Annex 4.1.8 – Practice cases for Group 3 (funding modalities)

Box 4.1.3 Practice case: Experiences with municipal contracting in the context of the Urban Development and Decentralisation Program in Senegal (UDDP 1998-2005)

The UDDP was the first project in Sub-Saharan Africa to introduce and experiment with the concept of municipal contracts. With a budget of 85 million Euros, the program was co-financed by the central government of Senegal and local governments (together 23%), the World Bank (IDA credit, 68%) and AFD (credit, 9%). It was executed between 1998 and 2005.

The UDDP project had four development objectives:
1) improve the financial and organisational management of 67 municipalities, which account for more than half of the Senegalese population;
2) improve the programming of priority urban investments;
3) rationalize and simplify the financing of urban investments;
4) upgrade the basic infrastructure in urban and some rural communities.

The project consisted of two main components:

1) Institutional development of central and local governments (9% of the project costs). This component included capacity-building of central and local governments and support activities aimed at providing an enabling environment for these municipal adjustment programs to take place (fiscal reforms, studies, training).

2) Construction, rehabilitation and maintenance of public infrastructure, facilities and services under the responsibility of local governments (91% of the project costs). This component involved physical investments for construction, rehabilitation and maintenance of public infrastructure, facilities and services under the responsibility of local governments, including urban infrastructure, commercial infrastructure and social infrastructure.

According to Goundrian, the UDDP achieved substantial results. It had a large **outreach; all 67 urban municipalities** of the country signed municipal contracts. The project carried out **421 municipal infrastructure investment projects** under the municipal contract, enhancing access to basic services and infrastructure for a large number of urban and rural poor. The project **increased the financing capacity** of the municipalities by 22% between 1997 and 2003. Given the low level of central government funding available for municipal projects, the project allowed municipalities to finance their priority investment projects. Many municipalities have demonstrated improvements in local resource mobilization. This was achieved through **broadening the tax base and collecting local taxes** in a number of large cities, as well as developing commercial facilities in nearly every municipality. The policy dialogue that continued under the project led to reforming the local taxation system, focusing on increasing local revenues through taxes on property and businesses. The project demonstrated that important changes took place in the **behavior of municipalities,** namely: a) the concept of self-financing and municipal borrowing was successfully introduced (loans have been reimbursed) and b) they complied with reciprocal contractual obligations with the central government through municipal contracts, c) they mastered and made use of new tools for programming municipal investments, and d) they bought into improving municipal practices, including making difficult decisions on staffing. The **institutional impact** of the project was considered substantial and the project established the clear distribution of roles between the central government, local governments, the technical agency (MDA) and the procurement agency. The project developed a rich set of basic databases and tools for monitoring and evaluating municipal sector performance (in urban, financial and organizational areas). Mechanisms for identifying local priority needs and establishing sustainable targets were put in place. Finally, the project was able to create an **attractive platform for donor investments** in the urban sector.

Some lessons learned

In his analysis, Goundrian draws the following lessons from the experience with UDDP:

1. **Targeting a large number of municipalities is possible** if sound mechanisms are in place. By providing well-crafted programming tools and clear rules of the game, UDDP was able to bring incrementally and progressively all municipalities on board, without “spreading the butter too thin”.

2. **Clear implementation arrangements and well-defined distribution of contractual roles** is essential for a successful municipal development program. In particular, local governments and community groups have found a platform (through the municipal contract) to voice their needs and commit themselves to specific objectives.

3. **Capacity-building works better if it is integrated into a contractual arrangement and linked to investments**, instead of being a free-standing component. Municipal adjustment programs, derived from the conclusions of the financial and organisational audits, are therefore tied to local needs and target specific goals and commitments.

4. **Seeking harmonisation of financing windows is a challenge** which has to be addressed at the country level. The goal is to prevent, as much as possible, having several windows of financing (either through donor funding or through funding by the government) with several rules of the game accessible to local governments.

5. **Improvements in the area of aligning with national budgets are necessary in the future**. Most of the UDDP program was channelled directly towards the municipal contracts signed with the MDA through an extra-budgetary mechanism. The World Bank IDA credit and the AFD grant were made to the central government. Hence, these aid flows should have appeared in the national budget. Full integration of the project into the national budget process also allows for earmarking of public (including donor) resources for municipal investments.

Source: Adapted from Goundrian (2010), pp. 22-26.

Box 4.1.4 Practice case: Harmonising funding for local government: The example of the FADeC in Benin

In 2008, the Government of Benin established a country-wide financing and equalization mechanism, the *Fonds d'Appui au Développement des Communes" (FADeC)*. This funding mechanism, which provides financial resources to Benin's 99 municipalities, is an example of an application of a performance-based national grant system for local governments.

The FADeC has also been lauded as an example of a local government funding mechanism that fully complies with the principles of the Paris Declaration on Aid Effectiveness. Donors who contribute to this performance-based grant system ensure that their funds are disbursed and allocated following common needs and performance criteria and are subject to national procedures of internal and external control. Moreover, the fund is fully owned and managed by Beninois organisation (Nitschke and Auracher 2010, p. 1).

The FADeC distinguishes between investment grants and grants for covering operational costs. The latter had already been provided for several years by the central government and have been integrated into FADeC. The investment grants are new and there are two different forms: conditional and non-conditional grants.

Conditional grants are provided to municipalities so that they can exercise competencies that have been delegated to them by sector ministries, e. g. invest in schools, health stations or water infrastructure. The sector ministries decide on the total allocations per "department". A department is an administrative unit of the central state that regroups several municipalities. Mayors can indicate their investment needs, but the amount of funding each municipality receives depends on a negotiation process at the departmental level.

Non-conditional grants can be freely used by the municipalities for investments that are in line with the priorities of their municipal development plan. The non-conditional grant has different components, i.e. a block grant, an equalization grant and a performance-based grant. The equalization grant is calculated on the basis of the following criteria: the population, the surface area, the level of poverty and the degree of urbanization of the municipality. The calculation of the *performance-based grant* refers to the following sets of criteria:

- indicators that aim to measure the quality of organisational organs (number of council meetings held, documentation of the work of permanent commissions, timely approval of the budget, timely presentation of general accounts).

- indicators referring to the performance of the municipal administration (compliance with procurement regulations, compliance with accounting procedures, timely delivery of birth certificates)

- indicators referring to the performance in the field of local finance (increase of own revenues, increase in the ratio "maintenance expenditures /recurrent expenditures, increase in the investment budget through cuts in the recurrent budget.

The non-conditional grants are allocated by the National Local Finance Commission (CONAFIL), which is composed of an equal number of mayors and ministerial representatives. Allocation follows clear rules:

Unlike similar funding mechanisms in neighbouring Ghana or Mali, the municipalities do not have to apply for infrastructure subsidies, but automatically receive allocations.

Until 2009, the FADeC relied exclusively on resources coming from the national budget. In 2010, donors started to channel financial assistance through this facility. When the FADeC was established, three donors decided to contribute, using different aid modalities: Germany and Switzerland provided basket funding, whilst the European Union provided assistance in the form of sector budget support.

An important challenge in the coming years will be to achieve a broad integration of different national and external resources for local government in this new national funding mechanism. This should include sector investment funds in areas such as primary education, drinking water and health, for which the municipalities have received competencies.

Experience shows that there is always a risk that parallel funding mechanisms will remain in place or will be created. As reported in interviews, some donors have hesitated to channel their assistance for municipalities through the FADeC, because they are afraid of losing visibility. Moreover, sector ministries may be reluctant to give up control over their funds (Hesselbarth 2007, interviews).

It is important to note that efforts to improve the financial resource base of municipalities have not been limited to the establishment of a performance-based grant system. With the help of some development partners, the government has reformed the tax system and introduced a new local development tax that helps the municipalities to increase their revenue mobilization. Moreover, substantial efforts have been made to improve decentralised public financial management, e.g. by strengthening the capacities of prefectures to exercise financial oversight and control functions vis-à-vis municipalities.

Source: Nitschke and Auracher 2010, Hesselbarth, S. et al. 2007; Association nationale des communes du Bénin (s.a.), Boschmann 2009, UNCDF 2010.