



PERFORMANCE-BASED GRANT SYSTEMS

CONCEPTS AND INTERNATIONAL EXPERIENCE

By Jesper Steffensen

The United Nations Capital Development Fund is the UN's capital investment agency that provides technical support and seed capital – grants and loans – to strengthen institutions that create economic opportunity and provide essential services for poor people. UNCDF is participating at the World Urban Forum with a view to **promote an understanding of the key role that local level capital investment can play in meeting development challenges.**

Resources for development often come pre-labeled or pre-packaged. A 'thematic' problem is identified and measures are designed to deal with it. This can be the case for health, education, agriculture, sanitation or a wide range of single issues. These measures are usually implemented by a particular national agency, for example the Ministry of Health. Yet, it is at the local level where the problem is keenly felt. At this level it is rarely something that can be resolved through the mandate of one central agency or through tight central government control. It requires a **local level holistic response and UNCDF seed capital is designed to encourage local government systems that can deliver such a response.** But how can the performance of local governments (LGs) be secured? What measures can be taken to ensure that local capital is used for effective development purposes?

UNCDF has piloted local government performance-based grant systems (PBGs) that are now being adopted in a variety of countries. This is the subject of a forthcoming UNCDF publication that shares the considerable knowledge and extensive experience that has now been accumulated by UNCDF in designing, piloting, scaling up and implementing PBGs. The publication provides:

- insights into the **rationale and principles** underlying PBGs;
- a discussion of the **issues and constraints** that PBGs seek to address;
- a comparative assessment and analysis of their outputs, **outcomes and impact;**
- a description of the range of ways in which PBGs inter-relate and are articulated with **other dimensions of support** to local governments; and
- a detailed analysis of some of the **technical and policy challenges** faced in designing and implementing such fiscal instruments.

By linking the level of fiscal transfers to performance, PBGs can provide incentives for local governments to improve themselves in a range of areas (such as revenue collection, planning, budget execution, downward/upward/horizontal accountability, financial management, and good governance in general). The calibration of grants to performance can give capacity-building more meaning and greater purpose, encourage local governments to do better all round, and significantly reduce the fiduciary and other risks associated with fiscal decentralisation. However, as this publication argues, getting things "right" (and avoiding some major pitfalls) is indispensable in making the most of the potential offered by PBGs and the incentives that they provide for

improvements in performance.

PBGSs need to be distinguished from other types of performance measurement (such as credit-rating systems or performance budgeting), which are complementary but which operate in very different ways. PBGSs have most often been developed for general-purpose block grants and tend to focus on leveraging generic aspects of government performance (such as planning, budgeting, public financial management, governance, etc.), where improvements to such processes can impact on a broad spectrum of end-outputs or outcomes. Nonetheless, PBGS principles can also be applied to more sector-specific grants – which may focus on more sector-specific dimensions to performance.

PBGSs typically consist of three inter-related and mutually reinforcing elements:

- 1) the **capital/development grant** scheme itself, which usually covers multi-purpose and largely discretionary grants. Transfers need to be of a size such that gaining access to them (or part of them, or increases/decreases in them) operates as a significant incentive.
- 2) a **performance-assessment process**, which most commonly relies on the use of indicators that measure general, institutional or functional performance, and which are measured on a regular annual basis. Getting the indicators “right” is fundamental to ensure that local governments are being assessed against actions or failures for which they are genuinely responsible and to ensure that the indicators are targeting intended performance areas in a balanced manner. And, perhaps as importantly, the process whereby indicators are assessed/measured needs to be robust, technically sound, credible, transparent and politically neutral.
- 3) **Local government capacity building (CB)**, which is usually a combination of: (i) supply-driven and mandatory activities; and (ii) demand-driven, more discretionary activities (tailored to the needs of the individual local governments). Demand-driven CB is increasingly ensured through the provision of CB grants to all local governments (irrespective of their compliance with the conditions for access to the capital/development grants). The CB component of the PBGS is important because it enables the local governments to respond to weaknesses identified in the regular performance assessments. It also enables non-compliant local governments to obtain CB services they need to improve their performance and thus access basic grants or receive larger grants. Moreover, the PBGS approach provides concrete incentives for local governments to utilize the CB support more efficiently.

Through the piloting of PBGSs, UNCDF has demonstrated how local catalytic capital can be relied on to bring about real improvements in local development and poverty reduction by encouraging local governments to improve their capacity and focus on results.

Performance-based grant systems: a “simplified” synopsis

What does a “typical” PBGS look like? Although there are many variants, in essence a PBGS operates such that the extent to which **Local Governments (LGs) access transfers from central government is conditioned upon their overall performance.**

In most PBGSs, LGs need to show that they have complied with **basic or Minimum Conditions (MCs)** in order to access their grants (or part of them). MCs, which are usually based on statutory provisions and are either complied with or not (there is no “half-way house”), are intended to measure the basic capacity of a given LG to perform its functions. Unless LGs can demonstrate this performance, they are unable to access all or part of their (most often, capital development) grants. However, when LGs are able to demonstrate compliance with MCs, which are designed to ensure a minimum capacity to handle grants, they become eligible to receive their grants. Many MCs are designed as basic safeguards to bring down fiduciary risks to an acceptable level.

Many PBGSs, however, go one step further – by either increasing or decreasing the size of basic LG grants in relation to the assessed performance of LGs. This performance is usually based on assessing **pre-determined and agreed Performance Measures (PMs)**. Here, and in marked contrast to MCs, the measurement of performance is more nuanced and “qualitative” – LG performance (as measured through PMs) is more or less good/bad, whereas MCs are not relative but absolute (the LGs either do or do not “qualify” to receive all or part of their grants). PMs are assessed for all LGs, but assessment results impact only LGs that (by virtue of having demonstrated compliance with MCs) are eligible to receive grants, the size of which depends upon their performance across a range of measures.

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