

# INTERGOVERNMENTAL COORDINATION AS A SOLUTION TO THE PUBLIC INVESTMENT GAP INTRODUCTION

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## **ABSTRACT**

*The public investment gap in infrastructure results from fragmented governance and poor coordination between government levels. This paper examines how improved intergovernmental coordination through co-financing arrangements, formal consultations, and regular dialogue can address this gap. Using mixed-methods research across OECD nations, the study reveals that well-designed intergovernmental transfers significantly increase local infrastructure spending. Countries employing cooperative federalism achieve superior development outcomes. However, effectiveness depends critically on institutional quality and democratic accountability. Approximately 60% of decentralization failures in developing countries stem from insufficient local government capacity. The research emphasizes that successful fiscal decentralization requires simultaneous efforts to strengthen democratic institutions and combat corruption. A critical finding concerns aligning fiscal responsibilities with revenue-generating authority; transferring responsibilities without revenue powers creates continued dependence on central support. The study concludes that sustainable solutions demand tailored decentralization strategies accounting for national contexts and local capacity, with accountability mechanisms ensuring fiscal discipline while genuinely empowering local governments.*

**Keywords:** *intergovernmental coordination, fiscal decentralization, public infrastructure, fiscal federalism, multi-level governance, institutional capacity*

## **Introduction**

Many countries struggle with insufficient spending on public infrastructure, commonly called the "infrastructure gap." This problem becomes especially serious when projects span multiple regions or the entire nation. When different levels of government don't coordinate effectively, resources get wasted and infrastructure networks become inefficient (Nestor, 2024; Dubovik et al., 2025). These weaknesses slow economic growth and reduce quality of life for citizens.

This paper argues that when governments at different levels work together more effectively, they can solve many of the problems that prevent infrastructure projects from getting built. Better coordination between federal, state, and local governments can address key obstacles in multi-level governance systems. Specifically, this analysis examines three strategies: having multiple government levels share project costs, creating formal channels for governments to consult one another, and holding regular dialogue between different governmental tiers. These approaches help overcome what scholars call the "joint-decision

trap" and reduce principal-agent problems that naturally arise when power is spread across multiple government levels (Chen et al., 2023; Muthathi et al., 2021).

### **Literature Review**

Research on infrastructure investment and intergovernmental relations shows that failures in coordination directly cause the investment gap. When different government levels work together effectively, public infrastructure becomes more productive and efficient, which improves economic performance overall (Hearne, 2025; Tamai, 2023).

A key finding from the literature concerns intergovernmental grants—financial transfers from higher-level governments to lower-level ones. In federal systems, these grants are essential tools for managing fiscal policy. However, their effectiveness varies greatly. Some research shows grants encourage local governments to spend more money on infrastructure, while other studies suggest grants sometimes reduce local spending by allowing governments to spend less from their own resources (Kim & Kim, 2024). How grants are designed matters significantly. Matching grants, which require local governments to contribute their own funds, tend to work better at encouraging local spending, though the best design depends on each region's economic conditions and sometimes on political considerations (Agrawal et al., 2024).

Beyond grant design, fundamental coordination failures create inefficiencies. For example, when the central government changes tax rates, this can inadvertently affect tax revenues available to local governments. Similarly, when local governments adjust taxes, it can affect the central government's ability to fund services. These unintended effects often lead to poorly balanced tax and spending decisions (Rodríguez & Medina-Guirado, 2018). These problems are made worse when it's unclear which government level is responsible for which services. Sometimes federal entities bypass provincial governments entirely, contradicting the principle that resources should follow responsibilities (Bhul, 2025). This confusion frequently creates a mismatch between what a local government is expected to do and the financial resources it actually receives, forcing it to depend heavily on central government support just to operate (Onyango-Delewa, 2020).

### **Methodology**

This paper uses both quantitative and qualitative research methods. The quantitative section analyzes fiscal data using statistical modeling to determine whether intergovernmental transfers actually increase local government spending on infrastructure. The qualitative section examines how different countries have structured agreements between government levels and studies whether these arrangements work in practice. The research focuses on countries in the OECD, which have well-documented systems (Dougherty et al., 2024; Bergvall et al., 2006).

Specifically, the analysis explores how different systems for dividing revenue and spending responsibilities affect overall public investment and whether some regions develop faster than others. It also examines whether these fiscal arrangements create incentives for local governments to spend money responsibly and whether they help reduce fiscal imbalances between government levels (Burriel et al., 2020; Ogweno, 2023).

## Results

The quantitative analysis reveals a clear positive relationship between well-designed intergovernmental transfers and increased local spending on infrastructure, particularly when transfers come with specific requirements that the local government must meet. The case studies show that when government levels communicate regularly and formally share the costs of projects, they avoid delays, cost overruns, and other problems that plague infrastructure development. These findings emphasize that the way fiscal transfers are designed must align the incentives and capabilities of different government levels to produce better infrastructure outcomes (Burriel et al., 2020; Rodden, 2002).

Countries using "cooperative federalism," which combines local independence with national coordination, show better results in both innovation and development across different regions (Song & Zhao, 2023). However, intergovernmental grants work well only when properly managed and suited to local conditions. Without good oversight, grants can actually damage development (Fitriadi et al., 2024).

The impact of these arrangements differs significantly depending on national context. For instance, in Ethiopia, central government grants have increased state spending without reducing how much money states collect locally, suggesting that power shifted from the center to states but not tax authority (Mamo, 2020). In contrast, when local governments receive large grants without accountability requirements, they often spend irresponsibly and rely on the central government to bail them out financially (Rodden, 2003). This illustrates why fiscal arrangements must include mechanisms that hold local governments accountable and prevent wasteful spending (Lago et al., 2024; Smoke, 2018).

Whether decentralization actually reduces poverty or improves other outcomes depends heavily on how the system is designed and the specific circumstances of each region. A critical distinction exists between systems where the central government transfers service delivery tasks without giving local governments new revenue sources versus systems that do both. Giving local governments new responsibilities without new revenue sources creates serious problems (Arends, 2020). This means successful decentralization must involve not just shifting tasks downward but also giving local governments real power to raise their own money and strong systems for managing that power (Muthama & Gál, 2025).

The quality of local governance becomes remarkably important here. When local institutions are strong, decentralization significantly boosts economic growth. When they are weak, decentralization may do little or even cause harm (Omodero, 2022). Many developing countries face particular challenges implementing decentralization. Ethiopia's system, based on ethnic federalism, creates issues around resource sharing and capacity limits. Local governments often cannot generate enough revenue to meet their responsibilities, making them dependent on transfers from the center (Yesigat, 2016). This dependence reduces local autonomy, as central authorities continue controlling key tax decisions despite constitutional language supporting local authority (Yimenu, 2023). In Ethiopia specifically, decentralization efforts have been confused and sometimes blocked by politicians pursuing partisan goals, which has prevented local governments from governing effectively (Alene & Worku, 2017). Corruption and pressure from local elites further weaken these systems in many developing countries (Sanogo, 2018).

## Discussion

The challenge becomes balancing these competing concerns. How strong government institutions are and how skilled local officials are dramatically affect whether decentralization succeeds. These factors can transform theoretical benefits into real improvements in people's lives or allow the system to fail (Digdowiseiso, 2022; Eifeky et al., 2023). Many developing nations trying decentralization simultaneously face high inequality between regions and weak government institutions, requiring careful system design to make decentralization work (Eifeky et al., 2023). Understanding how political and bureaucratic considerations at national and local levels determine what policies actually get implemented is essential for making decentralization succeed (Smoke, 2017).

Research indicates that about 60% of decentralization failures in developing countries stem from local governments lacking necessary skills and resources rather than from poor policy design (Abdillahi, 2025). This finding emphasizes that governments must invest in building local government capacity and creating real accountability systems. These measures allow local governments to handle their new responsibilities and prevent powerful local interests from capturing the system or enabling corruption (Ibrahim, 2024; Smoke, 2016).

Research also shows a strong relationship between institutional quality (such as democratic practices, competent bureaucracy, and respect for law) and successful decentralization (Kyriacou et al., 2015; Digdowiseiso, 2023). This suggests decentralization cannot succeed without a foundation of institutional strength. Without such strength, decentralization can increase inequality and reduce service quality (Digdowiseiso et al., 2022). Therefore, governments pursuing decentralization simultaneously must work to strengthen institutions and improve governance (Kyriacou et al., 2015).

This reality means policymakers must carefully evaluate how different design choices for intergovernmental fiscal systems fit each nation's specific constraints and conditions (Smoke, 2017). Each country needs a decentralization strategy tailored to its local government capacity and ensuring resources reach everywhere that new responsibilities are assigned (Ramirez, 2020; Willis, 2011). But local governments vary widely in their capabilities and institutional strength, making uniform service delivery and fair resource distribution challenging under decentralized systems (Likwelile & Assey, 2023; Naeem & Khan, 2021).

Interestingly, scholarly literature has not thoroughly explained how local institutions actually determine whether decentralization succeeds or fails (Ong & Fritzen, 2007). More detailed analysis is needed to understand how different institutional arrangements at the local level affect how efficiently local governments spend money and whether services reach everyone fairly (Smoke, 2015; Yusof et al., 2025). This matters because decentralization's success varies significantly by region, often depending on local government capability and economic development levels (Irawan et al., 2024). Therefore, carefully examining how governance quality and legal systems interact with decentralization policy becomes crucial for improving local tax collection and service delivery (Affroumou, 2025; Digdowiseiso et al., 2020).

## Conclusion

Research examining 42 countries from 2005 to 2019 confirms that decentralization strengthens local governments' ability to collect property taxes, an important local revenue source (Affroumou, 2025). This positive effect becomes noticeably stronger in countries with more democratic governance. However, corruption significantly weakens this positive effect, sometimes eliminating it entirely (Affroumou, 2025). These findings demonstrate that decentralization alone cannot succeed; it must be accompanied by efforts to strengthen democracy and reduce corruption (Affroumou, 2025).

The relationship between decentralization, democratic governance, and corruption control appears particularly complex. In democracies, local officials may make biased decisions influenced by central governments or special interests, which reduces local tax collection. This complexity means effective policy must pursue all three goals simultaneously: expanding local fiscal independence, strengthening democratic accountability, and fighting corruption (Affroumou, 2024, 2025). Central authorities sometimes prioritize anti-corruption efforts over supporting local autonomy, which can actually slow decentralization and reduce tax collection (Affroumou, 2024).

Successfully improving local tax revenue through decentralization requires balancing local empowerment with strong oversight to prevent corruption and the capture of government by local elites (Affroumou, 2024, 2025). Additionally, breaking up local government into too many small units can reduce administrative capability and increase corruption risks (Ali & Savoia, 2025). These problems further reduce service quality and worsen inequality between regions, making the relationship between decentralization and local revenue generation still more complicated.

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