**03.02.2016**

 **Providing EU Budget Support**

 **In Decentralized Contexts**

*A methodological Note*

 **Introduction**

The purpose of this note is to provide complementary analytical guidance for the design of EU Budget Support (BS) operations in decentralized[[1]](#footnote-1) partner countries. It is based on the principles developed in the Commission's Budget Support Guidelines of September 2012 and the new Guidelines on "Supporting decentralization reforms, local governance and local development in partner countries" (forthcoming in 2015). The current note complements these guidelines with additional specific technical input.

The present methodological note is not meant to help design decentralization reforms as such. It is focused on better taking into account the existing decentralized context when analyzing eligibility for budget support and designing a budget support operation. Support to encompassing reform of intergovernmental relations, including best practices on decentralization policies, will be addressed in the context of the above mentioned Guidelines on EU support to decentralization.

Decentralized contexts in partner countries constitute complex environments for budget support. Each country context is different and depends on the constitutional realities, traditions, and the local political economy. When assessing budget support in a decentralized context particular attention should be paid to the legal framework, mandates, institutional capacities at local level and the articulation between central and local governments responsibilities and resources. These are just some of the frequently observed key challenges that the implementation of policies and the sound management of funds have to face.

This note aims at providing guidance on aspects to be taken into consideration with regard to three types of operation:

* Budget support to decentralized public service delivery (type 1 operation). This corresponds to a 'standard' BS operation to implement a central government sector policy at the local level and within a given decentralization arrangement;
* Budget support to decentralization reforms and local authorities' systems development (type 2 operation). This corresponds to a BS operation that would be focused on deepening the decentralization arrangement; and
* Budget support to local authorities’ territorial development policies (type 3 operation). It targets the implementation of local authorities' own place-based development policies in situations where a subnational authority enjoys extensive political, administrative and fiscal powers, such as in a federal system. This type implies particular risks and preconditions and experience so far is very limited.

Budget support in decentralized contexts should be decided on a case-by-case basis. Before embarking on budget support, in particular support to local authorities' own development policies, Delegations have to carefully examine opportunities and risks involved including of possible default of subnational governments. They should also examine the implications of an intervention at the decentralized level on policy dialogue with the central government and on the human resource capacities in the Delegation. Type 3 operations should be undertaken only in exceptional cases. They should be submitted to the Budget Support Steering Committee for guidance.

The present note aims at assisting staff to better integrate the decentralization realities of the country when designing a BS operation so as to improve the expected output delivery of the BS operation. It focusses on opportunities and caveats of multi-level government delivery channels for budget support eligibility and more specifically, the reinforcement of the central-local government "contract", the role that local authorities might be able to play, as key components of the local public sector, in budget support formulation and implementation.

The note is directed primarily at staff in the EU Delegations and at Headquarters, who are concerned with the design, negotiation, implementation and evaluation of Budget Support operations in partner countries. Budget support must be understood as a tool whose scope includes not only financial transfers to the budget of the partner country, but also dialogue on policies, performance evaluation and capacity development, based on mutual accountability and partnership. The present note encompasses these dimensions. The note contains four chapters:

* *Chapter 1* discusses why Budget Support (BS) operations should help support partner countries’ decentralization reforms and effective local authorities systems and sets out the EU policy context;
* *Chapter 2* outlinesthree typical approaches of BS in decentralized contexts, based on a review and elaboration of the typology suggested by the *BS Guidelines*
* *Chapter 3* highlights the specific issues on which to focus when conducting an assessment of the eligibility of BS operations in decentralized contexts;
* *Chapter 4* highlights the issues that arise when formulating BS operations in decentralized contexts, including policy dialogue, mobilization of domestic resources, capacity building, performance assessment frameworks, risk management and accountability mechanisms.

**Chapter 1: Why BS operations should include Local Authorities?**

**Re-thinking decentralization and the developmental role of local authorities**

Decentralization is generally understood as a *public sector reform* process intended to transfer responsibilities, resources and general authority from higher levels to newly empowered lower levels of government. There are *three basic dimensions* of decentralization:

* *Administrative decentralization* comprises the systems, processes and policies that transfer administration of public functions to subnational governments. This need not involve autonomous authority over revenues and expenditures or formal mechanisms of accountability to local citizens.
* *Fiscal decentralization* refers to the formal assignment of expenditure functions and revenues (intergovernmental transfers and own tax and non-tax sources) to LGs. It need not involve formal mechanisms of accountability to local citizens.
* *Political decentralization* is the set of provisions designed to devolve political authority to LGs and enhance their accountability to the residents of their jurisdictions. Examples include the popular election of mayors and councils who previously may have been appointed or did not exist. *In effect, political decentralization adds democratization to the more technical mechanisms of administrative and fiscal decentralization.*

Over the last two decades a double shift of emphasis in the understanding of decentralization has occurred, opening the way to a greater developmental role for Local Authorities. First, the discussion on technical aspects of functional and fiscal reassignments within a country’s public administration has been brought under the frame of a broader analysis of the political economy of the reforms giving way to a more political understanding of decentralization as “*empowerment of people through the empowerment of their local governments*”. Second, concerns with exclusive allocation of entire functions across levels of government have given way to a search for “*multi-level governance*” arrangements under which several levels of government could share responsibility for a public good or service, and perform a certain number of tasksin the provision of services of all kinds, calling then for new and more intense forms of *inter-governmental cooperation*.

This has in turn shaped a new understanding of Local Authorities as developmental actors. As hinted by the above quote from the Busan Outcome Document, Local Authorities are no longer characterized as only *managerial entities* to deliver a set of specific services, but are increasingly recognized as *political bodies* through which local communities exercise their right to local self-government and which are mandated to both help implement national policies in the localities and develop and implement their own local policies, programs and projects. As a consequence Local Authorities are increasingly seen as critically important *partners* of central governments, who could both implement and supplement national development efforts.

**Giving equal attention to policies and institutions**

BS operations are meant to help partner countries design and implement their own effective development policies. Dialogue to assess and help shape the content of these *policies* (their objectives, targets and indicators) is therefore at the core of the formulation of BS operations. Yet, their actual development impact critically depends also on *delivery systems*. Equal attention must then be given to both the content of a *policy* and the multi-level *institutions* through which it is designed and delivered. Indeed, the latter make a critical difference with respect to responsiveness to citizens’ demands, efficiency in use of national resources, mobilization of additional local resources and accountability for results.

Past evaluations of BS operations, have pointed at the often ‘*missing middle’* in the service delivery system[[2]](#footnote-2) and called for (i) a better understanding of downstream institutional constraints to effective service delivery and (ii) strengthening front-line agents’ capacity and (iii) improving accountability to service users. In decentralizing contexts, this also means performing a dynamic assessment of how local authorities could become an *effective component of a multi-actor, local public sector system* and contribute to better and more accountable delivery of services.

Organizations and procedures to plan, implement and evaluate public sector policies are significantly influenced by (i) the country’s system of national and sub-national governance and public administration and by (ii) the role that the local public sector in general, and elected local governments in particular, may play in development management. Both depend primarily on the scope and depth of the country’s *decentralization reform* process. In fact, decentralization reforms turn a country’s governance and public administration into a *multi‐level system* in which responsibilities for development planning, financing and implementation are meant to be *shared* between national and local authorities.

A well designed Budget Support operation must recognize this reality and assess both the opportunities and the challenges that decentralization brings about in order to achieve poverty alleviation, sustainable and inclusive economic growth and consolidation of democracies. This may then lead to an effective involvement of sub-national authorities and their associations in both the planning and implementation of the national and sectoral policies to which Budget Support is provided. By contrast, a neglect of local authorities may not only lead to lower quality and impact of the policies supported, but may *also harm the decentralization process itself and reinforce centralist tendencies*.

**Ensuring EU policy coherence**

Budget Support operations in decentralizing contexts also raise *issues of policy coherence* for both the EU and the international community at large. Relevant EU policy documents emphasize the importance of empowerment of local authorities. The Commission Communication "The future approach to EU Budget Support to Third Countries"[[3]](#footnote-3) of 2011 highlights the need to strengthen the capacity of local authorities to act as an essential component of the State domestic accountability system, thus contributing to enhance government's capacity to deliver services to final beneficiaries. Beyond that, the EU has also made a broader commitment to help developmental Local Authorities. The Commission Communication “*Empowering Local Authorities in partner countries for enhanced growth and more effective development outcomes*”[[4]](#footnote-4) , calls for enhanced political, administrative and fiscal autonomy of local authorities. Decentralization is seen as an instrument (rather than an end in itself) to unlock the potential of Local Authorities as catalyst of local development.

Importantly, such commitment has also been made by the international community at large. TheBusan Outcome Document (2011) pledges to “*Further support local governments to enable them to assume more fully their roles above and beyond service delivery*”. And the report of the UN Secretary-General on the Post-2015 Agenda (Dec. 2014), calls for “new and innovative partnerships [of national governments] with […] effective local authorities” and reminds that “*national strategies will also have to be reviewed, and implemented at the local level, with the full engagement of local authorities*” because “*many of the investments to achieve the SDGs will take place at the sub-national level and will be led by local authorities [which] in many instances are already leading the charge for sustainable development*.”

# **Chapter 2: Approaches to Budget Support in decentralized contexts**

**Options for programming**

Based on the typology of interventions presented in Section 2.3.2 of the EU Budget *Support Guidelines* three types of Budget Support operations in decentralized contexts can be identified (see synthesis table in annex 1):

1. Budget support to decentralized public service delivery (type 1 operation)
2. Budget support to decentralization reforms and local authorities systems development (type 2 operation)
3. Budget support to local authorities’ territorial development policies (type 3 operation)

The purpose of all three types of operations, is *not* to induce the adoption of any particular policy, but to help partner countries operationalize and implement the *basic policy choices they have already made* with respect to the political opportunity, and relative developmental importance, of decentralizing governance and public administration, improving local governance institutions and promoting territorial development.

Real world programs may contain selected elements of any of these types, and also combine them with elements of the other two. All three types of BS operations may also need to be complemented by projects supporting analytical work, technical assistance and policy experimentation.

**Budget Support to decentralized Services Delivery (Type 1)**

Under this option, Budget Support would be provided within a given decentralization framework to help partner countries design and implement *sector* policies and programs that *rely on decentralized, multi-level, delivery systems* and dynamically invest in building such systems.

These programs seek to develop front-line services delivery capacities across the whole spectrum of the sub-national public sector, and would, where feasible, combine (i) the *de-concentration* of program management responsibilities to sub-national branches of central agencies, with (ii) effective forms of “contractual” *delegation* of key planning and implementation tasks to local authorities, thus operationalizing the concept of multi-level governance and bringing local authorities to put their comparative advantages ( understanding local priorities and mobilizing local resources) to bear on the achievement of national goals. Delegation arrangements might also be an effective way to build local capacities ahead of full *devolution* of specific functions and tasks.

Considerable investment in capacity building will be needed to overcome operational difficulties in implementing a national political and policy commitment to decentralized services delivery. This in fact requires central agencies to selectively shift from a direct implementation role to one of planning, financing, and monitoring the programs’ administration and delivery by their de-concentrated agents and local authorities respectively. It also requires local authorities to act as both partners and “agents” of the State and embrace a broader developmental role beyond their more traditional and limited responsibilities, as advocated by the Busan Outcome Document quoted above.

**Budget Support to Decentralization Reforms and LA systems Development (Type 2)**

Under this option, Budget Support would be provided to help decentralizing partner countries implement *decentralization reforms* and strengthen developmental *local authorities systems*.

The scope of these programs is potentially the broadest, but in practice it may vary greatly, depending on the political rationale behind the decentralization reforms, on the partner government’s understanding of, and commitment to, genuine *local development*,[[5]](#footnote-5) and on the desired features of the inter-governmental system. Program objectives may therefore be limited to the development and adoption of national decentralization strategies and related legislation. Or they may include changes of variable scope and depth with respect to (a) the architecture of the sub-national system of governance and public administration and related accountability relations (b) functional assignments and (c) resources assignments across levels of government, as well as (d) human resources management systems and responsibilities. Importantly, they may also include financial support to performance-based, inter-governmental grant mechanisms that enable local authorities to undertake meaningful local development planning and budgeting exercises and build related institutional capacities.

**Budget Support to LA’s Territorial Policies (Type 3)**

Under this option, Budget Support operations would help design and implement *place-based policies* to promote local/territorial development[[6]](#footnote-6). They would support sub-national actors to enable them to plan, finance and implement their own strategic and integrated territorial development plans in situations where a subnational authority enjoys extensive political, administrative and fiscal powers, such as in a federal system. In the design of these Budget Support operations, dialogue on (i) the policies to be supported, (ii) the necessary capacity building support and (iii) the appropriate performance assessment framework will be carried out jointly with the directly concerned sub-national authorities and the Ministry of Finance and other relevant agencies in representation of the central government. Partner government financing and transfer mechanisms should ensure that resources are fully programmable locally.

This option would “localize” Budget Support and promote central-local “contracts” for the development and implementation of *place-based development* strategies. It could help partner countries tackle increasing spatial and social inequalities and enhance social cohesion and political stability.

However, this option requires important conditions in order to manage fiduciary and other risks that accompany the advanced level of decentralized responsibility. It would require not only a strong *national* policy commitment to *local* development and an extensive degree of political decentralization, but also a well-established subnational government system with a relatively high degree of local *autonomy*, *capacity* and effective mechanisms of local authorities’ *accountability,* including well developed institutions for financial compliance and effective controls. It would therefore be feasible only in relatively more advanced contexts and to benefit larger, more capable, local authorities. Particular attention needs to be paid to rigorous eligibility analysis.

Attention should be paid to a clear definition of roles and responsibilities for central and subnational governments in type 3 budget support programmes. As a principle, the financing agreement should be signed with the central government (e.g. Ministry of Finance) and BS tranche payments would be transferred via the Central Bank to the central government treasury account. Funds would then be transferred within the existing budgetary circuits of the partner country and registered in the budget of the subnational entity.



**Selectivity and flexibility in designing Budget Support**

The three options outlined above are not mutually exclusive. Their selection and/or combination as well as their specific scope may vary greatly depending on the depth and extent of national political and policy commitment to local/territorial development and on the opportunities and priorities for external support revealed by a political economy analysis of decentralization reforms. Selectivity and flexibility will therefore remain key operational principles in designing any of the above forms of Budget Support in decentralized contexts.

Given likely variations in national political and policy commitment to local/territorial development, it may also be necessary to complement the adoption of any of the above forms of Budget support in decentralized contexts with specific projects to support the “policy experimentation” that may be necessary before innovative national policies of support to local/territorial development may be designed and supported.

**Relevance and suitability of different types of Budget Support Contracts**

Different types of contracts may have distinct comparative advantages for the provision of Budget Support in decentralizing contexts.

* *Sector Reform Contracts (SRC)* are broadly applicable to all three of the support options mentioned above. They are likely to be the contracts of choice in most circumstances. In the formulation of SRC, policy dialogue has to take into account both, central and subnational government levels, depending on the type of BS operation. Meaningful participation of sub-national authorities would typically be operationalized by involving the national associations of local authorities in the policy dialogue on BS operations. Scope and modalities of such involvement may differ depending on the extent to which local authorities are recognized as *autonomous* partners of state governments.

Sector Reform Contracts (SRC) may help specific sectors in partner countries (with varying degrees of decentralization), develop a more effective system of front-line service delivery, through a mix of de-concentration, delegation and devolution arrangements. Also, SRC may assist partner countries in developing their sub-national authorities system. They would fit the many cases where a LA system is already in place and is de facto assimilated to a “sector” of the national administration. The SRC allow for a greater EU involvement in the operationalization of the relevant national policy and a deeper policy dialogue. Finally, SRC might also be used to support the implementation of territorial development policies of selected local authorities. Policy dialogue on territorial development policies as well as scope and modalities for financial transfers, performance assessment and capacity development, will need to be discussed and agreed primarily with the beneficiary local authorities, jointly with core ministries/agencies of central government.

When providing SRC, emphasis should be on the equitable access to and quality of public service delivery, particularly for the poor, promotion of gender equality and rights of children and of the marginalized and on creating conditions at sector level for inclusive and sustainable growth.

* *Good Governance and Development Contracts (GGDC)* particularly fit situations where partner countries need help to embark in a process of substantial changes in their sub-national governance and public administration system. GGDC can help designing decentralization reforms and establishing the policy, legal and regulatory framework within which local authorities operate. It supports improvements in sub-national Public Finance Management (PFM) and oversight as well as appropriate mechanisms for State support and supervision to Local Authorities. To the extent that it also seeks to empower sub-national administrations with financial resources it supports unconditional transfers and other LA fiscal empowerment measures to finance their “general mandate” for the welfare of their communities, rather than specific services delivery responsibilities.

The objective of GGDCs being to strengthen core government systems and supporting broader reforms, they typically cover several policy areas. For more in-depth policy dialogue and conditionality on local authorities reform or specific sector service delivery a GGDC may usefully be complemented by a specific SRC operation.

* *State Building Contracts (SBC)* are primarily relevant to ensure continued public service delivery to final beneficiaries in a post-conflict, fragile or transition situation and to stabilize the regional security environment. SBC have a short term perspective of usually 1-2 years duration. Caution, however, needs to be applied with respect to the extent and depth of decentralization reforms that SBC could support, because the political and administrative complexity of the reforms may overstretch the capacities and limited timeframe of governments in fragile and transition situations. However in some cases of structural fragility and a pre-existing institutional basis at subnational level they could also support improved local governance and local development, where the empowerment of sub-national authorities may actually contribute to extending the presence of the State in the regions and help building the State “from below”.

**Box 1: Mali: State building in a decentralized context**

Following the end of the 2012 political crisis in Mali the EU financed from early 2013 a state building contract (SBC) of €225 million in order to support the implementation of the Transition roadmap, to strengthen good governance and to ensure the provision of essential public services. The programme could build on earlier decentralisation reforms carried out in the years before the crisis that had put in place a legal and institutional framework and had transferred certain competences to local government institutions (regions and municipalities).

The redeployment of local administration in the previously occupied territories of the North constituted a short term priority in order to stabilize the region and allow for a return of displaced populations. The SBC made it possible for the government to allocate substantial additional resources to the National Support Fund for Local Government (FNACT) which increased from initially FCFA 2.5 billion to 10 billion (2013) and 14 billion (2014). The funds from FNACT allowed local governments to resume their activities and restart essential service provision to the local population. In parallel, the SBC supported the redeployment of deconcentrated central government services in the Northern regions in particular in the areas of justice administration, water supply, health and food security. In addition, local private SMEs were involved in a road maintenance programme that allowed for the creation of around 6.000 temporary employment opportunities for the population in the North.

# **Chapter 3: Subnational aspects of eligibility criteria**

**Eligibility Criteria**

According to the 2012 BS Guidelines, the approval of all Budget Support programs is subject to meeting a set of *Eligibility Criteria* which are defined as the *relevance* and *credibility* of:

* the specific national/sector “public policies” that the programs are meant to support,
* The macro-economic policy framework,
* The PFM reform program
* The budget transparency and oversight institutions

During implementation, and prior to each budget support dis­bursement, an assessment has to be made of *satisfactory progress* in each of the four above areas of policy/institutions. Relevance, credibility and satisfactory progress are defined as follows:

* *Relevance* refers to extent to which key constraints and weaknesses are being addressed by the government's strategy to reach the objectives of the policy.
* *Credibility* refers to the quality of the reform process regarding its realism, institutional arrangements, track record and political commitment to the reforms.
* *Satisfactory progress* should be assessed through a *dynamic approach*, looking at past and recent policy performance benchmarked against reform commitments, but allowing for shocks and corrective measures and refining the objectives and targets if necessary.

The BS Guidelines stress that the assessment of eligibility criteria, is mandatory for all Budget Support operations but that “*the focus may vary according to the specific objectives of the program”*. Accordingly, this chapter seeks to complement the BS Guidelines by highlighting the ***specific* subnational *issues to focus on,*** when assessing the eligibility for BS in decentralized contexts.

While the eligibility assessment generally has to take into account both, the central and subnational government levels, but the depth of assessment of subnational aspects may vary depending on the eligibility criteria and the type of BS operation envisaged. The macroeconomic eligibility criterion always has to be analyzed from a central perspective since macroeconomic stability is the ultimate responsibility of the central government. Some subnational parameters may impact on macroeconomic stability at central level and need to be incorporated, as explained below. For the other eligibility criteria – public policy, PFM/corruption and budget transparency – analysis of subnational dimensions depends on the type of operation. For type 1 operations, in particular where the subnational level has limited fiscal autonomy or where service delivery relies mainly on deconcentrated branches of the central government, subnational aspects may primarily focus on public policy eligibility. The requirements for efficient and effective service delivery to the population have to be clearly identified and the role and potential of subnational authorities to contribute to service delivery should be analyzed. Specific attention has to be paid to inequalities in access to and quality of public services - between regions, gender and for vulnerable groups - and how the policy addresses them.

Type 2 operations of support to decentralization reforms require a full assessment at central level as well as of the subnational dimensions of the eligibility criteria as detailed below. The depth of the assessment of the subnational level depends on the degree of implementation of the decentralization arrangement. In the initial stages of decentralization reforms the assessment would be mainly forward looking and examine the relevance, credibility and consistency of the decentralization arrangement with regard to the eligibility criteria.

Type 3 operations of support to LA's territorial policies would primarily focus on the subnational level for public policy, PFM and budget transparency. Some central aspects may, however, also be of importance and the analysis has to take account of the division of roles and responsibilities between central and subnational levels and their articulation in practice.

Assessments should be reasonably short and analytical avoiding lengthy descriptions of policies. They should provide a clearly argued and justified recommendation regarding eligibility with a view to supporting implementation through a budget support programme or, if eligibility is not confirmed, to help identify elements, conditions and time frames so as to arrive at a credible and relevant policy, the type of dialogue to be considered, anticipated progress and modalities to help meet this objective.

# **Assessing Eligibility against the Public Policy Criterion**

The 2012 BS Guidelines indicate that all “national, sectoral or transversal*[[7]](#footnote-7)*, policies”, that are the subject of a Budget Support operation, must help achieve the general objectives of “*poverty eradication, sustainable and inclusive economic growth, and consolidation of democracies*”. And that “*The effectiveness of a budget support operation is therefore dependent on the relevance and credibility of the policy it supports*”. It follows that the relevance and credibility of the public policy to be supported as instrument to achieve the above general objectives, is the first criterion for eligibility that a related Budget Support operations should satisfy.

Understanding the role that decentralization may play for poverty alleviation, sustainable and inclusive economic growth and democracy consolidation is indeed a complex task. Country contexts matter and generalizations are neither warranted nor useful. The conceptual framework to guide such understanding is elaborated in some detail in a separate guidance document[[8]](#footnote-8). In summary it states that decentralization reforms (and related changes in local governance systems) in any given country, include both, *political* and *developmental* considerations. The immediate objective of the former is political stability, (with or without a consolidation of local democracy), while that of the latter is local development. The analysis should recognize both dimensions and focus on strengthening possible synergies between the two, depending on the specific country context.

In practice the assessment of the relevance and credibility of a policy, and related BS operation, for poverty reduction, economic growth and democracy consolidation, will need to address a number of program-specific issues, which may have different relevance, depending on the type of operation being considered. While the specific policy focus may be different (government sector policies or overall decentralization policy depending on the type of operation) some overall subnational determinants of policy relevance and credibility in a decentralized context can be identified. Generally there should be an assessment of:

POLICY FRAMEWORK

* Does the subnational authority have its own sector or overall development policy or is its mandate limited to implementing the central policies at local level? What is the legal basis?
* Does the subnational authority have an overall gender equality policy?
* What is the level of subnational ownership of the policy framework? Has the policy been consolidated through consultations with a wide range of stakeholders at subnational level, such as civil society (including women's and child's rights organizations), private sector, possibly development partners?
* Are the objectives of policies at central and sub-national level compatible with each other?
* For sector programmes: Is the intended role of subnational government institutions in the delivery of services and implementation of the sector policy compatible with the overall decentralization arrangement of the country?
* Are the risks of implementation and other constraints at subnational level properly addressed?
* Does the policy framework include implementation review processes owned by or including subnational/ local actors?
* Are institutional and human resource capacities at local level sufficient to implement the policy? Which are the mechanisms and stakeholders for policy implementation at subnational level?

*POLICY RELEVANCE*

* Whether the political drivers of decentralization reforms are compatible with and/or supportive of the consolidation of local democracy.
* Whether the proposed policy is likely to lead to more inclusive and better informed local political deliberations and more participatory policy-making and implementation. And how the policy addresses the risk of capture of the benefits of decentralization by local/regional elites.
* Whether planning and budgeting processes are inclusive of gender equality and of the most vulnerable and facilitate the participation of all stakeholders.
* Whether the electoral system is likely to favor, or constrain, the emergence of better local political representatives and innovative local development leaders.
* Whether the proposed policy is likely to reduce or increase territorial imbalances in economic development and social cohesion
* Whether there is or not a national policy commitment to the local development as an important complement of national /sector development policy. And whether the policy does or does not create space for autonomous and accountable local authorities to promote local development.
* Whether the policy supports the “localization” of national/sector development goals, policies and programs. And how it creates the incentives and capacities necessary for state agencies to devolve, delegate and monitor the implementation of national/sector policies and programs, by local authorities.
* To which extent the policy supports a more integrated and effective performance of the whole local public sector, as well as the intergovernmental cooperation mechanisms necessary for effective services delivery in a multi-level governance setting
* How the functions and resources reassignments supported by the proposed policy may deliver greater value for money in the public services delivery process.
* To which extent the proposed policy supports the establishment of robust mechanisms of local authorities’ accountability to both the State and the people in their constituencies.

*POLICY CREDIBILITY*

* The country’s track record in implementation of decentralization reforms, local authorities’ systems development and local development promotion, prior to the design of the proposed policy/program.
* Whether the policy follows a “whole-of-government” or a “sectoral” approach to the implementation of decentralization reforms. And to which extent its management arrangements offer a credible approach to resolving inter-ministerial differences and bureaucratic resistances to implementation.
* The extent to which the proposed policy is compatible with other national commitments, including both macro and sector policy agreements with the IMF and other international development partners.
* Whether the policy financing strategy is consistent with the country’s budgetary framework and the extent to which the fiscal decentralization measures it supports are realistic and sustainable.
* The extent to which the policy addresses weaknesses in statistical systems and generates quality data, disaggregated at sub-national level and, where feasible, for gender and age, to support effective management and evaluation of decentralized development planning and financing systems.

*POLICY MONITORING AND EVALUATION FRAMEWORK*

* Whether the Performance Assessment Framework (PAF) and its review documents, issued by the responsible authority, is likely to provide a sufficient basis for monitoring progress in policy implementation. Depending on the type of operation the PAF could cover three categories of results: (a) policy and legal framework development outputs (b) national and sub-national institutional development outputs and (c) sector/services delivery outputs
* The analytical products that the program is expected to deliver and the necessary additional studies
* The measures to analyse the impact of the allocations on gender as well as on inequalities (spatial, rural/urban, income or between specific groups of populations) .
* The modalities through which the policy PAF is going to be managed and the extent to which this may effectively support policy dialogue and the assessment of budget support disbursement conditions

# **Assessing Eligibility against the Macroeconomic Stability Criterion**

Macroeconomic stability has to be assessed at the national level and is under the overall responsibility of the central government. Yet, sub-national governments have few incentives, if any, to analyse the impact of their policies on macroeconomic stability. While responsibility for stability essentially belongs to the central government (through monetary and fiscal policy), poorly designed sub-national policies constitute a risk factor that could have macroeconomic implications. With respect to the Macroeconomic eligibility criterion, the specific question posed by a program that either substantially relies on decentralized services or supports decentralization and local development is whether, and to which extent, it may affect the country’s macroeconomic framework. Research shows that no generalization is warranted and that the impact of decentralized systems on macroeconomic stability depends on context and particular features of the proposed policies and programs.

*POTENTIAL SOURCES OF MACROECONOMIC INSTABILITY*

A program relying on a decentralized arrangement for the delivery of services or supporting decentralization reforms and local development may affect macroeconomic conditions in multiple ways. Issues often arise because the central government policy may generate or aggravate a mismatch between responsibilities and resources across levels of government.

Relevant questions to be examined include:

* **Is the decentralization of expenditures matched by adequate resources?** In certain cases the center cannot provide additional revenues (often because it is itself facing fiscal imbalances), limiting the ability of the local authorities to meet their new obligations. This may certainly apply in the case of a program supporting a decentralization process, as this would necessarily require a re-assessment of the resources available to subnational entities. But the same consideration may also be relevant for a program relying on an existing decentralized arrangement. Indeed, in both cases, sub-national governments may face serious difficulties.
* ***Are there fiscal rules or spending limits in place to ensure subnational fiscal stability***? *In case of absence of clear fiscal rules (e.g. a balanced budget rule or borrowing and spending limits) from the center, or a lack of enforceable penalties and/or performance incentives* sub-national governments may adopt a soft budget constraint, with the result that upward pressures on sub-national public spending translates into unsustainable deficits in the expectation of central government’s bailouts. A key question is then whether the reassignment of fiscal powers that the policy supports is large enough to have a potentially significant *impact on the country fiscal balance* and whether or not effective mechanisms to coordinate central and local fiscal policy (e.g. internal stability pacts) are in place
* ***Is there central government support for local revenue autonomy***: lack of support would limit the ability of local authorities to increase their own sources of revenue (both tax and non-tax), and create an overreliance on transfers. This would in turn reduce the incentives to internalize the cost of expenditures and adopt responsible fiscal practices and budget discipline. A key question is then whether the reassignment of fiscal powers supported by the policy is matched by local *political incentives and administrative capacities* to effectively and efficiently assess and collect local tax revenue, and whether efforts to build such incentives and capacities are included in the policy.
* ***Is the design of the equalization grants mechanism adequate?*** Inadequate provisions, including ex-post gap filling that incentivize local overspending and the dependence of the grant pool from single, or few, sources highly dependent on the economic cycle, may then lead to sub-national pro-cyclical spending. More generally, the key question is whether the political system, and the national policy commitment, provides the necessary autonomy and incentives for local authorities to promote active citizenship and involve civil society and private sector in local development planning and financing.
* ***Do the subnational authorities have authority to borrow and contract debt?*** Even when subnational levels of government gain more autonomy, the Centre nevertheless keeps some form of financial responsibilities on their activities. As a precautionary measure, it is important to assess the monitoring and analytic capacity of subnational levels. Restrictions should sometimes be introduced on the modalities of their borrowing instruments, possibly through an enforceable “golden rule” (e.g. borrowing should not exceed the level of investment) or the joint assessment and implementation of capital and current expenditure (especially where administrative capacity at the subnational level is limited). Borrowing in foreign currency by subnational levels should also be monitored closely as the Centre would bear the foreign exchange risk.
* ***May subnational authorities enter into contingent liabilities*** ***that affect fiscal stability in the future?*** In addition to debt, the provision of guarantees by lower levels of government can create difficulties for the Center when an investment fails (this could apply to failed PPPs). Implicit or explicit contingent liabilities eventually assumed by the Center could be extremely high and could be present in essential activities such as heating, water supply, production of electricity, and public transport. A transparent approach to contingent liabilities is critical.

Once an investment has gone astray, there should be mechanisms to address the resulting financial crisis. A formal crises resolution procedure should be transparent about societal cost and could involve a number of steps, including the appointment by a court of a trustee to take over financial management of a subnational government in financial distress. A number of countries have found that a formal procedure for resolving municipal financial crises decreases the costs for society of “municipal default”. There may also be a need for curbing, or making borrowing rights of the municipality dependent on MOF approval, for an extended probation period while its analytical capacity is improved.

*At the central level, a critical question, especially in the context of a policy that aims at increasing decentralization, is whether a loss of central control over monetary and fiscal policy,* due tofar-reaching fiscal decentralization and/or an excessive rigidity in the whole system of legislated central grants may deprive the center of a share of revenues and expenditures sufficiently large to influence aggregate demand or compromise the flexibility necessary for macro-economic policy responses during a fiscal crisis.

*CONTRIBUTION TO STRENGTHEN MACROECONOMIC RESILIENCE*

A policy supporting decentralization and local development may, or may not, help strengthen macroeconomic resilience, depending again on context and program design. Issues that require attention include:

* Whether, and through which channels, the policy may be expected to contribute to sustainable and inclusive *economic growth* in the given country context. The literature on decentralization and growth is notoriously inconclusive a contextual assessment is therefore critical.
* Whether the policy reflects, and helps operationalize, a national commitment to a *spatially balanced economy*, and how such commitment is reflected in (i) a *national urban agenda* supporting the role of cities as economic motors and (ii) a *rural/regional development policy* supporting selective spatial integration and urban-rural linkages.
* Whether the policy supports a greater role of local authorities in promoting *Local Economic Development* (LED) as a key instrument to maximise the economic potential of localities, mobilize local resources and enhance national macro-economic resilience.

# **Assessing Eligibility against the Public Financial Management Reform Criterion**

A sound PFM system is essential for the effective implementation of policies and the achievement of intended outcomes by supporting aggregate fiscal discipline, the strategic allocation of resources and efficient service delivery. With respect to the PFM eligibility criterion, the specific question posed by a program that either substantially relies on decentralized services or supports decentralization reforms and local development is whether, and to which extent, sub-national PFM systems may affect the relevance and credibility of the overall country’s PFM programme. The PFM eligibility assessment therefore has to include both central and subnational aspects. In case of budget support to subnational authorities’ territorial policies a separate full-fledged analysis of PFM eligibility for the subnational level should be undertaken (following the template in annex 5 of the budget support guidelines).

Subnational dimensions of PFM eligibility for budget support are related to two aspects: (i) a PFM system diagnostic to identify major weaknesses and establish a baseline; (ii) subnational aspects with regard to the evaluation of the government’s PFM reform programme.

When assessing the eligibility against the Public Financial Management (PFM) criterion, in particular for the PFM system diagnostic, EU Delegations substantially draw on the information produced by the PFM Performance Measurement Framework as developed and periodically updated by the *Public Expenditure and Financial Accountability (PEFA)* Secretariat[[9]](#footnote-9).

**Box 2: Subnational PEFA assessments**

Almost 100 sub-national applications of the PEFA methodology have been conducted (as of mid 2015), either as part of an overall assessment of PFM in a country, or as standalone exercises for one or more sub-national entities. While there is only one Framework, to ensure a consistent and appropriate application of the indicators and a sound basis for the interpretation of the findings at a sub-national level, the PEFA program has produced Supplementary Guidelines for the application of the PEFA Framework to Sub-National Governments (SNG), which are applicable to both an individual SNG and to a sample of SNGs within a country.

These *Guidelines* address the application of the indicator set (to the level of individual dimensions) and propose modifications and additions to the performance report, as well as offering suggestions for sampling and aggregation of results. As far as possible, they attempt to address the wide variety of sub-national government structures that exist..The sub-national PEFA guidelines – with one exception – follow the IMF’s Government Finance Statistics (GFS) 2001 manual, which provides for three levels of government: central; state, provincial, or regional; and local. Sub-national government by definition is anything below the national level and thus includes the state and local government sectors, but with a provision that these entities: *“must be entitled to own assets, raise funds, and incur liabilities by borrowing on their own account. They must also have some discretion over how such funds are spent, and they should be able to appoint their own officers independently of external administrative control.”* The exception to this GFS definition is that for the purpose of a PEFA assessment, the right to borrow is not a requirement.

The application of the PEFA Framework at both national and sub-national level should continue to provide essential information required to assess the eligibility for Budget Support. Subnational PEFAs should be encouraged where budget support in decentralized contexts is envisaged.

In addition, Delegations should take account of other sources of diagnostic work that may inform the assessment of subnational systems, such as the World Banks Public Expenditure Tracking Surveys (PETS)[[10]](#footnote-10) of frontline service providers or local governments. Reports from Supreme Audit Institutions should also be analyzed as regards issues related to subnational entities as well as the follow up given at the subnational level.

The first basis for the assessment of the subnational PFM system is the preparation of the synthetic *Sub-National Profile* that the PEFA Secretariat recommends prior to the application of the *Framework* to the assessment of sub-national PFM systems, to ensure that the assessors are clear about the legal and regulatory environment within which sub-national government operates as well as the overall intergovernmental relationship in terms of transfers, revenue and expenditure assignments, borrowing powers and the service delivery mandate. The Profile, (of which PEFA already offers a template[[11]](#footnote-11)) should provide an overview of:

* the overall sub-national government structure;
* the main functional responsibilities of the sub-national government;
* key sub-national budgetary systems
* key sub-national fiscal systems; and
* the main sub-national institutional (political, administrative, and fiscal) structures.

Based on these facts, the assessment of subnational aspects of PFM eligibility would look at two issues:

1. The *quality of the system* of subnational expenditure and revenue management, in particular if sufficient assurance exists to justify the provision of budget support at decentralized level;
2. The dynamics of *PFM reform policy* at subnational level, in particular in terms of local commitment and reform implementation and to what extent this enhances or compromises overall country wide PFM reform.

Relevant questions to be addressed include:

a) Quality of subnational PFM systems:

* *Credibility of the budget* –Is there a coherent regulatory and institutional framework in place for budget management at decentralised level? What is the process of budget formulation and its articulation with the central level budget process? Are local authorities budgets realistic and implemented as intended? Is there consistency between budgetary allocations and the functional mandates of the sub-national entity in accordance with the legal framework for fiscal decentralisation?
* *Comprehensiveness and transparency* –Are local budgets comprehensive or do extra-budgetary funds exist? Is local fiscal and budget information appropriately accessible to the public? Have local organizations, including women's and child's rights organizations, been consulted on policies and budgets?
* *Policy-based budgeting* – Are subnational development plans linked to decision making of subnational deliberative bodies? Are central and subnational policies reflected in the subnational programming and budgeting framework? Do medium term expenditure frameworks (MTEF) exist at subnational level? Are they consistent with the medium term fiscal forecasts at central level? Are annual budgets consistent with the medium term budget framework? Are gender and inequality policy priorities integrated in fiscal planning tools such as the MTEF?
* *Predictability and control in budget execution* – Does the sub-national government have the mandate to collect own *revenues/local taxes* or is the budget entirely financed by transfers from central government? Identify different roles and responsibilities (e.g. determination of tax base, tax collection, final benefit of tax receipts) of different levels of government (central administration; deconcentrated services; local government administration) and analyze possible consequences on the incentive structure. Does a revenue sharing and redistribution mechanism exist to prevent the widening of inequalities between regions/sub-national entities? - What are the *procurement procedures* – do subnational authorities have their own procurement agencies or is this done by deconcentrated services of central Ministries? Is there adequate transparency and control over procurement decisions? How is *treasury management* at subnational level organized? Analyze the circuit of financial transfers between the central and subnational level, the state of the local banking system, the possibility and time needed for bank transfers etc. Do effective systems of *internal control* of expenditure both with regard to financial compliance and to performance of services, exist at sub-national level?
* *Accounting, recording and reporting* – What is the quality of and capacity for local data production? What is the degree of automation of local data production and the state of IT infrastructures? How are local data systems linked with central data bases (e.g. IFMIS) and how is consistency ensured? Do subnational authorities produce adequate records and financial reporting on budget execution? Does reporting on budget execution include data and indicators related to gender and inequalities?
* *External scrutiny and audit* – Which arrangements exist at subnational level for scrutiny of public finances and related accountability of local authorities? Is the subnational level adequately covered by the central control institutions (Court of auditors, national Parliament) or does it have own external control mechanisms? Does external audit include financial control as well as performance of services? Do local deliberative bodies and social auditing institutions exercise effective control and stewardship in the use of public funds? Is there an active civil society at subnational level contributing to budget processes and oversight?

b) Subnational aspects of PFM reform programmes

Relevance of PFM reform

* How does the central government PFM reform programme address the subnational level?
* Do subnational governments have their own PFM reform strategies (as may be the case in federal states) and are they consistent with the overall reform strategy at central level?
* Are the priorities adapted to the needs and weaknesses observed at the subnational level?
* Is the sequencing realistic at subnational level?

Credibility of PFM reform

* What is the degree of political ownership of PFM reform? Identify political drivers, obstacles and interests at subnational level.
* How is fraud and corruption being addressed? Do policies and systems effectively reach out to the subnational level ? Do subnational authorities take an active stance to combat corruption and improve systems?
* Which local accountability mechanisms have been put in place?
* Are the institutional provisions functional and effective, in particular with regard to clear mandates, definition of responsibilities as well as vertical (central – subnational level) and horizontal coordination (i.e. between different entities at subnational level)?
* What is the level of institutional capacities at subnational level? What could be priority needs for strengthening capacities?

Dialogue

* What is the quality of PFM dialogue at and with the subnational level?
* Identify entry points and interlocutors.

**Assessing eligibility against the Budget Transparency and Oversight Criterion**

Transparency at the subnational level is required because it helps monitor the increased subnational responsibilities for the execution of the budget by monitoring the practices at local or regional field offices. While fiscal transparency at the national level reveals how government funds are distributed across lower levels of government, transparency at the subnational level is required to trace those funds. In this sense, subnational transparency enables the monitoring of policy and tracking of financial flows from the source to points of delivery. Crucially, subnational assessments allow for ex-post questions about execution, implementation and procurement, rather than just formulation and approval. On the subnational level citizens can find out whether central government funds actually got to where they were supposed to and how much of those funds were spent on what kind of resources. Transparency at the subnational level is therefore important for creating a mechanism for accountability. Accountability is crucial in order to prevent corruption and ensure effective service delivery to the local population.

Some specific issues require additional attention with regard to decentralization reform policies:

* Is the policy going to *affect* the transparency and oversight of the *national* Budget management process? e.g.: Does the policy/program support the establishment and operation of a broad based Local Finance Commission with representation from the Local Authorities sector? Is it going to improve the transparency of fiscal transfers’ formulas and related conditions of access/performance?
* Is the policy going to improve the transparency and oversight of the *local* Budget management process? e.g.: Does the policy support local-level participatory budgeting practices? social auditing? appropriate mechanisms of central support and supervision of the local budget formation and implementation process? Is the civil society (including women's and children's organizations) engaged in monitoring, including using media for raising awareness on poor/good performance?
* Are subnational budgets and timely information on budget execution accessible to the public? Are Court of Auditor reports disseminated? In case of lack of access to IT infrastructure for the local population which alternative modalities for transparency have been created at subnational level?

# **Chapter 4: Aspects of formulation of BS in decentralized contexts**

**Policy Dialogue**

Policy dialogue in the framework of budget support in decentralized contexts raises specific issues of *process* and *content* which take different forms depending on the scope of the operation being considered.

With respect to *process*, a critical issue is the management of the relevant policy by the partner country. Typically, for programs of budget support to decentralization reforms policy dialogue should be carried out at the highest political level and requires the setup of high-level program management structures (e.g. in the President or Prime Minister offices) as well as active inter-ministerial platforms, where the bureaucratic resistances that often threaten policy implementation, might be addressed and overcome.

On the other hand, dialogue around a policy to devolve or delegate specific service delivery functions (a type 1 operation) might take place primarily with the concerned sector ministry, but at the same time the Finance Ministry is also a key interlocutor. In addition, involvement of the national agency supervising the local authorities systems, is necessary.

Finally, when the policy being supported is one of promoting and co-financing local authorities *place-based* territorial development strategies, (a type 3 operation), appropriate platforms will need to be devised for a multi-actor policy dialogue involving central government and the local authorities that ultimately benefit from the BS operation.

More generally, Local Authorities should be able to participate, through their National Associations, in the policy dialogue on all types of BS operations in decentralized contexts. The scope and modalities of such participation must therefore be agreed on, when defining the BS policy dialogue process. The partner government (central or local depending on the type of operation) should take a strong lead and coordination.

Policy dialogue must also be supported by (i) a clear understanding of who is doing what among the country’s development partners and (ii) the related establishment of well facilitated donors’ consultative platforms. Ideally these should be two-tiered, with an inner circle involving donors providing Budget Support and a wider one involving all donors supporting the policy in question, of which many would be providing project aid. The latter could be useful to bring to bear on the BS policy dialogue, the results of relevant experience carried out through specific projects.

With respect to *content*, the policy dialogue should, first and foremost, be informed by a political economy analysis (PEA) of the country’s efforts to decentralize. The purpose is to understand their political drivers, the opportunities that they may open for promoting local autonomy and local development and the political and bureaucratic resistances that they may encounter.

This should help frame a realistic appreciation of the scope of the proposed policies, and of the extent to which they may contribute to political stability, good local governance, local development and ultimately poverty reduction. Depending on the type and scope of the operation the related policy dialogue may produce three *distinct* and *mutually reinforcing* sets of results:

* Improve the *policy, constitutional, legal and regulatory framework* within which autonomous and accountable local authorities may be able to operate. This may include formulating/revising national decentralization policies and strategies, undertaking constitutional revisions, developing Local Authorities’ organic legislation, and related detailed regulations.
* Improve the *institutions of sub-national governance and public administration*, to fulfill the potential developmental role of Local Authorities, under given constitutional and legal frameworks. This may include building the local policy-making and implementation institutions (organizations and procedures of local deliberative bodies and administrations). At the outset, priority is given to improving local resources management (planning, programming, budgeting, procurement, accounting, auditing).
* Improve *sector development outcomes*, through better resourced and more capable local authorities. This include empowering Local authorities to both (i) “localize” and implement national sector programs and (ii) deliver their own local development policies. The aim is both to improve the efficiency of national sector programs in the locality, and to mobilize additional local resources for investments in local economic development (LED) and other local priorities.

It is important to note that the three above categories of results, while hierarchically connected, are individually affected by different dynamics and timeframes. Even if there is lack of progress in one category of results often it may still be possible to advance on other areas. Indeed, although the legal framework sets the boundaries for local-level institutional development, there may be some space for improving local political deliberations and local resources management institutions, within such boundaries. Similarly there may be some space for empowering local authorities to deliver local development, within an existing, and not entirely satisfactory, set of institutions and capacities. Recognizing this may actually lead to a more realistic and effective dialogue on policies in decentralized contexts.

Specific guidance on policy dialogue in budget support operations is currently being elaborated in the form of an annex to the budget support guidelines. Given the multidimensional and transversal nature of policy dialogue in the framework of budget support in decentralized contexts there has to be close cooperation among the different sections in Delegations as well as systematic planning and clear documentation of results of the policy dialogue in order to create and preserve institutional memory.

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| **Box 3: Dominican Republic: Multi-actor policy dialogue informed by a sound monitoring system at local level** The PASCAL Program (2012-2017) was initially designed as a Sector Reform Contract (SRC-14M€) to support a national policy aimed at reforming municipal administration in the DR, particularly with regard to the management of human resources. The creative way in which the various budget support inputs were used (i.e. the performance assessment framework, policy dialogue, capacity development, complementary measures) made it possible to unleash much broader change dynamics. It transformed this financial support for managerial improvements into a domestic process of reviewing in an iterative manner the overall performance of municipalities in the wider intergovernmental ‘system’ with all actors and stakeholders concerned.Four factors explain this broader impact. First, right from the outset the policy dialogue was embedded in domestic policy and dialogue processes involving both the ‘supply-side’ organisations (i.e. the Ministry of the Public Administration, different directorates providing technical backstopping) and the ‘demand side’ (i.e. a network of civil society associations and the Association of local authorities, supported through complementary measures). Second, the policy dialogue is nurtured with empirical evidence provided by the SISMAP Municipal (a software tool for monitoring the performance of municipalities against different criteria). This tool soon transformed the nature and scope of the programme as it brought to the floor *all* the factors that affect the performance of DR municipalities (beyond the issue of human resources) and to feed this back into the multi-actor domestic dialogue process. It was thus discovered that many weaknesses at municipal level find their origin in the wider intergovernmental system or in inadequate central procedures (e.g. regarding procurement). Third, the EUD staff in charge played an effective role as trusted facilitator and broker of compromises to move forward the process in an inclusive and transparent way. Fourth, PASCAL invested in innovative communication to socialise the content and potential impact of the reform supported for the day-to-day life of citizens.  |

**Financial Transfers**

All EU budget support operations (including those in decentralized contexts) involve the transfer of financial resources *to the General budget (National Treasury) of a partner country, following the respect by the latter of agreed conditions for payment*.

Yet, a substantial share of the national budget is meant to end up on the revenue side of Local Authorities’ budgets to enable them to assume their developmental responsibilities. In practice, national budget systems may foresee different types of financial transfers:

* *General-purpose, fiscal transfer mechanisms*, which, adding to own source revenue, enable Local Authorities to operationalize their *general mandate* for the welfare of their constituencies and undertake autonomous processes of local development planning and financing.
* *Purpose-specific, conditional, and/or matching transfer mechanisms*, providing means and incentives for Local Authorities to carry out *specific functions* (administrative or services delivery), that might be devolved to them;
* *Financial transfer mechanisms associated with a variety of “contractual” agreements* between national and local authorities whose scope may range from (i) the delegation to local authorities of the implementation of specific national programs or components thereof, to (ii) the establishment of broader “*local development contracts*” through which territorial development strategies developed and managed by local authorities are co-financed by the central level. These mechanisms have the potential to both effectively “localize” *national* development goals and give national visibility and support to *local* development strategies, thus building effective inter-governmental “*partnerships for development*”.

Contractual arrangements are different from the two other categories (general purpose and purpose-specific) on the following grounds:

* The two first categories are regular transfers that accrue in principal to all LA by virtue of a legislative or equivalent act; they are meant to be permanent (although the purpose-specific could be limited in time); and relate to devolved spending responsibilities (general mandate and/or specific functions); while
* The contractual transfers are, in general, temporary arrangements based on formal voluntary contracts (not legislative or regulatory acts) agreed between a LA and either a sectoral ministry (in this case, the ministry delegates to LA the implementation of well-defined tasks as part of a sectoral policy/programme), or with the central government (in the case of a cross-cutting national policy/programme). These contractual arrangements are meant to be terminated when their intended purpose has been fulfilled, or could evolve into general or purpose specific if the delegated functions are definitively devolved. (Two examples of those are the "contrat Etat-ville" in Mauritania, and “contrat-programme” (in France between Regions and the State, and in Morocco in the future).

The financial transfer component of Budget Support operations may indeed make a strategic contribution to the design and implementation of domestic transfer mechanisms for local development financing.

**Domestic Resources Mobilization at subnational level**

While decentralization advocates often stress the potential efficiency gains on expenditure side of public finances, an equally important rationale of decentralization policies is their potential to help on the revenue side, improving domestic revenue (and more broadly: resources) mobilization (DRM). However, while the existence of stable resources is important for local development it also has to be ensured that these resources are well managed and spent by local authorities and that capacities exist to collect and administer own funds. Therefore, a progressive approach should be privileged. An appropriate legal framework for domestic revenue mobilization at subnational level has to be in place and it should be accompanied by action to improve local systems for tax administration, expenditure management and control, fight against corruption and accountability towards taxpayers.

Some complexities of local taxation have to be taken into account. Rural specificities can generate different kinds of rules for taxing properties in urban or rural areas. Regarding the taxation of companies, subsidiaries of large company are sometimes depending on the national large taxpayers unit. Furthermore, the tax mix and the performance targets for tax administration officials may be more favorable to the collection of national taxes. Appropriate incentive systems could therefore be put in place in order to encourage revenue mobilization at subnational level.

*Tax reform* can be an essential element to assign appropriate revenue sources (e.g. property taxes) to local authorities and concurrently create the incentives, and build the capacity, for them to effectively assess and collect own source revenue. An assessment of the scope and feasibility of tax reassignment and related capacity development requirements, would be an important dimension of the dialogue over the proposed policy and an integral part of the assessment of the macroeconomic (fiscal policy) and public financial management (tax administration) eligibility criteria, as outlined above.

In addition, meaningful *autonomy* and adequate incentives for local authorities to reach out to communities, civil society and the local private sector may mobilize additional resources for local development through forms of community co-provision and co-production of services, including in-kind contributions, as well as effective public-private partnerships. Effective empowerment of local stakeholders yields the potential to contribute to less costly and more sustainable service delivery by local authorities.

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| **Box 4 Local resources mobilization by local authorities (beyond local taxation).**Since 2011, in Yemen, the “Empowerment for Local Development” (ELD) program of the Social Fund for Development (SFD) helps local authorities (district Councils and administrations) mobilize resources for local development above and beyond revenue from local taxation, or fiscal transfers. These additional resources are then applied to projects that enhance the welfare of local communities, protect the environment and promote local economic activity.As of March 2015, in 51 operating Districts (out of the 72 eventually targeted by the ELD), and through 640 “Uzlla Development Committees (UDC)” and 3,983 “Village Cooperative Councils (VCC)” 12,939 projects costing about 1.6 Billion Yemeni Rials (US$ 7.2 Million) were identified, included in District plans, financed entirely (100%) through local communities’ contributions, and implemented through community contracting modalities. Also under a district-level 50%-50% co-financing scheme with local communities so far, 38 public works projects (paving secondary roads, building water tanks and cisterns, rehabilitating and furnishing classrooms and teachers quarters, etc.) which required an SFD/ELD contribution of 26 Million YR (120,000 US$) mobilized community contributions (in materials and labor) for 29 Million YR (135,000 US$) which exceeded 50% of the total cost. While the future of the ELD program will ultimately depend on establishing peace and related security conditions across Yemen, its early implementation clearly points at the potential that exists, given effective central support and incentives, for empowered local authorities to become key developmental actors and mobilize a wide range of local resources, not least local social capital, bringing them to bear, as a true additionality, on the financing of a country’s development effort.**(Data source: Yemen Social Development Fund. “Empowerment for local Development” annual reports)**  |

**Capacity Development**

Capacity development (CD) is an essential component of Budget Support operations. As the 2012 BS guidelines suggest, it includes a dialogue with partner countries to develop “*shared views on key [capacity] constraints and [capacity development] opportunities*” as well as “*providing access to knowledge”*.

When it comes to supporting decentralization policies and programs, developing the above shared views and providing the right kind of knowledge, requires (i) a realistic assessment of what local capacity is already in place, an understanding of related CD priorities and (ii) the capacity to bring the lessons learned in decades of global experience with CD, to bear on the situation at hand. Several issues require attention.

* Local capacity itself must be understood as the result of (i) an enabling policy and legal framework, (ii) appropriate policy making and development management institutions and (iii) appropriately skilled and motivated human resources. It follows that CD cannot be limited to “training” efforts. Yet in practice it should also be recognized that for all their interdependence, these dimensions could still be addressed through partial and specific efforts that may not be as comprehensive and coordinated as the ideal case would require.
* The scope of capacity building must be understood as covering both the capacity for informed evidence-based deliberations by the elected local Councils and capacity for development management by local executives and administrations. A critical issue in many contexts, where decentralization reforms are still incipient or incomplete, is precisely the lack of effective connection and accountability between local policy making and local executive and administrative action. Efforts to strengthen such linkages should be an important part of local CD efforts.
* The potential beneficiaries of CD efforts are in no way limited to local authorities. They may include civil society organizations whose capacity to move from “confrontation” to “cooperation” with elected local authorities should be supported, and also, and most critically, it includes a number of “core” and “sector” ministries. The inadequate capacity of the latter to (i)appropriately “support and supervise” the local authorities’ sector and (ii) manage innovative services delivery “delegation” contracts, is one of the greatest stumbling blocks to the operation of autonomous, accountable and effective local authorities.
* Importantly, when CD efforts are directed to local administrations, these should not aim to reproduce locally the structures and functions of the central state administration. Organizational models of local authorities’ administrations may vary depending also on the organization of the local public sector at large, and there is often considerable room for innovating and enhancing public sector efficiency, when designing them.
* With respect to the content and sequencing of the CD efforts there are also no blueprints. Yet experience shows that in most situations CD should start with devising a technically sound, and yet participatory and inclusive cycle of public resources management. This is actually the bedrock on which capacity for improved services delivery and development management can then be built, in parallel with the capacity to “reach out” to local people, civil society organizations and private sector to involve them in local development planning, financing, implementation and evaluation.
* With respect to method, when developing the CD component of BS operations, a balance should be struck between a “supply-driven” and a “demand-driven” approach. The former may be necessary to a limited extent and for specific purposes, but experience shows that its generalization would be costly and ineffective. CD objectives would be better served by a demand-driven approach under which local authorities could determine their own needs and invest in their own CD , accessing as necessary, purpose-specific financing windows setup as a component of the national financial transfers system.
* Finally, it is important to note that considerable, and continuing, field-based experimentation may be necessary to devise and improve CD programs, and that such experimentation might be better carried out through preparatory or complementary project aid operations.

**Performance Assessment**

The indicators required for budget support provide the basis for the policy dialogue and for evaluating the progress which determines the disbursement of variable tranches. All indicators are selected by the delegations in agreement with the partner country and in coordination with other donors.

These indicators should, wherever possible, be outcome (or result) indicators. In addition, input/process indicators and (direct) output indicators may also play a useful complementary role especially when the programme targets the regulatory framework or when outcome statistics are not considered sufficiently reliable. Impact indicators are in general not considered appropriate for conditionality given the potential importance of external factors and possible time lags. The selected indicators must be in line with existing policy data and indicators (partner country Performance Assessment Framework) and be coherent with the DEVCO results framework. Examples of indicators for budget support in decentralized contexts are provided in annex 1.

The choice of indicators is obviously crucial for successful implementation of a budget support programme. Only those indicators should be selected for which realistic medium term targets can be defined. Indicators must also be chosen in such way that there is no possibility of controversy when the evaluation of results is made. Therefore, only objectively verifiable indicators should be selected in the matrix of results. In all cases, the methodology to collect data needs to be clearly defined. Measuring development results, is often made difficult by inadequate national statistical systems, which lack capacity for data collection and processing and cannot provide accurate, timely and appropriately disaggregated information. In decentralizing contexts, the lack of disaggregated statistical information affects both (i) the ability of national authorities to tailor programs to local realities and (ii) the ability of local authorities to carry out evidence-based deliberations and undertake sound local development planning. To address such difficulties, some countries have experimented with l*ocal performance assessment systems* that rely on “bottom-up” community-based data collection and processing. Others have piloted the “*localization*” of national statistical systems and indicators[[12]](#footnote-12). Whatever the approach, an effective local data collection and processing system must be part of any realistic subnational public policy. In this context, it is also important to strengthen capacities for the inclusion of horizontal issues, notably with regard to gender and inequalities, in the collection of data and the use of performance indicators.

Also, assessing the performance of policies with regard to decentralized contexts includes measuring progress in creating a regulatory environment that promotes the autonomy and accountability of local authorities, and in building systems and capacities for local democracy and good local governance. Monitoring and evaluating progress along these “softer” dimensions requires adopting specific and realistic assessment frameworks. This may be facilitated by over two decades of efforts made by the international community, to clarify normative principles and develop assessment frameworks[[13]](#footnote-13) based on them. Yet, the adoption, by partner countries and the EU, of country-specific decentralization policy and local governance assessment frameworks, and the endorsement of the normative principles which should guide them, can only be the result of a sustained, and in depth, policy dialogue.

**Risk Assessment**

The preparation of any EU-funded BS operation must be informed by a country-level Risk Management Framework (RMF) which focuses on country systems and aims to identify the risks that may impede achieving the *general* objectives common to all budget support operations: eradicate poverty, sustainable and inclusive economic growth, and consolidate democracies. The 2012 BS guidelines therefore suggest that “*As the risks are assessed according to the general objectives of budget support in a country, it is not necessary to provide different assessments for different types of BS operations”.*

Yet, to inform the policy dialogue during preparation and implementation of BS in decentralized contexts, it is important to identify in the Action document the specific risks that may be associated with the emergence of a decentralized, multi-level system of governance and public administration, drawing also on the results of the eligibility assessment. Specific risks at subnational level could also be identified in the narrative part of the overall *Risk management framework* for budget support. Care should be taken to assign different risks to the right levels (central vs subnational) in order to identify potential conflicts and obstacles.

Annex 2 provides a detailed overview of typical risks in decentralized contexts based on the risk categories and dimensions of the country-level RMF.

**Accountability**

Governments of partner countries should be accountable to both external partners and domestic constituencies for the process and outcomes of all externally funded BS operations. It remains therefore essential that effective domestic accountability mechanisms be in place also at local level, and that as necessary and appropriate, they be strengthened through specific activities that may be included in the BS operation, or carried out through a separate project. These would be directed to support national legislative and oversight bodies, internal audit and control institutions as well as associations of sub-national authorities and civil society organizations, to contribute, as appropriate, to shape, monitor and evaluate BS in decentralized contexts.

But, in addition to supporting national-level domestic accountability mechanisms and while promoting the level of local autonomy necessary for genuine local development to happen, BS should specifically aim at (i) clearly defining Local Authorities’ accountability relations, (ii) strengthening the State capacity for effective support and supervision of the Local Authorities sector and (iii) strengthening the institutions of public participation and social auditing for local policy-making that enable local constituencies to hold their authorities accountable.

In practice, attention should be given to three types of accountability relations, which again may take different forms in different contexts:

* *Accountability of Local Authorities to the State*. This calls for balancing autonomy and accountability, and enabling the State to provide facilitation services and technical assistance, exercise legality and/or opportunity controls, and monitoring local authorities’ performance. Experience shows that this is often made problematic by overlapping responsibilities and bureaucratic competition between multiple central government agencies.
* *Accountability of Local Authorities to their constituencies*. This calls for the establishment of participatory planning, budgeting and implementation of local development and services delivery, and for building the capacity of local communities to monitor and audit their local authorities’ action.
* *Internal accountability of local executives and administrations to elected councils*. This is about ensuring the connection between policy-making policy implementation through locally accountable executive and administrative structures. This may be problematic where decentralization reforms do create elected councils, but either fail to provide them with a minimum of own administration capacity or assign to deconcentrated structures of the state (whose primary accountability remains indeed to the State), the task of formulating and implementing local development policies.

Other issues of accountability may need attention in the policy dialogue on BS in decentralized contexts. For example, a common one is whether national legislation is aligned with the principle of “non-subordination”, which makes all local authorities accountable to the State (unitary or member of a federation), but no one accountable to another local authority (of higher rank). Often this is not the case and regional or provincial councils are given the final say on policy decisions made by lower-level districts or municipalities. The implications for local autonomy are obviously very different.

Finally and with respect to government accountability to aid providers, BS in decentralized contexts implies that accountability is effectively *a joint one,* committing both central and local authorities. This calls for a forum for policy dialogue, on design and implementation of BS, in which local authorities are effectively represented (by their national association or selected/designated authorities depending on the scope of the program).

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| **Box 5:  Peru - Mutual accountability (national and regional level) for results**Over the past years the EU has provided sector budget support for the implementation of national strategies promoting social inclusion, particularly in the areas of health and child malnutrition. The government sought to creatively integrate the local dimension into the process taking into account the existence of huge territorial inequalities in the country. As a result, it was decided to ‘regionalize’ the budget support operation. The MEF remained the beneficiary of the budget support and in charge of implementation, yet the measurement of the indicators foreseen for the variable tranche focalized on 54 districts of the three poorest regions of Peru. This made it possible to adapt indicators to diverging territorial realities and actively engage the regional authorities and other stakeholders around the delivery of the program’s objectives. To underpin this, the Ministry of Economy and Finance concluded specific contractual arrangements with the three regions to associate them as partners in the implementation of the national policy and establish relations of mutual accountability for achieving the expected results. The central government thus integrated the local dimension and strengthened subnational authorities' responsibility for improving services. The regionalized budget support included complementary measures that focused on strengthening local PEFAs and other supporting institutional infrastructure.  |

# **Conclusions**

Decentralized countries may be defined as those that have chosen to undertake a decentralization reform process of variable scope and depth, find themselves at different stages of such processes and currently experience a greater or lesser momentum in the reform process. After more than two decades of worldwide decentralization reforms, most EU partner countries actually fit this broad definition.

The EU Budget Support operations in decentralized countries need to be consistent with the EU policy commitment to strengthen the developmental and democratic role of local authorities. This may be operationalized through the three categories of BS operations in decentralized contexts identified in this note. The Note also provides a framework to assess the eligibility of BS operations, in terms of the four EU standard criteria (policy relevance, macroeconomic sustainability, quality of PFM system and Budget Transparency) and reviews the general issues of process and content that need to be addressed when preparing these BS operations.

Based on the general programming options outlined in this Note, EU Delegations should be able to identify the actual scope for budget support in decentralized contexts in their respective countries. They should then be able to determine issues for the policy dialogue associated with the preparation of these BS operations.

DEVCO B2 and DEVCO 03 can support this work by offering expertise in the form of missions and/or remote working and the provision of external expertise / consultants for Delegations which request it.

**List of annexes:**

Annex 1: Typology of budget support in decentralised contexts (synthesis)

Annex 2: Examples of indicators relating to budget support operations in decentralized contexts

Annex 3: Overview of typical risks in decentralized contexts

**Annex 1: Typology of budget support in decentralized contexts (synthesis)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Types /****Characteristics** | **BS for decentralized service delivery** **(type 1)** | **BS to decentralisation reforms****(type 2)** | **BS to support local territorial policies** **(type 3)** |
| ***Objectives*** | Effective frontline service delivery | Reforms and institutional aspects | Implementation of local development/ sector policy  |
| ***Policy to be supported*** | National sector policy (health, education…) | Decentralisation reform policy | Development policy of local authority |
| ***Scope of decentralisation arrangement*** | Different stages possible; typically: some administrative decentralisation | As from initial stages of decentralisation reforms | Advanced stages (including political decentralisation) - pre-requirements |
| ***BS dialogue*** | Central + subnational | Central + subnational | Mainly subnational  |
| ***Eligibility assessment*** | Central + some subnational aspects | Central + subnational aspects | Macro: central ;Public policy, PFM, transparency: mainly subnational |
| ***Types of BS contract*** | SRC; in certain cases SBC | SRC; GGDC or combination | SRC |

Annex 2: **Examples of Indicators relating to Budget Support in Decentralized Contexts**

The table below outlines examples of topics that could be envisaged for the identification of indicators in variable tranches. The list is by no means exhaustive and is meant to be an illustrative sample of results that budget support operations could pursue. Indicators need to be tailored to the different country contexts (political, administrative and fiscal).

The indicators are presented in different sets:

* Indicators that are common to all types of BS in decentralized contexts
* Indicators that are specific (to the most extent) to different types of budget support operations (decentralized services delivery, decentralization reforms, and support to territorial development policies of local authorities/LA)

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| --- | --- | --- |
| **Expected Results** | **Indicators** | **Data Sources** |
| **Common Indicators in Decentralized Contexts** |
| Legal environment promoting good local governance and local development | * Legislation and subsequent regulation on Sub-national authorities governance structures, functions and autonomy
 | * Legislative records
* President (Council of Ministers) decisions/ records
 |
| Empowered, autonomous local authorities | * Scope of powers and functions assigned to local authorities: List of types of assigned powers and service provision responsibilities
* Degree of LA autonomy: in terms of resource allocation decision making, power to decide on local revenue bases and rates
 | * Legislative acts and/or regulations records
* Surveys and assessments
* LA activity reports
 |
| Local Authorities adequately funded | * A general purpose fiscal transfers mechanism is in place
* Additional (purpose-specific) fiscal transfer mechanisms are in place
* Local own-source revenue system in place (consistent with relevant good practices)
* Increase of own-source revenue share in LA total budget
* Increase in the share of discretionary resources in LA budgets
* % increase of fiscal transfers to LA in total national budget appropriations
* % of fiscal transfers actually disbursed to LA
* % of disbursed fiscal transfers actually spent by LA
 | * Legislative acts and/or regulations records
* Surveys and assessments
* LA activity reports
* Public finance records
* LA budgets and financial statements
 |
| Institutions and capacity for local public expenditure management (L-PEM) | * Local planning procedures designed
* User-friendly planning manual is developed and used
* Financial management rules and procedures are enacted, covering the whole PEM cycle (budgeting, procurement, accounting, cash management, internal control, reporting...)
* A gender and inequalities responsive budgeting process in place
* % of Local Authorities with data records on tax assessment bases
* % of Local Authorities undertaking periodic updating of their local tax assessment bases
 | * Regulations records
* Manuals of procedures
* Surveys
* LA reports
* Ministry of Local Government reports
* Ministry of Finance reports
 |
| Adequate, operational support and monitoring institutions and arrangements in place | * Adequate support arrangements recognizing LA autonomy
* Systems of LA performance monitoring
* Rules and procedures for legality controls of Local Authorities.
* Independent audit of LA accounts in place and operational
* Anti-corruption mechanisms in place and enforced
 | * Government official records
* Manuals of procedures
* Performance monitoring and legality controls reports
* Audit reports
 |
| Institutions and capacity for democratic participation, transparency and accountability  | * Legal provisions to enable participation of citizens in the governance of local affairs (planning, budgeting processes, social auditing…).
* % of LA actually enable effective participation of citizens in LA planning and budgeting
* Arrangements for social auditing of LA are enforced
* % of LA which adopted a Charter
* % of LA disclosing their budgets and financial reports as per the established schedule and formats
* % of LA disclosing tenders and awarded contracts
 | * Government official records
* Planning and budgeting manuals (procedures)
* LA performance monitoring manual (procedures)
* Surveys
* LA reports
 |
| **Specific Indicators (Decentralized Services Delivery)** |
| Enhanced participation of LA in the formulation of sectoral policies and programmes, and their implementation  | * Number of sector policies and programmes involving LA in their design and implementation
* % of sectoral services delivery budget resources being managed by LA under delegation arrangements
 | * Sector policies and programs documents
* Sector ministries reports
* LA reports
 |
| Deconcentrated front-line delivery agents of sector ministries are strengthened  | * Sector ministry branches are established countrywide
* Sector deconcentrated branches' activities are reflected in Sector annual budgets under separate lines
* Coordination mechanisms between LA and sector deconcentrated branches are developed and applied
 | * Sector Ministries charts
* Sector budgets
* Sector activity reports
 |
| LA are empowered to contribute to the design and implementation of sector policies and programs | * Policy and legislation supporting a multi-level public service delivery system are in place
* Sectors regulations are revised/adjusted to accommodate participation of LA in sector services delivery
* Specific sectoral services delivery responsibilities being delegated to LA
* Contractual delegation arrangements (LA-Sectors) are developed and applied % of LA which have entered into contractual arrangements with sector ministries
 | * Sector policies and programs documents
* Functional assignment legislation and/or regulations
* Contracts between LA and concerned sector ministries
* LA and Sectors activity reports
* Surveys
 |

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| **Specific Indicators (Decentralization Reforms and LA systems Development)** |
| Increased (improved) decentralized public services delivery  | Share of decentralized expenditures in total public finances | * National budget
* Public finance statements
 |
| Public finance management (PFM) rules and regulations are adjusted to account for LA functions, autonomy, and operating modalities | Evidence of revised PFM rules and regulations | * Government records
* LA budgets and reports
 |
| Sound local governance structure with adequate capacities | * Legal assignment to LA of (i) a general mandate for local development, and (ii) specific local services delivery functions.
* Legal empowerment of LA with meaningful administrative and financial autonomy
* Legal requirements for upwards (to the State) and downwards (to local constituencies) accountability of LA
* Legal requirements for LA to promote people’s participation in local policy making and implementation
* A framework/process for consulting civil society organizations (including women's and children's organizations) is in place.
* A sound system of LA performance monitoring (including sanctions and rewards arrangements)
* Legal requirements for LA transparency (right to public information, handling of citizens’ complaints, anti-corruption efforts).
 | * Legislation and regulations records
 |
| National program to operationalize the decentralization reform | National programme adopted institutions foreseen in the national programme are established and operational | * Government records
* National program document
* Surveys
 |
| Enhanced decentralization process  | Changes to:* Sub-national governance system architecture
* Functional assignment across levels of government
* Resources assignment across levels of government
 | * Legislations records
* National budget records
 |
| Increased LA investment in service delivery infrastructure and local development  | * Establishment of LA investment grant financing instruments
* Increase of investment budget execution by LA
 | Legislation/regulations recordsLA reports |

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| **Specific Indicators (Territorial Policies)** |
| Enhanced, equitable territorial development | * Change in per capita investment by LA across territories
* Change in per capita LA expenditures across territories
* Establishment of an instrument to measure citizens’ and businesses satisfaction with local services delivery
* % increase in number of new local businesses
* LA investment in developing economic infrastructure
 | * Government statistics
* LA reports
* Surveys
 |
| Local services delivery improvement | * Types of services being delivered by LA
* Service coverage (number of citizens disaggregated by age and sex within delivery reach)
* Number of affirmative action measures introduced.
 | * Government records and statistics
* LA activity reports
* Surveys
 |
| LA capacity to promote territorial development  | * Territory-based subnational planning system is designed and applied
* Capacity building programme for territorial development designed and applied
* Institutions and/or arrangements for supporting LA in applying territory-based local development are adopted and applied
 | * Government documents
* Surveys
* LA activity reports
 |
| Local economic development (LED) | * Types of LA services and investment that are business development centered
* % of LA undertaking the marketing of their territory (business attractiveness)
* % of LA entering into partnership with local businesses
* % of LA involving communities and private sector in the production and/or delivery of local services
 | * Government statistics
* LA plans and budgets
* LA reports
* Surveys
 |
| Local environmental management | * Environment-related services provided by LA
* Capacity building provided to LA on mainstreaming climate change in the local planning and budgeting processes.
* LA spending on climate change adaptation and local natural resources management
 | * Government records
* LA plans and budgets
* LA financial statements and reports
* Surveys.
 |

**Annex 3 : Overview of typical risks in decentralized contexts**

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| **RISK MANAGEMENT FRAMEWORK (RMF)** |
| **Risk Category** | **Dimensions** | **Risks of DR-LG-LD policies/programs** **(an indicative list)** |
| Political | * Human Rights
* Democracy
* Rule of Law
* Insecurity and Conflict
* Gender equality
* Children's rights
 | * Risk of inter-jurisdictional inequalities in the interpretation and upholding of human rights (especially women and children's rights), particularly in countries with significant ethnic, religious and cultural diversity
* Risk of creating pockets of weak local democracy where entrenched local power structures may restrict political contestation and/or participation and the rule of law
* Risk of contributing to insecurity and conflict, because of inconsistencies and delays of the reform process, which may push regional/local minorities in search of greater autonomy, to initiate insurgencies or secessionist movements.
 |
| Macroeconomic | * Macroeconomic Policy & Financial Sector
* Debt Sustainability
* Vulnerability & Exogenous Shocks
 | * Risk of mismatch between responsibilities and resources across levels of government, resulting in difficulties to contain public sector spending and reduce public indebtedness.
* Risk of failure to enforce a hard budget constraint for local authorities, also resulting in additional pressures on total public spending and/or the running of unsustainable local deficits.
* Risk of loss of central control over monetary and fiscal policy, due to fiscal decentralization reforms that may deprive the center of a share of revenues and expenditures sufficiently large to influence aggregate demand during a fiscal crisis or in the face of external shocks.
 |
| Developmental | * Public Policy
* Government Effectiveness
 | * Risk of reducing the potential of decentralization to promote local development by denying effective powers of autonomous policy-making, to decentralized authorities
* Risks associated with delays and inconsistencies in central-to-local transfer of resources and responsibilities.
* Risks associated with the lack, or limitations, of the capacity of multiple central agencies (Ministries of Finance, Planning and Local Government, as well as sector agencies) to effectively share and carry out, the State responsibilities to support and supervise local authorities.
 |
| PFM | * Comprehensiveness of the Budget
* Controls in Budget Execution
* Procurement
* External Audit
 | * Risks (of both fiduciary and developmental nature) associated with bureaucratic resistance to new regulations of local planning and financial management that would enable local authorities to be both more autonomous and more accountable.
* Risks of inadequate in-house local authorities’ capacity for policy-based planning and budgeting, and both supply and demand constraints on securing planning and technical services from other providers in the public, private and non-profit sectors.
* Risks of complex or inadequate public procurement rules, which may impede efficient local procurement of goods and services, or even lead to sub-optimal local spending choices in order to circumvent the more burdensome aspects of the regulations.
* *External scrutiny and audit* – Does the program help establish the appropriate arrangements for scrutiny of local public finances and related accountability of local authorities?
 |
| Corruption/Fraud | * Corruption & Fraud
 | * Risk of elite capture of decentralized governance institutions and related suppression of social participation and auditing institutions leading to an increase in corruption.
* Risk that decentralization reforms (which may increase the opportunities for corruption) are not accompanies by an opening of the political system and a corresponding increase of local political competition (which makes it easier for citizens to detect corrupt officials).
 |

1. A decentralized country is defined as one that has chosen to undertake a decentralization reform process of variable scope and depth, finds itself at different stages of such processes, and maintains some commitment to the reform process. After more than two decades of worldwide decentralization reforms, a large number of EU partner countries actually fit this broad definition [↑](#footnote-ref-1)
2. See ODI-CAPE (2011) ODI’s Response to the EC Green Paper on the Future of EU Budget Support to Third Countries. On Budget Support and the role of local authorities as services delivery channels, see in ODI (2010) Sector Budget Support in Practice , Synthesis Report [↑](#footnote-ref-2)
3. COM (2011)638 final of 13/10/2011 [↑](#footnote-ref-3)
4. COM (2013)280 final of 15/05/2013 [↑](#footnote-ref-4)
5. Understood as a necessary complement to “national” development efforts. On the definition of “local development” see the new *EU guidance on Supporting decentralization-Local Governance and Local Development* (forthcoming in 2015) [↑](#footnote-ref-5)
6. This note adopts the definition of “place-based policy” recently advanced in an independent report commissioned by the DG-REGIO “A place-based policy is a long-term strategy aimed at tackling persistent underutilization of potential and reducing persistent social exclusion in specific places through external interventions and multilevel governance. It promotes the supply of integrated goods and services tailored to contexts, and it triggers institutional changes”.

See: F. Barca (2009) An Agenda for reformed cohesion policy : A place-based approach to meeting EU challenges and expectations. <http://ec.europa.eu/regional_policy/archive/policy/future/pdf/report_barca_v0306.pdf> [↑](#footnote-ref-6)
7. Typical “transversal” policies, according to the 2012 BS guidelines are “public sector reform policies”, of which “decentralization” is obviously a major example [↑](#footnote-ref-7)
8. See Chapter 2 in the “Supporting decentralization reforms and local/territorial development in partner countries" (forthcoming) [↑](#footnote-ref-8)
9. PEFA, Supplementary Guidelines for the application of the PEFA Framework to Sub-National Governments, January, 2013 [↑](#footnote-ref-9)
10. http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALDEVELOPMENT/EXTPCENG/0,,contentMDK:20507700~pagePK:148956~piPK:216618~theSitePK:410306,00.html [↑](#footnote-ref-10)
11. PEFA, Supplementary Guidelines for the application of the PEFA Framework to Sub-National Governments, January, 2013, page 7 [↑](#footnote-ref-11)
12. See, for example the ECOLOC program in West Africa [↑](#footnote-ref-12)
13. For a comparative review of local governance assessment frameworks , see: UNDP (2009), A User’s Guide to Measuring Local Governance , Oslo Governance Center <http://www.undp.org/content/undp/en/home/librarypage/democratic-governance/oslo_governance_centre/governance_assessments/a-users-guide-to-measuring-local-governance-.html> . A decentralization Diagnostic Framework is also currently being developed by DEVCO-B2 (forthcoming 2015) [↑](#footnote-ref-13)