



DECENTRALISATION &
LOCAL GOVERNANCE



External Support for Decentralization Reforms & Local Governance Systems in the Asia Pacific: Better Performance, Higher Impact?

Module 5:

Fiscal Decentralization: Performance Based Grants

Paul Smoke
New York University
Wagner Graduate School of Public Service

25-27 August 2015, Manila, Philippines

The views expressed in this presentation are the views of the author/s and do not necessarily reflect the views or policies of the Asian Development Bank, or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this presentation and accepts no responsibility for any consequence of their use. The countries listed in this presentation do not imply any view on ADB's part as to sovereignty or independent status or necessarily conform to ADB's terminology.

OUTLINE

- **I. National Performance Incentives for Local Governments in Decentralized Systems?**
- **II. Overview of the Objectives and Design of Local Government Incentives**
- **III. Selected International Experiences**
- **IV. Concluding Comments**

I. National Performance Incentives for Local Governments in Decentralized Systems?

- Some decentralization advocates *are wary of central government designed LG incentives because:*
 - They infringe on local government autonomy
 - Role of center under decentralization should be primarily to develop intergovernmental structures, systems and procedures
 - Incentives for improved LG behavior should be provided primarily through local elections and other downward accountability measures

Potential Role of Performance Incentives (continued)

- Other decentralization experts see a need for an **active/supportive center and LG incentives**:
 - Downward accountability is limited in newly decentralizing systems and local elections are a blunt accountability mechanism
 - Center has a legitimate role in promoting local behavior that supports national priorities
 - Central incentives can encourage behavior that improves LG resource use and downward accountability and can also help build capacity

II. Objectives and Design of LG Performance Incentives

Possible Broad Purposes

- **Adoption of system reforms:** range from technical systems and operating procedures to participatory governance approaches
- **Fiscal/economic/social performance:** include budget aggregates, service delivery/revenue generation targets, other priority goals (from broad targets like poverty reduction to more limited targets like pollution control)
- **Innovation:** include technology adoption, use of public-private partnerships, cooperation with other local governments, etc.

Specific Focal Objectives

- **Simple reform compliance certification:** formal adoption of budgeting, legal, governance or other LG reforms
- **Reform adoption performance:** extent, quality, or ongoing use of adopted reforms
- **Aggregate or specific fiscal performance:** surplus, deficit or debt reduction goals; altering expenditure composition or increasing revenue
- **Inputs, outputs, outcomes:** e.g. in education, student-teacher ratios, enrollment rates, literacy rates (progressively more difficult), test scores

Major Design Decisions

- **Degree of flexibility in targets:** fixed reforms, menu, individually negotiated with LGs
- **Absolute or relative standards:** former desirable but unfair if LGs have different capacity/experience
- **Positive or negative incentives:** rewards, penalties or both, fixed levels or scales
- **Financial or non-financial:** offer resources, recognition/publicity, or some combination
- **Existing mechanisms or creation of new ones**
- **Performance period:** some performance can be improved quickly, others cannot

Measurement/Institutional Responsibility

- **Subjective or objective:** measures can be one or both; latter desirable but some aspects difficult to measure objectively
- **Choosing appropriate/accurate measures for aspect of performance targeted:** can be a challenge, e.g., do increases in revenue measure improved performance or growth in base?; do increases in expenditures represent improved services or waste?
- **Sources of data:** can existing sources be used or do new data have to be collected?
- **Institutional responsibility:** which agencies will assume the tasks/do they have capacity

III. Selected International PBG Experiences

- **Main approaches:**
 - **Sectoral performance based grants:** involve a conditional transfer (sometimes matching) and can involve other incentives
 - **General performance based grants:** can be multi-sectoral and flexible, but subject to *minimum conditions* for access and *performance incentives* after that; typically based more on compliance with system requirements in newly developing systems

Sectoral Performance Based Grants

- Usually involve conditional transfers that require **certain norms and standards to be met**—often quantity, but sometimes quality
- Had **not been very common in developing countries but rising interest and experimentation** with pressures from MDGs/SDGs, donor “value for money” push, and demands for better services
- Increasingly common in health and education, but also used in other sectors

Early Sectoral PBGs: Africa Examples

- **Uganda education grants** under Poverty Action Fund (targets increased, quality less clear):
 - School Facilities Grant: for desks, latrines and classroom upgrade (with specific targets for each)
 - Universal Primary Education capitations grants: rewards schools for increasing enrollment
- **Rwanda health grants** (local facility not LG)
 - Cases admitted, staff bonuses, facility improvement
 - Quality assessed with process indicators: timeliness of reports and frequency of supervisory visits
 - Success of pilots led to scaling up, better measures of quantity, expansion to other sectors

Indonesia Performance Based DAK Reimbursement Based on Criteria

Physical Realization of Outputs

- **Construction Completion Certificates.**
- **Compliance with Technical Specifications (as per Technical Guidelines)**

Compliance with National Procurement

- **National Procurement Law and Regulations (Perpres 54/2010) through competitive procedures in hiring of contractors**

Compliance with Environmental & Social Safeguards:

- **Compliance with Indicators listed in the Project Operations Manual.**
- **MPW Minister Issue Supplement to Technical Guidelines.**



Other Examples

- **Other examples:**
 - Increases in various types of performance based grants in **India** under 13th Finance Commission (2010-2015)
 - Various **Latin American countries** adopting performance grants: Brazil (health), Chile (education), Colombia (education, health, water and sanitation) and Peru (several local functions plus contribution to national priorities, such as education)

General PBGs

- Most focus on **process-oriented LG reforms**, e.g, PFM, planning, transparency and human resource management
- LGs are allowed to **participate only after meeting minimum conditions.**
- **Beyond minimum conditions, local governments may be offered bonuses (or subject to penalties)** based on performance (usually compliance) targets
- **Results are made public**, providing information to citizens about LG performance
- Some countries have **attached sector-specific grants** to the larger PBG system

Performance Based Grants Basic Taxonomy

Table 2: Grant – Taxonomy	Sector – Specific*	Non-Sector Specific
Recurrent (operational and maintenance costs)	A.1. E.g. grants for salaries to finance school teachers.	A.2. Non-sectoral grants with earmarking for recurrent expenditures, but LG discretion to use the funds across the sectors according to local priorities.
Capital	B.1. E.g. grants for the construction of class rooms.	B.2. E.g. capital-investment grants for discretionary spending on various sectors (typically various forms of local development funds).
No limits on the type of expenditure to be funded in terms of capital or recurrent costs	C.1. Grants to finance all kinds of expenditure within a specific sector (sector specific conditional grants).	C.2. Unconditional grants with no limitations on utilisation (or a very short “negative list”).

Source; Steffensen, UNCDF 2010

Performance Type/Uses of PBG Funds

I. TYPE OF PERFORMANCE THAT IS TARGETED IN THE INDICATOR SYSTEM	II. USE OF FUNDS – MULTI-SECTOR VERSUS SPECIFIC (EARMARKED)	
	MULTI-SECTOR USAGE	SECTOR-SPECIFIC USAGE
SERVICE DELIVERY	<p>A. Multi-Sector Usage Service Delivery Focus (e.g. pilot testing in Nepal of grants to urban authorities).</p>	<p>B. Sector- Specific Usage Service Delivery Focus (e.g. Uganda – School Facility Grant, Philippines- Health Grants). Numerous grants within the education area, such as grants linked with enrolment rates (capitation grants in Kenya and Ghana) and/or specific outputs (level of students passing exams with certain quality, etc.)</p>
INSTITUTIONAL	<p>C. Multi-Sector- Usage Institutional Focus (e.g. Uganda, Tanzania, Kenya, Mali, Sierra Leone, Nepal, Bangladesh, Ghana, Indonesia, Solomon Islands, Bhutan and emerging systems in the Philippines and India).</p>	<p>D. Sector-Specific Usage Institutional Focus (e.g. Philippines (Health), new sector-development grants in Tanzania (Agriculture, Health, Water).</p>

General PBG Experience

- **Uganda** was one of the first and most widely publicized countries to adopt a systematic general PBG system (it evolved from a series of UNCDF-World Bank activities), which served as a general model for many other less developed countries
- **Some other countries that use or are developing PBG in some form** include Bangladesh, Bhutan, East Timor, Ghana, Kenya, Laos, Nepal, Pakistan, the Philippines, Sierra Leone, and Tanzania

PBG Experience (continued)

The Philippines has two major forms:

- **Performance Challenge Fund (PCF)** offers small capital grants to LGUs attaining a "Seal of Good Local Governance" (a set of operating standards determined by DILG to be associated with good governance)
- **Bottom-Up Budgeting (BUB) Program** provides LGUs with access to funding for both hard and soft sub-projects if LGU agrees to use a participatory budgeting process to identify projects in conjunction with local civil society organizations.

IV. Concluding Comments

- PBGs have **potential** to be useful, but impact has **mostly been demonstrated for encouraging compliance** in newly developing systems
- There is **much less documentation of improvements** in service delivery (other than first step measures such as school enrollment)
- **Measurement of PBG indicators can be a challenge**—defining appropriate indications, data limitations, often some element of subjective assessment of process requirements that requires considerable care to ensure consistency