some regions may be more autonomous than others within the same country (e.g. in Malaysia) and some municipalities may also have a second status as an intermediate, regional or state government (e.g. Australian Capital Territory in Australia, and several countries in Central and West Asia). There can also be significant differences between urban and rural areas. In India, urban areas can be organised in a single tier (urban councils), while the *panchayat* system in rural areas may have three tiers depending on the population and state.

Asymmetric federalism is common across federal countries in Asia and the Pacific. Of the five federal countries, four countries have a form of asymmetric federalism (India, Malaysia, Australia and Pakistan). Only Nepal, which has recently become federal, does not have a form of asymmetric government, yet its Constitution provides a legal basis for it. In India, the Constitution makes special provision for 9 of the 28 states. In Malaysia, Sabah and Sarawak retain a higher degree of autonomy than the other 11 states as they joined the federation after other regions. In Australia, the six states have a

[9] These smaller sub-localities are generally established at the initiative of a municipality (called "mother" municipality), that oversees their operations and that is responsible for determining their names, status, and delegated responsibilities.

higher level of autonomy than the federal territories (including Australian Capital Territory and Northern Territory).

In federal countries, asymmetric arrangements are also typical at a local government level. In most federal countries, local governments are governed by the state constitution and/or legislation, meaning that there can be substantial variation across states. In India and Australia, for example, state governments set their own municipal regulations, although these must be compatible with federal regulations. Therefore, local governments' status, powers, responsibilities and funding mechanisms often vary from state to state.

Unitary countries also often have asymmetric arrangements. Many unitary countries have autonomous regions, capital cities, other cities with special status and other specific categories of local government with different responsibilities, revenue assignments or rights (e.g. to borrow). In Thailand, the three types of municipalities have different responsibilities. In New Zealand, the Auckland City Council has additional responsibilities as compared to other Territorial Authorities. In Japan, Tokyo's 23 metropolitan special wards have additional administrative and fiscal autonomy than other municipalities. In Bangladesh, urban corporations and municipalities have more power and autonomy than their rural counterparts.

Asymmetric arrangements are diverse and vary according to the objectives they pursue

There are political, fiscal and administrative or managerial motivations for asymmetric arrangements (Table 4). Countries may decide to decentralise asymmetrically through political means, for example by giving a heavier representation to certain subnational governments than others, by enforcing special regional constitutional arrangements or by relaxing rules or laws. They may also accommodate the diversity of fiscal needs and requests of subnational governments by differentiating the allocation of taxing powers or special exemptions or the application of differentiated fiscal rules. Finally, some subnational governments may be allocated different administrative powers such as the ability to form contracts by themselves or their PPP management.

Although navigating the diversity generated by asymmetric arrangements may be more complex than symmetrically decentralised countries, agreeing to these types of decentralisation arrangements may help adopt regional policies that are better tailored to the subnational needs (Allain-Dupré, Chatry and Moisio, 2020[21]). Several countries are creating special economic jurisdictions to promote industrial development within and across regions, as a form of administrative asymmetric decentralisation. For instance, Thailand, Malaysia and the Republic of Korea have developed special economic zones, which benefit from an enabling business environment with specific incentives for trade and economic development. These initiatives are aimed making the most of the economic fabric of specific regional areas, and to promote balanced regional development by strengthening regional competitiveness of isolated or less dynamic areas.

Table 4. Three types of asymmetric decentralisation

	Political	Fiscal	Administrative and management
Characteristics	- Representativeness in national institutions - Special regional constitution / political arrangements - Internal political structures (e.g. local government organisation) - Relaxation of rules or laws - Adaptation of laws and rules (primary or secondary) - Use of referendum	- Differentiation in the allocation of taxing power/special exemptions - Special grants - Fiscal rules - Budget autonomy - Access to borrowing / financial markets	- Differentiated responsibilities - Possibility to "opt in" or "opt out" assignments - Ability to contractualise - Creation of municipal companies - PPP management - Supervision - Adaptation of norms / standards
Countries	Malaysia, Cambodia, Georgia, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Thailand, New Zealand, Viet Nam, Pakistan	Mongolia, Bhutan, Viet Nam, Tajikistan	Bangladesh, Kazakhstan, Republic of Korea, Thailand, People's Republic of China, Malaysia

Source: (OECD, 2020[22])

Asymmetric arrangements are increasingly applied at the municipal level

While historically, asymmetric decentralisation unfolded at the regional level, such arrangements have been applied to large cities at the municipal level. This can be linked to the broader recognition of the benefits of urbanisation and agglomeration economies (OECD, 2019[23]). This is the case, for instance, in countries in early decentralisation stages, which have assigned a special status to newly created territories to give them specific powers, such as the four self-governing "Class-A" municipalities of Thimphu, Phuentsholing, Gelephu and Samdrup Jongkhar in Bhutan as from 2011. This is also occurring in Viet Nam, which is increasingly leaning towards more asymmetrical territorial arrangements to reform its local public administration system. Pilot policies have been launched since 2020 to develop new urban governance models in the major cities of Da Nang, Ha Noi, and Ho Chi Minh City (Box 4).

Box 4. Asymmetric decentralisation to strengthen urban governance in Viet Nam

Viet Nam is increasingly leaning towards more asymmetrical territorial arrangements to reform its public administration system. Pilot policies have been launched since 2020 to develop new urban governance models in the major cities of Da Nang, Ha Noi, and Ho Chi Minh City.

As part of this pilot experiment, the three provincial-level city governments have been given more leeway to reorganise the local government units within their jurisdictions (known as districts, communes and wards) for their needs. For instance, Ha Noi initiated a reform to reduce the number of local governments' layers, by removing the wards' unit within its jurisdiction. In the other direction, the governments of Da Nang and Ho Chi Minh City are removing the "district" level (an intermediate level) to strengthen the linkages between the provinces and the communes.

The central government also adopted an asymmetric approach when drafting the national plan for development of smart sustainable cities for 2018–2025. The plan sets up as a target to turn the four biggest cities in Viet Nam (Ha Noi, Ho Chi Minh City, Da Nang, and Can Tho) into cities with core smart functions by 2025 or 2030.

However, both pilot experiments are still not completed as of 2022, due to some limitations, including the lack of adequate legislation to accompany the pilot reforms; the need of new co-ordination mechanisms (for example through digitalisation); a lack of vision and political leadership; and the need to create consensus and mobilise other stakeholders, including businesses and citizens.

Source: (Cuong, 2022[24]) ; (Communist Party of Vietnam Online Newspaper, 2021[25]) ; (Hien, 2021[26])

Asymmetric decentralisation arrangements have been put in the spotlight by the COVID-19 crisis, which had highly asymmetric impacts within countries (OECD, 2021[27]). Many countries have adopted regionally and locally differentiated lockdown strategies, and SNGs within the same country may have undertaken various types of measures for managing the crisis and supporting citizens and businesses. In Bangladesh, for instance, urban subnational governments have played a key role with regard to COVID-19 response, contrary to rural local governments. Indeed, urban local governments worked closely with the field administration and Department of Public Health and Engineering to provide support to public health activities, ensuring routine and critical urban services including emergency response, and coordinating and facilitating local sectoral activities to meet citizens' needs. In the People's Republic of China, measures were taken to adapt the COVID-19 response to local specificities, such as local lockdowns and inter-provincial travel restrictions.

Decentralisation reforms in Asia and the Pacific

Decentralisation in Asia and the Pacific began in the 1990s, with variations across sub-regions and countries, according to different objectives

The current territorial structures of countries in Asia and the Pacific is the result of three decades of decentralisation, which has been a primary goal of some reform agendas. Since the 1990s, decentralisation in South Asia and Southeast Asian countries such as India, Indonesia, Japan, the Republic of Korea and Thailand has been seen as a means of adopting *new public management* models, oriented towards more effective public policies and service delivery, which seeks to contribute to economic competitiveness and respond to the challenges of globalisation (OECD/KIPF, 2019[28]). Other reasons include the willingness to strengthen democracy, supported by pro-democracy movements and popular mobilisation rejecting centralised autocratic governments and dictatorships (e.g. India, Indonesia, Republic of Korea, and Philippines). Decentralisation has also been promoted to address ethnic and religious conflicts and preserve historical, linguistic, and cultural specificities (e.g. Indonesia, Philippines, and Cambodia). Most recently, decentralisation reforms have continued in Indonesia, with the enactment of a dedicated legislation on villages as a distinct layer of SNGs, separate from the provincial and district levels, together with the allocation of new resources (2014), as well as in Bhutan, which provided an overarching legal framework for local governments (2009 and 2014), and Nepal, which moved from a unitary form of government to a federal structure with the devolution of inherent state powers (funds, functions and staff) to the state and local levels (ADB, 2022[29]).

In Central and West Asia, decentralisation processes have been embedded in the restructuring processes that followed the break-up of the Soviet Union in 1991. At this time, most Central and West Asian countries faced a strong polarisation of their territories, and an uneven development of regions, due to agglomeration effects favouring larger cities, particularly capital cities. Decentralisation in these countries therefore pursued specific objectives including democratisation, balanced economic development, and post-conflict reconciliation of ethnic communities (UCLG, 2019[17]). The level of decentralisation now varies significantly, from a highly centralized system in Azerbaijan and Kyrgyz Republic, to relatively autonomous local self-government in Armenia and Georgia (at the municipal or district level). Recent reforms include the recognition of new subnational governments Kazakhstan (2013 Law) and Kyrgyz Republic (2021), where a new Act on Local State Administration and Local Self-Government prescribes the creation of a representative body and budget at the intermediate district level, while district chief executives are still appointed by the upper level of government.

Decentralisation is not always a linear process and some countries have experienced a back and forth between decentralisation and recentralisation of the country. In Malaysia, for example, where federalism has historically been disputed, the trend in institutional reforms in recent decades has been towards the recentralisation of responsibilities traditionally devolved to subnational governments and the concentration of decisions and fiscal capacity at the central level. In Kyrgyz Republic, districts and regions used to have a certain degree of financial autonomy and their own budgets until 2014 when the central government recentralised public resources at the central government level. As a result, regional and district budgets were abolished and integrated within the central government budget. Now this system is in the process of being reversed. Recentralisation processes have also been at play in countries such as Mongolia, Thailand, Bangladesh, and Sri Lanka.

Decentralisation processes have not been fully implemented in some countries

Decentralisation processes in Asia and the Pacific have had a tendency to result in mismatches between the political, financial and administrative dimensions of decentralisation. Indeed, countries tend to give priority to so-called administrative decentralisation (devolution of responsibilities), to the detriment of the political and financial dimensions (devolution of power and resources), which are often less well developed. These three components of decentralisation cannot, however, be considered in isolation, and to be truly effective, they should be approached in a comprehensive manner (Chatry and Vincent, 2019[8]).

In terms of fiscal decentralisation, the imbalances between responsibilities, capacities and funding opens the door to the emergence of unfunded or underfunded mandates, which can create a drag on economic development. Vertical fiscal imbalances are created by limited autonomy of subnational government to raise and manage own-source revenues or take decisions regarding their expenditure, compared to extensive devolved responsibilities. These imbalances might create a serious drag on the potential positive economic effects of decentralisation (Rodríguez-Pose and Vidal-Bover, 2022[30]). For instance, the People's Republic of China's fiscal system is characterised by a vertical hierarchical relationship between different tiers of government, similar to its administrative system. Provinces bear the largest share of fiscal mandate among Chinese subnational governments. The People's Republic of China's local governments, on the other hand, do not have taxing power, have limited access to borrowing, and often have unfunded mandates. In Uzbekistan, the misalignments between fiscal, political and administrative decentralisation stem from a lack of demarcation of responsibilities between the central and regional governments.

Furthermore, many countries in Asia and the Pacific suffer from an unclear allocation of responsibilities among levels of government. This can generate the perverse incentive of shifting costs to other levels of government and may lead to policy duplication at different levels of government, to the non-fulfilment of responsibilities allocated vaguely to different governments, and to an erosion of transparency and accountability. Some examples of unclear allocation of responsibilities in the region include:

- In Malaysia, there is a federal list of competencies, a state list and a concurrent list, as well as vertically shared responsibilities between states and municipalities.
- In the Republic of Korea, the functions of local governments are not clearly defined by the Local Autonomy Act, which only makes the distinction between functions delegated by the central government and those that are local by nature. There is a large degree of overlap in the division of responsibilities, as the regional and local levels have the same functions, but at different scales, and the central government can use its own power and control over any function.
- In Japan, there is also no clear-cut delineation of tasks between the responsibilities of prefectures and municipalities.
- In Kyrgyz Republic, the 2008 Law on Local Self-Government and Local State administration defined a list of 23 competences to be decentralised at local government, but despite this effort, it did not provide a clear definition of functions, nor a clear vertical and horizontal division of responsibilities.

- In the Philippines, despite the specifications included in the 1991 Local Government Code, responsibilities of provinces, cities, municipalities and barangays tend to intersect, a situation that is exacerbated by the existence of various other public agencies that provide public services and carry out public works at the local level.

The issues related to the unclarity and overlap in responsibilities in Asia and the Pacific are further complicated by the co-existence in many countries of deconcentrated and decentralised entities. Deconcentration results in a geographic displacement of power from the central government to units based in regions (territorial administration of the central government, line ministerial departments, territorial agencies, etc.) (OECD, 2019[1]). Deconcentration enables the central government to maintain certain functions at the local level, ranging from representational functions to more significant ones, such as implementing national policies at the territorial level, carry out legal and fiscal oversight functions over SNGs, or provide national public services at the territorial level (OECD, 2019[1]).

In practice, distinguishing between decentralisation and deconcentration systems is a challenge in many countries. In some countries, there exists a dual system of territorial administration, with a mix of decentralised and deconcentrated entities at subnational level that have to co-exist (Box 5). Examples exist in Kazakhstan, Kyrgyz Republic, Mongolia, Viet Nam and the People's Republic of China, among others. This can result in an intricate system of governance, which can generate tension and reduce transparency and accountability (OECD, 2019[1]).

Box 5. A dual system of territorial administration: decentralised vs. deconcentrated

Many countries in Asia and the Pacific have a dual system of territorial administration, with a mix between decentralised and deconcentrated entities at the subnational level. In many cases, a deconcentrated executive body, often at the regional level, is appointed by a central government (or an upper level of government), and a deliberative body is elected by the population (e.g. local council). In such a situation, regional or local governments bodies elected by citizens have to co-exist alongside deconcentrated bodies that embedded in a vertical hierarchical structure and are under the supervision of the tier of government above them.

Among the sample of countries, this system is predominant in countries in Central and West Asia and in some countries in Southeast Asia, which can be partly explained by their highly centralised political heritage legacy. This mixed political-administrative system exists in Kazakhstan and Kyrgyz Republic, or in Mongolia, where provinces and districts have both a local assembly composed of democratically elected citizens, and an executive branch led by an appointed governor, that all serve for four-years terms. This is also the case in the People's Republic of China and in Viet Nam, which has a single political party, the Communist Party of Viet Nam, and where SNGs are each governed by both a People's Committee holding executive power, and a People's Council, which functions as the legislative bodies.

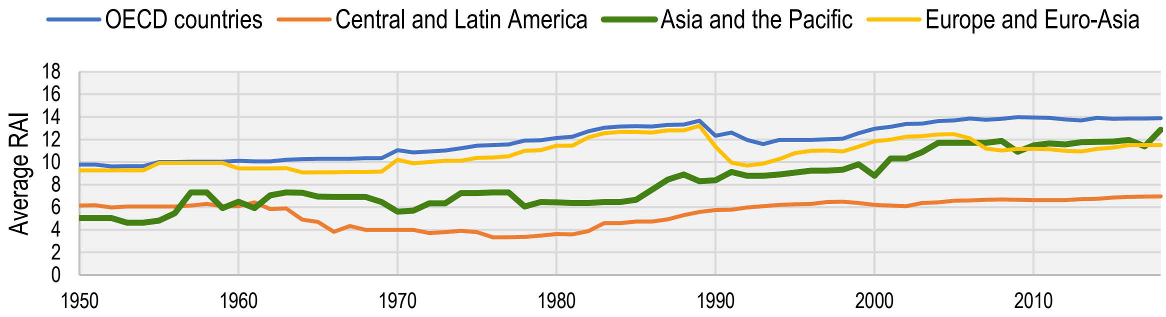
Source: Authors' elaboration based on SNG-WOFI country profiles

Countries from Asia and the Pacific could learn from other regions on how to address the overlap of responsibilities across levels of governments. Many OECD countries have responded to this issue through reforms to ensure that responsibilities are clearly defined across layers of government (OECD, 2019[1]). In 2013, Spain undertook a reform to clarify municipal responsibilities and avoid duplication of responsibilities. The so-called Local Reform improved the definition of local competences, provided a list of core competencies, and established that if the Autonomous Communities were to delegate any other non-core competencies to lower tiers of government, they would be required to ensure that earmarked resources properly fund the newly devolved responsibilities. In Denmark, a reform was also passed in 2007 following the reallocation of tasks among levels of government. One of the aims of the structural reform was to reduce the degree of shared assignments and reduce incentives for cost shifting between government levels. In order to tackle the latter problem, the municipalities were obliged to co-finance the rehabilitation services and training facilities provided by the counties.

The authority of regions has doubled from 1950 to 2018 in Asia and the Pacific

Decentralisation processes in Asia and the Pacific have led to the strengthening of regional governance, and of a regional level of administration. Based on data from the Regional Authority Index[10] (RAI), the Asia Pacific region is the one where the power of regional authorities increased the most, between 1950 and 2021, across all world regions. The Asia Pacific index increased from 5.2 in 1950 to 11.7 in 2018, in line with a general increase in decentralisation (Figure 5).

Figure 5. Evolution of the Regional Authority Index in Asia and the Pacific and other world regions (1950-2018)



Note: The average Regional Authority Index score for Asia and the Pacific includes the following countries: Australia, Bangladesh, Bhutan, Cambodia, People's Republic of China, Japan, India, Indonesia, Republic of Korea, Lao People's Democratic Republic, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, the Philippines, Sri Lanka, Thailand, Viet Nam.
Source: Author's elaboration, based on (Schakel et al., 2018[31]) (Hooghe et al., 2016[32])

The increase in the RAI in Asia and the Pacific has been driven by a significant increase in regional authority in Bangladesh, India, Nepal, Thailand, and Pakistan, among others. On the other hand, it decreased in Malaysia. The overall increase in regional authority was due to the development of metropolitan governance and city corporations (Bangladesh), the creation of new regions (New Zealand, Kazakhstan) or the introduction of a federal structure with seven new provinces with substantial authority (Nepal, since 2015). However, implementation remains often partial, and in the medium-term, regional entities tend to remain deconcentrated entities with few powers and responsibilities (e.g. Nepal, where the provinces have a mixed executive body, both deconcentrated and decentralised).

The territorial reforms that are ongoing in Asia and the Pacific show an effort to enhance public service provision and the well-being of citizens. However, these changes also involve new challenges to take into account to ensure their implementation. To have a real impact, it is crucial that territorial reforms

[10] The Regional Authority Index (RAI) is a measure of the authority of regional governments in 96 democracies or quasi-democracies. The sample consists of all OECD member states, all European Union member states, 12 countries in Europe and beyond the EU, all Latin American countries, and 25 countries in Southeast Asia and the Pacific. The index has been calculated on an annual basis for all countries over the period 1950-2018. The RAI assesses regional authority according to two main concepts: self-rule, i.e. the authority exercised by a regional government over those who live in the region; and shared-rule, i.e. the authority exercised by a regional government in the country as a whole. The index is calculated based on 10 dimensions: institutional depth, policy scope, fiscal autonomy, borrowing autonomy, representation, law-making, executive control, fiscal control, borrowing control and constitutional reform. Primary sources (constitutions, legislation) are triangulated with secondary literature and consultation of country experts to achieve reliable and valid estimates.

are accompanied by matching reforms in the authority, responsibilities and resources of subnational governments (OECD, 2017[33]; OECD, 2019[1]).

Territorial reforms in Asia and the Pacific

Asia and the Pacific countries have experienced numerous territorial reforms

In recent years, countries in Asia and the Pacific have moved from having a very heterogeneous organisation to a model of medium-sized municipalities. Countries across Asia and the Pacific have reached an average of 56 600 inhabitants per municipality across Asia Pacific (versus 41 000 inhabitants in the OECD, and 5 172 in the European Union, on unweighted average).

Changes in territorial organisation have occurred through three main types of reforms: municipal amalgamation, municipal partition, and inter-municipal co-operation. These three types of reforms have taken and are currently taking place, sometimes concomitantly, in most countries of the region. These reforms often aim to readjust subnational governments to a level in which they can effectively deliver public services and infrastructures to their citizens, be equipped with sufficient institutional and fiscal resources, and at the same guarantee local democracy and accountability.

For territorial processes to succeed in bringing about their intended gains, several factors need to be taken into account. Governments undertaking these reforms must ensure that they find a balance between smaller and larger areas to ensure equitable access to services, be able to manage the costs associated with the reform, build confidence and trust with the citizens and garner sufficient political support to steer the reform process to completion. The choice to implement a particular reform is thus guided by the specific objectives decision-makers wish to attain, but also needs to take into account specific challenges (Table 5).

Table 5. Benefits and challenges of reforming the territorial structure

Type of reform	Example countries	Definition	Objectives	Potential challenges
Amalgamation	Armenia, Australia, Azerbaijan, People's Republic of China, Georgia, Japan, Nepal, New Zealand	Reducing the number of entities within a given territorial level, and increase the average population size, most often by merging existing territorial entities	- Increase the efficiency of administration and service delivery (economies of scale) - Increase capacity of smaller subnational governments - Improve economic competitiveness and ease access to finance for investment	- Build confidence and trust with the citizens - Find a balance between smaller/larger, urban/rural settlements to limit inequalities in public service access - Face costs associated with the merging process (pre-merger) - Garner sufficient higher-level political support to guide the amalgamation process
Inter-municipal co-operation	Japan, Kyrgyz Republic	Partnership agreements between municipalities aimed at sharing infrastructure and co-delivering services	- Promote local and regional dynamism and growth across urban and rural areas - Increase the efficiency of administration and service delivery (economies of scale) - Preserve existing jurisdictions and jurisdictional autonomy - Increase flexibility - Avoid modifying local democratic institutions and political dynamics (no changes regarding the number of representatives)	- Develop an adequate and enabling legal framework - Provide sufficient incentives to subnational governments - Higher administration costs due to the creation of a new hierarchical layer - Less transparent decision-making - Lower accountability to voter - Creation of a 'common pool', which can lead to increased expenditure
Partition	Georgia, Indonesia, Philippines, Uzbekistan, Kazakhstan	Increasing the number of entities within a given territorial level, often by splitting existing territorial entities	- Enhance local democracy - Address historical, linguistic, economic and cultural specificities - Increase allocative efficiency in public service delivery for municipalities whose size is too large	- Respond to the larger need to build capacity at the subnational government level, both human and financial - Ensure transparency and accountability processes in new and more numerous territorial entities - Manage the risks of overlaps with other subnational governments in responsibilities and access to funding

Source: Authors' elaboration based on SNG-WOFI country profiles; (McQuestin, Drew and Dollery, 2018[34]; Karkin, Gocoglu and Yavuzcehre, 2019[35]; Tavares, 2018[36]); (McQuestin, Drew and Dollery, 2018[34]); (ADB, 2023[37]).

Municipal and regional amalgamation is the most common territorial reform in the region

At least 10 out of 26 countries throughout Asia and the Pacific have implemented amalgamation policies. These have typically been implemented gradually over time, as countries deepen their decentralisation process (Table 5). Amalgamation policies refer to a decrease in the number of entities within a given territorial level, most often by merging existing territorial entities. They have been long-term trends in Japan, the Republic of Korea, New Zealand and Australia since the 1950s, but they are now slowing down in those countries. In Japan for instance, several waves of mergers have, since 1953, drastically reduced the number of municipalities from 9 868 to 1 747 in 2021. In West Asia, a wave of municipal amalgamation started in the beginning of the 21st century (e.g. Georgia, Armenia, see Box). Contrary to municipal partition processes, amalgamation processes are often driven by incentives from the central government, in an effort to increase the efficiency of the territorial organisation, in particular in terms of service provision and administrative costs.

Box 6. Armenia's amalgamation policy towards increasing self-governance efficiency

Armenia is an interesting example of comprehensive territorial reform taking into account all the dimensions of decentralisation: fiscal, administrative and institutional.

Local self-government was established in Armenia in 1995 (the first local elections took place in 1996), starting with 931 local communities at the municipal level, including both cities and villages. Since then, the central government has undertaken four rounds of Territorial-Administrative Reforms, aimed at promoting mergers of small communities and increasing the efficiency of self-governance and public services provision. Mergers were done based on the limits of functional urban areas (e.g. Dilijan, Jermuk), on joint business interests (e.g. Zaritap, Gorayk), on geographical characteristics.

By the end of 2021, the number of local communities had been divided by three, from 931 in 1995 to 502 municipalities in 2016, and to 308 municipalities in 2021. As a result, the average municipal population size increased, from 5 848 inhabitants in 2016 to 9 624 inhabitants in 2021. This reform was also combined with a shift to a new, proportional electoral system for almost all municipalities in Armenia.

Following these drastic reductions in the number of local communities and political changes, the central government, along with subnational governments and all other stakeholders involved, are currently working on drafting of a new legislative framework in order to better reflect the new realities on the ground, and help consolidate the decentralisation process.

Source: (RA Ministry of Territorial Administration, 2014) ; (OECD/UCLG, 2022) ; (Council of Europe, 2022)

Inter-municipal co-operation is an alternate to amalgamation that is less frequent in Asia and the Pacific than in the OECD

Horizontal coordination at the municipal level aims to support efficient service delivery. Many countries globally are promoting inter-municipal co-operation as an alternative to amalgamations. If well-designed, inter-municipal co-operation mechanisms can be a useful tool to overcome municipal fragmentation and to generate economies of scale, efficiency gains and cost savings, with a lesser political costs than amalgamation policies (OECD, 2017[33]; OECD, 2019[1]).

Inter-municipal co-ordination mechanisms are not as common in Asia and the Pacific as they are in other regions of the world. In the OECD, inter-municipal co-ordination is widely present and diverse, ranging from the softest (single or multi-purpose co-operative agreements) to the strongest forms of integration such as supra-municipal authorities with delegated functions in France, Portugal and Spain. Latin America has also seen an upward trend towards the adoption of inter-municipal co-operation mechanisms, enshrining legal provisions to encourage these tools in Guatemala, Honduras, Brazil or Bolivia. By contrast, countries in Asia and the Pacific has lower use of using inter-municipal cooperation to support horizontal co-ordination, relative to other world regions. This may stem from the fact that this type of arrangement is more common between small-size subnational government units, and that municipal governments in Asia Pacific are of relatively larger size. In addition, and perhaps most importantly, countries in Asia and the Pacific generally lack a robust legal framework defining and structuring the functioning of these mechanisms. This is the case for Sri Lanka, where horizontal co-operation at the subnational level mainly operates through informal mechanisms dependent on personal endeavours and leadership of both the political and administrative bodies. Informal co-operation has also emerged in Mongolia under the form of collaborative inter-soum service delivery models in the areas of health and education, but any progress is contingent upon the development of an adequate legal framework.

Some countries in the Central and West Asia region have taken steps to legislate inter-municipal co-operation in the past decades. In Georgia, the 2014 Local Self-Government Code is gradually serving as a way to empower municipalities to establish joint enterprises, drawing from the successful experience of a metropolitan governance project in 2009. In Kyrgyz Republic, the Local Self-Government Act of 2021 promotes inter-municipal collaboration, but to date the country still lacks specific regulation for such arrangements.

Several countries have been undertaking municipal and regional partitions

With the aim to better cater for specific local needs, at least 5 out of 26 countries in Asia and the Pacific have resorted to municipal partition at the subnational level (Table 5)**.** Partitions often follow the transition of countries from a centralised to a more decentralised or deconcentrated structure or significant country transformations. Territorial partitions refer to the increase in the number of entities within a given territorial level, often by splitting existing territorial entities**.** It is most often a bottom-up process, often taking advantage of a certain gap in the legislation, and in response to a strong need of citizens and certain territories for more representation and democracy. Today, territorial partition occurs in particular in countries with rapid demographic and institutional changes such as the Philippines, Indonesia or Uzbekistan. This is particular true in countries with a sub-municipal government level (see Table 3). As such, in Indonesia, the number of villages has increased by 20% between 1999 and 2020, reaching 83 813 villages, in parallel with the devolution of new responsibilities and funding to village settlements (2014 Village Law).

Partition can also occur at the regional level to better develop the economic and cultural potential of certain regions. This may involve readjusting borders to improve connectivity and accessibility of services for people in the most isolated areas. It may also aim to distinguish regions with specialized economic fabrics in one sector or another (e.g. tourism). For instance, in Kazakhstan, the number of regions further increased from 14 regions in 2019 to 17 regions in 2022, by splitting existing regions. This reform was implemented by the central government with the objective to optimise public administration and enhance mobility of inhabitants from the regions and their proximity to the regional centre by adjusting the functional urban area. In addition, it aims to increase regional attractiveness and competitiveness for the new Ulytau region, to make it a tourist hub in the country.

Vertical co-ordination mechanisms

Decentralisation and territorial reforms should be accompanied by vertical co-ordination mechanisms to ensure policy coordination and coherence. Vertical co-ordination mechanisms serve to avoid policy duplication and overlaps, to increase efficiency, and to foster trust among tiers of government, which are all essential especially in times of emergency or crisis, as the COVID-19 pandemic illustrated (OECD, 2014[10]; OECD, 2021[27]). Vertical coordination is important as several countries in Asia and the Pacific have a dual system of deconcentrated local administration representing the central government and local autonomous self-governments. Coordination between these bodies is essential for effective policymaking.

Vertical co-ordination mechanisms vary across countries in Asia and the Pacific

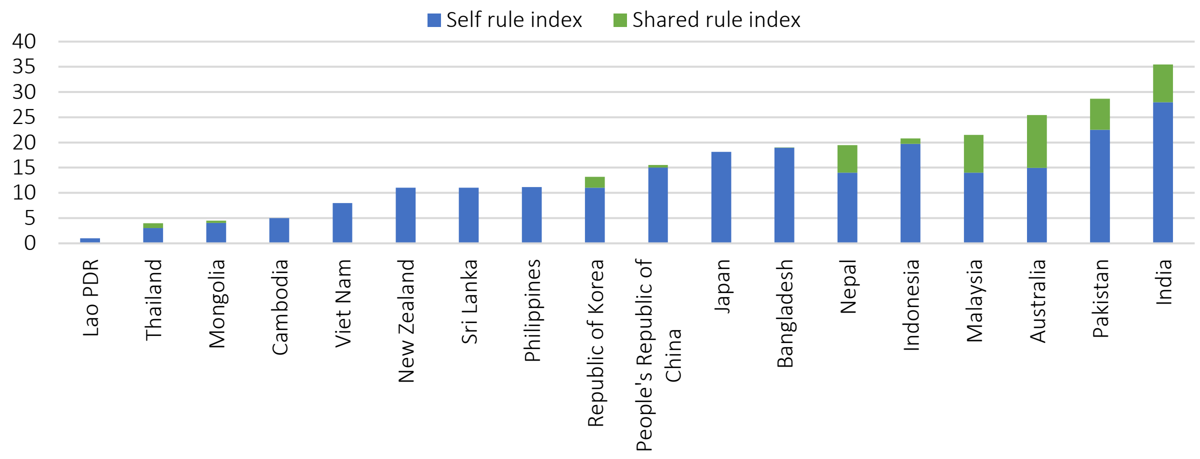
Vertical coordination mechanisms between upper-level governments and municipal governments are highly varied across and within countries. Some interesting examples are Australia's new National Cabinet, an inter-governmental decision-making forum composed of the Prime Minister, and state and territory representatives; or Georgia's consultative national forums and regional meetings between the National Association of Local Authorities of Georgia, the Ministry for Regional Development and Infrastructure and the Parliament of Georgia, which happen regularly to discuss new legal initiatives and draft decisions taken by the government that have direct impact on municipalities, while in parallel, there is direct dialogue between municipalities and ministries on various aspects of delegated tasks and responsibilities.

Over time, vertical co-ordination mechanisms continue to adapt to changing circumstances and to include relevant stakeholders. As new trends and crises emerge, it can be relevant to revise coordination mechanisms to make sure they remain relevant (OECD, 2021[27]). In Georgia, the 2014 code established Regional Advisory Councils as consultative bodies representing the authorities that operate at the municipal level and are chaired by the state governors. Amid stark and worsening regional disparities, their role is to report the challenges and specificities of each region and incorporate them into regional development plans. The Regional Consultative Council is a special collegial body responsible for consultation on regional development strategies with mayors and heads of local councils from the municipalities located on the territory of administrative regions.

A closer look at the composition of the Regional Authority Index reveals discrepancy between increased responsibilities at the regional level, and the absence of co-ordination mechanisms and involvement of these regions by the central government.[11] For most countries of the sample, self-rule indicators make up the most, if not the entirety, of their overall RAI score (Figure 6). This means that they are not strongly involved in multi-level governance, are not consulted by the central government on a regular basis, and do not take part in constitutional reforms at the country level. This is the case In Bangladesh, or in Nepal, where the 2015 Constitution established the Inter-Provincial Council, but this council only meets on an ad hoc basis (instead of planned regular meetings) and is limited to the aim of settling disputes (rather than coordinating policies). Similarly, the recently created National Natural Resources and Fiscal Commission does not include representatives of provincial governments.

[11] The RAI assesses regional authority according to two main concepts: self-rule, i.e. the authority exercised by a regional government over those who live in the region (measured based on institutional depth, policy scope, fiscal autonomy, borrowing autonomy, and representation); and shared-rule, i.e. the authority exercised by a regional government in the country as a whole (measured by law-making, executive control, fiscal control, borrowing control and constitutional reform).

Figure 6. Regional Authority Index in 2018 in a selection of countries in Asia and the Pacific



Source: Author's elaboration, based on (Schakel et al., 2018[31]) ; (Hooghe et al., 2016[32])

The COVID-19 crisis resulted in the development or reactivation of vertical co-ordination mechanisms

The COVID-19 crisis re-emphasised the importance of effective intergovernmental co-ordination for crisis management. In some countries, central governments have been able to foster co-ordination by involving subnational governments and other stakeholders in the design and/or implementation of their response, usually by setting up or reactivating joint inter-governmental fora. In Indonesia, provincial governments prepared individual provincial response plans, covering the issues of coordination with the central authorities, with support from the World Health Organization and the Indonesian Ministry of Health and National Disaster Agency. In Kyrgyz Republic, the central government established the Republican Strategic Headquarter to combat coronavirus. The Headquarter is chaired by the Prime Minister of the Kyrgyz Republic, with representatives from the central government in the regions of Osh, Batken, Jalal-Abad, Issyk-Kul, Naryn, Talas and Chui, as well as the mayors of the cities of Bishkek and Osh. In Pakistan, the central government established a new National Co-ordination Committee, headed by the prime minister, which served as a platform for Pakistani provincial governments to work in unison with the federal government (despite a pre-existing constitutional inter-governmental body, the Council of Common Interest).

In some countries, such fora already existed as a result of previous pandemic outbreaks, which allowed them to respond quickly. In Thailand for instance, Communicable Disease Committee (CDC) exist since 2005, to deal with pandemics at the territorial level. They are headed by the governor of each province. During the COVID-19 crisis, the CDCs had to implement at the provincial and local levels the measures emanating from the central level. In Viet Nam as well, the central government benefited from its experience with the past SARS outbreak, and delivered rapid guidelines to local governments through the creation of the National Steering Committee for COVID prevention and control. The People's Republic of China's public health reporting system relies on local Centres for Disease Control (CDCs), that act under the authority of local governments (there were around 3 403 local CDCs in 2019), which then report to the central CDC. This decentralised system was developed in 2002 based on lessons learned from the SARS epidemic. The efficiency of this system is, however, hindered by the lack of funding and staffing of some local CDCs, as well as the lack of communication and transparency of information between the central and local CDCs.

Even when COVID-19 policy responses were designed primarily at the central government level, countries set up specific strategies to ensure the implementation of these policy responses across the

territory, often involving state deconcentrated entities. For instance, in Lao PDR, to ensure good co-ordination, the Department of Communicable Disease Control conducted a series of workshops in the provinces to discuss provincial preparedness and response. In the Philippines, the central government issued a National Action Plan Against COVID-19 which provided guidelines on how to manage the crisis across the country.

On the other hand, in some countries, the lack of vertical co-ordination mechanisms has hampered the response to the COVID-19 crisis and hindered the capacity of subnational governments to face this crisis. In Nepal, for instance, the COVID-19 Crisis Management Centre (CCMC), which is led by the Deputy Prime Minister and other ministers, includes no representatives from subnational governments nor consulted them in the decision-making process. In turn, provincial and local replications of the federal CCMC were created in subnational governments. The lack of co-ordination and dialogue between the instances, added to ambiguities in the allocation of responsibilities in health, have caused technical problems in managing the pandemic.

3 Subnational government finance

Following the trend towards decentralisation that has unfolded in most countries in Asia and the Pacific since the 1990s, subnational governments (SNGs) have acquired important responsibilities, resulting in an increase in the share of these subnational governments in public expenditures and revenues (Allain-Dupré, Chatry and Phung, 2021[9]). Nevertheless, fiscal decentralisation remains partial in many countries, resulting in a weak capacity of these governments to direct their expenditures and adjust their revenues, in particular with regards to own-source tax revenue. In light of the overall strained public finance situation of countries across the globe, an in-depth analysis of local finances in Asia-Pacific is needed to define the levers to be activated to strengthen the financial resilience of these governments.

After having explored subnational government structures in the previous chapter, as well as the various institutional and territorial reforms, this chapter explores the state of subnational government finance in Asia and the Pacific compared with other world regions, in terms of expenditure, investment, revenue, debt, fiscal frameworks and fiscal rules, and financial management.

Fiscal decentralisation in Asia and the Pacific

Subnational governments in Asia and the Pacific account for 29% of total government expenditure and 35% of revenue on average, above the world average

Countries in Asia and the Pacific have, on average, higher subnational expenditure than other world regions. Subnational governments account on average for 29.1% of total public expenditure representing 8.8% of GDP, compared with 21.5% and 8.3% respectively at global level[12] (Figure 7). Subnational expenditure in Asia and the Pacific amounted, on average, to USD 1 787 PPP per capita in 2020. These figures are based on a sample of 19 countries in Asia and the Pacific with available data.

Countries in the region also have a higher proportion of subnational revenues than other world regions. On average, subnational government revenue accounts for 35.0% of total public revenue in Asia and the Pacific in 2020 (Figure 9), representing 8.5% of GDP. This is well above the world averages (25.6% of total public revenue and 8.0% of GDP) and the averages for countries from Latin America (21.6% and 5.7%), and even slightly above the averages for OECD countries (34.1% and 13.9%). Subnational government revenue accounts for a larger share of total public revenue in the five federal countries from the sample, reaching 52.5% on average. For unitary countries, subnational government revenue accounts for 30.3% of total public revenue on average. The composition of these revenue varies, and revenue ratios cannot be automatically interpreted as indicating the level of revenue autonomy of SNGs, in particular due to the prominence of grants and shared taxation (see Box 7).

Subnational expenditure in the region represents 8.8% of GDP whereas subnational revenue amounts to 8.5% of GDP. This indicates an average 0.3 percentage point deficit in the region, which is similar to the OECD and world averages. Subnational expenditure in the OECD and the world lies at 14.1% and 8.3% of GDP respectively on average while subnational revenue stands at 13.9% and 8.0%.

[12] Unweighted average, based on a sample of 122 countries.

Figure 7. Subnational government expenditure as a share of GDP

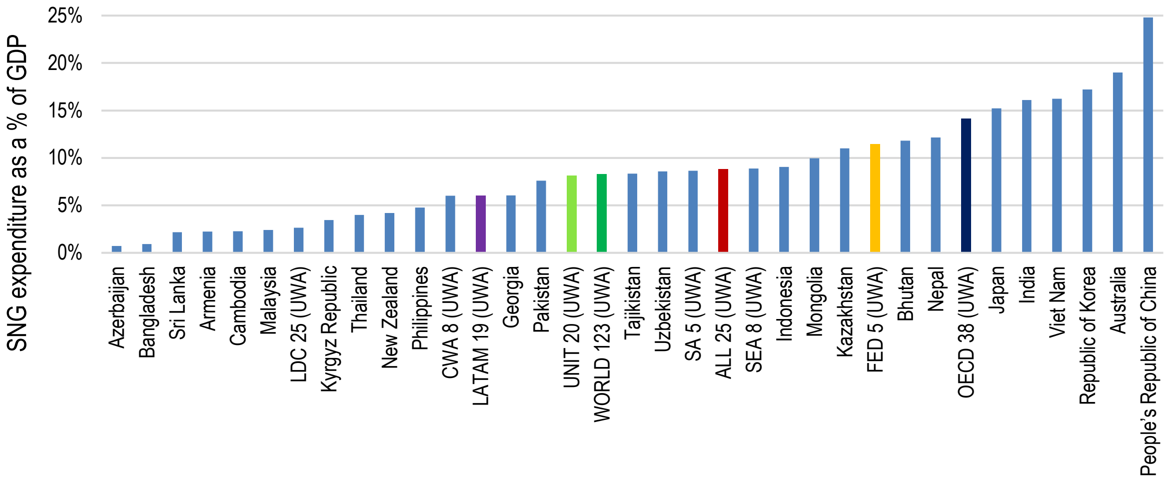


Figure 8. Subnational government expenditure as a share of total government expenditure

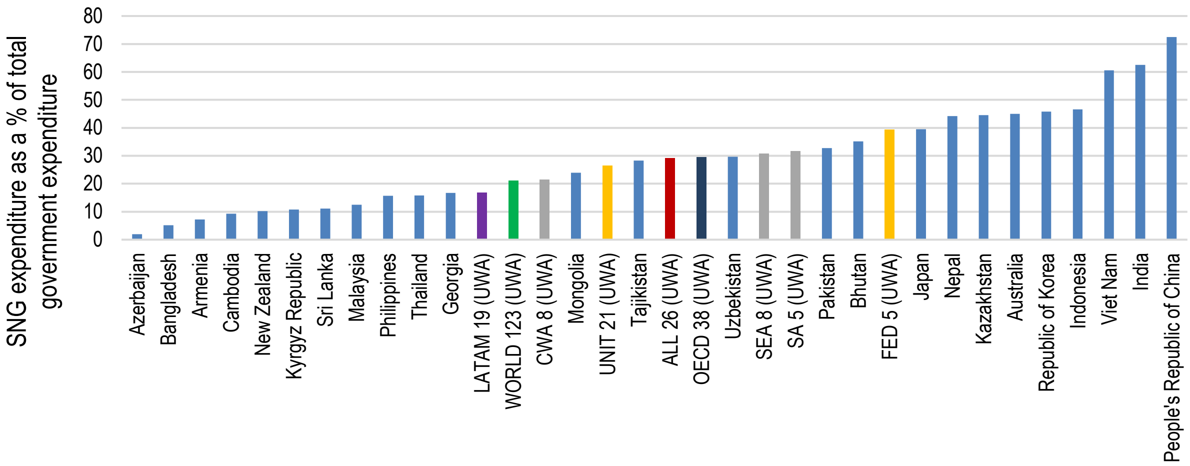


Figure 9. Subnational government revenue as a share of GDP

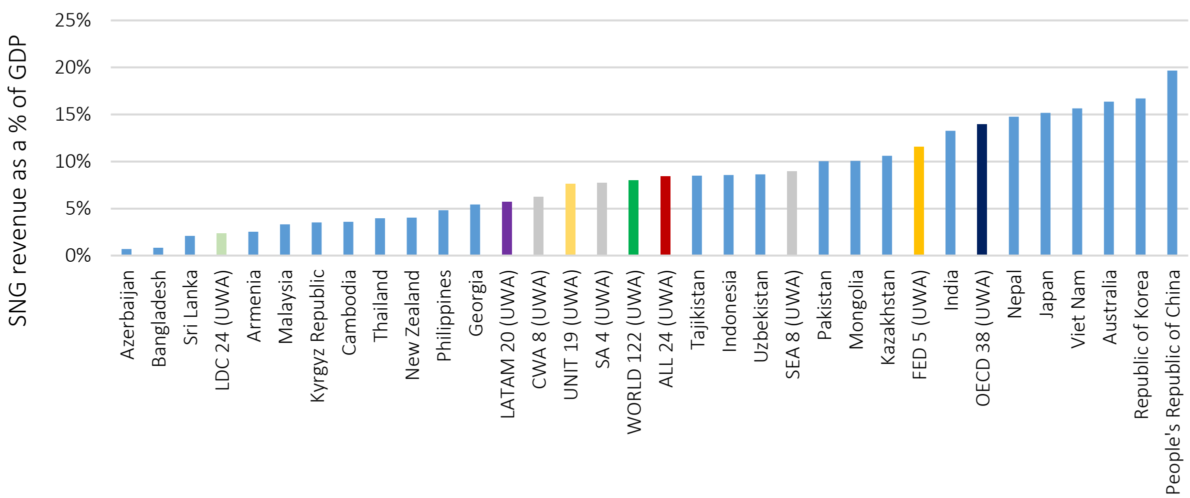
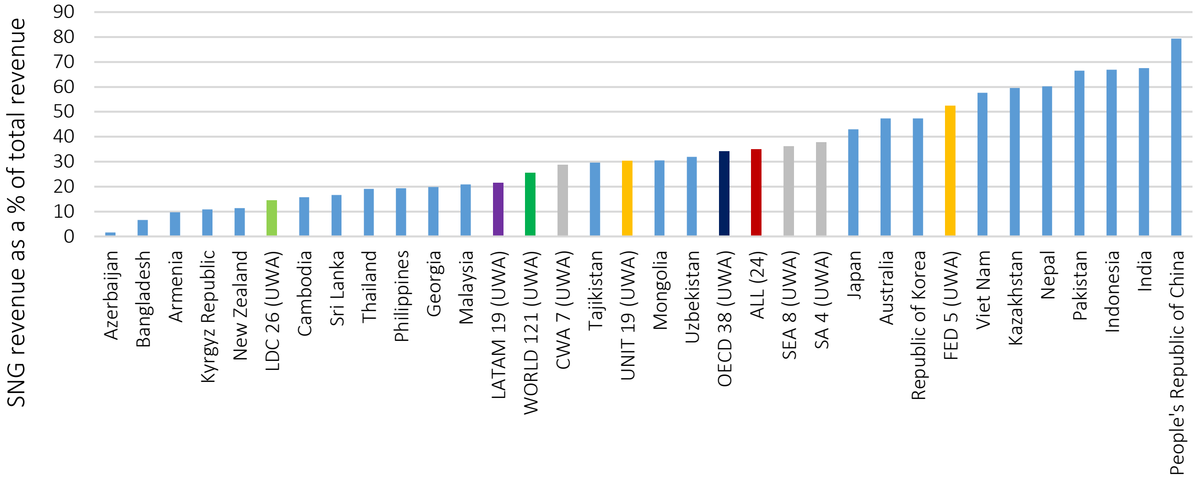


Figure 10. Subnational government revenue as a proportion of total government revenue



Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

These figures must, however, be interpreted with caution and do not necessarily reflect a high level of spending or revenue autonomy, and they are subject to distortion due to large variations across countries (see Box 7). In the People's Republic of China, for instance, more than 70% of public expenditure is made by subnational governments; however, the country is particularly representative of a "magnifying effect" that can distort the reality of spending autonomy. Despite their large subnational spending values, in practice, subnational governments are part of the national governmental system and most spending at the subnational level is delegated and then executed on behalf of the central government. The country also tops the ranking on the revenue side, with subnational governments revenue accounting for 79.4% of total public revenue and 19.7% of GDP, compared to 17.1% on average in the OECD in 2020. However, subnational governments have little control over local revenue, which primarily emanate from a tax sharing system managed and supervised by the central government.

Box 7. Challenges associated with measuring fiscal decentralisation in Asia

Decentralisation processes have resulted, on average, in high levels of subnational expenditure and revenue in Asia and the Pacific. This shows that subnational governments are key economic and social actors in the region. Yet, when taking into account other dimensions of subnational autonomy, such as the reliance on own-source revenue or legal and institutional arrangements, many countries in Asia and the Pacific are more centralised than what fiscal indicators suggest.

Expenditure and revenue ratios cannot be automatically interpreted as indicating the level of spending or revenue *autonomy* of subnational governments. High levels of subnational expenditure may not reflect a high level of decentralisation, as in some cases expenditures are delegated from the central government. Indeed, it is not because responsibilities are assigned to subnational governments that the latter automatically have full autonomy in exercising them by independently choosing how and where to allocate their funds and resources. In other words, subnational governments may simply act as a "paying agent" with little or no decision-making power or room for manoeuvre.

This is often the case for subnational governments that are in charge of paying teachers or health staff wages on behalf of the central government, without any control over the disbursement of these resources (e.g. Uzbekistan). This also happens when subnational governments share some decision-making authority in their fields of responsibility with other levels of government, functioning sometimes more as agencies funded and regulated by the central government rather than as independent policy makers (e.g. India, Malaysia, Sri Lanka). Moreover, subnational governments can also be constrained by regulations, norms and standards which can impose compulsory expenditures (e.g., environmental norms, security standards, etc.), as well as guided by strict budgetary rules. This is the case for instance in Cambodia, Republic of Korea, Sri Lanka and Thailand, where the central government has the power to intervene directly in subnational affairs. This is also valid in countries where the central government appoints subnational leaders, such as the People's Republic of China, Malaysia, Mongolia or Sri Lanka.

Consequently, the share of subnational government expenditure in general government expenditure or GDP in Asia and the Pacific, while providing a valuable macroeconomic overview of the level of decentralisation, is sometimes open to overestimation.

Furthermore, fiscal decentralisation cannot be properly analysed looking exclusively at revenue ratios. Revenue autonomy is also a complex issue that goes beyond simple tax autonomy. Greater reliance of subnational government on central government transfers is an indication of low levels of decentralisation. Nonetheless, autonomy is also contingent upon the extent of discretion in intergovernmental transfers, which can be limited when earmarked and conditional transfers, whereas it can be wider when these are general-purpose grants based on a formula. In Australia, for example, subnational governments have a high level of discretion over transfers collected through the federal Goods and Services Tax.

The same complexity applies to the tax systems. The tax revenue indicator conveys relatively little information on the discretion provided to state and local authorities over their tax base and rates and therefore, reflect only partially the real level of tax autonomy of subnational governments. With the data currently available in the framework of the government statistics of the national accounts, it is not possible to make the distinction between shared and own-source taxes. National accounts only consider the "ultimately received" tax revenues. This means that the shares displayed under subnational governments do not only include "own" taxes of government sub-sectors, but also the relevant part of the tax revenue that is actually "shared" between the different levels of the general government, even in cases where a government sub-sector has practically no power to vary the rate or the base of those particular taxes.

Source: (OECD/UCLG, 2022[38]; Allain-Dupré, Chatry and Phung, 2021[9])

There are large disparities in the responsibilities and financial resources of subnational governments across different countries in the region

Averages hide large disparities in subnational expenditure across countries. Some countries have a very high level of expenditure and revenues at a subnational level, such as the People's Republic of China. Subnational expenditure in half of the countries in Asia and the Pacific reached over 25% of total public spending. At the other end of the spectrum, many countries have shares of subnational expenditure well below the world average. In four strongly centralised countries, subnational expenditure is below 10%.

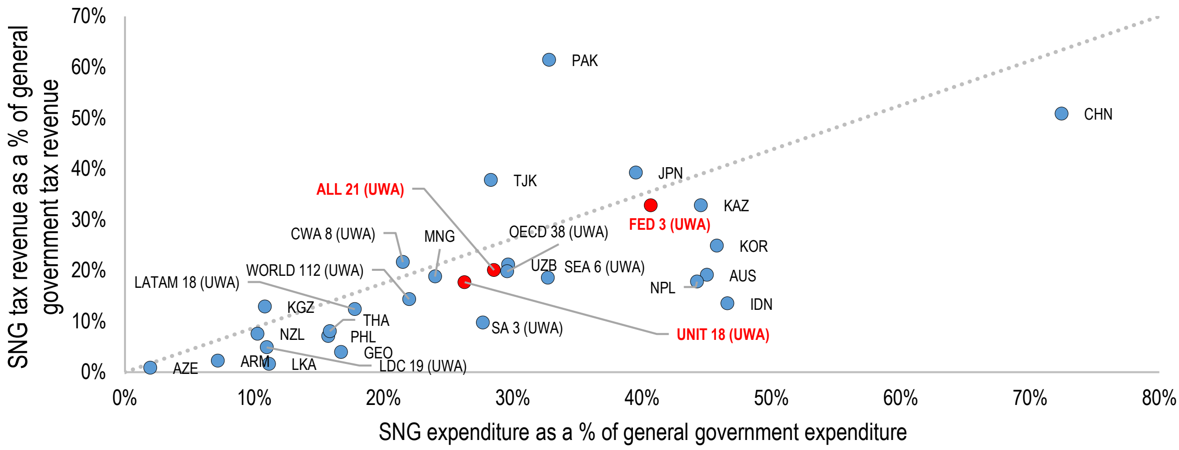
There is a large diversity in the share of subnational revenue across Asia and the Pacific, and significant disparities across and within sub-regions. The share of subnational government revenue in total public revenue is highest in countries from South Asia and Southeast Asia. It is lower in countries from Central and West Asia, on average. However, subnational revenue also varies strongly within sub-regions. Looking at Central and West Asia region, subnational governments' revenue in Pakistan and Kazakhstan represents 60% or more of total public revenue, whereas in Azerbaijan, Armenia and Kyrgyz

Republic, it accounts for 10% or less. Among federal countries, Malaysia has a rather centralised revenue structure, as subnational government revenue represented only 20.8% of total public revenue in 2020. Among unitary countries, Azerbaijan is the most centralized country regarding revenue.

Several countries in Asia and the Pacific suffer from vertical fiscal imbalances as indicated by the level of tax revenue

Looking both at the level of expenditure and at the level of subnational tax revenue, it is possible to draw an estimation of the degree of vertical fiscal imbalance in Asia and the Pacific. This comparison indicates whether SNGs, given their spending responsibilities, are appropriately financed through the tax system (comprising both shared taxes and own-source ones) (Figure 11). Countries close to the dotted line are most likely to be fiscally balanced from a tax revenue perspective, with more or less comparable levels of tax revenue and expenditure decentralisation. On the other hand, countries far from the line are those who are more fiscally imbalanced, most often undertaking a high share of public spending but with a limited share of public tax revenue, such as the People's Republic of China, Indonesia, Nepal, Australia, Republic of Korea and Kazakhstan. There is also the case of Pakistan and Tajikistan, where SNGs represent a greater share of public tax revenue than their participation in public expenditure.

Figure 11. Comparing tax revenue and expenditure of SNGs in Asia and the Pacific



Source: Author's elaboration based on (OECD/UCLG, 2022[38])

Many countries in Asia and the Pacific are characterised by significant vertical fiscal imbalances between the level of subnational expenditure and the level of subnational tax revenue. On average, subnational tax revenue account for 20% of total public tax revenue whereas subnational expenditure account for 29.1% of total public expenditure in Asia Pacific[13], a gap of 9.1 percentage points. These ratios amount to 19.8% and 29.6%, respectively, for OECD countries, and 14.4% and 21.5% for the world average[14]. For instance, the share of public expenditure and tax revenue by SNGs (shared and own-source taxes) are almost equivalent in Japan, Kazakhstan, and Mongolia, while in Australia, Indonesia, Nepal, Georgia and Sri Lanka, the subnational share of public expenditure is more than double the subnational share of public tax revenue. However, this comparison remains imperfect, as the tax indicator above comprises both own-source and shared tax revenues, therefore not reflecting full tax autonomy.

[13] Sample of 21 countries with available data.

[14] Sample of 112 countries with available data.

Vertical fiscal imbalances appear to be even greater in countries where autonomy on local taxes is restricted. In several countries, the local own-source taxes are significantly controlled by the central government through various regulations, such as the imposition of minimal or maximal rates and obligations to apply certain exemptions, resulting in significant vertical fiscal imbalances.

Subnational government expenditure

The bulk of subnational government expenditure goes to education, general public services and economic affairs

Subnational expenditure is highest for education, economic affairs and general public services[15] in terms of GDP (Figure 12). Subnational expenditure in education represents 2.4% of GDP on, followed by economic affairs (2.1%) and general public services (1.7%). Social protection and health represent 1.1% of GDP on average, with the rest of functions below 1% of GDP: housing and community amenities (0.9%), public order and safety (0.4%), and finally recreation, culture and religion (0.3%) as well as environmental protection (0.3%). Some functions display higher rates of variation than others across countries. For example, while education and defence both respectively remain high and low across virtually all countries of the sample, this is not the case for health, where subnational governments in countries like Australia, the People's Republic of China, and Uzbekistan spend much more than others, especially in Central and West Asia, such as Armenia, Kyrgyz Republic, Azerbaijan and Georgia. In Mongolia, subnational government expenditure on general public services represent almost half of their total expenditure (and 4.6% of GDP). The People's Republic of China also stands out for its very high subnational government expenditures as a percentage of GDP, especially in economic affairs (8.7%), which has increased rapidly in recent years to respond to urbanisation dynamics.

Figure 12. Subnational expenditure by function as a percentage of GDP

Subnational government expenditure as a percentage of GDP by COFOG level 1 category

	People's Republic of China	Australia	India	Japan	Republic of Korea	Nepal	Kazakhstan	Mongolia	Indonesia	Uzbekistan	Tajikistan	Georgia	New Zealand	Thailand	Philippines	Kyrgyz Republic	Armenia	Azerbaijan	SAMPLE Unweighted average	OECD unweighted average	Difference (SAMPLE-OECD)
Education	3.4	3.9	2.6	2.7	4.2	2.1	3.4	3.4	2.5	3.8	3.7	0.8	0.0	0.0	0.0	1.2	0.8	0.1	**2**	**2.9**	**-1.0**
General public service	2.3	1.9	2.9	1.5	2.2	3.3	0.8	4.6	3.0	1.4	0.3	0.7	1.3	4.0	2.4	0.7	0.6	0.2	**1.7**	**1.8**	**0.0**
Economic affairs (inc. Transport)	8.7	3.6	4.9	2.2	2.2	3.2	3.1	0.5	0.6	0.4	0.2	1.5	1.2	0.0	0.6	0.2	0.2	0.2	**1.7**	**1.6**	**0.0**
Social protection	3.9	1.5	3.0	4.0	3.3	0.2	0.6	0.1	0.1	0.6	0.1	0.5	0.0	0.0	0.9	0.1	0.1	0.0	**1.0**	**2.7**	**-1.7**
Health	1.9	4.5	1.1	1.8	0.6	0.8	0.5	0.5	1.4	1.8	1.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	**0.8**	**2.0**	**-1.2**
Housing and community amenities	2.2	0.6	0.8	0.6	1.0	2.1	1.4	0.4	1.1	0.4	1.2	1.4	0.5	0.0	0.0	1.0	0.2	0.0	**0.7**	**0.4**	**0.3**
Public order and safety	1.2	1.7	0.8	1.0	0.3	0.1	0.3	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	**0.3**	**0.4**	**-0.1**
Recreation, culture and religion	0.4	0.7	0.0	0.4	0.6	0.2	0.5	0.3	0.1	0.2	0.7	0.5	0.6	0.0	0.0	0.2	0.1	0.0	**0.3**	**0.7**	**-0.4**
Environmental protection	0.7	0.6	0.0	1.0	0.8	0.2	0.4	0.1	0.2	0.0	0.0	0.4	0.6	0.0	0.0	0.0	0.3	0.0	**0.3**	**0.5**	**-0.2**
Defence	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	**0.0**	**0.0**

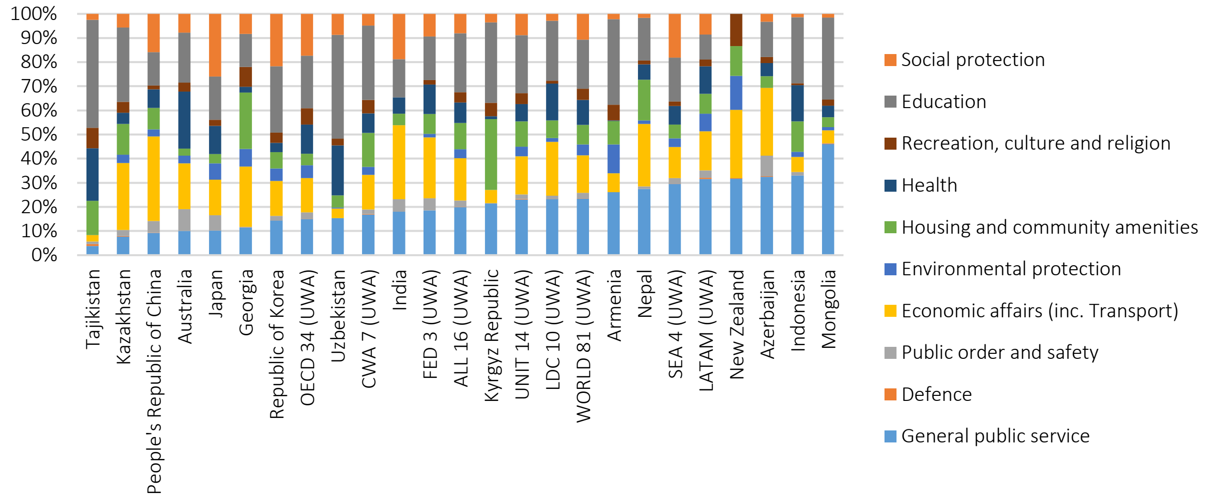
Note: Analysis of countries with COFOG Level 1 data available. Dark green indicates high subnational government expenditure as percentage of GDP. White indicates low or no subnational government expenditure in the COFOG category and country. Light blue indicates federal countries (India, Australia, Nepal).
Source: (OECD/UCLG, 2022[38])

[15] The COFOG category "General public services" covers government expenditure relating to the administration, development and management of general public services.

Over a fifth of subnational expenditure in Asia and the Pacific goes to education. This amounts to 24.4% of total subnational government expenditure, on average, compared to the world average at 20.2% (Figure 13). The second and third biggest categories of subnational expenditure by functional classification are general public services (19.9%) and economic affairs (17.5%). For economic affairs, the world average is also lower at 15.5%. The next areas include housing and community amenities (10.8%), health (8.5%), social protection (8.0%), and finally recreation, culture and religion (4.3%), environmental protection (3.8%) and defence, public order and safety (2.6%). Furthermore, subnational expenditure in education in Asia and the Pacific is much higher than in Latin America, where it only reaches 10.3% of total subnational spending (i.e. 1.3% of GDP).

On the other hand, subnational governments in Asia and the Pacific spend a smaller share of their expenditure than the global average on non-education expenditure categories. These include general public services (19.9% in Asia and the Pacific vs 23.4% globally), social protection (8.0% vs 10.7%), health (8.5% vs 10.4%), and environmental protection (3.8% vs 4.6%) (Figure 13). Subnational government expenditure on health as a share of GDP is low in most countries in Asia Pacific, below the world average (1.3%), except for Australia, Japan, the People's Republic of China, and Tajikistan and Uzbekistan. India and Nepal have particularly low shares of subnational expenditure in this area despite their federal status.

Figure 13. Subnational government expenditure by functional classification (COFOG Level 1) as a percentage of total subnational government expenditure (2020)



Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

In terms of responsibilities as a proportion of total government expenditure, subnational governments in the sample are typically responsible for a significant share of expenditure relating to the environment, housing, community and education. Across the 16 countries with data available, subnational governments are responsible for the largest share of public spending on public housing and community expenditure (68%, on average), followed by environmental protection (48%), recreation, culture and religion (47%), education (48%), health (32%) and economic affairs and transport (28%) (Figure 14). Important exceptions are Azerbaijan, Kyrgyz Republic and Thailand, which are highly centralised countries with subnational governments only responsible for 3%, 14% and 4% of total public expenditure, respectively.

Figure 14. Subnational government expenditure responsibilities in Asia and the Pacific

Subnational government expenditure as a percentage of total government expenditure by COFOG level 1 category

	Australia	Uzbekistan	Kazakhstan	Indonesia	Republic of Korea	Nepal	Mongolia	Georgia	New Zealand	Armenia	Kyrgyz Republic	Azerbaijan	SAMPLE Unweighted average	OECD unweighted average	Difference (SAMPLE-OECD)
Housing and community amenities	78	81	58	89	77	72	100	86	47	60	78	8	**69**	**75**	**-6**
Environmental protection	65	77	78	69	63	43	28	62	66	78	0	1	**52**	**66**	**-14**
Education	53	70	70	71	49	68	73	18	0	25	18	4	**43**	**49**	**-5**
Recreation, culture and religion	79	61	70	45	59	53	35	43	59	25	25	4	**46**	**59**	**-13**
Health	49	79	18	67	11	43	17	4	0	0	1	3	**25**	**26**	**-1**
Economic affairs (inc. Transport)	47	12	58	18	40	36	19	23	17	8	5	2	**24**	**34**	**-10**
General public service	26	23	14	26	32	22	19	9	30	9	8	4	**19**	**21**	**-3**
Public order and safety	84	0	30	11	19	9	0	0	0	0	0	3	**13**	**23**	**-10**
Social protection	13	10	10	6	34	11	1	5	0	1	1	0	**8**	**14**	**-6**
Defence	0	0	1	0	1	0	3	1	1	0	0	0	**1**	**0**	**0**

Note: Analysis of countries with COFOG Level 1 data available. Dark green indicates high subnational government expenditure. White indicates low or no subnational government expenditure in the COFOG category. Values represent subnational government expenditure in each category and country, as a percentage of total government expenditure in the same category and country. Light blue indicates federal countries (India, Australia, Nepal).
Source: (OECD/UCLG, 2022[38])

The role of subnational governments in healthcare is high in four of the twelve countries with data available. In two federal countries (Australia, and Nepal) and two of the thirteen unitary countries studied (Indonesia and Uzbekistan), subnational governments haves a major role in health care with subnational expenditure representing at least 40% of total health care expenditure (and often much more). In the remaining eight countries with data available, subnational governments limited or no health responsibilities. Nevertheless, these expenditures may be fully delegated from the central government, leaving little to no control over the disbursement of resources (e.g., Uzbekistan) or different responsibilities within healthcare may be delegated. In Kazakhstan, subnational government's responsibility for hospitals is low, but responsibility for medical products and public health services is higher. In Australia, the opposite is the case, with medical products and public health services mainly at a federal level, but expenditure responsibilities for hospitals mainly at a state level.

Subnational government expenditure on economic affairs, which includes transportation, is relatively high in seven countries. In these countries (Australia, Nepal, Georgia, Indonesia, Republic of Korea, Mongolia, New Zealand), subnational governments have moderate responsibility for this category of expenditure (17%-47% of total expenditure, Figure 14). Economic affairs are most often carried out at the regional or provincial level in the People's Republic of China, India and Kazakhstan. In the People's Republic of China, subnational government expenditure on economic affairs represents 8.7% of GDP, well above the OECD average of 1.6% (see Figure 12).

Subnational governments responsibilities for social protection, and public order and safety is relatively low in most countries in the region. In one country, subnational expenditure for social protection is above 30% (Republic of Korea). In most of the other countries with data available (11), subnational governments are responsible for almost no social protection expenditure. In only three countries do subnational governments have substantial responsibilities for public order and safety (People's Republic of China, India and Australia). In Australia, expenditure on this category is at 84%.

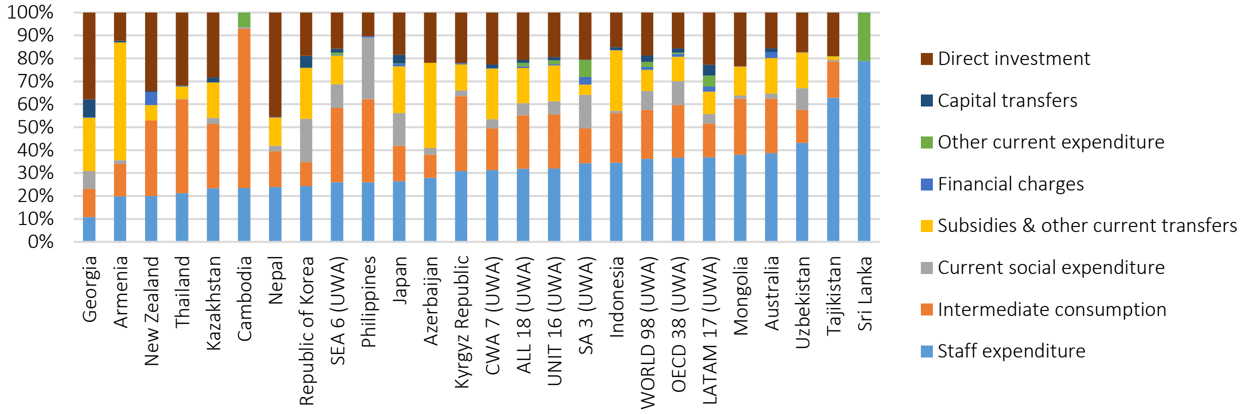
It is relevant to note greater expenditure responsibilities do not necessarily reflect greater spending autonomy. In some countries, subnational government spending on education is fully funded via earmarked grants. For example, in Mongolia the central government is obligated to transfer the necessary resources for subnational governments to cover the full costs of delegated responsibilities in education (which is the second category of subnational government spending at the country level).

Undertaking performance reviews of subnational governments can help to support expenditure assignments. Assessing and measuring the performance of subnational governments in terms of fiscal management and public service delivery, and increasing subnational institutional capacity, can help achieve this goal, as illustrated by the experience of Colombia, where the Colombian government is using this certification system to identify the subnational governments that are best capable to provide important public services, to encourage better management, quality of spending and outcome-oriented investments (OECD, 2019[23]). Similarly, the Philippines has implemented a system called "Seal of Good Local Governance" which helps highlight subnational achievements, compare and encourage performance of SNGs, and identify capacity development needs (ADB, 2023[37]).

Staff expenditure is the main area of subnational government expenditure in Asia and the Pacific

Staff expenditure, intermediate consumption and direct investment are the top three expenditure items of subnational governments in Asia and the Pacific (Figure 15). Subnational governments also have social expenditure, financial charges and subsidies and current and capital transfers.

Figure 15. Subnational government expenditure by economic classification (2020)



Note: CWA, Central West Asia; FED, Federal countries; LATAM, Latin America; SA, South Asia; SEA, Southeast Asia; UNIT, Unitary countries; UWA, unweighted average.
Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Staff expenditure is the most important expenditure item, accounting for 31.9% of expenditure (unweighted average). In countries such as Sri Lanka and Tajikistan, staff expenditure exceeds 60% of subnational expenditure. Staff expenditure is followed by intermediate consumption, and then direct investment, which account, respectively, for 23.2% and 20.7% of total subnational expenditure. Intermediate consumption includes a wide variety of items such as small equipment and supplies, maintenance and repairs, general expenses, heating and electricity, communications and IT, studies, consulting, insurance, etc. This spending category can fluctuate considerably depending on changes in certain components such as energy (fuel, electricity), commodities or VAT rates. Subsidies and other transfers[16] come next, amounting to 15.4%, followed by current social expenditure[17] (5.3%). However, these variations may represent different ways of classifying expenditure in national accounts and should be taken with caution.

The average in Asia and the Pacific is broadly aligned with the world average, but there are some disparities across countries and sub-regions. Some countries, such as Georgia, New Zealand or Nepal, have a more equally diversified basket of expenditures, with a larger than average share of direct investment, instead of a preponderance of staff expenditure. In addition, subsidies and other transfers are remarkably higher in Central and West Asian countries, reaching 22.2% of total subnational expenditure against 15.4% in Asia and the Pacific or 9.3% in the world.

Subnational investment in Asia and the Pacific is higher than the world average. Across the 18 countries with data available, the share of total subnational expenditure that is dedicated to direct investment in Asia and the Pacific (20.7%) is higher than the world average (18.8%) (See Figure 15).

Subnational government investment

Investment will be needed across Asia and the Pacific to limit global warming to less than 1.5°C and make progress towards achieving the SDGs. In developing Asia, there is a need to invest USD 26 trillion in infrastructure to maintain the region's growth momentum and respond to climate change between 2016 and 2030 (ADB, 2017[39]). Given the magnitude of investment needs, all levels of government, and the private sector will need to be mobilised over the coming years. Subnational governments will have a significant role in many countries, given their key responsibilities relating to the SDGs and climate change (OECD, 2020[6]; OECD, 2022[15]).

Subnational government investment can help to address large spatial divides in infrastructure across the region. Throughout Asia and the Pacific, there are often large gaps in economic development between different regions within countries, particularly between rural and urban areas. In many countries, reforms of the 1990s provoked strong polarisation and uneven development, driven by agglomeration that favoured larger cities and in-migration (UCLG, 2019[17]). These gaps are highlighted by differences in access to essential public services and infrastructure, such as for education and healthcare, which is exacerbated by low digital connectivity in rural areas (OECD, 2022[3]). In G20 countries, download speeds over fixed networks in rural areas are on average 31 percentage points below the national average, while download speeds in cities are on average 21 percentage points above the national average (OECD, 2021[40]).

This section provides an overview of subnational public investment in Asia and the Pacific. To help understand how to better mobilise subnational government investment to meet future needs, this section highlights the current state of investment across the region in comparison with other world regions and OECD countries.

Investment by subnational governments represents an important share of the gross domestic product in Asia and the Pacific

Subnational government investment in Asia and the Pacific represents 2.0% of GDP, slightly above the average for OECD economies and well above the global average. Subnational governments across Asia and the Pacific invest on average 0.2 of a percentage point of their GDP more than in OECD countries. They invest 0.6 of a percentage point more than the global average (of 1.4%) and almost

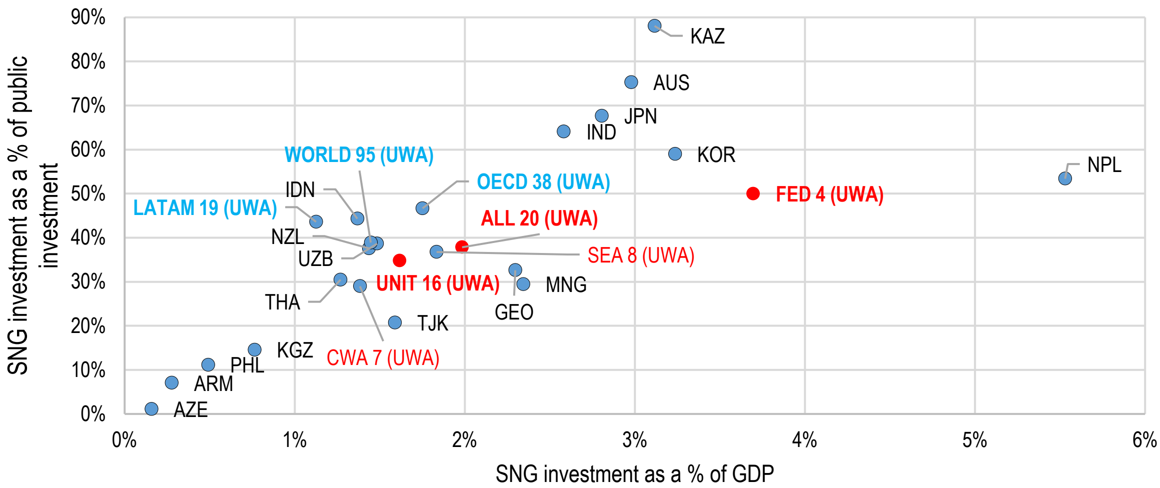
[16] Subsidies and other current transfers refer to transfers dedicated to cover current expenditure, including to social security funds.

[17] Current social expenditure refers to social benefits and social transfers in kind via market producers.

1 percentage point more than Latin American countries (1.1%) (see Figure 16). In general, subnational governments in more developed countries in the region (e.g., Australia, Japan and Republic of Korea) invest more, while subnational governments in less developed countries invest less (e.g. Philippines, Armenia, Azerbaijan). Nepal is a significant outlier, with a very high level of subnational governments investment at 5.5% of GDP. This reflects their significant role in total public investment (53%) and a high level of overall public investment as a percentage of GDP in the country.

The share of total public investment undertaken by subnational governments in Asia and the Pacific is in line with the world average, but below the OECD average. In 2020, an average of 38% of public investment was undertaken by subnational governments in Asia and the Pacific, virtually the same as the global average (see Figure 16). This is lower than in Latin America (44%) and in the OECD, where subnational governments are responsible for 47% of public investment (unweighted average). The lower role of subnational governments in total public investment exists even though subnational governments in Asia and the Pacific have higher spending as a proportion of GDP, as countries in the region have higher levels of total public investment as a proportion of GDP.

Figure 16. Subnational government investment as a percentage of total public investment and as a percentage of GDP (2020)



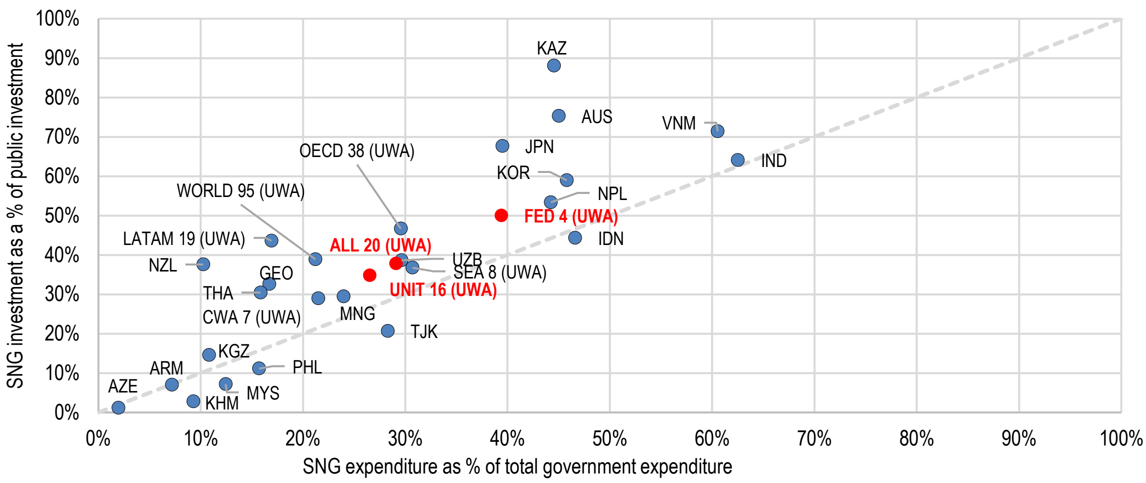
Note: ISO codes stand for: ARM, Armenia; AUS, Australia; AZE, Azerbaijan; GEO, Georgia; IDN, Indonesia; IND, India; JPN, Japan; KAZ, Kazakhstan; KOR, Republic of Korea; KGZ, Kyrgyz Republic; MNG, Mongolia; NPL, Nepal; NZL, New Zealand; PHL, Philippines; TJK, Tajikistan; THA, Thailand; UZB, Uzbekistan. All averages are unweighted.
Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

There are significant variations in the role of subnational governments in public investment across countries in the region. Subnational governments in Kazakhstan and Australia carry out over 75% of public investment, representing around 3% of GDP. By contrast, Armenia and Azerbaijan undertake less than 10% of total public investment (respectively 7% and 1.1%). Although Kazakhstan has very high investment at a subnational government level, it is important to note that investment is mainly mandated by the central government but executed at the subnational level.

Subnational government investment also varies across sub-regions in Asia and the Pacific. Subnational governments in eight countries from Southeast Asia tend to invest more than the seven countries with data available from Central and West Asia. Subnational governments in Southeast Asia invest 1.8% of GDP, representing around 37% of total public investment, versus 1.4% of GDP and 29% of total public investment in Central and West Asia. Although there are large variations within both region, Central and West Asia does tend to have lower levels of investment decentralisation in many countries (e.g., Armenia, Azerbaijan, Tajikistan).

Subnational governments in most countries in Asia and the Pacific have higher responsibilities for public investment than for other forms of public expenditure, in line with other world regions. In 15 of the 20 countries with data available, subnational governments are responsible for a higher proportion of total public investment than of total public expenditure (Figure 17). On average in Asia and the Pacific, they are responsible for 38% of public investment but only 29% of total public expenditure. Similar gaps exist at a global level (39% vs 21%) and across OECD countries (47% vs 30%). The difference is even higher in some countries. In New Zealand, subnational governments are responsible for 38% of public investment but only 10% of total government expenditure. In Japan, they are responsible for 68% of public investment and 40% of total public expenditure.

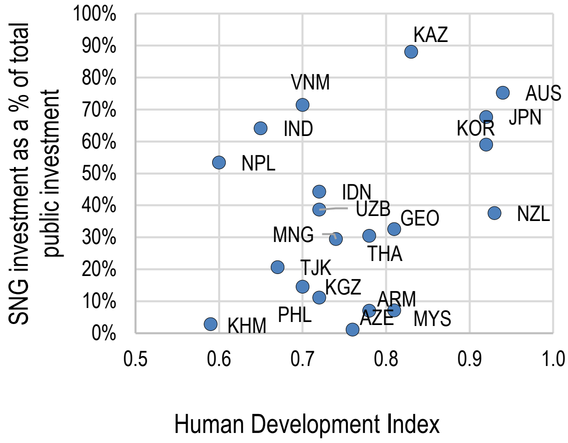
Figure 17. Subnational government investment as a percentage of total public investment and subnational government expenditure as a percentage of total government expenditure (2020)

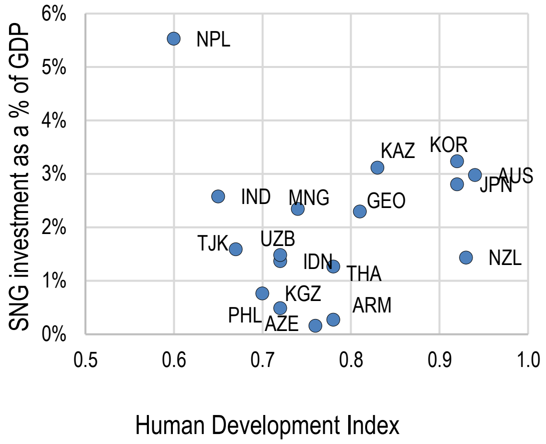


Note: ISO codes stand for: ARM, Armenia; AUS, Australia; AZE, Azerbaijan; GEO, Georgia; IDN, Indonesia; IND, India; JPN, Japan; KAZ, Kazakhstan; KOR, Republic of Korea; KGZ, Kyrgyz Republic; MNG, Mongolia; NPL, Nepal; NZL, New Zealand; PHL, Philippines; TJK, Tajikistan; THA, Thailand; UZB, Uzbekistan. All averages are unweighted. Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Countries that have higher development needs often have lower levels of subnational government investment, although the relationship is complex. While there is significant variation across countries and some important exceptions, subnational governments in countries with lower scores on the Human Development Index tend to have lower levels of subnational government investment. This is shown both as a percentage of total public investment and as a proportion of GDP (Figure 18). Many countries with lower scores on the index, such as Azerbaijan, Armenia, Kyrgyz Republic and the Philippines, have low levels of subnational government investment as a proportion of GDP (below 1%) and of total public investment (below 15%). An important exception is Nepal, where subnational governments investment represents an important part of GDP.

Figure 18. Subnational government investment and the Human Development Index





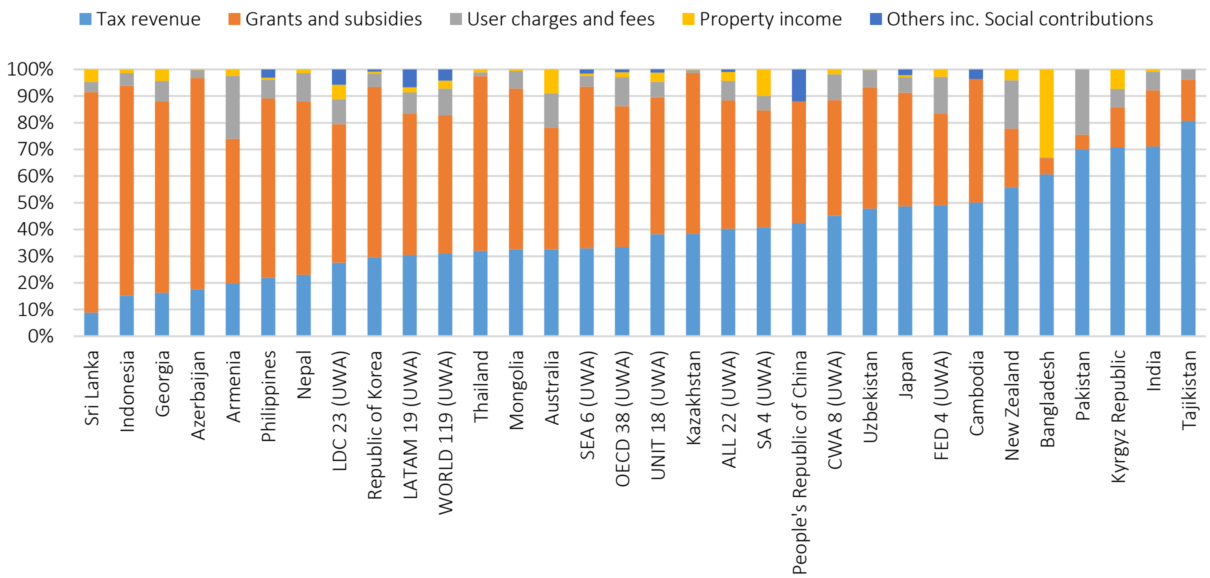
Note: ISO codes stand for: ARM, Armenia; AUS, Australia; AZE, Azerbaijan; GEO, Georgia; IDN, Indonesia; IND, India; JPN, Japan; KAZ, Kazakhstan; KOR, Republic of Korea; KGZ, Kyrgyz Republic; MNG, Mongolia; NPL, Nepal; NZL, New Zealand; PHL, Philippines; TJK, Tajikistan; THA, Thailand; UZB, Uzbekistan. All averages are unweighted. Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Subnational government revenue

Grants are the primary source of subnational revenue

Subnational government revenue in Asia and the Pacific are mainly composed of grants and subsidies and tax revenue. Grants and subsidies represent 48.2% of revenue, while tax revenue represents 40.2% (unweighted averages) (Figure 19). It is also composed, to a lesser extent, of tariffs and user fees (7.3%), property income (3.3%) and other revenues, such as social contributions (1.0%).

Figure 19. Subnational government revenue as a percentage of total subnational government revenue (2020)



Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Grants and subsidies are the main revenue source. In 2020, they represented 48.2% of revenue, although this amount was lower than in other world regions. At the global level, grants and subsidies account for 51.5% of subnational government revenue, 51.2% for the Latin America region, and 53.5% for Europe and North America, and 52.7% for OECD countries.

Grants and subsidies can serve a variety of objectives, ranging from funding devolved or deconcentrated responsibilities, to providing incentives to subnational governments based on their performance, and reducing territorial disparities (in the case of fiscal equalisation transfers). The capacity of the intergovernmental transfer system to reach these objectives depends on both the volume and the design of the transfer system. First, the volume of transfers will determine the levels of spending and must be adjusted to the responsibilities that are devolved. Second, the quality of transfer will depend on their stability, regularity, and their design, including which objectives they aim to target.

If they are well implemented, equalisation transfers are crucial tools for inclusive growth. In Asia and the Pacific, most countries have established an equalisation system in their intergovernmental fiscal transfers, which serves as a tool for central or federal governments to address – to some extent – disparities across territories in terms of revenue or spending needs (Box 8). Precisely, equalisation mechanisms may aim to correct horizontal fiscal imbalances and thus provide approximately comparable levels of public services at comparable tax burdens. These equalisation mechanisms are based on formulas that determine the redistribution of funds between richer and poorer SNGs. The complexity is to have transfer systems with no disincentive or counterproductive side effects on local and regional development, which is, however, sometimes the case (Rodríguez-Pose and Vidal-Bover, 2022[30]).

Box 8. Equalisation transfers in countries in Asia and the Pacific

The following are some interesting examples of intergovernmental equalisation transfers and reforms in the region of Asia and the Pacific.

- In **Indonesia**, the intergovernmental fiscal transfer system has a strong focus on equalisation. With transfers accounting for 78.7% of subnational revenue, the equalisation transfer system operates within the General Allocation Fund (*Dana Alokasi Umum*, DAU). This is a general-purpose block grant and, by far, the largest transfer, accounting for around half of all central government transfers in 2020. Although general, half is dedicated to wages and salaries. As per the national budget, total amount of the DAU must be equivalent to at least 26% of all central government revenue (after revenue sharing). Transfers from DAU are formula-based, consisting of a base allocation (equal to the amount of staff expenditure) and a fiscal gap allocation (which can be positive or negative) based on a difference between needs and capacity and a set of variables (level of government, population, natural resources, surface area and regional socio-economic inequality). This main transfer acts together with other more specific ones, such as the Special Allocation Fund, the Revenue-Sharing Fund, and the Village Fund.
- In the **Philippines**, the National Tax Allotment (NTA) (previously called Internal Revenue Allotment until 2022) is by far the main transfer from central government to subnational governments. The NTA is a revenue sharing system, and amounts to 40% of internal revenue collected at the national level on the third preceding year. However, this grant is to some extent earmarked: for example, 20% must be targeted specifically to development projects. The NTA gross amount is first divided among provinces, cities, municipalities and barangays, and then the share allocated to individual subnational governments is calculated on the basis of population, land area and a fixed quota. Overall, 23% of the NTA goes to provinces, 23% to cities, 34% to municipalities and 20% to barangays. In 2020, this transfer accounted for 43% of cities' total revenue, 74% of municipalities and up to 79% of provinces' revenue.

- In **Mongolia**, the transfer system is structured around the Local Development Fund (LDF), a formula-based transfer made up of 25% of VAT, 5% of royalty on minerals, and donations from national and international organizations collected into a single General Local Development Fund (GLDF). At least 60% of the GLDF transferred to *aimags* and the capital city must be allocated to lower tiers of government, on the principle of regional equalisation and a pre-set formula: one fourth based on the official level of development of *aimags*; one fourth based on the population; one fourth based on population density, remoteness from Ulaanbaatar, and the area of the *aimag*; and one fourth based on local tax amounts. The LDF tends, however, to be unpredictable, as revenues from mining royalties vary from year to year and depend on macro-economic cycles.
- In **Japan**, the Local Allocation Tax Grant (LAT) is an equalisation grant based on national tax revenues which are then redistributed to subnational governments. Subnational governments receive between 25% and 34% of the receipts, based on their local fiscal capacity and expenditure needs. Therefore, no distribution is made to local governments with base revenues exceeding their financial needs. The LAT is broken down into an "ordinary" LAT (94% of funds) and a "special" LAT (6%), dedicated to extraordinary expenses such as damages from natural disasters. LAT still requires topping up from other funding sources, including the general account of the national government's budget, and debt financing co-financed at 50% by local governments.

Source: (OECD/KIPF, 2019[28]; OECD/UCLG, 2022[38])

Transfers can also be used as an incentive for SNGs to build capacity and improve the use of SNG resources to align them with national priorities, as illustrated by performance-based transfers. Performance-based grants are transfers subject to minimum conditions for access, and the beneficiaries must then comply with performance incentives. These grants can be earmarked to a specific sector (e.g. education, health), or more generally process-oriented (e.g. related to performance in planning, transparency, public financial management). Such transfer systems should however be designed carefully, not to undermine SNG downward accountability and financial autonomy. The Philippines' "Seal of Good Local Governance" initiative (SGLG) is an interesting example. The SGLG programme, launched in 2019 and managed by the Bureau of Local Government Finance, assesses the activity each SNGs based on criteria related to good governance (including financial administration, disaster preparedness and youth development, among others). SNGs that pass the assessment may be eligible to a SGLG incentive fund, to finance their local development initiatives in line with national objectives (Bureau of Local Government Finance of the Philippines, 2022[41]).

Within Asia and the Pacific there is high variability in the role of grants and subsidies. They account for more than 65% of revenue for subnational governments in Thailand, the Philippines, Georgia, Indonesia, Azerbaijan and Sri Lanka. In most cases, the transfer system includes an equalisation component. This is the case for instance in Indonesia, where transfers account for 86% of subnational government revenue, with a strong focus on equalisation. In Cambodia as well, the volume of transfers via the District/Municipality/Khan Fund and the Communes/Sangkat Fund has increased since 2012, due to an increase in conditional transfers in order to cover new delegated responsibilities and to act as a fiscal equalisation mechanism between territories. Many other countries are also reforming their transfer systems with a focus on fiscal equalisation (Table 6).

On the other hand, transfers represent 6% or less of subnational government revenue in Bangladesh and Pakistan. In these countries, the transfer system tends to be quite unpredictable, without any equalisation component, and the volume of transfers to be allocated to subnational governments is often left at the discretion of the central government. In Tajikistan as well, the criteria laid down in the law for distributing fiscal transfers for municipalities are not clear, and the entire allocation process is therefore not fully transparent. The inter-governmental transfer system is still under development in Lao PDR.

Table 6. Examples of recent and upcoming reforms to enhance transfer systems in Asia and the Pacific

Country	Main objective	Example
Armenia	Equalisation	In 2016, the adoption of a new Law on Financial Equalisation defined concepts and principles of financial equalisation, as well as calculation and allocation procedures for the subsidies granted according to the equalisation criteria. The implementation of the law, initially planned for 2019, has been delayed and is still on-going as of 2022.
Bhutan	Equalisation	The 12th Five-Year Plan (covering the period 2018-2023) introduced the GNH Index score as one of the criteria to determine resource allocation to subnational governments. Accordingly, a District, Block and Class-A Municipality with a lower GNH Index score will receive higher allocation of resources, based on a specific weight (10% for Blocks and Municipalities, and 15% for Districts).
Georgia	Equalisation	Georgia's equalisation system enacts that the central government transfers funds on an annual basis, according to a formula including the sum of expenditure and increase of nonfinancial assets of a particular municipality, the sum of own revenues in local budgets and a preferential factor for additional support to particular municipalities. This system is subject to critics among experts, because it concentrates revenues in largest municipalities, and it does not incentivise small municipalities to increase their revenue bases, The introduction of a new equalisation system is planned for the 2023-2024 period.
Philippines	Equalisation	In 2022, the calculation of the NTA was reviewed, in order to include a broader range of national taxes in its tax base (new taxes such as those collected by the Bureau of Customs) to thereby ensure a more equitable share redistributed to subnational governments compared to the central government.
Republic of Korea	Equalisation along with creation of a new tax	Part of the second phase of the decentralisation programme, the Government of the Republic of Korea plans to transfer an additional part of the national VAT into a local consumption tax, along with new tools for equalisation that will ensure that revenues from the new tax will be redistributed with different regional weights (Seoul Metropolitan Area, metropolitan cities and provinces weighting each 1; 2 and 3).
India	Increase outcome-oriented transfers	The Fourteenth Finance Commission, in its recommendations for 2016-2021, has recommended improving the system of central government transfers to the states by notably i) reducing certain conditional grants; ii) streamlining the number "centrally sponsored schemes" (special purpose grants from the central government to states to encourage and motivate state governments to plan and implement programmes that help attain national goals) from 66 to 28; and iii) allocating funds based on more objective and progressive criteria (fiscal capacity was given more weight in the formula). The federal government also aims to increase outcome-oriented transfers in all policy areas, a move monitored by NITI Aayog and the Ministry of Finance.

Source: (OECD/UCLG, 2022[38])

While tax is the main source of subnational government revenue, fiscal autonomy can be limited

Subnational governments in Asia and the Pacific rely more on tax revenue than the rest of the world. Indeed, tax revenue are the second largest source of revenue for subnational governments in Asia and the Pacific, accounting for 40.2% of revenue, versus 31.1% on average at the global level (Figure 19). Taxes are a primary source of revenue (over 50%) for subnational governments in Cambodia, New Zealand, Bangladesh, Pakistan, Kyrgyz Republic, India and Tajikistan. On the other hand, they represent less than 20% of the revenue of subnational governments in Armenia, Azerbaijan, Georgia, Indonesia and Sri Lanka.

There are some countries where tax revenue represents a large share of local revenues, but where the share of subnational taxes remains small in the total tax revenues levied at the country level. A large gap can be identified for countries such as Kyrgyz Republic, New Zealand and Cambodia (Comparing Figure 20 and Figure 21): whereas the vast majority of subnational revenue in these countries come from tax revenue (70.7%, 55.8% and 50.1%, respectively), subnational tax receipts represent only a small share of public tax revenue (12.9%, 7.5% and 9.1% respectively). This may be explained by the fact that in these countries, subnational governments do not have significant expenditure responsibilities compared with the central government level.

As a percentage of GDP, subnational tax revenue in Asia and the Pacific represents on average 3.5% of GDP, which is lower than the OECD average (5.1%). 13 countries fall below 4% of GDP while India, the People's Republic of China and Japan top the list at over 7% of GDP. Subnational tax revenue as a share of GDP is 3.4% higher in federal countries than in unitary ones.

Figure 20. Subnational tax revenue as a percentage of total tax revenue

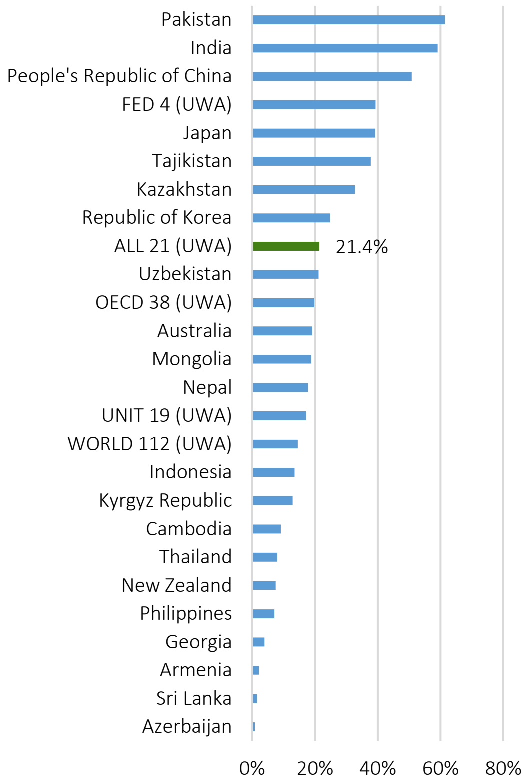
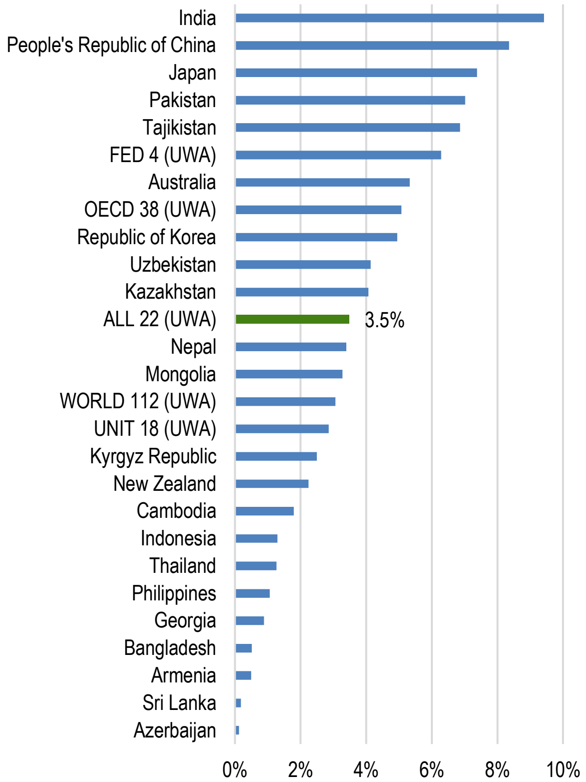


Figure 21. Subnational tax revenue as a percentage of GDP



Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Nevertheless, the high proportion of taxes can be a misleading indication of fiscal autonomy. The tax ratio provides some insights into the degree of tax revenue decentralisation in a country, but it remains an imperfect proxy because it comprises both shared taxation and own-source taxation. Own-sources taxes are taxes for which subnational governments have a certain power to set rates and bases, while shared taxes are national taxes (mainly personal income tax [PIT], value-added tax [VAT], corporate income tax [CIT], but also excise taxes), redistributed to subnational governments according to allocation criteria that are defined nationally with a wider or narrower margin of manoeuvre for subnational governments to intervene or negotiate, i.e. no or little taxing power.

In Asia and the Pacific, tax sharing arrangements are commonplace. This implies that despite the high values for tax revenue in the data (Figure 19), the fiscal autonomy of subnational governments is limited. For instance, shared taxes make up the bulk of tax revenue in the People's Republic of China, India, Kazakhstan, Thailand and Viet Nam.

- In the People's Republic of China, four taxes (the VAT, the CIT, the PIT and the securities trading tax) are shared with the provinces. The tax sharing system only specifies how taxes should be divided between central and subnational governments and leaves it to the provinces to divide funds among the four levels of subnational governments further.

- In Viet Nam, shared taxes include the VAT, the CIT, the PIT, environmental protection tax and excise tax on domestic goods and services. There is one state budget for all levels of government, and revenue sharing is defined according to a sharing rate defined for three to five years, called the “Stability Period” and redistributed according to an equalisation scheme.
- In Kazakhstan, most subnational tax revenues are shared taxes (PIT and the social tax, based on payroll), which are also redistributed through an equalisation mechanism.

In principle, own-source taxes provide more autonomy to subnational governments. However, even for own-source taxes, tax autonomy can be limited. Although they may be classified as local taxes, in many countries in the region it is the central government that sets the rate and base of these taxes, and in other countries the local leeway over rates and bases may be strictly regulated, thereby reducing tax autonomy. Regulation of this kind may take the form of caps on rate increases or imposition of a minimum rate, limitation of exemptions decided locally or, by contrast, an obligation to apply exemptions decided at the national level and by the central government (OECD/KIPF, 2019[28]). Examples include Viet Nam, the People’s Republic of China, Kazakhstan and the Republic of Korea.

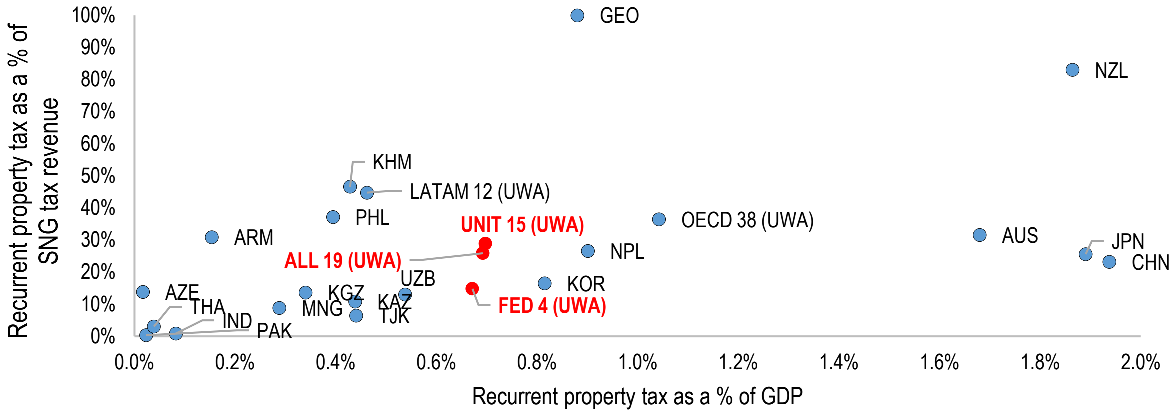
- In Viet Nam, tax bases and rates are determined largely by the central government for natural resources taxes, licence tax, land use taxes and levies, etc., while the tax base is determined by the municipal or Provincial People’s Committee for residential, commercial and industrial land taxes.
- In the People’s Republic of China, local governments have no discretionary power to raise taxes as the central government sets the legislation governing taxation and the rate of each tax.
- In Kazakhstan, subnational governments have very little taxing power over the rate or base of local taxes. They can only revise the land tax rate within a margin of 20%, depending on the characteristics of the land and fix the rate of minor local taxes.
- In the Republic of Korea, even though the 2011 reform simplified the tax mix, the number of taxes allocated to local authorities declined from 16 to 11, and most tax rates are determined by the central government. In Mongolia, local governments have little autonomy over their tax revenues, as any change to tax rates or bases requires the approval of the central government.

A certain degree of fiscal autonomy is needed for different reasons. Fiscal autonomy includes relying on own-source revenue, such as taxes, rather than grants and subsidies from the central government. Some of the reasons for fiscal autonomy include: improving the quality and efficiency of spending and improve budget management efficiency; promote fiscal responsibility and increase accountability to citizens; and ensure the ability of subnational governments to invest, and to have a better access to external financing. Subnational governments can make the most out of these benefits of higher fiscal autonomy levels only when they are accompanied by the necessary human and technical capacity at the subnational level (OECD, 2020[42]).

Property tax remains underexploited in many countries in Asia and the Pacific

In countries from Asia and the Pacific, subnational government revenue from the property tax are low. They account for 0.7% of GDP and 25.9% of subnational government tax revenue in 2020, below the average of OECD countries (1.0% and 36.4%, respectively) (Figure 22). Among all world regions, Asia and the Pacific ranks last, below Latin America (44.8% of subnational tax revenue), Africa (39.5%) and Europe and North America (35.0%). This can be related to challenges in assessing and updating the value of the tax base, due to a lack of appropriate skills and/or proper cadastre systems, high degree of informality in some countries; difficulties in tax collection and management; a lack of flexibility and margin of manoeuvre of subnational governments to act on the tax rates or base; restrictions and exemptions imposed by the central government, which all contribute to reducing the potential revenue of the property tax for subnational governments (OECD, 2020[42]).

Figure 22. Share of the property tax in total subnational government revenue and GDP (2020)



Note: ISO codes stand for: ARM, Armenia; AUS, Australia; AZE, Azerbaijan; GEO, Georgia; IDN, Indonesia; IND, India; JPN, Japan; KAZ, Kazakhstan; KOR, Republic of Korea; KGZ, Kyrgyz Republic; MNG, Mongolia; NPL, Nepal; NZL, New Zealand; PHL, Philippines; TJK, Tajikistan; THA, Thailand; UZB, Uzbekistan. All averages are unweighted.
Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Nevertheless, the recurrent immovable property tax is a key local revenue source with significant revenue potential for several reasons. It is a tax that is relatively immobile, more stable than consumption and income tax bases (particularly for area-based property tax system), also due to the possibility to adapt tax rates annually (ADB, 2020[43]; OECD, 2021[44]). Moreover, if SNGs have control over the rates and/or base, the property tax can promote local fiscal autonomy. Depending on its design, the tax can also comprise implicit progressivity and horizontal equity for the taxpayers, contrary to other taxes (e.g. the VAT). Property tax also generates little if any distortion. Finally, it is a tax most usually levied at the local level (except for Australia where it is levied at state and local level). All these make the recurrent property tax the "local tax by excellence". However, the rates and base are often set by central authorities who are also in charge of tax collection and administration; alternatively, subnational governments can be allowed to set a rate that falls within a range defined jointly or independently by central authorities (OECD/UCLG, 2022[38]).

To better exploit revenue from this source, property tax reforms have become widespread in Asia and the Pacific and across the globe. In Asia and the Pacific, these reforms focus mainly on two objectives: the creation of a new property tax (e.g. pilot experiment in Shanghai and Chongqing in the People's Republic of China), or the establishment of new tax base valuation or revaluation methods (e.g. the Philippines, Cambodia) (Table 7).

Table 7. Examples of recent and on-going reforms of the property tax in Asia and the Pacific

Country	Type	Example
Cambodia	Broaden the tax base by improving the cadaster and reassessing property valuation	Under the Revenue Mobilisation Strategy 2014-2018, the country aimed to increase property tax collection by improving the cadastral system from the General Department of Cadastre and Geography of the Ministry of Land Management Urban Planning and Construction. Properties have also been revaluated as of July 2019, resulting in an increase of 70%-80% of the market value in some areas. Tax exemptions or modification of the tax base are considered by the government to limit the impact of tax increase. To monitor and evaluate the results of the reform, the country developed a set of performance indicators and targets under its Revenue Mobilisation Strategy 2019-2023.
People's Republic of China	Creation of a new recurrent property tax (pilot)	Several subnational taxes are related to real-estate properties in the People's Republic of China (i.e. urban and township land use tax, arable land occupancy tax, the real estate tax, the deed tax and the land appreciation tax). These taxes are based on physical area and transaction values of properties, instead of recurrent assessments based on properties' market value. A scheme for introducing a recurrent property tax is underway in the pilot cities of Shanghai and Chongqing. The scheme, extended

		until October 2021, applied at purchase to a relatively narrow range of property owners. The new scheme is to include all residential and non- residential properties (excluding farms).
Philippines	Broaden the tax base by reassessing property valuation	In the Philippines, the Parliament adopted the Real Property Valuation and Assessment Reform Act in November 2019 with the aim to broaden the property tax base without increasing the tax rates. The reform includes (i) the establishment of a single market-based property valuation, (ii) the support to subnational governments on property valuation and assessment through the strengthening of the Bureau of Local Government Finance (BLGF) and (iii) the recentralisation of the approval of the schedule of market values to the Department of Finance with review of the BLGF. The reform is expected to increase tax collection of property taxes in the country.
Thailand	Introduction of a new land and building tax	The Land and Building Tax Act, which entered into force in January 2020, aims to increase tax revenue, increase land use and strengthen fiscal autonomy of subnational governments. The new land and building tax, which replaces the previous recurrent property tax, notably includes residential properties in the tax base and fully taxes secondary residences. The new tax has also progressive tax rates, with higher rates for unutilised land. The tax base is the total property value for both building and land as set by the central government, rather than the rental value. The government is also developing a centralised property database, which will enhance co-operation and sharing of data between the Department of Land (cadastre) and the property valuation from the Treasury Department

Source: (OECD/UCLG, 2022[11])

The spectrum of property tax reforms can be even broader, based on the examples of countries in other regions of the world:

- **Modernisation of technical systems for tax collection**: in Ghana, a new property valuation software was implemented in 49 local governments across the country in 2020 to replace the manual process that was in place since then. The use of geographic information system (GIS) in some municipalities led to a substantial increase in the number of registered properties.
- **Digitalisation of the tax system**: in Angola, the Ministry of Finance also created the “Portal do Munícipe" to facilitate the digital collection of local taxes, to enhance information sharing across jurisdictions and thus to facilitate co-ordination.
- **Extension of the recurrent property tax to new categories of owners or assets (land of building)**: In Poland, municipal taxes on immovable property include a property tax on land and buildings, an agricultural land tax and a forest tax, and the central government is considering a new tax on unoccupied properties, which represented 11% of dwellings in rural areas and 6% in urban areas in 2020.
- **Implementation of a surtax on properties, above a certain threshold**: in Greece, since 2014 a new property tax applies to individuals and legal entities owners of land and buildings. It comprises a main tax and a supplementary tax. The main tax, which is for buildings, plots, fields and so on, is calculated on the basis of “objective values” based on several criteria, such as the location, etc. The supplementary tax is imposed on very expensive property. Greece readjusted the taxable value for the real estate property tax and increased the threshold of the supplementary tax.
- **Modification of the tax rates or brackets**: in Rwanda, the key change included an increase in tax rates (to be set by the district council) for residential buildings with tax exemption for buildings used by owners as their residence.

In addition to the recurrent property tax, a range of other common taxes are implemented by subnational governments in Asia and the Pacific. Some of the most common local taxes include: motor vehicle taxes (e.g. Australia, India, Indonesia, Japan and Republic of Korea), excise taxes, in particular on fuel or domestic goods and services (Indonesia, Malaysia, New Zealand, Thailand, Viet Nam), local business taxes, licences, tax on payrolls and professional tax (Australia, India, Japan, Republic of Korea, Mongolia, the Philippines, Viet Nam), local consumption taxes (Japan, Republic of Korea), land use taxes (People’s Republic of China, Viet Nam), taxes on natural resources (Indonesia, Viet Nam, Kazakhstan) and other minor taxes such as an education tax (Republic of Korea, Philippines), or taxes on touristic activities and entertainment. There are also specific taxes targeted specifically at cities (city planning tax in Japan), metropolitan cities (Republic of Korea) or even a special tax for the capital Ulaanbaatar in Mongolia.

Revenues from user charges and fees and property income are low

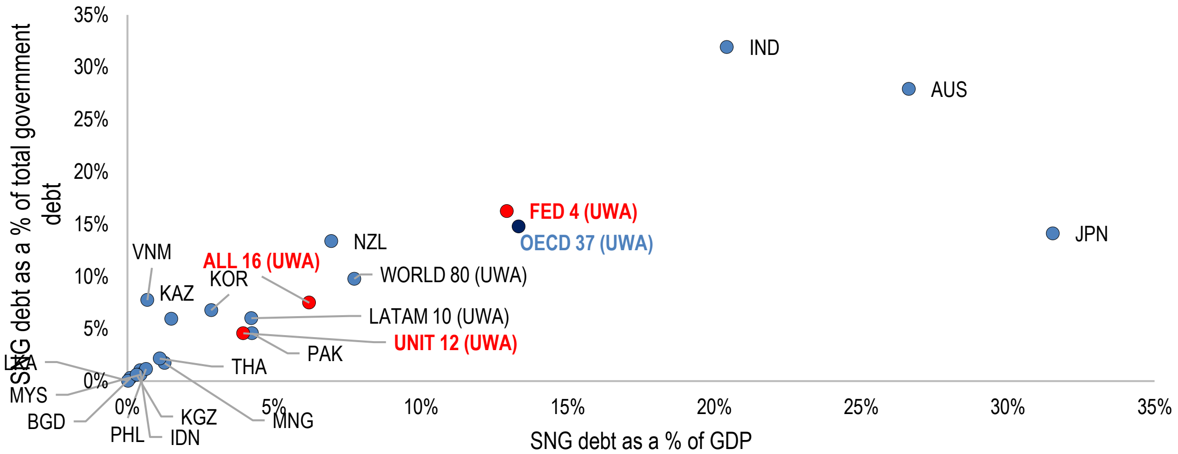
The share of user charges and fees and property income in subnational governments revenue is relatively low compared to world averages (Figure 19)**.** They account altogether for 10.5% of subnational government revenue in Asia and the Pacific versus 13% on average in OECD countries and at the global level. Some exceptions are Armenia, where tariffs and fees account for 23.5% of subnational government revenue, New Zealand (18.0%) and Australia (12.8%). This demonstrates a low diversity of subnational government revenue on average. Nevertheless, tariffs and fees can be valuable fiscal tools to finance public service delivery, and there is an opportunity for subnational governments to diversify their sources of revenue. In countries such as Australia, Viet Nam and Kazakhstan, subnational governments also benefit from royalties from mineral exploitation (property income). In New Zealand, subnational governments' revenues come to a higher degree from service charges and fees as well as permits and licenses. In the People's Republic of China, the sale of land-use rights is a powerful subnational tool.

Subnational governments borrowing and debt

Subnational government debt is very low in many countries in Asia and the Pacific

Subnational government debt in Asia and the Pacific is similar to the global average but low compared to the OECD. On average, subnational debt in Asia and the Pacific accounts for 7.4% of total public debt, representing 6.2% of GDP (data for 16 countries, see Figure 23). This is below the world average, which stands at 9.8% of total public debt (representing 7.9% of GDP). It is well below the OECD average, where subnational debt represents 15% of total public debt and 13% of GDP. This difference reflects both a lower level of borrowing by subnational governments (on average) in Asia and the Pacific and lower levels of total public debt as a proportion of GDP.

Figure 23. Total subnational government debt as a proportion of general government debt and of GDP (2020)



Note: ISO codes stand for: ARM, Armenia; AUS, Australia; AZE, Azerbaijan; GEO, Georgia; IDN, Indonesia; IND, India; JPN, Japan; KAZ, Kazakhstan; KOR, Republic of Korea; KGZ, Kyrgyz Republic; MNG, Mongolia; NPL, Nepal; NZL, New Zealand; PHL, Philippines; TJK, Tajikistan; THA, Thailand; UZB, Uzbekistan. All averages are unweighted.
Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Subnational outstanding gross debt varies significantly across countries, with three countries having substantially higher levels of subnational government debt than other countries. These four countries - Japan, Australia and India – all have debt levels above the average for the region and the OECD average, both a share of GDP and as a share of total government debt. In Japan, for example, subnational government debt is similar to the regional average as a proportion total government debt (14%), but is high as a proportion of GDP (31%). This difference reflects higher overall levels of public debt in Japan. These three countries also have relatively high levels of subnational debt compared to the OECD average (noting that two of the countries are OECD countries).

Many countries in the region have low levels of subnational government debt as compared to OECD countries. There is a large gap between the countries with higher levels of debt and other countries in the region. In many countries, such as Bangladesh, Philippines, Malaysia and Indonesia, subnational governments have almost no debt. In 11 countries, subnational debt represents less than 8% of total public debt and less than 3% of GDP. This is below the world averages (10% of total public debt and 8% of GDP) and is well below OECD averages (15% and 13%, respectively). It is closer to the average in Latin American countries (6% and 4%, respectively), although mostly due to the four outlier countries subnational debt in Asia is nearly 4 percentage points of GDP higher than in Latin America.

Low subnational government debt in many countries in the region is particularly striking considering that subnational governments have a similar role in public investment to OECD countries in terms of the share of GPD. Subnational government investment in Asia and the Pacific represents 2% of GDP, but subnational government debt only represents 6% of GDP, and a much lower amount in some countries. In the OECD, subnational government investment also represents around 2% of GDP, but subnational debt represents a higher proportion of GDP (13%). This 7-percentage-point gap between these country groups reflects low level of subnational debt in some countries Asia and the Pacific. It indicates that subnational governments in these countries invest by harnessing funding sources other than debt to pay the up-front costs of investment (e.g., capital grants, taxes, etc.).

Except for a few countries, subnational government debt levels remained relatively stable between 2016 to 2020, indicating limited access to external finance in the region. Subnational government debt as a percentage of GDP increased the most in Australia, rising by 6.8 percentage points to 27% of GDP, a 34% increase (Figure 24 and Figure 25). At the same time in Australia, the proportion of total public debt that is subnational dropped by 1.2 percentage points, indicating simultaneous and slightly larger increases in federal debt in Australia. Kazakhstan and Kyrgyz Republic both had a small but notable increase in subnational government debt during the period, of 0.6 percentage points of GDP (a 60% increase) and 0.3 percentage points of GDP (a 755% increase), respectively. These increases were mainly incurred by the capital cities of each country, which relied heavily on bond issues during the pandemic through PPP arrangements in order to sustain investment projects. By contrast, subnational government debt in Viet Nam decreased by -0.8 percentage points of GDP (-54%). In Japan and the Republic of Korea, subnational government debt decreased by 2.4 percentage points of GDP and 1.3 percentage points of GDP, respectively. The proportion of total public debt that is subnational also decreased in these countries.

Figure 24. Change in subnational government debt as a share of total public debt (2016-2020)

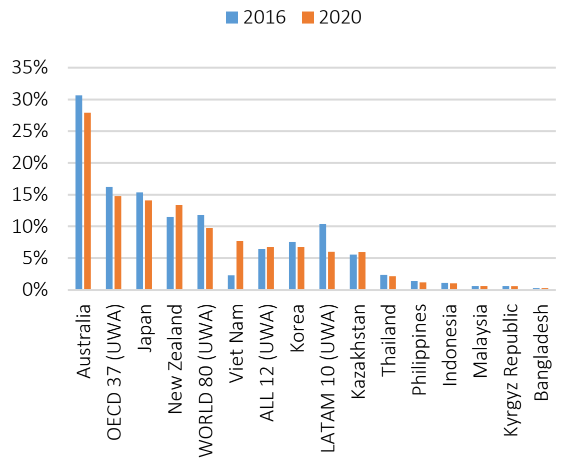
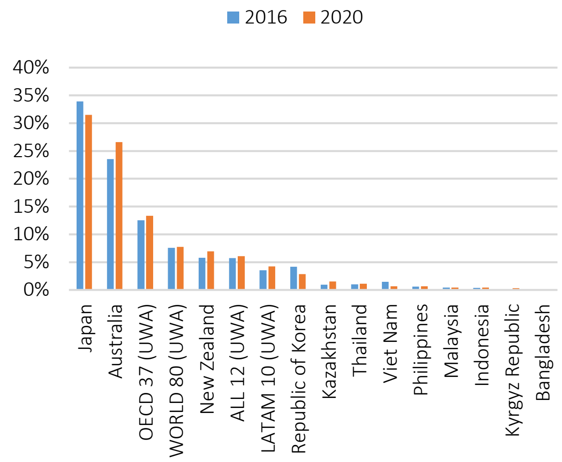


Figure 25. Subnational government debt as a share of GDP (2016-2020)



Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

Many subnational governments in Asia and the Pacific have low level of debt relative to their revenue, well below the OECD average. The ability of subnational governments to borrow for investment is linked to their ability to repay debt through revenue sources. Indeed, the availability and predictability of revenues, particularly of own-source revenues, is one of the criteria that credit rating agencies consider when rating subnational government debt (OECD, 2022[45]). Revenue to debt is also a common ratio used by central governments as a borrowing rule to limit subnational government indebtedness. On this metric, many countries are well below the OECD average (Table 8).

Four out of sixteen countries in Asia and the Pacific have a subnational debt to annual revenue ratio above the regional average and OECD average. Four of these countries display larger amounts of total debt than annual revenue, including three OECD countries. Japan tops the list with subnational debt representing more than twice annual subnational government revenue. In New Zealand, Australia and India subnational debt represents over 1.5 times subnational government revenue. Subnational debt is higher in these countries for variety of reasons, including higher subnational government investment responsibilities, better access to financial markets or higher creditworthiness. Lenders in these countries may consider a subnational government more creditworthy for a variety of reasons, such as having a robust financial management system, good fiscal responsibility frameworks, stronger debt servicing capacity (e.g., control over revenues) and an implicit or explicit support from the central governments (OECD, 2022[45]).

Table 8. Subnational government debt as a proportion of subnational government revenue

Country	Total subnational government debt (Per capita USD PPP)	Total subnational government annual revenue (Per capita USD PPP)	Subnational government debt to subnational government annual revenue
Japan	13524	6513	2.08
New Zealand	3070	1779	1.73
Australia	13949	8574	1.63
India	1363	885	1.54
OECD 38	6479 (UWA)	6760 (UWA)	**0.81 (UWA)**
ALL 15	2393 (UWA)	2281 (UWA)	**0.58 (UWA)**
Pakistan	204	483	0.42
Thailand	201	720	0.28
Republic of Korea	1222	7229	0.17
Malaysia	125	923	0.14
Kazakhstan	400	2837	0.14
Mongolia	157	1245	0.13
Philippines	53	406	0.13
Bangladesh	4	44	0.09
Kyrgyz Republic	17	193	0.09
Indonesia	52	1032	0.05
Viet Nam	59	1354	0.04

Source: Authors' calculations based on SNG-WOFI database: www.sng-wofi.org

The eleven remaining countries all have subnational government debt to revenue ratios below the average for the region and for the OECD. These can be classified into two main groups. The first is comprised of eight countries where subnational government debt is less than 60 percent of annual revenue, but more than 25%. These are Thailand and Pakistan, which both have relatively strong borrowing rules at the subnational level. The second group encompasses nine countries whose subnational debt represents less than 10% of annual revenue. These include Viet Nam, Indonesia, Bangladesh and Kyrgyz Republic.

Low subnational government borrowing is partly a reflection of strong fiscal rules and low subnational government creditworthiness. Central governments in Asia and the Pacific often place strong controls over subnational government debt, such as a requirement for central governments to approve subnational borrowing or constraints on subnational debt levels or debt servicing. Even where subnational governments are permitted to borrow, they may not be able to access financing (especially affordable financing) as they are not considered creditworthy. Low creditworthiness is linked to a range of factors, including fiscal frameworks and rules, insufficient and unpredictable subnational revenues (particularly own-source) and limited institutional capacity.

While this section has attempted to analyse debt across the region using available data, for many countries in the sample, data on subnational debt is usually incomplete, rarely harmonised and sometimes inexistent. Due to data inconsistency and unavailability, a breakdown of debt by category (e.g., bonds, loans, etc.) is unavailable for countries in the region. This highlights the important need to improve the collection of data on subnational government debt across the region.

Public financial institutions typically have an important role to finance subnational government investment in Asia and the Pacific

Subnational governments in Asia and the Pacific often borrow through public financial institutions. A small number of subnational governments in Asia and the Pacific access financing through direct bond issuances (Table 9). More often, subnational governments access finance through public financial institutions that are created by subnational governments or by a central government. Many examples of these different approaches and public institutions were identified across the region. Some of the public financial institutions act as financial intermediaries by issuing bonds on capital markets, and then on-lending to subnational governments. Others act as a revolving fund or are supported through loan programmes from multi-lateral development banks and other partners. Many subnational governments also borrow from private financial institutions, although information relating to this is limited.

Table 9. Examples of subnational governments and public institutions that provide access to financing in Asia and the Pacific

Examples of subnational governments that directly issue bonds	Examples of financial institutions owned by subnational governments	Examples of financial institutions owned by national governments that target subnational governments
Auckland Council, New Zealand	State Treasury Corporations (TCV, TCorp, etc.), Australia	Housing and Urban Development Corporation Limited, India
Ahmedabad Municipal Corporation, India	Tamil Nadu Urban Development Fund, India	Regional Infrastructure Development Fund, Indonesia
City of Almaty, Kazakhstan	*Regional Development Banks*, Indonesia	Municipal Development Fund, Philippines
Bishkek city government, Kyrgyz Republic	*Local Government Financing Vehicles*, People's Republic of China	Land Bank of the Philippines
Pasir Gudang, Malaysia	**Pooled financing mechanisms:**	Development Bank of the Philippines
Ulaanbaatar, Mongolia	Local Government Funding Agency, New Zealand	Subnational Investment Fund, Cambodia
Ho Chi Minh City Finance and Investment State-Owned Company, Viet Nam	JFM, Japan	Bank of Lao
Hai Phong People's Committee, Viet Nam	Local Government Funding Vehicle, Australia	Town Development Fund, Nepal
Regional development bonds, Republic of Korea		Local Loans and Development Fund (MOF), Sri Lanka
		Public Loan Fund, Republic of Korea
		Bangladesh Municipal Development Fund

Source: Authors' elaboration based on SNG-WOFI country profiles: www.sng-wofi.org

Subnational governments that access finance directly from capital markets tend to be larger urban or regional governments. Issuing bonds on capital markets typically requires a certain scale and frequency of issuance, meaning that this option is mostly reserved for large subnational governments. Examples of these include Auckland in New Zealand and Ulaanbaatar in Mongolia (see Table 9).

Some subnational governments in the region own financial institutions that issue bonds on capital markets and then on-lend to lower levels of government. In some countries, subnational governments (particularly regional or state governments), create 'bond banks' that provide them with access to finance and may also provide finance to lower-levels of subnational government within their jurisdiction. Examples are found with the State Treasury Corporations in Australia and the Tamil Nadu Urban Development Fund in India (Table 9).

Some subnational governments access financing through pooled financing mechanisms. Many subnational governments do not have sufficient scale to regularly access capital markets on their own. To overcome this hurdle, subnational governments in some countries have created 'pooled financing mechanisms' that issue bonds on capital markets on behalf of multiple subnational governments and then on-lend to individual subnational governments. One example is the Local Government Funding Agency in New Zealand (Box 9).

In many countries, national governments create public financial institutions to finance subnational governments. These 'subnational development banks' are owned by national governments and can act as "last-mile banks" to finance subnational governments. Examples are found in India, Philippines, Lao

PDR and Bangladesh, among other countries (Table 9). These banks may have a greater knowledge of local governments, stakeholders, and local projects as well as their technical and financial viability, which helping to overcome information asymmetries (Finance In Common, 2021[46]).

Box 9. New Zealand Local Government Funding Agency

In New Zealand, the Local Government Funding Agency (LGFA) is a publicly owned financial institution created in 2011. Its shareholders include 30 local governments and the central government. This debt vehicle groups acts on behalf of 72 out of 78 councils in New Zealand to issue bonds on financial markets and then on-lends to their councils at competitive rates. It can only lend to local governments. Overall, the LGFA provides about 90% of loans to subnational governments, and de facto imposes a strict (though high) debt ceiling of net debt ratio below 250% to access its loans. Loans from LGFA to local governments are guaranteed by their property tax income: in case of default, the LGFA could appoint a receiver to directly collect the tax.

Source: (OECD/UCLG, 2022[11]; OECD, 2021[47])

Fiscal frameworks and fiscal rules

This section analyses different elements of the fiscal frameworks and fiscal rules that underly subnational government finances across Asia and the Pacific.

Many countries in Asia and the Pacific have strong controls on subnational government finances

A certain level of subnational government borrowing can support investment and economic development. Borrowing by subnational governments is generally considered appropriate to finance part of long-term subnational investment, particularly for high quality investments that have a local benefit (IMF, 2020[48]). However, subnational borrowing is generally not considered appropriate for financing current expenditure, which should preferably be financed from revenue sources (IMF, 2020[48]). Although some subnational borrowing can be appropriate, borrowing by subnational governments can be difficult to control for a variety of reasons. In particular, subnational governments may have a 'deficit bias' (relating to political or other factors), which can materialise in under-taxing or overspending that results in excessive borrowing (IMF, 2020[48]).

Countries around the world place diverse constraints on subnational government finances to manage risks related to excessive borrowing or from taking excessive liabilities. In order of increasing autonomy for subnational governments, constraints range from direct control by the center over subnational government finances, to fiscal rules, to co-operative arrangements, to pure market discipline (e.g., requirements for municipal bond issuances) (Ter-Minassian and Craig, 1997[49]). Fiscal rules are the most common constraint. These are a particular type of constraint that is "numerical, lasting, and applies to large fiscal aggregates such as budget balances and total expenditures" (IMF, 2020[48]). Often multiple fiscal rules are combined together. In the OECD, balanced budget rules are the most common type of fiscal rule, followed by expenditure and debt rules (de Biase and Dougherty, 2022[50]). Co-operative arrangements involve a level of negotiation between national and subnational governments on debt limits, as exists in Belgium, for example (Ter-Minassian and Craig, 1997[49]). Pure market discipline involves the issuance of subnational government debt instruments (e.g., municipal bonds) that are subsequently valued by the market to partly reflect the ability of the subnational government, with the largest subnational government debt market being in the United States. Rules may also control subnational governments issuing of guarantees to prevent significant financial liabilities.

Countries where subnational governments are subject to pure market discipline sometimes have less reliance on fiscal rules. For example, the New Zealand government imposes very light rules on local councils, and governments in Japan and the Republic of Korea have one main fiscal rule (expenditure rule) for internal use. Although market discipline can reduce the reliance on fiscal rules, this approach requires a set of preconditions that are absent in some countries: availability of timely and/or reliable SNG fiscal information, rapid responsiveness to market signals, no privileged access to financing, no history or expectation of bailouts by the central government and an adequate level of tax autonomy (de Biase and Dougherty, 2022[50]). Applying a market discipline approach also requires sufficiently developed and well-functioning local financial markets for subnational government debt and a higher level of institutional and public financial management capacity. It also requires a credible 'no bailout' policy from central governments.

Various controls and fiscal rules are placed on subnational government finances in Asia and the Pacific. These range from direct controls, such as complete bans on subnational government borrowing or a requirement for borrowing to be approved by government, to specific fiscal rules, such as golden rules limiting borrowing for investment Table 10). Restrictions are sometimes also placed on borrowing from non-public financial institutions, on bond issuances and on borrowing in foreign currencies. While fiscal rules are often in place, they may not always be strictly enforced or may be softened under certain circumstances.

In some countries, subnational governments are required to submit budgets for approval by the central government, which is one of the strongest fiscal controls. These countries have a law that requires subnational governments to submit their budgets for approval before being able to execute. This type of restriction was identified in Uzbekistan and Sri Lanka, with regards to general budgets, and in the Philippines and Viet Nam, with regards to investment. This restriction can exist even where subnational governments have a relatively large array of expenditure responsibilities.

Most countries were identified to have some form of budget balance rule. These rules require subnational governments to maintain their budget within a defined limit. They can allow new borrowing to finance a deficit up to a target and to roll over debt (de Biase and Dougherty, 2022[50]). Ten countries were identified to have clear budget balance rules prescribed at the subnational level and eleven countries were identified to have less strict budgetary rules with softer constraints, such as expenditure ceilings or budget balance rules that can be lifted in some circumstances (Table 10). In India, most state governments have introduced their own fiscal responsibility laws (FRL) that are stricter than the ones imposed by the Union (state FRL typically limit deficits to 3% of gross state product (GSP), whereas the Union Budget for the year 2022-2023 allows the states to incur in a fiscal deficit of 4% of GSP).

While the golden rule restricting borrowing to be used for investment purposes is common across OECD countries, it was identified in less than half of the countries in the region. In many countries, the Golden Rule does not apply to subnational government borrowing (Table 10), although it is generally seen as appropriate to support the effective use of debt by subnational governments to support investment (de Biase and Dougherty, 2022[50]). Instead, subnational governments might borrow also to fund provincial or local budget deficits or repay outstanding debt.

Table 10. Fiscal rules identified in the country profiles of the World Observatory on Subnational Government Finance and Investment

Country	SNGs required by law to submit budget for approval?	SNG balanced budget rules identified?	SNGs permitted to borrow?	Golden rule identified?	Debt rules identified	SNGs identified to be permitted to borrow from non-public institution?	SNGs identified to be permitted to issue bonds?	SNGs identified to be permitted to borrow in foreign currency?	National government oversight of SNG bond issuances	Development of SNG bond market
Armenia		Yes	No							
Australia		Yes, less strict [6]	Yes	No	Varied [6]	Yes	Yes	Yes	Minimal	Developed
Azerbaijan		Yes, less strict	Yes	No		Yes				
Bangladesh		Yes	Yes	Yes		No	No	No		
Bhutan		Yes, less strict	Yes*							
Cambodia		No	No							
People's Republic of China		Yes, less strict	Yes	Yes	Varied	Yes	Yes[3]	No [3]		Developed
Georgia		Yes	Yes	Yes	Debt to revenue: 10%	No	No	No		
India		Yes, less strict	Yes	No	Varied	Yes [4]	Yes [4]	No		Developing
Indonesia		Yes, less strict	Yes	Yes	Varied, Debt service ratio: 40%	Yes	Yes [5]	No	Strict	Very limited
Japan		Yes	Yes	Yes		Yes	Yes	Yes	Moderate	Developed
Kazakhstan		Yes, less strict	Yes	No	Debt service ratio: 10% Debt to revenue: 75%	No	Yes	No	Strict	Very limited
Republic of Korea		Yes	Yes	Yes		Yes	Yes		Minimal	Developing
Kyrgyz Republic		Yes	Yes	No	Debt service ratio: 20%	No	Yes^	No		Very limited
Lao PDR		No	Yes	Yes		No	No	No		
Malaysia		Yes, less strict	Yes	No		No	Yes		Strict	Very Limited
Mongolia		Yes, less strict	Yes	No	Total public debt ceiling: 50% of GDP	Yes	Yes		Strict	Very Limited
Nepal		No	Yes	No	Debt to revenue: 12%	Yes	No	No		
New Zealand		Yes, less strict	Yes	Yes	Debt service ratio: 20%	Yes	Yes	Yes	Minimal	Developed
Pakistan		No	Yes	No	Total SNG debt: 0.85% of GDP	Yes	No	Yes		
Philippines	Yes, for investment	Yes	Yes	Yes	Debt to revenue: 20%	Yes	Yes		Strict	Very limited
Sri Lanka	Yes	Yes, less strict	Yes^	No		No	No	No		
Tajikistan		Yes	No							
Thailand			Yes[1]	No	Debt to revenue: 10%	Yes [1]	Yes*[1]		Strict	Very limited
Uzbekistan	Yes	Yes	No[5]							
Viet Nam	Yes, for investment	Yes	Yes	No	Debt to capital expenditure: 30% Debt to retained local revenue: 60% (cities); 30% (provinces)or 20%	Yes	Yes		Strict	Very limited

Note: This table has been developed based on information collected in the SNG-WOFI country profiles and is not fully comprehensive but instead provides information where available. Blank cells indicate information gaps. In many countries, limited information is available on the existence of fiscal rules for subnational governments. Furthermore, borrowing rules often vary depending on the level of subnational government and asymmetric borrowing arrangements are common (for example the Bangkok Metropolitan Administration and the City of Pattaya in Thailand have additional borrowing rights). [1] In Thailand, subnational government borrowing is permitted but is discouraged by the central government. [2] In New Zealand, only Auckland Council and the Local Government Funding Agency can borrow in a foreign currency. [3] In the People's Republic of China, most subnational governments are not permitted to issue bonds; however, Local Government Financing Vehicles often issue bonds on behalf of these governments. [4] In India, since 2017, financially sound state government entities are allowed to borrow from foreign entities. Borrowing rules in India also vary across levels of subnational government. [5] In Indonesia, subnational governments are only allowed to issue revenue bonds. [5] In Uzbekistan, subnational governments can obtain short-term loans from the upper level of government, which is to be repaid by the end of the fiscal year. [6] In Australia, some rules apply to territories, but states have a lot of discretion and local government rules depend on the level of government.

Sources: Author's elaboration based on the SNG-WOFI country profiles and other sources (Smoke, 2019[51]; ADB, 2017[52]; Standard & Poor's, 2015[53]; Republic of Nepal, 2017[54]; IMF, 2020[48]; de Biase and Dougherty, 2022[50]; OECD/UCLG, 2022[38])

In four countries in the region, subnational governments are not permitted to borrow. This direct control over subnational government borrowing was identified in Armenia, Cambodia, Uzbekistan and Tajikistan (Table 10). In Uzbekistan, subnational government can only obtain short-term loans from the central government to be repaid by the end of the fiscal year.

In seven countries, subnational governments appear to be only permitted to take loans from public financial institutions. In Georgia, Lao PDR, Bangladesh and Sri Lanka subnational governments are only permitted to borrow from public financial institutions (e.g. National Development Banks or Ministries of Finance), such as the Bank of Lao (see Table 9). In Sri Lanka, local councils can borrow from the Loans and Local Development Fund, but provinces cannot (although provinces are vested with the power to borrow under the 13th Amendment to the Constitution, the required laws permitting the extent of borrowing have not been made by the Parliament). In Kazakhstan, Kyrgyz Republic and Malaysia, subnational governments are only permitted to take loans from public financial institutions, but some subnational governments are also permitted to issue local currency bonds (although issuance is controlled). In many of these countries, central governments review and approve subnational government borrowing.

Many countries have strong borrowing limit on subnational government debt, particularly in countries with less developed debt markets and subnational governments with lower creditworthiness. Borrowing limits identified include restrictions related to the total level of debt as compared to annual subnational government revenue (debt to annual revenue) or on the ability of subnational governments to service debt (Table 10). Debt to revenue ratios were identified in five countries, ranging from 10% in Thailand and Georgia to 12% in Nepal, 20% in the Philippines and 75% in Kazakhstan. Debt service ratios, which measure the amount of annual subnational government revenue required to repay debts (interest and principal), were identified in four countries. The ratio is lower in Kazakhstan (10%), Kyrgyz Republic and New Zealand (both 20%), but higher in Indonesia (40%). State governments in Australia have no defined borrowing limit but rely on maintaining a good credit rating to continue issuing affordable debt.

Debt rules are often asymmetric, in line with asymmetric subnational government structures. In some countries, selected subnational governments are given privileged access to financing. These might be given due to their institutional capacity, economic specificities or after compliance with certain rules. In Bhutan, for example, Class-A municipalities that are more populated and developed have a specific borrowing status. In Mongolia, the capital city of Ulaanbaatar, which accommodates almost 50% of the population, has its own status and can borrow from the capital market and issue bonds. In Viet Nam, the provinces of Hai Phong and Dong Nai are the only ones that have access to commercial banks loans. In the Republic of Korea, subnational governments have been able to issue bonds without prior approval from the central government since 2006 if their debt levels are less than the maximum debt ratios set by the central government.

During the COVID-19 crisis, some countries adjusted their fiscal and borrowing rules, to allow subnational governments to borrow more to close their fiscal gap. This was the case in countries where subnational government borrowing is the most developed (e.g. People's Republic of China, Japan, Republic of Korea). In some countries, this was done by allowing subnational governments to issue extraordinary, special bonds. For instance, in Kazakhstan, there was a surge in subnational bonds issued by special-status cities (Almaty, Shymkent and Nur-Sultan), and in the Republic of Korea, the Seoul Metropolitan Government plans issued special bonds to finance its "Corona Survival Fund". In some countries, the subnational government debt or bond ceilings were raised (e.g. People's Republic of China). However, these measures were mostly temporary and started to be reversed in 2022, such as in Japan. In countries where subnational governments could not increase their borrowing, subnational governments had to draw heavily on their reserve funds (e.g. Philippines, Viet Nam).

Some countries in Asia and the Pacific have fine-tuned their fiscal rules to enhance their resilience to crises. For example, Armenia's Law on the Budgetary System states that municipal budgets may include a contingency fund to finance unplanned expenditures, interests on borrowings and capital investments. This fund may not exceed 30% of the total budgeted revenue of the municipality for the given fiscal year. In the Republic of Korea, a Local Fiscal Crisis Alert System was introduced in 2012 to prevent local governments from being in fiscal insolvency or moratorium, which monitors seven local fiscal status that may be connected directly to fiscal crisis.

Subnational governments' use of bonds is often permitted, but in many countries their use remains limited

In 14 out of 26 countries legislation was identified that allowed subnational governments to issue bonds (sometimes known as "municipal bonds"). Countries identified that allow subnational governments to issue bonds include Australia, New Zealand, Indonesia, Japan, Republic of Korea, Malaysia and Viet Nam, among others (see Table 10). Capital markets for subnational government debt are more developed in Australia, New Zealand, People's Republic of China and Japan, and are developing in the Republic of Korea and India. In the remaining countries, there have only been a handful of bond issuances by subnational governments. In at least three countries (New Zealand, Australia and Japan), at least some subnational governments are able to borrow in foreign currencies, although this permission can be asymmetric and change across levels of government. In New Zealand, for example, only Auckland Council and the Local Government Funding Agency can borrow in a foreign currency.

The People's Republic of China is a special case where most subnational governments are not permitted to issue bonds but there is a substantial local government bond market. Some wealthier municipalities in the People's Republic of China have been allowed to directly access to capital markets under the supervision of the central government. Other subnational governments have sometimes established Local Government Financing Vehicles (LGFV) to issue 'local government bonds' to support development and infrastructure investment projects. Due to concerns about the use of LGFV by subnational governments, new restrictions were placed on their use in 2021, in particular to require that the undertaking of debt is accompanied with corresponding funding.

In many countries where the issuance of bonds by subnational governments is permitted, their use is not commonplace. Some of the potential reasons for the limited issuance of bonds include:

- **Strict or unclear rules on bond issuance** - In Malaysia, Indonesia, Kazakhstan, Viet Nam and Mongolia, for example, strict rules are placed on the issuance of bonds by subnational governments, such as a requirement for approval from the central government.
- **Insufficient scale** – Bond issuances typically need to be of a sufficient scale and frequency to attract financing. Larger subnational governments can have sufficient scale to issue bonds on capital markets, but intermediary and small subnatinoal governments often do not. In Japan, larger subnational governments, such as the Tokyo Metropolitan Government issues bonds directly on capital markets, while smaller subnational governments typically lend through JFM, a financial intermediary owned by subnational governments.
- **Low creditworthiness** (including insufficient subnational revenues and financial management capacity) – Many subnational governments may not be considered creditworthy or would require a guarantee from a central government to issue bonds. Low creditworthiness can be due to a range of factors, including limited own-source revenues, insufficient recurrent revenues, insufficient public financial management capacity and limited credit history (Smoke, 2019[51]; OECD, 2022[45]; Fitch Ratings, 2021[55]).
- **Under-developed local capital markets** – In many countries in the region, local currency capital markets are not well developed for subnational debt or other debt instruments.

The issuance of social, sustainable and climate bonds by subnational governments in Asia and the Pacific is increasing but is concentrated in countries with established subnational bond markets.

For example, in June 2021, during the COVID-19 pandemic, the Tokyo Metropolitan Government issued Japan's first municipal social bond, a JPY 30 billion five-year bond whose proceeds are earmarked specifically for projects with a measurable social benefit. In Viet Nam, subnational governments can issue municipal bonds to invest in socio-economic development projects, upon approval from the Provincial-level People's Council.

Most countries have audit systems to oversee subnational government finance, although they are lacking in some countries

In most countries in Asia and the Pacific audit systems are centralised. Responsibility often falls upon the central audit agencies of countries, such as Bangladesh Office of Comptroller and Auditor General, Bhutan's Royal Audit Authority, Mongolia's National Audit Office, New Zealand's Office of the Auditor General, or Thailand's Office of the Auditor General. In Viet Nam, this task is deconcentrated to regional audit offices, still attached to the State Audit Office. These audits can be conducted on an annual basis or on a more ad hoc basis (e.g. environmental auditing in Bhutan). In some countries, such as Bangladesh, subnational governments are explicitly enabled to also form audit and account committees of their own in addition to the central procedures.

Auditing systems are lacking or are not effectively working in some countries. Based on the country profiles, this appears to be the case in Kyrgyz Republic, Lao PDR, Sri Lanka, Tajikistan, or Uzbekistan (OECD/UCLG, 2022[11]). In these countries, financial reports on subnational government accounts are often incomplete or published unaudited. This often results in limited public access to fiscal information on the subnational government sector.

In addition to national audit mechanisms, government programs can be set-up to guide subnational governments to improve their performance in financing and delivering services and infrastructure. For instance, in New Zealand, the CouncilMARK is a local government excellence programme that was set up to enable local governments to be assessed by independent experts every three years and given an overall rating (from triple AAA to C). The councils are assessed based on indicators across four priority areas: governance, leadership, and strategy; financial decision-making and transparency; service delivery and asset management; and communicating and engaging with the public and business. Assessment reports are public and contain recommendations for improving specific elements, including best practice case studies (Vammalle, C. et I. Bambalaite, 2021[56]).

Several countries are undertaking reforms focused on strengthening fiscal responsibility and improving fiscal relations among levels of government

Many countries in Asia and the Pacific have launched reforms to enhance fiscal responsibility across levels of government. These reforms often have an important focus on increasing transparency and accountability between central governments, subnational governments and citizens (Table 11). In Indonesia, for example, the Law n°1 of 2022 on Financial Relations between the Central Government and Regional Governments (UU HKPD, to be implemented by 2024) includes the strengthening of regional fiscal capacity and a harmonisation of central and regional expenditure. In Cambodia, the Subnational Budget System Reform Strategy 2019-2025 aims to improve subnational policy outcomes and to strengthen public finances by reinforcing budget-policy linkages and enhancing fiscal balances. In Viet Nam, the government made further efforts to increase transparency by publishing a "citizen-friendly" state budget online for the first time in 2022.

Table 11. Examples of recent fiscal and public financial management reforms in Asia and the Pacific

Country	Year	Name	Objective
Australia	2008	Inter-governmental Agreement on Federal Financial Relations	Enhance the transparency of public performance reporting.
Bhutan	2012	Local Governance Rules and Regulations; Local Government Act	Establish Standing Committees in charge of rule-making, disciplinary measures, monitoring, evaluation, etc., provide clear guidance on how they shall be transparent and accountable to citizens, as well as put in place appropriate mechanisms for information dissemination. Accordingly, all subnational governments are now required to have public notice boards, annual budgets, annual work plans and calls for tenders.
People's Republic of China	2020	Implementing Regulations of the Budget Law	Improve budget transparency.
Indonesia	2022	Financial Relations between the Central Government and Regional Governments	Ensure transparent and accountable intergovernmental fiscal relations as well as a harmonisation of central and regional expenditure.
Philippines	2021	Budget Modernisation Bill (currently being examined by the Parliament)	Streamline the management of public resources, introduce a Budget Priorities Framework (to ensure that the national budget is allocated towards clear national priorities, in particular for infrastructure), and enhance accountability, transparency and people's participation, in particular through participatory budgeting.
Viet Nam	2022	Treasury and Budget Management Information System	Increase transparency by, for instance, publishing a "citizen-friendly" state budget online

Source: Authors' elaboration based on SNG-WOFI country profiles (OECD/UCLG, 2022[11])

Financial management

Public financial management capacity at a subnational government level needs to be strengthened to accompany decentralisation and devolution processes

Beyond improvements to fiscal frameworks and rules, strengthening public financial management (PFM) is essential to achieve the benefits of decentralisation and devolution. Effective and transparent public financial management can serve as a tool to foster trust between subnational governments and the population, and to improve government efficiency by making best use of scarce resources. Underlying all government activities, PFM is a basic tool that incorporates all items of a country's budget cycle, including the mobilisation and the allocation of revenue as well as the expenditure and accounting for spent funds. PFM is important for subnational governments because they are often in a position where they must be efficient and produce high returns, in a constrained fiscal environment and in a global context where successive shocks require permanent adjustments in spending.

Subnational government effectiveness can be constrained by a lack of sufficient public financial management capacity. Effective public financial management is contingent upon subnational governments having the technical and managerial capacity to comply with public financial management regulations and rules. Lack of skilled human resources, as well as the necessary financial and infrastructure resources to conduct public financial management activities, may lessen the quality and reliability of financial public management systems at the subnational level (IMF, 2022[57]).

Several countries are undertaking reforms to improve the quality of public finance management. Examples include the development of new centralised systems of public finance and data management (e.g. Thailand), or by establishing specific institutions dedicated to monitoring and evaluation (e.g. Local Governance Rules and Regulations of 2012 in Bhutan) (Table 11). In Viet Nam, budget execution and fiscal reporting have become more transparent in recent years due to the implementation of a new Treasury and Budget Management Information System.

Priority-based budgeting and participatory budgeting is increasingly used by subnational governments in the region

Budgeting can be a practical tool for subnational governments to use to achieve strategic priority objectives, enhance spending efficiency and increase accountability. Through planning and managing their budgetary process, subnational governments can rationalise their spending and direct it toward specific policies, such as gender-sensitive or climate-significant actions. By linking spending directly to SDGs or to climate and environmental actions, subnational governments can improve the transparency of their budgets. This allows them to demonstrate good budget management and supports capacity building. Budgeting is also a basis for dialogue with citizens, central government, and development partners, that may support access to climate-related grants or other financial tools (green bonds). Two emerging instruments in Asia and the Pacific are participatory budgeting and green budgeting (a form of priority-based budgeting), although other forms are also emerging (e.g., SDG budgeting).

Participatory budgeting

Participatory budgeting is a concrete budgetary practice that subnational governments can use to enhance local accountability and citizen participation. It is a democratic process in which community members decide on how to spend parts of a public budget (OECD, 2022[15]). This approach builds upon two different needs: improving public performance and enhancing the quality of democracy. Participatory budgeting varies from city to city, yet at its core it consists of a city, region or country setting aside a portion of its public budget, citizens then submit project proposals, and finally citizens vote on which projects to fund using the allocated budget. The first participatory budget was in Porto Alegre (Brazil) in 1989 and has since been adopted by 2 700 national and subnational governments worldwide (Gelman and Votto, 2018[58]). It is particularly widespread as a systematic practice in Latin America and in Europe, and examples vary strongly in terms of the nature and the scope of public participation.

In Asia and the Pacific, Indian subnational governments stand out for promoting citizens' participation in the budget process. India is a reference in this field, with participatory budget mechanisms in place in some Indian states and municipalities since 1996. Kerala was the first Indian state to implement participatory budgeting at the subnational level, enabling citizens to decide on the allocation of expenditure accounting for up to 40% of the state budget. At the local level, Bengaluru became the first Indian city to experiment with participatory budgeting in 2001, and participatory budgeting was officially implemented by the municipality of Pune in 2005, which is renewed on an annual basis. Citizens can propose policies in sectors such as street lighting, water and sanitation, parks and green areas, and public transport.

Citizen participation in the budget process is also promoted in other countries, although it is at an earlier stage of development (Table 12). In Mongolia, for instance, the importance of community participation in the local budget process is acknowledged in the law (Article 62 of the 2013 Integrated Budget Law), specifically for the allocation of capital expenditure (local development funding), which represented 2% of Mongolia's GDP and 29.5% of total public capital expenditure in 2020. Promoting participatory budgeting is also among the objectives of recent bills and policies in Kazakhstan and in the Philippines.

Table 12. Examples of integration of participatory budgeting practices

Country	Year	Name	Description / Objectives
India	Since 1996	Kerala's Participatory Budgeting	Serving as a pilot, this programme was implemented through the Kerala People's Campaign under the Ninth Plan (1997-2002) and ensured that citizens decided on the allocation of expenditure accounting for up to 40% of the state budget. Since then, the model has been adopted in all state planning.
Kazakhstan	Since 2019	Pilot experiments in Nur-Sultan and Almaty	Participatory budgeting started to be implemented in selected districts of the two largest cities of Kazakhstan (with population of over 1 million inhabitants): Nur-Sultan and Almaty. Based on these pilots, the central government plans to further increase the amounts allocated to participatory budgeting and to scale-up the successful experiences to all 14 regions of the country.
Mongolia	2013	Integrated Budget Law	Acknowledges the importance of community participation in the local budget process, especially for the allocation of capital expenditure.
Philippines	2021	Budget Modernisation Bill	The Bill (still under scrutiny by the parliament) aims to streamline the management of public resources, to introduce a Budget Priorities Framework, and to enhance accountability, transparency and people's participation, in particular through implementing participatory budgeting.
Uzbekistan	Since 2019	Pilot experiment	Based on a Presidential Decree from April 2021, it is planned to allocate 5% of the approved total expenditures of the districts (cities) budgets to projects submitted by citizens. At least 30% of additional revenues of districts and cities' budgets are to be directed to citizens' initiatives. In 2021, the initiative was piloted in one district and in every region of Uzbekistan, before being extended to all districts in 2022.

Note: Authors' elaboration based on SNG-WOFI country profiles (OECD/UCLG, 2022[11]) **Source**: (UNDP, 2022[59]; Yernazarova, 2022[60]; OECD/UCLG, 2022[38])

Green budgeting practices

Budgetary processes can be used to promote the achievement of climate and environmental objectives through green budgeting. Green budgeting is defined as "using the tools of budgetary policy making to help achieve environmental and climate objectives". It is a concrete, practical tool that governments can use to address, climate change, biodiversity loss and environmental degradation. In recent years, interest in subnational green budgeting has also grown steadily as has the number of subnational governments implementing green budgeting practices across the globe (OECD, 2022[15])).

Among countries in Asia and the Pacific, instances of climate budget tagging and green budgeting at a subnational level were identified in Cambodia, Indonesia, Nepal, India and the Philippines (Table 13). In some countries, such as Indonesia and the Philippines, subnational climate budget practices followed the implementation of green budgeting practices at national level. In others, such as India, subnational green budgeting has emerged on its own. In Indonesia, the Ministry of Finance, with support from the United Nations Development Programme (UNDP), conducted a pilot project in 2020 to implement climate budget tagging in three Indonesian provinces (Gorontalo, Riau, and West Java). In the Philippines, subnational governments have been required 2015 to tag climate programmes, activities, and projects during the preparation of their annual investment programmes. In India, the state of Odisha has developed its own climate budget tagging methodology in 2020 and recently applied it ex-ante to the 2021-2022 state budget.

Table 13. Examples of green budgeting practices

Country	Year	Name	Description / Objectives
India	2020	Odisha's climate tagging methodology	Develop a methodology and apply it to the 2021-2022 state budget. The investment budget of 11 departments deemed to be climate-related is tagged manually during the budget preparation phase. Tagging is centralised in the Finance Department rather than in the respective line ministries.
Indonesia	2020	Pilot project on climate budget tagging in Gorontalo, Riau, and West Java	Implement climate budget tagging in three Indonesian provinces (Gorontalo, Riau, and West Java) using the same climate budget tagging methodology used at the national government level since 2014.
Philippines	2015	Typology of climate programmes	Subnational governments are required to tag climate programmes, activities, and projects during the preparation of their annual investment programmes based on a typology developed by the Department of Budget Management, the Climate Change Commission, and the Department of Interior and Local Government.

Source: (UNDP, 2022[59]; Yernazarova, 2022[60]; OECD/UCLG, 2022[38]) **Note**: Authors' elaboration based on SNG-WOFI country profiles (OECD/UCLG, 2022[11])

Climate budgeting, a type of green budgeting focused on climate change adaptation and mitigation, continues to develop in Asia and the Pacific. UNDP and the World Bank, in particular, have played a key role in advancing this area of work through the funding and implementation of climate budget tagging exercises in countries such as Bangladesh and Nepal. National and subnational exercises are also found in Cambodia, India, Indonesia, the Philippines, and Pakistan.

Subnational green budgeting is in its nascency. In order for subnational governments to make full use of green budgeting however, more support is needed. At the global level, there is growing interest in green budgeting and the OECD's Centre for Entrepreneurship, SMEs, Regions, and Cities (CFE) collaborates actively with internal and external partners to raise awareness of the topic and disseminate the latest research. In 2022, the OECD developed a set of guidelines and instruments for subnational governments to use in developing and launching a green budgeting practice (Box 10).

Box 10. OECD Subnational Green Budgeting Guidelines and tools

In 2022, as part of a joint OECD and European Commission project, the OECD's Centre for Entrepreneurship, SMEs, Regions and Cities (CFE) developed the Subnational Government Climate Finance Hub, an online platform with unique data and analysis on subnational government climate finance.

In this framework, the OECD developed six subnational green budgeting guidelines:

- **Guideline 1:** Conduct a diagnostic of local environmental and climate challenges as a pre-requisite to launching a green budgeting practice.
- **Guideline 2:** Ensure strong, high-level involvement and support from both the administrative and elected sides of government.
- **Guideline 3:** Ensure the practice has a robust, shared scientific basis to facilitate public trust and ensure the practice can adapt to changing scientific evidence.
- **Guideline 4:** Adopt a stepwise approach to implementing green budgeting in order to learn from previous steps and reinforce the alignment of the practice with local strategic priorities.
- **Guideline 5:** Integrate the green budgeting practice into existing public financial management procedures and tools to help ensure the practice endures.
- **Guideline 6:** Include revenues within the scope of the green budgeting practice to ensure the entire budget aligns with green objectives.

Any region or municipality can use these guidelines, and the recommendations that accompany them, to develop their own green budgeting practice or strengthen an existing one.

The full publication, detailed guidelines and the Self-Assessment Tool are available on the OECD's Subnational Government Climate Finance Hub (the Hub).

Source: (OECD, 2022[15])

Other budgeting practices

While participatory and green budgeting are the most widespread in the region, some initiatives are underway to explore other types of budgetary practices in the region. This is the case for gender-responsive budgeting, which aims to allocate resources to meet the different needs and priorities of men and women, in order to allow men and women to achieve equality of outcomes from economic policies. In Bhutan, for example, the central government identified gender equality as one of the national key results areas in the 12 Fiver-Year Plan. Accordingly, efforts are being made to mainstream gender into development plans and to incorporate gender issues in the annual budgets of government agencies, as well as in the inter-governmental transfer system. Budgetary practices can also be implemented to align subnational government budgets with the achievement of the SDGs and 2030 Agenda (e.g. Azerbaijan, Tajikistan).

Strengthening the management of subnational governments' assets has the potential to improve the benefits created

Subnational governments in Asia and the Pacific often own or manage substantial asset portfolios, but limited data is available on these assets. These assets include land, property, infrastructure, state-owned enterprises, financial resources and natural resources, among other types. In most countries, even developed countries, there are limited databases of subnational governments assets meaning that it is difficult to assess the value and quality of assets owned by subnational government. Many subnational governments also do not keep registers of their assets. This limits the ability to identify revenue opportunities.

Assets can provide an important source of revenue for subnational governments but can also have substantial costs. Assets can provide revenue for subnational governments (e.g., rental income, resource taxes, dividends, etc.). In Australia, for example, royalties from mining leases represent 24 % of subnational government expenditure in Western Australia and 8% in Queensland (but represent much less in other states). They can also come with operational and maintenance costs. While effective asset and resource management can provide a way to mobilise additional subnational government revenue, effective asset management can also lower future expenditure requirements (e.g. on maintenance). This means that resources can be allocated to higher priorities. In many countries, subnational governments are often important owners of property and land, which can be leased at commercial rates to provide an income for subnational governments

Subnational governments can seek to adopt a portfolio management approach to effectively manage these assets in the long-term public interest (United Nations, 2021[61]). This might involve seeking opportunities to increase asset revenues, to create additional benefits from existing assets (for example, by optimising the use an existing rail network) or to decrease whole-of-life costs. Subnational governments may directly manage public assets, or these assets may be managed by subnational State-Owned Enterprise or through a Public-Private Partnership (see other sections of this report).

Strong regulatory and institutional frameworks are required to ensure that subnational government assets are managed effectively and in the long-term public interest (United Nations, 2021[61]). Long-term leases or asset divestment, for example, can reduce public control over land and assets, which can result in inefficiencies and reduce equity and accessibility. It can also increase the cost of future public interventions as, for example, the sale of public land might prevent public upgrades in the future. Table 14 highlights a few examples of policies aimed at improving subnational asset management in Asia and the Pacific.

Table 14. Examples of initiatives to improve subnational asset management

Country	Type	Description
Cambodia	Improved property management to help development	The 2011 Law on Subnational Fiscal Regime and Property Management aims to create sources of finance for the subnational administrations to have sufficient ability to carry out their local development, and has its scope of operation over the financial regime and property management of the administrations of capital, province, municipality, district and Khan. The law, however, does not cover the operation of the financial regime and property management of the administrations of commune and Sangkat.
Mongolia	Local mining revenues	Local governments are empowered to collect subnational revenues from mining exploration. The 2006 Mineral Laws acknowledge subnational governments' capacity to establish agreements between local legislative bodies and mining companies. Provinces and districts that host extractive industries have also established subnational councils to promote transparency in the management of resources at local level. The adoption of the 2014 Law on Glass Accounts was an important step forward to increase fiscal transparency as it aims to ensure the efficient use of state and local government funds and assets, improve the transparency of decisions and actions concerning budget management and strengthen citizens' oversight through an information system.
People's Republic of China	Activating existing assets	In May 2022, the People's Republic of China published "Opinions on Further Activating Existing Assets and Expanding Effective Investments", which mentions revitalising existing assets and forming a virtuous investment cycle, in part for improving infrastructure.
Georgia	Asset transfers	According to the National Agency of State Property, the central government transferred a significant number of its immovable properties into the ownership of municipalities in 2016 and 2017.

Source: (UNDP, 2022[59]; Yernazarova, 2022[60]; OECD/UCLG, 2022[38]) **Note**: Authors' elaboration based on SNG-WOFI country profiles (OECD/UCLG, 2022[11])

The number of subnational state-owned enterprises appears to be increasing in some countries in Asia and the Pacific

State-owned enterprises (SOE) are an important part of the economy in many countries in Asia and the Pacific. While there has been a decline in state-ownership over recent decades, SOEs (both national and subnational) continue to account for about 20% of investment and 5% of employment globally (ADB, 2020[62]). In emerging markets and low-income developing countries, SOEs are responsible for 55% of infrastructure investment, as compared to 28% of investment by public entities (treasuries, ministries, local public companies) and 17% by the private sector (World Bank, 2017[63]).

While data on the number of subnational SOEs is limited, the number of subnational SOEs is increasing in some countries. Most data sources do not distinguish between SOEs overseen by national and subnational governments, meaning that there is limited internationally comparable data available on the role of subnational SOEs. In a couple of countries with data available, however, the number of subnational SOEs is increasing. In Georgia, for example, the number of non-commercial enterprises established by municipalities has doubled in recent years. In India, the central government is reforming the energy sector and decentralised energy to the state level, with the aim to support upgrades to energy infrastructure. In Japan, a network of 8 165 local public companies are active in public service delivery, especially in sewerage (44% of all local public companies), water supply (22%) and hospitals (8%). In New Zealand, a decrease in the number of subnational SOEs under the Three Waters Reform Programme as the existing 67 existing council-owned water authorities are proposed to be amalgamated into four new state-owned enterprises.

Subnational governments in Asia and the Pacific oversee many different SOEs who provide infrastructure and public services on their behalf. Many different names for subnational SOEs exist across Asia and the Pacific, including municipally-owned corporations, municipal public companies or local public companies. Typical functions include the management of land, public transport networks, utilities and infrastructure projects. Development authorities might be established to manage land and support developments on behalf of subnational governments, such as with local government financing vehicles in the People's Republic of China. Public transport agencies are often created to manage and operate public transport networks, as exist in Uzbekistan. Subnational SOEs are also sometimes created to manage key services such as water, sewerage, waste and energy; however, these services are also often contracted out to the private sector.

Effective use of municipal SOEs can support access to innovation and skills, and support the pooling of external financial resources. SOEs can potentially be flexible and responsive, while also upholding the general interest and community values (OECD, 2017[64]). Where they are established, governments at all levels should seek to ensure that SOEs operate effectively, avoid simply crowding-out private sector companies and ensure accountability and transparency (OECD, 2022[45]). Better governance, capacity to manage local public companies and a stronger rational for public intervention can correlate with higher performance. (OECD, 2015[65]; IMF, 2020[66]).

Subnational public-private partnerships appear to be less common in Asia and the Pacific than in OECD countries

In Asia and the Pacific, public-private partnerships[18] (PPPs) are frequently seen as a way to increase the level of infrastructure investment and support economic development. Over the last decade many countries in the region have adopted PPP legal frameworks, regulations and guidelines, and established PPP units, to help support the use of PPPs for infrastructure investment (World Bank, 2022[67]). While representative data on the use of PPP's in Asia and the Pacific is limited, a general perspective of the potential role of PPPs for infrastructure investment can be taken from OECD countries, where PPPs represent around 5% of the total value of public sector infrastructure investment (OECD, 2018[68]; OECD, 2019[69]).

In Asia and the Pacific, there is limited or no use of PPPs by subnational governments in many countries. In eight countries studied, no use of PPPs by subnational governments was identified (Table 15), and in some of these countries the use of PPPs by subnational governments is not permitted or supported by the central government. In Georgia, for example, subnational governments are not allowed to undertake PPPs, but do have some limited involvement in PPP projects (e.g. to support planning). In eleven other countries the use of PPPs exists but is somewhat limited at a subnational level. In Kyrgyz Republic and Thailand, for example, only subnational governments in the capital region are permitted to use PPPs (Bishkek and Bangkok). In Armenia and Mongolia, PPPs are also mainly used by subnational governments in capital city regions (Yerevan and Ulaanbaatar) where a significant population live. In Indonesia, subnational governments are sometimes encouraged to undertake PPPs but can lack the capacity and face unstable regulatory frameworks.

[18] A wide variety of different types of PPPs exist. A broad definition is that a PPP is "a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance" (World Bank Group et al., 2017[96]). This definition also includes public service contracts and concessions. A PPP is usually described by the type of asset involved (greenfield, brownfield), the role of the private party (design, build, finance, maintain, operate) and how the PPP is funded. A useful categorisation of PPPs models is through their funding model. A user-pays PPP is primarily funded by user charges, while a government-pays PPP is primarily funded through a defined payment scheme with funding ultimately provided from other government revenues (e.g., grants, taxes, property income, etc.). A PPP can also be funded by a mix of these two methods. (World Bank, 2022[67])

Table 15. Use of PPPs by subnational governments in Asia and the Pacific

No use of PPPs by SNGs identified	Limited use of PPPs by SNGs identified		Frequent use of PPPs by SNGs
Azerbaijan	Armenia^	Mongolia^	Australia+
Bangladesh	Bangladesh	Nepal	People's Republic of China
Cambodia	Bhutan	New Zealand	India
Georgia	Indonesia	Pakistan	Kazakhstan+
Lao PDR	Japan	Sri Lanka	Philippines
Malaysia	Republic of Korea	Thailand*	
Pakistan	Kyrgyz Republic*	Uzbekistan	
Sri Lanka	Malaysia		
Tajikistan			
Viet Nam			

Note: In many countries, limited information is available on the use of PPPs by subnational governments. This table has been developed based on information collected in the SNG-WOFI country profiles. Legend: * indicates that PPPs are only permitted to be used by some subnational governments (examples include Bishkek in Kyrgyz Republic and Bangkok in Thailand). ^ indicates that PPPs are mainly used in certain major cities (examples include Yerevan in Armenia and Ulaanbaatar in Mongolia). + indicates that most PPPs are at a subnational level (e.g., Australia 80% of PPPs are subnational). SNG indicates subnational government.
Source: Authors' elaboration based on SNG-WOFI country profiles: www.sng-wofi.org

The use of PPPs by subnational governments is frequent in a small sample of countries. Subnational governments were identified to regularly use PPPs in around five countries (Table 15). In Australia, for example, approximately 80% of PPPs occur at the subnational level (OECD, 2018[68]). In Kazakhstan only 10 of 1361 PPPs undertaken were by the national government. In the Philippines, the total number of PPP projects in December 2020 was 234, with half of these projects being implemented by subnational governments.

To support the effective use of PPPs, national governments in some countries have recently updated legal frameworks, regulations and guidelines. In Armenia, for example, a new Public-Private Partnership law was passed in 2020. In 2017, the People's Republic of China created new regulations on PPPs in Infrastructure and Public Services. In Japan, the so-called PFI Promotion Council has established a guidance for local governments for the use of the various types of PPPs in 2015. In 2020, the Government of the Republic of Korea amended the regulations related to PPPs to increase transparency, requiring all procuring authorities to disclose the agreements of PPP projects. In Bhutan, the Ministry of Finance has developed public-private partnerships (PPP) rules and regulations, guidelines, screening tools and other materials in 2015.

Most national governments (and some subnational governments) have established specialised PPP Units to support the development of PPP projects. PPPs require specialist expertise that is not always available with a subnational government but is essential to ensure benefits from PPPs are achieved (OECD, 2022[45]). Most countries in Asia and the Pacific have established PPP units to help develop these projects (World Bank, 2022[67]). In the Republic of Korea, the Public and Private Infrastructure Investment Management Centre has a Public-Private Partnership Unit that provides technical assistance to subnational governments. In some countries, state or regional governments also have well established PPP units. In Australia, state governments have their own dedicated PPP units and guidelines.

National governments in some countries provide financial and non-financial incentives to support the use of PPP projects by subnational governments. In India, for example, the government has a Viability Gap Funding scheme to provide financial support in the form of grants, one time or deferred, to infrastructure projects undertaken through PPPs, with a view to make them commercially viable. India has also recently developed the Jawaharlal Nehru National Urban Renewal Mission program, to foster PPPs in urban sectors such as solid waste, water supply, sewage, and urban transport. The programme will provide additional resources and transfers to Urban Local Bodies and includes additional viability gap funding. Indonesia has adopted a similar Viability Gap Funding scheme targeted at PPP projects. In Japan, in 2019, the government launched the Public-Private Partnership Smart City Platform, which gathers representatives from the central and local governments, academia and the business sector.

Effective use of PPPs requires subnational governments to have significant institutional capacity, which is not always in place in subnational governments in Asia and the Pacific. PPPs have significant benefits, costs and risks for subnational governments that need to be carefully assessed. PPPs are generally considered justified where they are carefully assessed as being affordable and produce greater value for money than would be provided by the delivery of public services or investment through traditional public procurement (OECD, 2018[68]; IADB, 2018[70]; OECD, 2022[45]). Benefits, costs and risks of PPPs need to be considered against other infrastructure delivery models and long-term fiscal risks and costs from PPPs need to be carefully evaluated. This all requires sufficient expertise and institutional capacity (OECD, 2019[71]; OECD, 2022[45]; OECD, 2012[72]).

4 Policy Opportunities

Strengthening subnational government finances and multi-level government frameworks across Asia and the Pacific can help to support economic development, improve wellbeing and achieve the sustainable development goals. Based on the analysis contained in the previous sections of in this report, this section outlines potential policy opportunities that could be explored to strengthen subnational government finances and multi-level governance in the region. The ten opportunities identified below may be appropriately considered in combination with each other, or at different points in time. They may be adapted and considered in the national and local contexts.

1. Ensure responsibilities are clearly defined across layers of government.

An unclear or misallocation of responsibilities across levels of governments is common to many countries across Asia and the Pacific. This unclear allocation can lead to policy duplication at different levels of government, to the non-fulfilment of responsibilities in key sectors and to an erosion of transparency and accountability. Responsibilities can be defined across layers of government by detailing core local competences, reducing the degree and clarifying shared assignments. Furthermore, in cases of asymmetric decentralisation, the way asymmetric responsibilities are allocated can be made explicit so that they are mutually understood and clear for all actors (OECD, 2019[1]).

2. Enhance co-ordination mechanisms across levels of government (vertical) and support cross-jurisdictional co-operation (horizontal).

Appropriate inter-governmental co-ordination mechanisms can ensure policy coordination and coherence but can be underdeveloped in the region. Since most responsibilities are shared across levels of government, dialogue and governance mechanisms are essential to manage joint responsibilities, avoid policy duplication and overlaps, increase efficiency and foster trust among tiers of government (OECD, 2019[1]). Countries can foster co-ordination by involving subnational governments and other stakeholders in the design and/or implementation of policies, including in times of crisis, by creating or reactivating joint inter-governmental fora and other instruments such as fiscal councils or contractual arrangements. Further adoption of inter-muncipal cooperation mechanisms, which are underdeveloped in the region, may also support improved coordination.

3. Make the most of inter-governmental transfer systems as a reliable source of revenue for subnational governments, including by carefully designing grants and equalisation arrangements to address disparities and promote the tax and development efforts of subnational governments (e.g., fiscal equalisation, performance-based grants).

Grants and subsidies, which are the first source of subnational government revenue in Asia and the Pacific, can serve a variety of objectives, ranging from funding devolved or deconcentrated responsibilities, to providing incentives to subnational governments and improve spending efficiency, and to reducing territorial disparities in the case of fiscal equalisation transfers. In Asia and the Pacific, the transfer systems in place in many countries could be enhanced through creating or improving equalisation arrangements to better address disparities across territories in terms of revenue or spending needs, with consideration of the local contexts, incentives and disincentives, and effects on regional development. Performance-based transfers could also be considered to build capacity of SNGs and increase the efficiency of subnational spending and its alignment with national priorities, such as climate action objectives.

4. Support subnational governments to secure a sufficient, stable and balanced basket of revenues, including by harnessing physical and financial assets (e.g., land, property and natural resources) and further expanding own-source revenues such as property taxes.

Some countries in Asia and the Pacific are characterised by significant vertical fiscal imbalances between the level of subnational expenditure and the level of subnational tax revenue. This is often characterised by a high degree of shared taxation, which can lead to limited decision-making power for subnational governments, and low subnational own-source revenue, in particular revenue from property taxes. This imbalance opens the door to the emergence of unfunded or underfunded mandates, which can limit the ability of subnational governments to effectively deliver on their responsibilities. Supporting subnational governments to harness a diverse basket of revenues can help to address these imbalances. Countries can harness the revenue potential of the recurrent immovable property tax by undertaking comprehensive tax reforms, including the creation of new recurrent property taxes or surtaxes, revising the tax base and rates, or even modernising and digitalising tax systems. There can also be an opportunity to improve the use of assets and resources by subnational governments. In particular, better asset management can help ensure that the limited resources of subnational governments are mobilised most effectively (OECD, 2022[45]).

5. Strengthen subnational expenditure autonomy to enhance accountability, support effective design and delivery of public services, and improve budget management, among other benefits.

Subnational governments in Asia and the Pacific are responsible for a significant share of government expenditure yet can sometime have limited control over their expenditure. Strengthening subnational governments autonomy in the design and delivery of these responsibilities can help to ensure that these governments can effectively meet local needs. It can also enhance local accountability and improve budget management. This goal can be supported by assessing and measuring the performance of subnational governments in terms of fiscal management and public service delivery, and increasing subnational institutional capacity (see Table 11)

6. Support the effective use of debt by subnational governments by adopting effective fiscal responsibility frameworks, building institutional capacity, exploring the use of financial intermediaries and ensuring sufficient and stable funding sources are available.

Many subnational governments in Asia and the Pacific have very low levels of debt relative to their revenue, well below OECD countries. In countries with strong fiscal responsibility frameworks and institutional capacity, there may be opportunities to increase the use of debt by subnational governments for quality investments. This would need to be accompanied by capacity building and the adoption of appropriate fiscal rules, including borrowing rules to encourage subnational governments to be financially healthy over the long term. In some countries, it may be appropriate to explore the use of public financial intermediaries to improve subnational governments access to finance and address market failures (OECD, 2022[45]). These need to be supported by robust governance and fiscal responsibility frameworks, and strong institutional capacity.

7. Build the institutional capacity of subnational governments alongside the decentralisation of responsibilities, including relating to revenue collection, public expenditure, investment, asset management and debt management.

Building subnational government capacity must accompany fiscal decentralisation processes, in particular improvements in public financial management. Many countries in Asia and the Pacific can further develop their institutional capacity across many areas, but particularly for financial management. Developing tools and skills for public financial management at subnational level, such as systems for data collection management and for fiscal reporting, can contribute to increase accountability and transparency and improve government efficiency by making best use of scarce resources. Improving the quality of public finance management can help to improve subnational institutional capacity. They can also strengthen subnational investment capacities throughout all stages of the investment lifecycle. Such initiatives can be coupled with amendments and improvements in the legal and regulatory framework for public financial management and to support effective subnational government investment (OECD, 2014[10]; OECD, 2022[45]).

8. Enhance Public Financial Management and Public Investment Management, including through digitalisation and by strengthening the link between planning, investment programmes and budgets to help deliver a pipeline of investable projects.

Strengthening Public Financial Management and Public Investment Management are essential to achieve the benefits of decentralisation and devolution and ensure effective multi-level governance. Effective and transparent public financial management can serve as a tool to foster trust between SNGs and the population, and can improve government efficiency by making best use of scarce resources. This is also important when it comes to managing public investment, to ensure that investments are well planned, prioritised, budgeted and implemented to deliver long-term value for money that contributes to balanced growth and improvements in well-being. Co-ordination policies across levels of government and across sectors, proper financial management and investment management systems and framework conditions, and capacity-building, are ways to strengthen the effectiveness of public spending and investment (OECD, 2014[10]).

9. Support emerging practices of priority-based (e.g., green budgeting) and participatory budgeting practices to enhance local accountability and support prioritisation according to strategic objectives.

Budgeting can be a practical tool for subnational governments to use to achieve strategic priority objectives, enhance spending efficiency and increase accountability. Use of these tools remains limited in the region. Countries may consider promoting priority-based and participatory budgetary practices at subnational level to enhance local accountability and to support the achievement of policy objectives. In addition to strengthening underlying budgeting practices, there can be opportunities to explore emerging budgetary practices, such as green budgeting and participatory budgeting, for instance by establishing pilot programmes. Central governments can play a role in this by providing the methodology, tools and financial resources to support these initiatives (OECD, 2021[7]).

10. Improve collection and transparency of data on subnational government finances to better support subnational governments' actions, in particular data on subnational government own-source revenue, assets and debt.

Data on subnational government finances in Asia and the Pacific is often inconsistent and incomplete. This is especially true for least developed countries (LDCs) and small countries, such as the Pacific Islands. Improving data collection and encouraging transparency can help to support effective policymaking and promote dialogue at national and international levels on decentralisation and multi-level governance. For example, although assets (e.g., land, buildings, SOEs, natural resources, etc.) provide an important source of potential revenue for subnational governments, there is limited data on the use of assets. There is also a lack of data available to distinguish between own-source revenue, shared taxes and transfers, as well as data on subnational government debt. Supporting the collection of data on subnational government finances, including own-source revenue, debt and assets, as well as establishing accompanying regulatory and institutional frameworks, can support effective public financial management.

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Annex A. Key indicators for the country sample

Two tables provide key indicators about the countries analysed in the report:

- Annex A1 – Economic and socio-demographic indicators in the country sample; and
- Annex A2 – Subnational government structures in the country sample.

Annex A1 – Economic and socio-demographic indicators in the country sample

Country	Population growth 2016-2020 (average annual rate)	Urban population (% of total population)	Urban population growth 2020 (average annual growth)	Density 2020(habitants/ km2)	Population in capital city 2020 (% of total population)	GDP 2020 (in billion dollars PPP)	GDP per capita 2020 (in dollars PPP)	Real GDP growth 2020 (annual growth rate, %)	Real GDP growth (10-year average 2011-2020)	Foreign direct investment, net inflows (BoP current USD, millions)	Gross fixed capital formation (% of GDP)	HDI Index value	HDI World ranking	Change in poverty level (headcount at $3.20/day 2015-2020, millions of people)[1]	Unemployment rate	Young-age dependency ratio	Old-Age Dependency Ratio
Armenia	0.3	63.3	0.0	99.6	36.5	39.4	13,312	-7.4	3.5	47.2	16.6	0.78	81	0.22	20.9	30.9	17.5
Australia	1.3	86.2	1.4	3.3	1.7	1,369.9	53,330	0.0	2.4	19,638.9	22.7	0.94	8	0.00	5.1	29.9	25.1
Azerbaijan	1.0	56.4	1.3	116.5	22.6	146.1	14,480	-4.3	0.9	507.2	23.5	0.76	88	0.00	6.6	33.7	9.7
Bangladesh	1.1	38.2	3.0	1,116.0	5.4	846.3	5,139	3.5	6.4	1,143.2	30.5	0.63	133	-24.44	5.2	39.3	7.7
Bhutan	1.2	42.3	2.8	20.1	14.8	8.6	11,130	-10.1	3.9	-2.8	33.8	0.65	129	-0.02	4.3	36.1	9.0
Cambodia	1.5	24.2	3.2	92.3	9.4	73.9	4,421	-3.1	6.1	3,624.6	24.1	0.59	144	-1.56	0.6	48.2	7.6
People's Republic of China	0.5	61.4	2.1	147.0	1.3	24,283.2	17,211	2.3	6.8	212,475.7	42.9	0.76	85	-59.63	4.8	25.2	17.0
Georgia	-0.2	59.5	0.5	53.3	31.9	54.8	14,767	-6.8	3.6	534.0	22.4	0.81	61	-0.23	10.7	31.3	23.6
India	1.0	34.9	2.3	419.8	8.0	8,975.5	6,504	-7.3	5.1	64,362.4	27.1	0.65	131	-41.72	6.0	38.9	9.8
Indonesia	1.1	56.6	2.2	142.7	3.8	3,302.2	12,073	-2.1	4.6	19,122.1	31.7	0.72	107	-17.61	4.4	38.3	9.2
Japan	-0.2	91.8	-0.2	332.9	7.7	5,334.2	42,390	-4.6	0.4	62,723.1	25.3	0.92	19	0.02	2.8	21.0	48.0
Kazakhstan	1.3	57.7	1.5	6.9	6.2	501.8	26,754	-2.5	3.5	7,406.5	24.7	0.83	51	-0.02	4.9	46.3	12.6
Republic of Korea	0.2	81.4	0.1	515.9	18.7	2,344.3	45,274	-0.9	2.6	9,223.6	31.1	0.92	23	-0.01	3.5	17.5	13.2
Kyrgyz Republic	1.8	36.9	2.8	33.0	16.1	32.7	4,965	-8.6	3.4	-401.5	25.1	0.70	120	0.04	9.1	52.1	7.5
Lao PDR	1.5	36.3	3.3	30.7	13.0	59.9	8,239	0.5	6.5	967.7		0.61	137	-0.15	1.3	50.1	6.7
Malaysia	1.3	77.2	2.0	98.0	5.7	903.8	27,924	-5.6	4.0	4,313.0	20.9	0.81	62	-0.01	4.6	33.8	10.4
Mongolia	1.8	68.7	1.8	2.1	47.8	40.5	12,367	-4.6	6.7	1,719.1	23.6	0.74	99	0.00	7.1	48.1	6.7
Nepal	1.5	20.6	3.9	198.0	3.3	116.8	4,009	-2.1	4.3	126.6	28.4	0.60	142	-2.07	5.1	44.1	8.9
New Zealand	0.9	86.7	2.2	19.0	4.8	226.2	44,491	1.9	2.6	4,057.5	22.8	0.93	14	0.00	4.1	30.3	25.5
Pakistan	2.0	37.2	2.7	277.5	0.5	1,063.1	4,813	-0.9	3.7	2,105.0	13.7	0.56	154	11.49	4.4	57.2	7.1
Philippines	1.4	47.4	1.9	365.3	1.7	919.4	8,390	-9.6	4.7	6,585.6	21.3	0.72	107	-0.75	2.4	46.6	8.6
Sri Lanka	0.0	18.7	1.2	334.1	3.0	289.9	13,225	-3.6	4.1	433.9	25.4	0.78	72	-0.82	5.4	36.4	17.3
Tajikistan	2.4	27.5	3.0	67.5	8.6	36.8	3,858	4.5	6.8	106.5	25.6	0.67	125	-0.62	7.8	62.6	5.3
Thailand	0.3	51.4	1.7	136.0	12.0	1,272.6	18,233	-6.1	2.3	-4,845.4	23.1	0.78	79	-0.05	1.4	23.5	18.4
Uzbekistan	1.6	50.4	1.9	76.3	7.5	264.8	7,734	1.7	5.9	1,731.5	35.7	0.72	106	-2.25	7.2	43.4	7.2
Viet Nam	1.0	37.3	2.8	293.9	8.5	842.0	8,650	2.9	6.2	15,800.0	24.4	0.70	117	-3.64	2.2	33.6	11.4
Average	**1.1**	**44.6**	**2.0**	**192.2**	**8.7**	**2,051.9**	**16,680**	**-2.8**	**4.3**	**16,673.3**	**25.9**	**0.7**	**92**		**5.5**	**38.4**	**13.5**

Source: OECD-UCLG, 2022; World Bank, 2022, Gender statistics (age dependency and population growth); [1] Sachs, Lafortune, Kroll, Fuller, and Woelm (2022), Sustainable Development Report (poverty level)

Annex A2 – Subnational government structures in the country sample

Country	Income group	ADB Region	Development status	Form of state	Area (km2)	Population (thousand inhabitants)	Number of SNG at Municipal level	Number of SNG at Intermediary level	Number of SNG at Regional or State level	Total number of SNGs	Average number of inhabitants per municipality	Average size of municipality (km2)	Average number of inhabitants per state or region	Average size of state or region (km2)
Armenia	Upper middle	Central West Asia	Developing	Unitary	29,740	2,963	484			484	6,122	61		
Australia	High	Pacific	Developed	Federal	7,741,220	25,687	537		8	545	47,834	14,416	3,210,880	967,653
Azerbaijan	Upper middle	Central West Asia	Developing	Unitary	86,600	10,093	1,606		1	1,607	6,285	54	10,093,121	86,600
Bangladesh	Lower middle	South Asia	Developing-LDC	Unitary	147,570	164,689	4,894	492	64	5,450	33,651	30	2,573,272	2,306
Bhutan	Lower middle	South Asia	Developing-LDC	Unitary	38,390	772	209		20	229	3,692	184	38,581	1,920
Cambodia	Lower middle	Southeast Asia	Developing-LDC	Unitary	181,040	16,719	1,646	203	25	1,874	10,157	110	668,759	7,242
People's Republic of China	Upper middle	East Asia	Developing	Unitary	9,600,013	1,410,929	2,844	333	31	3,208	496,107	3,376	45,513,850	309,678
Georgia	Upper middle	Central West Asia	Developing	Unitary	69,700	3,714	64		3	67	58,031	1,089	1,238,000	23,233
India	Lower middle	South Asia	Developing	Federal	3,287,259	1,380,004	267,428		36	267,464	5,160	12	38,333,455	91,313
Indonesia	Lower middle	Southeast Asia	Developing	Unitary	1,916,862	273,524	83,813	514	34	84,361	3,263	23	8,044,812	56,378
Japan	High	East Asia	Developed	Unitary	377,974	125,836	1,747		47	1,794	72,030	216	2,677,362	8,042
Kazakhstan	Upper middle	Central West Asia	Developing	Unitary	2,724,902	18,754	6,938	216	17	7,171	2,703	393	1,103,202	160,288
Republic of Korea	High	East Asia	Developed	Unitary	100,370	51,781	226		17	243	229,118	444	3,045,916	5,904
Kyrgyz Republic	Lower middle	Central West Asia	Developing	Unitary	199,950	6,592	484	12	2	484	13,619	413	3,295,800	99,975
Lao PDR	Lower middle	Southeast Asia	Developing-LDC	Unitary	236,800	7,276	8,507	148	18	8,673	855	28	404,198	13,156
Malaysia	Upper middle	Southeast Asia	Developing	Federal	330,345	32,366	151		13	164	214,344	2,188	2,489,692	25,411
Mongolia	Lower middle	East Asia	Developing	Unitary	1,564,116	3,278	1,710	339	22	2,071	1,917	915	149,013	71,096
Nepal	Lower middle	South Asia	Developing-LDC	Federal	147,180	29,137	753		7	760	38,694	195	4,162,401	21,026
New Zealand	High	Pacific	Developed	Unitary	267,710	5,084	67		11	78	75,885	3996	462,209	24,337
Pakistan	Lower middle	Central West Asia	Developing	Federal	796,100	220,892	12,369		4	12,373	17,858	64	55,223,083	199,025
Philippines	Lower middle	Southeast Asia	Developing	Unitary	300,000	109,581	42,046	1,634	82	43,762	2,606	7	1,336,355	3,659
Sri Lanka	Lower middle	South Asia	Developing	Unitary	65,610	21,919	341		9	350	64,278	192	2,435,444	7,290
Tajikistan	Lower middle	Central West Asia	Developing	Unitary	141,380	9,538	368	68	4	440	25,917.5	384	2,384,411	35,345
Thailand	Upper middle	Southeast Asia	Developing	Unitary	513,120	69,800	2,443		76	2,519	28,571.4	210	918,421	6,752
Uzbekistan	Lower middle	Central West Asia	Developing	Unitary	448,924	34,232	9,168	294	14	9,476	3,733.9	49	2,445,146	32,066
Viet Nam	Lower middle	Southeast Asia	Developing	Unitary	331,230	97,339	10,614	707	63	11,384	9,170.8	31	1,545,057	5,258
				Averages	1,217,081	158,942	17,748	413	25.1	17,963	56,600	1,118	7,751,698	90,598

Source: OECD-UCLG, 2022

Annex B. Summary of recent territorial reforms

COUNTRY	TYPE	CONTENT OF THE TERRITORIAL REFORM OR POLICY
Armenia	Amalgamation	Over the period 1995-2021, the national government has undertaken four rounds of administrative-territorial reform, aimed at promoting mergers of small communities and increasing the efficiency of self-governance and public services provision. By the end of 2021, the number of municipalities had been divided by three, from 931 in 1995 to 502 municipalities in 2016, and to 308 municipalities in 2021. As a result, the average municipal population size increased, from 5 848 inhabitants in 2016 to 9 624 inhabitants in 2021.
Australia	Amalgamation	Following merger policies initiated by several states (South Australia, Tasmania, Victoria, Queensland, New South Wales and Western Australia), the number of municipal-level governments fell, from 869 in 1980, to 562 in 2016, and to 537 in 2022. However, due to failed attempts to amalgamate municipalities in several areas, there remain some very small local governments, and amalgamation policies are still on-going.
People's Republic of China	Amalgamation	Between 2000 and 2017, a total of 174 county-level cities were merged with 119 prefecture-level cities.
Japan	Amalgamation	Several waves of mergers have drastically reduced the number of municipalities, from 9 868 in 1953 to 1 724 today. The first wave ("Shōwa no Daigappei") reduced the number of municipalities from 9 868 in 1953 to 3 472 in 1961. A second wave ("Heisei no Gappei") took place from 1999 until 2010, which reduced the number of municipalities from 3 232 to 1 727, based on a voluntary merger policy.
New Zealand	Amalgamation	Several measures were introduced in the late 1980s and early 1990s to reform local governments in New Zealand. They were often aimed at amalgamating and restructuring local authorities and improving access and quality to local public services. The number of local authorities was therefore reduced from around 200 prior to 1989, to 74 territorial authorities (and subsequently to 67).
Azerbaijan	Amalgamation	The central government began a process of municipal amalgamation in 2009, with the aim to reduce the number of municipalities by 40%. The latest amalgamation process took place in 2014, entailing a reduction in the number of municipalities from 1718 to 1607 in 2021.
Georgia	Amalgamation	In 2006, the two-tier system of self-government that dated back to 1997 was replaced with a single tier of municipalities (munits'ipaliteti), subdivided into two categories: cities (and communities. In 2017, amendments to the Code of Local Self-Government reduced the number of cities from 12 to 5 (Tbilisi, Kutaisi, Rustavi, Poti and Batumi). Several communities were also merged and their number was reduced from 67 communities in 2016 to 59 communities in 2021.
Philippines	Partition	Since the enactment of the 1987 Constitution, the number of cities increased from 60 to 146 as of 2021. Their number has risen steadily under the impulse of the successive governments, and it has slowed down in the past decade. The latest city to be created was the city of Sto. Tomas, in 2018.
Bhutan	Asymmetric decentralisation	Four self-governing, 4 Class-A municipalities ("Class A" Thromde) were created in 2011.
Malaysia	Asymmetric decentralisation	Between 2019 and 2022, the number of local governments changed due to the upgrade or creation of 6 new municipal councils and 5 new city councils. In addition, there are four special local authorities ("Modified PBT") in Malaysia, which are authorities in charge of administering special areas such as recent settlements that do not yet meet the requirements to be classified as districts or councils.
Viet Nam	Asymmetric decentralisation	Viet Nam is increasingly leaning towards more asymmetrical territorial arrangements. Pilot policies have been launched since 2020 to develop new urban government models. Under this pilot scheme, the three major cities of Ha Noi, Da Nang and Ho Chi Minh City have been given more leeway to reorganise their municipal units (districts, communes and wards) and create stronger linkages between the municipal and provincial government units.
Thailand	Asymmetric decentralisation	Since 2016, there are three categories of Special Economic Zones (SEZ) with a specific set of rules and incentives for economic development. These include the Eastern Economic Corridor, the Clustered Provinces and the Provinces bordering other ASEAN countries. Municipalities and provinces may belong to several SEZs at a time.
Republic of Korea	Regionalisation	Addressing the regional imbalance between Seoul and surrounding regions is at the core of the Republic of Korea's regional development strategy, with the aim to develop Mega Regional Corporations to improve the attractiveness of regions outside of Seoul, through three main axes: 1) establishing the legal and financial basis for regional corporations ; 2) municipal integration for the stable implementation of large projects, and 3) focusing on infrastructure, transport, services and workforce to increase mobility.

New Zealand	Regionalisation	The 1989 municipal reform was also a regional reform, as 12 "regional councils" were created (subsequently 11). In 2010, the regional council and seven territorial authorities, which had made up the Auckland metropolitan area, were amalgamated further to form the Auckland Council unitary authority.
Kazakhstan	Regionalisation	The Regional Development Program 2020-2025 focuses on cities and regions as the main drivers of national economic development. It aims to increase the competitiveness of regions through the development of functional urban areas, of "mono-towns" (between 10 thousand and 200 thousand inhabitants) and of rural settlements in parallel. In October 2021, the central government adopted another important development strategy "Strong regions – the driver of the country's development", whose objectives for the period 2021-2025 include ensuring equal access of the population to basic services, and improve housing and transport connectivity. In June 2022, three regions were split, leading to the creation of three more regions and to a total of 17 regions compared with 14 regions in 2019.
People's Republic of China	Inter-municipal co-operation	In recent years, the focus of IMC in the People's Republic of China has been on large urban agglomerations. There are 19 urban agglomerations mentioned in the 14th Five-Year Plan. Urban agglomerations can be created following three types of development: (i) coordinated development, which focus on coordination in sectors such as industry, transport, and environment (e.g. the Beijijng-Tianjing-Jibei agglomeration); (ii) regional integration, centred on facilitating the movement of people and goods and creating common internal markets; (iii) regional cooperation, which corresponds to administrative cooperation.
Japan	Inter-municipal co-operation	Inter-municipal cooperation is increasingly promoted, in particular through voluntary partnership agreements that are established under the Local Autonomy Act. The "Central Urban Area Initiative", launched in 2014, promotes cooperation between a central city and its neighbouring localities through a cooperation agreement to promote regional dynamism and growth across Japan. As of 2022, 362 municipalities across Japan were involved in a Central Urban Area Initiative.
Republic of Korea	Asymmetric decentralisation	The implementation of the Local Autonomy Act in 2022 introduced the status of "Special Cities" to municipalities with a population of more than 1 million inhabitants but without "metropolitan city" status, in order to better take into account their administrative needs (applied to the cities of Suwon, Goyang, Yongin, and Changwon, Gyeongsangnam-do).

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