Intergovernmental Fiscal Transfers

DRAFT

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## Acronyms

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<th>Description</th>
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<tr>
<td>CALM</td>
<td>Council of Local Authorities of Moldova</td>
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<td>CEE/CIS</td>
<td>Central and Eastern Europe and the Commonwealth of Independent States</td>
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<td>CFOA</td>
<td>Community Finance Officers of Armenia</td>
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<td>CoE</td>
<td>Council of Europe</td>
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<td>CRA</td>
<td>Commission on Revenue Allocation</td>
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<td>IGT</td>
<td>Intergovernmental Fiscal Transfer</td>
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<tr>
<td>LPA</td>
<td>Local Public Administration</td>
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<tr>
<td>LSP</td>
<td>Local Social Planning</td>
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<tr>
<td>MLFSP</td>
<td>Ministry of Labor, Family and Social Protection</td>
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<tr>
<td>MoRES</td>
<td>Monitoring Results for Equity System</td>
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<tr>
<td>NGO</td>
<td>Non-governmental organization</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PBGS</td>
<td>Performance-Based Grant Systems</td>
</tr>
<tr>
<td>PF4C</td>
<td>Public Finance for Children</td>
</tr>
<tr>
<td>TDF</td>
<td>Territorial Development Fund</td>
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1. Setting the context

UNICEF has increasingly focused its efforts on addressing inequities and on reaching the most vulnerable and disadvantaged children. UNICEF operationalizes its equity approach through the Monitoring Results for Equity System (MoRES), which identifies local-level bottlenecks or barriers to equitable results for children. Frequently identified bottlenecks include insufficient local budgets to ensure the adequate delivery of key services, leading to, for instance, teacher absenteeism and medicine stock-outs.

However, it has also become increasingly clear that root barriers to locally identified bottlenecks may lie elsewhere. A common budget related barrier is inequitable or insufficient allocation from the central level to local governments when the latter are responsible for the delivery of services but lack their own financial resources to do so.

In devolved contexts, local governments frequently take up service delivery and planning functions, including in the areas of civil registration, emergency preparedness, primary health care, education, water and sanitation (WASH), and social welfare. To the extent that local governments rely on transfers from the central government to fund these responsibilities, intergovernmental fiscal transfers (IGTs) play an important role in addressing service delivery bottlenecks, as well as, ultimately, in the realization of child rights.

Indeed, in recent years, several UNICEF offices have directly engaged on IGTs, particularly in order to strengthen equitable financing of local governments. At the same time, even when not actively engaging on IGTs, aspects of how the existing IGT framework affects the delivery of WASH, education, health services, etc. at the frontline must be understood in order to enhance overall effectiveness and impact of UNICEF programming.

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Box 1. What are IGTs?

IGTs refer to the transfer of money from the central government to lower levels of government, or from subnational governments to local government units. These transfers include various kinds of public financing instruments, such as the sharing of tax revenues, intergovernmental grants, subsidies and subvention (Bahl and Boex 2001).

IGTs play an essential role in the funding of key child-related services provided by local governments and in geographical equity.

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1 Prepared by Marija Adrianna de Wijn (Policy Specialist, Public Finance and Governance Unit, Social Inclusion Section). This note benefited from the views of UNICEF CO staff who participated in a webinar discussion and who provided inputs on the case studies.

2 For instance, one of the key recommendations of the Formative Evaluation of UNICEF’s Monitoring Results for Equity System (MoRES) is to support stronger links between locally identified barriers/bottlenecks and access to the resources required to remove them.

3 Devolution is a type of decentralization that focuses on the transfer of authority and responsibility for public functions to local government.

4 Local governments generally have three types of funding sources: Own revenues, e.g., local taxes, fines and/or user fees, Intergovernmental fiscal transfers (IGTs), and local government borrowing and debt.
This Technical Note focuses on the role that IGTs play in the equitable funding of child-related services. The main purpose of this Note is to inform design and practices of UNICEF programmatic interventions in IGTs and to contribute to the overall effectiveness of UNICEF programming by drawing attention to both positive and negative implications of an IGT system in a country. The objective of this Note is to introduce the concepts behind IGTs, to establish relevance for UNICEF programming and to identify entry points and lessons learned.

This Note is based on an extensive literature review, four UNICEF country office case studies and on expert presentations from a Webinar on IGTs, organized by the Public Finance and Local Governance Unit on 9 March 2015. The case studies document the experiences of UNICEF with IGTs in Kenya, China, Armenia and the Republic of Moldova. They are, in conjunction with issues raised during the Webinar, referenced in the text. Full case studies can be found in Annex 1; an audio recording of the Webinar can be found on the Public Finance for Children (PF4C) Community of Practice.

2. Understanding an IGT system

Whether directly engaging on IGTs or understanding the constraints and opportunities of an existing IGT system for UNICEF programming, five questions are important to consider to make IGTs work for children:

- How are IGTs framed within the legal/regulatory framework?
- What is the objective of the IGT?
- How does the central government decide on the total transfer pool to be distributed?
- How is the transfer pool distributed among local governments?
- What is the type of transfer?

2.1. IGTs within the national legal and regulatory framework

IGTs are anchored within legal and regulatory frameworks. In some countries, broad parameters are set within the constitution. In Kenya, for example, the Constitution makes specific provisions for the financing of devolved services (See Box 2: Constitutional financing provisions in Kenya). Fiscal and local government acts may provide further details. In South Africa, the Constitution mandates that provinces receive an equitable share of revenues: a framework that is further detailed in the 1997 Intergovernmental Fiscal Relations Act. Disparities in local government financing may thus find roots in how IGTs are framed within the legal and regulatory framework.

The legal and regulatory framework may also provide crucial information on IGT actors. In many contexts, the central government plays a key role in the design of the transfer system. In other cases, agreement on the system is based on central-local negotiations or the advice of a, for that purpose established, commission or forum. In terms of the latter, three commonly practiced options are independent grants commissions (composed of external experts), intergovernmental forums (composed of local government...
stakeholders) and intergovernmental-cum-civil society forums (Farvacque-Vitkovic and Kopanyi, 2014). A commission or forum can have a permanent presence, as is the case with the Commission on Revenue Allocation (CRA) in Kenya, or it can convene periodically. In India, for instance, independent grants commissions at state level convene every five years and act as advisory bodies for state-local fiscal transfers (Broadway and Shah 2007). A commission can have decision-making authority or it can be purely advisory.

Box 2. Constitutional financing provisions in Kenya

Kenya’s 2010 Constitution devolves powers for a range of critical functions and services to 47 elected county governments. The devolved services include all health services below referral; nutrition services; rural water and sanitation; early childhood development and education; and childcare. The Kenyan 2010 Constitution also stipulated a number of important features in connection with financing of devolved services. In particular, the law specifies for (a) at least 15 per cent of national revenues to be allocated to counties for financing of devolved services; (b) a Commission for Revenue Allocation (CRA) to be established to develop a revenue allocation formula for the horizontal allocation of resources between counties; (c) counties to raise local revenues from sources such as tourism, local markets and taxation, and service charges; and (d) an Equalisation Fund equivalent to 0.5 per cent of national revenues for a period of 20 years, to be established for the purpose of investing in social infrastructure in historically marginalized counties and facilitating the equalisation of service provision.

Finally, the legal and regulatory framework can provide information on how intergovernmental transfers flow from the central government to subnational levels. Not every local government level may receive its own transfer. In federal systems, for instance, central government transfers are, with the notable exception of Brazil, to the state/regional level. The state then employs its own methods in further dividing the transfer pool among local governments below state level. It is therefore possible that in federal systems certain states divide the resources in a more equitable manner than in other states. In unitary countries, grants for local government on the lowest levels may be part of central government transfers to provincial or district local government. In practice this may mean that community level local governments receive a limited amount of funds either due to leakage, political dynamics between the different governance levels, or simply because the IGT was insufficient.

Key questions:

- Which legal documents outline the IGT system in your country context?
- Are there planned or ongoing fiscal decentralization reforms that signal opportunities for UNICEF engagement in IGTs?
- Who are key actors (e.g., a grant commission, local government associations) in the design/implementation of the IGT system that could be influenced or advocated with?
- How do IGTs flow from the central government to the different levels of local government?

See the CRA website for further information on their structure and mandate: [http://www.crakenya.org/](http://www.crakenya.org/).

2.2. IGT objectives

A country may use a variety of different transfers and grants, each with its own objective. Four main objectives can be distinguished: (i) to address a vertical imbalance; (ii) to equalize a horizontal imbalance; (iii) to correct externalities; and (iv) to support national priorities.

Vertical imbalance

A transfer may be designed to address a vertical imbalance. Vertical imbalances are created by the assignment of local expenditure responsibilities (service delivery functions) combined with limited local government capacity to collect own revenues – e.g., taxation and fee collection - to cover the cost of these responsibilities. Local government expenditure needs are higher in countries where local governments are assigned many responsibilities for service delivery. Local expenditure needs are also frequently greater in urban areas, as large cities are often assigned broader service delivery responsibilities and existing service delivery standards are usually higher in large urban areas than in rural areas. While in theory the vertical balance could be addressed by recentralizing expenditure responsibilities or by assigning more local revenue sources, in most countries, and particularly in development contexts where there is a limited local revenue base, a mismatch between local revenues and local expenditures remains.\(^6\) Finally, it is important to address vertical imbalances to ensure quality delivery of services: if funds transferred from the national level do not cover expenditure needs, service quality will fall short or services may even be non-existent.

Horizontal imbalance (equalization)

A transfer may be designed to minimize disparities and ensure inter-jurisdictional equity. IGTs may address horizontal imbalances created by differences in expenditure needs, costs and/or capacity to raise own revenues among local governments at the same level. Different expenditure needs may reflect the local context. For example, education expenditures of a local government in a remote mountainous setting may be different from those of a local government in a densely populated urban area, even if the number of children attending school is the same. Similarly, the revenue base in a middle class urban area is different from a revenue base in a poor rural or agricultural area. Due to existing inequalities in developing countries, horizontal imbalances are often quite significant. The absence of an equalizing factor in fiscal transfers would result in even greater disparities. In many countries equalization is therefore considered the most important function of a transfer system.

\(^6\) Frequently, central governments are reluctant to devolve taxing powers for fear of having to compete with local governments for the same tax bases and/or fear of losing control of fiscal policy. At the same time, local governments may be reluctant to engage in local taxation, as this may be politically unpopular. This means that in many contexts the vertical imbalance remains quite significant and that there is an overreliance on fiscal transfers. (Smoke, 2015).
Externalities

Sometimes the delivery of local government services results in a cost or benefit to residents from neighbouring jurisdictions. This is referred to as an externality or spillover. A transfer may therefore be designed to counter the (negative) incentives caused by externalities and spillovers. For example, a local government may be hesitant to invest in the local health clinic (e.g., medicine stock, staff and infrastructure) if other local governments don’t take similar measures, because if other local governments fail to invest in their own clinics, said investment may lead to citizens from neighbouring areas inundating the newly upgraded clinic. In this case, a specific (conditional) transfer for health would ensure a certain level of spending across local governments. Similarly, a specific (conditional) transfer for wastewater treatment may ensure that all local governments, including those located upstream, invest in the treatment of sewage water.

National priorities

Lastly, a transfer may be designed to support national priorities. This may be particularly important if activities are considered high priority by the central government but lower priority by local governments. For example, in the Central and Eastern Europe and the Commonwealth of Independent States (CEE/CIS) region, social protection services for vulnerable children are a crucial part of deinstitutionalization. However, as these services are designated for a relatively small group of beneficiaries, local governments in the region tend to underfund these initiatives. In this instance, a specific transfer for the delivery of social protection services may offer a solution.

2.3. The transfer pool

The transfer pool constitutes the total budget for the local government sector. In practice there are two main ways in which the total transfer pool is decided upon: it can be rule-based or it can be decided in an ad-hoc fashion.

In a rule-based approach, a country determines the size of the transfer pool according to a fixed proportion of central government revenues. This can either be in the form of a fixed percentage of central revenues or by assigning the revenues of a particular tax to the local government sector. In some countries, such as in Kenya (see Box 2, above) the percentage of central revenues to be allocated is set within the constitution. The percentage may also be set by law, such as in the Philippines and Indonesia. In other countries, such as Cambodia, the local government act may prescribe the percentage to be set by administrative decision, for instance by the Ministry of Finance, and that it may be revised every few years (Smoke, 2012). In an ad-hoc based approach, the total transfer pool is decided as part of the annual budget decision, as is the case in South Africa and Uganda (Smoke, 2012). Some countries may use different pools for different types of
transfers. In this case it is possible that the pool for some transfers are rule-based, while the pool for other transfers are decided on in an ad-hoc fashion. The pros and cons of rule-based and ad-hoc approaches are compared in Table 1, below.

### Table 1. Pros and Cons of approaches for deciding the total transfer pool

<table>
<thead>
<tr>
<th>Approach</th>
<th>Pros</th>
<th>Cons</th>
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<tbody>
<tr>
<td>Rule-based</td>
<td>Provides degree of local budget predictability</td>
<td>Can compromise the fiscal flexibility at the central level, particularly if percentage is set in the constitution</td>
</tr>
<tr>
<td>Ad-hoc</td>
<td>Preferred by the central government as it allows for maximum flexibility</td>
<td>Not transparent; may result in budget fluctuations for the local government sector</td>
</tr>
</tbody>
</table>

Regardless of the approach, the total transfer pool is rarely based on precise calculations of local need but is more likely a reflection of available funds. A common problem related to the transfer pool is that the grant pool is inadequate for the intended purpose, either by design or through inadequate implementation, leading to (structural) under-funding of local expenditure functions. When local governments across the board are unable to fund their responsibilities, UNICEF country offices, together with partners, may want to assess the adequacy of the transfer pool to meet local government expenditure requirements and engage in related advocacy work.

In contexts where local governments rely on transfers from the central government to fund their service delivery functions, the adequacy of the overall transfer pool will need to be taken into account in UNICEF programming with local government, particularly around local planning and budgeting processes. In Armenia, for instance, the UNICEF-supported Local Social Planning programme (LSP) focuses on integrated planning at the subnational level to better address the needs of disadvantaged children. While IGTs were initially not a focus, the implementation of LSP reinforced the issue of sufficient and reliable municipal funding. An important lesson learned from UNICEF Armenia in this area is that it would have been more efficient if IGTs had been considered from the onset of designing LSP programme interventions.

### Key questions:

- How is the total transfer pool decided in your country context?
- What implications does this have for budget predictability for the local government sector?
- If the pool is decided in an ad-hoc manner, is there an advocacy opportunity within budget negotiations to ensure the delivery of devolved services that impact children?
- Is the total pool adequate to cover local expenditure needs?

### 2.4. Distributing the transfer pool

There are three main models to distribute the transfer pool among local governments. The transfer size can be based on: (i) a derivation approach, in which the total pool is

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7 Based on Bahl 2000
8 Jamie Boex, Webinar on IGTs, 9 March 2015
determined as a share of a national tax (e.g., income tax or value added tax), and each local government receives an amount based on collection of that tax within their boundaries; (ii) ad-hoc distributions; and (iii) formula-based distributions. The potential implications for each approach in terms of equity and service delivery are discussed below.

**Derivation approach**

A derivation approach is frequently used to close the vertical imbalance and is common in transition economies. However, a derivation-based approach tends to favour richer regions, and under this approach existing disparities will be perpetuated unless they are addressed by other transfers. A tax sharing approach that shares proceeds based on a formula could also prevent this issue.

**Ad-hoc allocation**

The ad-hoc model, in which the distribution of the transfer pool among local governments is decided on by the central government in an ad-hoc manner, is widely used within a developing and transition context (Bahl, 2000). The model isn’t data heavy and allows for flexibility. However, it is not transparent. The ad-hoc model may distort local government incentives for efficiency in service delivery as well as involve significant local-central negotiations and rent-seeking behavior. Increasingly, ad-hoc allocations are replaced by more systematic approaches, such as derivation approaches and formula-based approaches (Smoke, 2012).

**Formula-based approach**

Formulas are frequently used when equalization is the objective of the transfer. Formulas usually include variables on needs, including population size/service users, geography and poverty levels, as well as fiscal capacity. Formulas are heavy on data (See Box 3), which may not always be available in developing countries.

Due to the many different characteristics of local governments (e.g., poverty rates, geography), it may be difficult if not impossible to design a formula that truly equalizes. Furthermore, the equalizing power of formula grants depends on the variables used and their respective weights (See Box 4 for a discussion on child related variables in formula grants).

While the formula-based approach is considered best practice, there remain common issues. These include poorly designed (inefficient, inequitable) allocation formulas and/or ‘bad’ allocation factors, for instance strong reliance on equal shares for local governments. Allocation formula may not be applied during budget execution and grants may be incomplete and/or may be disbursed in an untimely manner. Sometimes

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9 In some contexts the total set by the shared tax amount in accordance with a formula that attempts to take into account both needs and capacity.

10 Jamie Boex, Webinar on IGTs, 9 March 2015
equalization formulas may even equalize too well and do not take into account that certain local governments may have higher expenditure needs because their existing service levels are above average, as is frequently the case with large metropolitan areas.

**Box 3. The equalization formula in South Africa**
South Africa's equalization system, the Provincial Equitable Sharing System, is needs based, as provincial own-source revenues are small. The South African system is based on seven components: education (41 per cent); health (19 per cent); welfare (18 per cent); a population component (7 per cent); an economic activity component (7 per cent); an institutional component (5 per cent) and; a backlog component (3 per cent). The needs requirements of each province for each component are calculated and summed to arrive at the provincial share of the grant. The provinces are then free to allocate their revenues, including these transfers, as they choose. The education component of the grant is based on the number of children in school and the number of school-age children in the province. The health component is based on the number of people with and without private medical insurance. The welfare or social development component is based on the number of people receiving transfers and the number of people in the province who are in the bottom 40 per cent of the national income distribution. The economic activity component is determined by the province’s share in total remuneration of employees. The institutional component is a lump sum, shared equally across all provinces. The backlog component is based on surveys of needs in the health and education sectors as well as on the degree of ruralness (Wilson 2007, 339-359).

**Box 4. Perspectives on child-related variables in formula grants**
On 9 March 2015 the PF4C team hosted a Webinar on Intergovernmental Fiscal Transfers. During the Webinar, Jamie Boex explained that the relevance of a child-related variable depends on the functions assigned to local government. If local government functions pertain to infrastructure development such as rural roads, then a child-related variable in a formula might not be appropriate. Nicoletta Feruglio (Social Policy Specialist, EAPRO) noted certain functions may indirectly benefit children. For instance, if the function of infrastructure development includes the maintenance of local school buildings and health clinics, a child-related variable might affect both school enrolment and under-five mortality rates. Awareness of local government expenditure responsibilities is therefore important when it comes to advocacy around the transfer formulas.

Due to the equity implications, UNICEF engagement in IGTs frequently focuses on analysis and advocacy related to equalization formulas. In Kenya, for example, UNICEF engaged in a strategic partnership with the CRA, the main agency responsible for design of a new equalization formula (Box 5). The adjusted formula resulted in significantly increased resources for many of the counties with higher levels of child deprivation. UNICEF estimates the cumulative benefit to be in the region of $67 million to the 12 counties with the highest levels of child deprivation.

Where local governments rely on fiscal transfers to fund child-related services and functions, UNICEF analysis/assessment of the equity implications of the distribution approach and the monitoring of the actual implementation of this approach, including
(timely) disbursements and how disbursements flow from the central to local level, will be relevant. The latter will also be relevant if the focus of UNICEF is not on IGTs per se but, for instance, on supporting local government planning and budgeting processes.

Box 5. *UNICEF advocacy around the design of a new equalization formula in Kenya*

Kenya’s 2010 constitution provided a key window of opportunity for UNICEF advocacy around the design of a new equalization formula. For this, UNICEF engaged in a strategic partnership with the CRA, the main agency responsible for design of the revenue allocation formula. Key steps included: 1) an equity analysis, which pointed towards existing unequal subnational capacities, unequal revenue generation potential and differences in unit costs; 2) preparation of a technical brief on devolution, equity and revenue allocation; 3) a workshop with the CRA in which the technical brief was presented; 4) participation in a joint UN workshop with the CRA on the draft formula; and 5) technical support to the revision of the formula. Following the workshop and consultations, the CRA revised its proposed formula. The revision increased the weight of the poverty gap variable to 20 per cent and gave greater weight to counties that were further behind in terms of interregional differences in service delivery and child-rights outcomes. The adjusted formula resulted in significantly increased resources for many of the counties with higher levels of child deprivation. UNICEF estimates the cumulative benefit to be in the region of $67 million to the 12 counties with the highest levels of child deprivation.

**Key questions:**

- In which manner is the transfer pool distributed?
- If the distribution is formula based:
  - What variables are used and what is their respective weight?
  - Do variables cover local government needs (e.g., are the variables in line with the services to be provided by local governments and/or do the variables adequately address inter-jurisdictional equity)?
  - Are allocation formula’s applied during budget execution?
- Are transfers complete and disbursed in a timely manner?

2.5. **Transfer types**

IGTs are operationalized through two principal forms (Broadway and Shah, 2007). The first major type is general-purpose transfers, which provide local governments with general budget support. These transfers allow for full local autonomy and policy discretion. General-purpose transfers can be fully discretionary or fall into block grants (Broadway and Shah, 2007). Block grants are used for specific expenditure areas such as...
health or education, or for specific purposes, such as infrastructure development, (see Box 6. Capital Grants). However, block grants allow for full local spending discretion within the stipulated area.

In countries where there is a preference for strong local government autonomy, few restrictions will be imposed on the use of local resources. In these countries transfers are usually based on strict formulas.

The second major type is conditional transfers, which are intended for specific expenditure purposes. These grants may be mandatory or discretionary in nature (Broadway and Shah, 2007). In countries where local governments implement programmes on behalf of the central government, stricter conditional transfer models may be followed. Conditional grants are best suited for subsidizing activities considered high priority by a higher-level government but low priority by local governments. Conditional transfers may also be useful for financing programmes that generate a high degree of externalities (Broadway and Shah, 2007). In practice, however, conditional grants are frequently used by the central government as a way to control local government decisions. (See Table 2 for the pros and cons of unconditional and conditional grants.)

### Box 6. Capital Grants

Most countries provide local governments with some type of capital grant. Capital grants are specific grants for infrastructure development, such as roads, water and sewerage treatment facilities, school buildings, etc. Capital grants commonly take the form of block grants, but in some cases they may also be more conditional in nature, with or without a matching component. A common issue related to capital grants is that the infrastructure investment is not matched by a sufficient level of recurrent grants, meaning that a school may be built through a capital grant, but that there are not enough funds to cover teacher salaries, books and maintenance.

### Table 2. Pros and Cons of Unconditional and Conditional Transfers

<table>
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<tr>
<th>Types of grants</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td>Unconditional</td>
<td>• Support local autonomy and efficiency, local planning and budgeting</td>
<td>• May lead to inefficient spending if lack of local capacity to plan and prioritise</td>
</tr>
<tr>
<td></td>
<td>• Easy to administer and reduce transaction costs</td>
<td>• May lead to crowding out of local contribution to funding of services</td>
</tr>
<tr>
<td></td>
<td>• Strengthen downward accountability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Useful for devolved services</td>
<td></td>
</tr>
<tr>
<td>Conditional</td>
<td>• Support national minimum standards of services</td>
<td>• May lead to too much control and lack of clear accountability</td>
</tr>
<tr>
<td></td>
<td>• Stimulate services in core areas</td>
<td>• Hard to measure and control - many transaction costs</td>
</tr>
<tr>
<td></td>
<td>• Useful for agency functions and functions with externalities</td>
<td>• May distort local priorities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Reduce local efficiency in resource allocation in accordance with local needs and priorities</td>
</tr>
</tbody>
</table>

Source: Steffensen (2010)
Conditional transfers often place conditionalities on inputs: the number of doctors or teachers recruited, or even the number of books or computers to be purchased. Input-based conditionalities may lead to inefficiencies and do not incentivize local governments to strive for better performance and results. Recently, there has been a shift towards formulating conditionalities in terms of results, such as test scores and graduation rates to be attained. In such a system, focus is on desired policy outcomes, while allowing for flexibility in the way local government programmes are designed and implemented. However, while an outcome-based system avoids some of the inefficiency and accountability issues, it may also penalize those local governments with the least resources or lowest capacity.

In some context, development partners have piloted Performance-Based Grant Systems (PBGS), in which local governments access to transfers from central government is conditioned upon their overall performance and/or specific (health, education) outcomes. A review of UNCDF in this area pointed towards indications that PBGS leads to positive infrastructure and service-delivery outcomes – in terms of allocative efficiencies, better implementation, cost efficiency and sustainability. For example, in China, UNICEF engaged in PBGS could be further explored.

Other examples of UNICEF engagement related to this transfer type includes analysis and advocacy related to conditional versus discretionary funding of key social services. For instance, in light of fiscal decentralization reforms, UNICEF Moldova conducted an in-depth analysis of the impact of the reform process on the continued financing of social services. A specific concern included the impact of local financial autonomy on the continued financing of social services. The paper proposed a conditional funding modality to ensure the delivery of these services. (See Box 7).

In addition, many UNICEF country offices have programmes around local planning and budgeting, which aim to strengthen inclusive and child-friendly local budgets. In these initiatives it is crucial to understand the extent to which local governments have discretion in decision-making. For instance, advocacy with local governments to increase budget allocations to social services may have little effect if these functions are funded through conditional grants. Where general purpose is the modality (either block grants or discretionary grants), a strategy that focuses on the design of grants and influencing local government decisions and practices will likely be effective. Where child-related services are primarily funded through conditional grants, a strategy that works with both central government and local government in influencing the design of (outcome-based) conditional grants and supports monitoring and tracking of resource flows may be needed.

Key questions:

- Are IGTs related to child-related services discretionary or conditional? Is there a matching component?
- In the case of conditionalities, are these input- or outcome-based?
- May child-related services be supported by block or conditional (outcome-based) grants?

3. Programming steps

3.1. Finding a window of opportunity

IGTs are highly political in nature. Therefore, successful direct engagement in IGTs may depend on identifying and making use of strategic opportunities. In Kenya, UNICEF engagement in IGTs came in response to the newly drafted Constitution, which mandated a new and equitable transfer formula. Other opportunities may be offered by ongoing decentralization reform, which is often paired with reforms in fiscal decentralization.
As IGTs are highly political by nature, it may also be useful to conduct a political economy analysis, taking into account that different actors may seek different outcomes. A political economy analysis may point towards specific entry points, opportunities and strategic partnerships.

3.2. Stakeholder assessment and strategic partnerships

Once an opportunity for engagement in IGTs has been determined, it is crucial to identify and build on strategic partnerships with relevant government and external stakeholders. For instance UNICEF China conducted an analysis of stakeholders and the policy-making environment, which pointed towards partnerships with the Ministry of Finance and China’s National Development and Reform Commission.

Forming strategic partnerships with other development partners (e.g., UNDP, UNCDF, World Bank, bilateral development agencies) is also important. In Armenia, the partnership between UNICEF and the World Bank was found to be instrumental in promoting child-focused approaches in the area of fiscal transfers. The trust and joint advocacy efforts with the World Bank allowed UNICEF to engage within non-traditional areas. At the same time, partners looked to UNICEF for specific expertise on child-focused services. In Kenya, partnership with UNDP was highly strategic for achieving results because it allowed UNICEF to draw on the technical expertise and reputation of UNDP and ensured that UNICEF inputs were supported by international experience.

3.3. Analysis

Analysis and assessment of the IGT system in terms of its role in explaining and removing locally identified bottlenecks (both positive and negative) can be done on each step outlined in section 2. Due to the complexity of IGTs, this work requires strong technical capacity in the form of external technical assistance. In Kenya, for instance, an external consultant with strong expertise on fiscal decentralization was recruited to develop a policy brief on devolution, equity and revenue allocation. The brief set out the equity context, some of the technical issues and potential variables to be considered and pitfalls from other country experiences.

3.4. Policy dialogue and advocacy

Ongoing policy dialogue and advocacy in collaboration with other stakeholders is an important aspect of work on IGTs. In Kenya and Moldova, policy papers provided an important background for advocacy. While advocacy can be in the form of direct engagement as described in the Kenya case, above, in Armenia focus is on ‘soft advocacy’ around the reformulation of the equalization formula (see Box 8, below) Advocacy can be child and equity focused, but should be in line with best practice on IGTs (see Annex 2).
3.5. Monitoring

Follow-up and ongoing support to the administration of the IGT system is also important, particularly in the case of more demanding, performance-based systems (Steffensen 2010). From a UNICEF perspective, monitoring the impact of IGTs on equity and the delivery of child-related services is particularly relevant. In Kenya, for instance, county spending on service delivery and equity areas are below pre-devolution levels, with significant variances across counties. For instance, health spending is around 80 per cent of pre-devolution levels. UNICEF found major challenges in budgeting and budget execution at county level and is undertaking budget analysis and accountability initiatives.

4. Lessons learned

4.1. What has not worked well?

Internal

- Recognizing the value of engaging in IGTs: Few UNICEF country offices understand the potential returns for investing in this work in terms of time, resources and partnerships.

- Measuring results: Work on IGTs requires long-term efforts, and it can be difficult to quantify specific UNICEF contributions.

- Approaching IGTs from an integrated, cross-sectoral perspective: In Moldova, for instance, an internal challenge was that the approach of UNICEF to the decentralization reform process was rather ad-hoc and sector based, instead of
having an overall cross-sectoral focus, which made it difficult to assess the overall involvement of UNICEF in the process. In Armenia, engagement in IGTs required UNICEF to reposition to an intersectoral perspective of policy development and implementation.

**External**

- **Getting a seat at the table:** Perceived lack of legitimacy of UNICEF engagement in discussions around IGTs by government and other development partners. The reason is our failure to link locally identified child-specific problems with IGTs. Talking about IGTs for the sake of IGTs is clearly not UNICEF’s mandate. Making that link is essential for both external and internal purposes.

- **Achieving quick results:** Even when a reform window presents itself, work on IGTs can be slow. (See Box 9: Engaging in IGT through decentralization processes in China)

- **Work on fiscal decentralization may deviate from traditional sector perspectives:** In Armenia, a key risk was the inevitable deviation from the usual interaction with key social sector ministry partners that often, due to narrow institutional interests, are not willing to give up direct service provision lines in favour of local authorities.

**Box 9. Engaging in IGT through decentralization processes in China**

In China, the social policy team of UNICEF identified IGTs as a crucial area for intervention since launching the Budget for Children project with the Ministry of Finance in 2007. A particular window of opportunity has been China’s ongoing fiscal decentralization reform debate. The objective of the engagement is to promote the systematic equalization of fiscal capacity by reforming tax rebates and increasing transfers across geographic regions. However, because it is a fundamental issue that affects China’s entire political economy, the fiscal reform process has until very recently been quite slow despite the opened window for reform.

### 4.2. What has worked well?

- **Strong internal capacity on public finance and fiscal decentralization and the recruitment of technical assistance with expertise on fiscal decentralization.**

- **Building on the strengths and mandate of UNICEF as an entry point:** focus on child rights, equity and service delivery.

- **Mapping and engaging in strategic partnerships with relevant government stakeholders and development partners, including other United Nations agencies and the World Bank.** Partnerships are crucial for creating an entry point into the discussion, the sharing of technical expertise and creating political clout.

- **Clearly documenting and publicizing results to generate and sustain internal support and generate external funding.**
Engaging in IGTs is more efficient if a situation analysis takes them into consideration from the beginning of designing a programme intervention.

5. Concluding remarks

IGTs impact the delivery of child-focused goods and services and, hence, the realization of child rights. At the same time, influencing IGTs is complicated and highly political, often requiring willingness to respond to a sudden window of opportunity, a deep understanding of the potential winners and losers of reform processes, and teaming up with various partners.

However, country experience has shown that when there are major reform opportunities, such openings of political space may be utilized successfully to create a greater enabling environment, which in turn contributes to the removal of local bottlenecks. Even when such reform opportunities have not presented themselves, aspects of IGTs and their implications remain important to consider, and should be included as an integral part of sector programmatic strategy.

This is an emerging area, and ongoing learning by doing is needed to further refine and expand UNICEF collective knowledge. IGTs are also contextual in nature. What works well in one context can be irrelevant for another country in a given time frame and stage of development. Notwithstanding, there are some emerging ingredients of success and pitfalls to avoid:

- Work on specific child-related block/conditional transfers may provide an easier entry point, particularly in the absence of overall reform opportunities.

- Strong technical expertise, identification of government counterparts and strategic partnerships with other development agencies are crucial factors when it comes to influencing IGTs.

- IGTs are not implemented in isolation but informed by decentralization reform processes and policy objectives therein.

- Work on IGTs should be in line with overall reform objectives: While there may be a desire to influence local government budget allocation through conditional transfers, local government budget autonomy should be considered, especially in countries following a strong devolution model.

- It should be considered how the work on IGTs can be strengthened through engagement in other aspects of decentralization: Just as local government capacity development by itself may not be enough to achieve results for children, the work on IGTs may need to be combined with other strategic engagement in decentralization. In particular, IGTs only concern the distribution of public resources across geographical areas. However, they do not address the distribution of resources across people within communities.
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Annex 1. UNICEF Country Office Case Studies

Closing the horizontal gap in Kenya
Case study by Joanne Bosworth, UNICEF Kenya

Kenya has a history of high levels of inequality and marginalization of specific regions with large interregional differences in service delivery and child-rights outcomes. In August 2010, Kenya’s second Constitution was adopted by referendum. The Constitution contains a Bill of Rights, clear principles and accountabilities for equity, provisions for equitable allocation of state resources and devolves powers for a range of critical functions and services to 47 elected county governments. The devolved services include all health services below referral; nutrition services; rural water and sanitation; early childhood development and education; and childcare. Other functions critical to the realization of children’s rights are shared, including disaster preparedness and management, planning, monitoring and statistics. The new Constitution also created a unique window of opportunity to design and implement a stronger equalizing transfer.

UNICEF engaged in a strategic partnership with the Commission for Revenue Allocation (CRA) as the main agency responsible for design of the revenue allocation formula, as well as with key development partners including UNDP and UN Women.

Key steps included:

1. Equity analysis: The analysis pointed towards existing unequal subnational capacities, unequal revenue generation potential of counties and differences in unit costs owing to geographical and capacity differences.
2. Preparation of a technical brief on devolution, equity and revenue allocation: This was conducted by a consultant experienced in fiscal decentralization. The brief set out the equity context, some of the technical issues and potential variables to be considered and pitfalls from other country experiences.
3. Advocacy and dialogue with the CRA on the technical brief: A meeting was held with the CRA in June 2011, just as they were to begin their work. The brief was presented and the CRA members had the opportunity to request further explanation. The CRA Chair and members were highly appreciative of the session, which exposed many of the issues to be considered as they developed their formula.
4. Participation in a joint United Nations workshop with the CRA and other stakeholders on the draft revenue allocation formula: The CRA released its first draft formula early in 2012, which was then subject to consultation. In June 2012, United Nations agencies participated in a workshop with the CRA to highlight equity issues, consider the draft formula and highlight other potential options to enhance the equitable basis of resource allocation in line with Constitutional provisions.
5. Technical support to the revision of the formula: After the workshop, UNICEF supported the technical revision of the formula, including recommending the poverty measure to be used.
Following the workshop and subnational consultations, the CRA revised its proposed formula by using the poverty gap as its measure of poverty. The revision increased the weight of the poverty gap variable to 20 per cent and gave greater weight to counties that were further behind in terms of interregional differences in service delivery and child-rights outcomes. The adjusted formula resulted in significantly increased resources for many of the counties with higher levels of child deprivation. UNICEF estimates the cumulative benefit to be in the region of $67 million to the 12 counties with the highest levels of child deprivation.

Enabling factors:

- There was a clear window of opportunity due to the profound change happening in the country.
- Internal refocus of UNICEF on equity highlighted the issue of inequality and resources and created internal space to work on this issue.
- UNICEF and United Nations staff capacity and relationships with Government facilitated technical support on the final formula.
- The strategic partnership with UNDP was key for achieving results because it allowed UNICEF to draw on the technical expertise and reputation of UNDP and ensured that UNICEF inputs were supported by international experience.
- The formula was developed before the advent of the new devolved entities, which came into being in March 2013. This meant there was little political opposition at the time. This is less likely to be the case when the formula comes up for revision.

Challenges:

- Lack of good disaggregated data at the level of the new counties meant equity analysis was limited during this period.
- The concept of equity is itself not clearly defined or understood and is subject to multiple interpretations.

The initial decision to develop a technical brief that highlighted issues of equity and service delivery played to the strengths and mandate of UNICEF, was well received by the concerned Commission and led to further engagement with key agencies working on devolution (i.e., World Bank and UNDP). However, it was difficult to sustain UNICEF engagement at this level because it is a less-recognized area of work for UNICEF. While it was a good entry point into work on devolution, it has not translated into a clear voice at the table for UNICEF in these discussions on an ongoing basis. It was difficult to reflect this result through the country programme results structure, which at the time had no specific social policy result area. On reflection, it is important to clearly document and publicize these results at a high level to generate and sustain greater support and to support external fundraising.
Promoting more equitable results for children in fiscal decentralization
Case study by Yan Mu, UNICEF China

Although China has a strong unitary political system, it is combined with a high level of fiscal decentralization. Local governments in China are organized in a hierarchical manner, with each level of government reporting to the next highest level. In 1994 the institution of a revenue-sharing system established roughly half of revenue power at the central government level, while expenditures were still decentralized. The system includes intergovernmental transfers; tax sharing transfers; tax rebates as well as various conditional grants; and is characterized by large fiscal flows from central to provincial and from provincial to sub-provincial level. However, the current fiscal system still faces unclear assignment of intergovernmental fiscal relations, while the transfer system is not equalizing and is marked by rent-seeking through subnational lobbying for central grants.

Since the launching the Budget for Children Project with the Chinese Ministry of Finance, the social policy team of UNICEF identified IGTs as a crucial area for intervention. A particular window of opportunity has been China's ongoing fiscal decentralization reform debate. The objective of the engagement is systematic reform that involves improving equalization for fiscal capacity to delivery essential social services across regions by reforming tax rebates and increasing transfers.

Strategic partners were identified based on an analysis of stakeholders and the policy-making environment in China: China's Ministry of Finance; China's National Development and Reform Commission; the international and domestic research community/think tanks; and development partners such as World Bank, Asian Development Bank and UNDP.

Key steps included:

1. Analysis and assessment of current grants and fiscal formulas in terms of adequacy, effectiveness and equity of allocation. This includes assessment of the cost effectiveness and efficiency of national earmarked grants within the Expanded Programme on Immunization; review of conditional grants for maternal and child health; rural community sanitation; HIV/AIDS prevention and treatment; support for street children; social protection (e.g., cash transfers, health insurance). In these analytical pieces, current status, including funding levels and programme effectiveness (i.e., reaching the most vulnerable), was assessed and challenges identified.

2. Policy advice and delivery and advocacy for systematic change and governance reform. This included advocacy on centralizing some crucial spending duties for children through transfers to those most in need; allocation criteria for various grants to social sectors; public governance reform going hand in hand with fiscal system reform (e.g., accountability of and performance reviews for local governors regarding the delivery of, and citizen empowerment in, social services in the areas of health, education and social protection, and monitoring and evaluation).
It was recently outlined by top administration in China that new reforms will take place in the fiscal decentralization structure, i.e., some essential social service financing duties will be more centralized so that they can be more equalized across the nation. The policy advisory and advocacy by UNICEF has been around this core message, as the reforms would entail more equitable social services for women and children.

Challenges

Internal:
- Internal buy-in of value for engagement in this area by the country office, particularly when the funding situation deteriorates with competing priorities.
- Challenges in measuring results: The process requires long-term efforts and engagement before results are visible. In addition, it is hard to predict breakthroughs and to quantify the contribution of UNICEF.

External:
- Political will and fiscal space from government: While there exists a window for reform, because it is a fundamental issue that affects the whole political economy in China, the fiscal reform process has, until very recently, been quite slow.
- Child focus enables us to make small and piecemeal differences. It is much more difficult to achieve systematic changes.
Supporting an integrated approach: Intergovernmental fiscal transfers in Armenia

Case study by Artur Ayvazov, UNICEF Armenia

Shortly after independence from the Soviet Union, Armenia embarked on a large-scale transformation of the public machinery, including decentralization reform. In 1996 a two-tier system of subnational governance was established, creating a total of 915 directly elected rural and urban municipalities in addition to a regional level of non-elected administrations. Municipalities assumed responsibility for functions in the areas of health, education, waste management and public greening. However, as almost every settlement in the country received local self-government status, the system is marked by extreme fragmentation. Almost half of the municipalities have less than 1,000 inhabitants. In addition, local governments experience budget shortages due to limited allocation of financial resources combined with small revenue bases.

In Armenia, three types of intergovernmental transfers are provided to municipalities: equalization transfers, subventions and subsidies. Own revenue through taxation accounts for approximately 27 per cent of the municipal budget\(^\text{12}\). Equalization plays a critical role, covering approximately 56 per cent of the budget\(^\text{13}\), and has a strong impact on service provision. However, the current equalization formula has serious methodological problems. While the formula considers local fiscal capacity for municipalities, financial needs are not considered. In addition, while the regional level has planning and service delivery responsibilities, it has marginal control over the budget, which is influenced by ministries and disbursed directly to service delivery units. These issues combined affect the performance of the local governance system and predetermine not only the quality but, in many instances, even the existence of basic public services, especially services for disadvantaged groups, including children. Therefore, UNICEF Armenia, in consultation with public financial management and local governance finance experts, initiated a process that would not only diagnose but also evaluate the relevance of various entry points to address the issue.

As a first step, UNICEF focused on assessment, technical assistance and policy advocacy that assisted not only to properly diagnose the situation but also to inform subsequent advocacy. In 2009 UNICEF commissioned a paper, ‘The Impact of the Public Finance Management System on Children in Armenia’, that highlighted the role of subnational authorities and their financing instruments, including IGTs.

Second, in 2011 UNICEF Armenia initiated, in partnership with the Government and the World Bank, the Integrated Social Services Programme, with the aim of strengthening the performance of locally-delivered social protection services. A key aspect of the programme is Local Social Planning (LSP), which stresses integrated planning at the subnational level to better address the needs of disadvantaged children. While this was not initially a main focus, the implementation of LSP reinforced the critical issue of predictable and sufficient municipal funding. At the same time, the World Bank initiated\(^\text{12}\) The capital Yerevan excluded.
\(^\text{13}\) Ibid.
reform of the Armenian Social Investment Fund, a capital development pool that supported the rehabilitation of municipal infrastructure, into a government-owned Territorial Development Fund14 (TDF). The primary aim of the TDF is to mitigate territorial inequalities in service provision and to boost local economic development. As the TDF is supposed to manage a pool of predictable resources to be disbursed locally, UNICEF is linking the TDF as a main entry point to fund municipal initiatives developed under LSP.

Third, in 2012 UNICEF conducted an analysis of the Armenia budgetary framework. The analysis suggested, among other things, that a major opportunity exists if the Medium-Term Expenditure Framework process gives regions the same status as the line ministries in budgetary negotiations. Currently, regional budgets are formed through the compilation of line ministry based priorities, which often neglect local needs and preferences. UNICEF is developing a detailed scenario that brings regional lenses into the process, thus enabling additional financial opportunities for social initiatives generated under LSP.

The fourth pillar of the engagement is aimed at expanding child-care services at the local level, where they are currently voluntary functions, and ensuring guarantied financing by formulating the services as a delegated function. This is seen as an intermediate solution that will be reframed into a fully-fledged community-based service provided by municipalities within the scope of their mandatory functions.

Fifth, influencing the equalization formula through ‘soft’ advocacy. A current attempt for equalization reform is led by the Council of Europe (CoE) and implemented by the experts of Community Finance Officers of Armenia (CFOA), an association of municipal finance officers with NGO status. The core element of the proposed revision is based on the budget adequacy principle: the ratio of the revenue ability and the expenditure need factors of the particular municipality. It assumes an introduction of a set of expenditure proxies that more accurately portray the financial needs of municipalities: for example, population breakdown including the number of children; geographic fragmentation; distance from the capital and regional centre; and altitude above sea level.

As the CoE initiated this process, UNICEF Armenia is not directly involved in the process of revision of the equalization formula, nor does it have a dedicated programme to tackle the issue. However, the technical partner implementing the reform, the CFOA, is a principal and long-standing partner of UNICEF through which the LSP was introduced and promoted. At this stage, the strategy of UNICEF is, through informal discussion with CFOA, to closely follow the proposals made and to provide informal advice on how to include a child-rights perspective, emphasizing the role and weight of those expenditure factors that could directly lead to improvement of child-focused social services. This approach has already had success, as the number of children is now a separate expenditure factor with a relative weight of 10 per cent in the newly proposed equalization formula. At a later stage, UNICEF will start a gradual process of involvement

14 At the moment the TDF is not integrated with capital subventions but this is the intention.
in the equalization formula area in order to respond to the needs of children living in poor and remote communities. The intention is for the revised formula to: i) mitigate the budget gap between vulnerable municipalities and ii) address the specific needs of children, enabling expanded scope and quality of existence as well as a planned set of community-based services referred to above.

The main counterparts for UNICEF in this work are the Ministry of Territorial Administration and Emergency Affairs and the Ministry of Finance, both of which are relatively new partners. The CFOA is a key-implementing partner of UNICEF in relation to LSP as well as in the reform of the equalization formula. The primary partners of UNICEF in relation to the TDF are the World Bank and UNDP. The World Bank is also a key ally in the implementation of LSP. The partnership with the World Bank has been particularly instrumental in promoting child-focused approaches in the area of IGTs. The trust and joint advocacy efforts with the World Bank allowed UNICEF to engage within non-traditional areas such as the TDF. At the same time, partners looked at UNICEF to bring in specific expertise on child-focused services. UNICEF is now seen not only from the narrow perspective of being a policy advocate in the social sector, but also as an actor that can understand and propose solutions of a financial nature, capable of bridging ‘on the ground experience’ with viable policy alternatives.

A key success factor is the generation of relevant evidence that qualitatively and quantitatively justifies the need for revision of the system of intergovernmental transfers. The 2012 analysis of the budgetary framework outlined the key directions for UNICEF and its partners to achieve results for children by focusing on local authorities, particularly by strengthening their financial capabilities. An important external factor relates to the relatively stable political momentum and economic austerity that, due to limited resources, opened the door for policies that introduce efficiency gains. The combination of the proper international and local expertise also played an important role in developing sound approaches and realistic policy alternatives.

For UNICEF Armenia, IGTs were a new area of engagement. Neither the Government nor the key partners considered UNICEF a significant voice in this field. The breakthrough with counterparts and partners happened due to credibility achieved in the traditional areas, new ways of cooperation and the clear message of UNICEF not to take a leading role but rather to support from a child and social sector perspective. However, engagement in IGTs would be more efficient if the situation analysis considered it from the very onset of designing programme interventions. A key risk was the inevitable deviation from the usual interaction with key social sector ministry partners that often, due to narrow institutional interests, are not willing to give up on direct service provision lines in favour of local authorities. The engagement also required UNICEF to reposition with a focus on intersectoral perspective of policy development and implementation.
Impact of IGT reform on continued local government funding of social services in Moldova
Case study by Veronica Sandu, UNICEF Moldova

In 2006, Moldova initiated decentralization reform with the Law 435-XVI, which defined distinct steps of the decentralization process. The law created a two-tier system of local public administration (LPA) with villages and municipalities on the lowest level (LPA1) and rayons on a second level (LPA2). In April 2012, a decentralization strategy was approved. The Strategy has five objectives: I) decentralization of services and competences; II) fiscal decentralization; III) patrimonial decentralization and local development; IV) improving administrative capacity of local governments; and V) promotion of democracy, ethics, human rights and gender equality. The Action Plan for the Implementation of the Decentralization Strategy 2012-2015 includes specific activities for the social sector, including decentralization of social assistance and social services. Over the past years, there was an expansion of local government social services, including services in the area of disability, social assistance and childcare.

Up to 2014, the fiscal transfer system in Moldova followed an expenditure reimbursement model with one transfer to LPA2 for both levels of local government. However, the reimbursement model resulted in strong financial dependence of LPAs on the central government and did not create the necessary motivation at the local level to streamline and enhance the quality of services. The financial dependence was particularly acute on LPA1 level, as this tier of government only has a small revenue base and was almost entirely dependent on the LPA2 budget. Overall, the framework permitted the perpetuation of an extensive, but ineffective, social services system that was not financially viable.

In order to enhance financial and functional autonomy of local governments, a range of important amendments were made to the Law on Local Public Finance, which came into effect in January 2015.

The reform has the following implications:

1. An income-based transfer system that aims to motivate local governments to streamline local tax collection.
2. Identification of local development priorities by local government and the allocation of budget resources depending on the respective priorities.
3. Separate transfers for different tiers of local government (LPA 1 and LPA 2).
4. A financial support fund based on a clear formula that will ensure budget predictability for LPAs.
5. An additional compensation fund, amounting to up to 1 per cent of the national budget revenues, for the first two years to cover potential risks related to the fiscal reform.

In light of the decentralization reform process, line ministries requested UNICEF support with an in-depth analysis of the impact of the reform process. A specific concern included the impact of local financial autonomy on the continued financing of social services, particularly those services that are high in cost but have a small number of beneficiaries. It was felt that the reform might negatively impact the availability of these services,
especially in resource-poor local governments where social services consume a large share of the budget.

UNICEF engagement involved providing technical assistance to sector ministries in the analysis of the impact of fiscal decentralization on social issues. This included a policy paper that aimed to identify the probable impact of the new law on local public finance on the social services system. The aim of the study was to provide a set of recommendations to mitigate short-term risks and capitalize on the long-term opportunities of the reform in the social services area. It also included the sharing of best practices from other countries on the financial set-up for the social services provided at community level, such as a Lithuanian and Romanian case study. UNICEF also served as convener between key policy makers from sector ministries, the ministry of Finance and local governments, including the Council of Local Authorities of Moldova (CALM).

Specific achievements include proposed amendments to the law on fiscal decentralization, awareness raising and public discussions. The recommendations from our studies were used by line ministries in advocacy and the creation of a discussion platform in the parliament on the impact of decentralization on the social sector. The Ministry of Labor, Family, and Social Protection (MLFSP) has formulated amendments to the law for financing social services in Moldova. The amendments mainly request "special budgetary lines", i.e., budgetary lines with a special destination, for specific social services. The amendments have been sent to the Ministry of Finance and State Chancellery. However, due to elections in late 2014, discussions of the proposed changes have been delayed.

Success factors included a demand-driven approach, i.e., engaging with sector partners that showed the greatest interest, including the Ministry of Education and MLFSP; connecting the right actors, e.g., best local expertise, line ministries, including the Ministry of Finance, local governments and local government associations; UNICEF engagement from the start of the decentralization reform process; maintaining awareness of potential issues in this complex reform; and continued dialogue with key actors in the process.

Challenges were encountered too. An internal challenge was that the approach of UNICEF to the decentralization reform process was rather ad-hoc and sector based, instead of having an overall cross-sectoral focus; this made it difficult to assess overall involvement of UNICEF in the process. Externally, cooperation with the Ministry of Finance and other key ministries in the reform process was sometimes challenging, as UNICEF is not always considered a major discussion partner in the area of decentralization.
Annex 2. Best Practice Intergovernmental Fiscal Transfers

- Local government budget autonomy - The potential benefits of decentralization are intrinsically linked to discretion in local decision-making. Any conditions placed on transfers should balance national priorities and local autonomy.

- Clear objectives - A transfer program should ideally address only one policy objective.

- Revenue adequacy - Transfers should provide adequate resources for purpose at hand (avoid unfunded mandates).

- Equity - Transfer mechanisms should support fair allocation of resources and avoid 'equal shares' (each local government receives the same amount).

- Simplicity - Transfers mechanisms should be simple, easy to understand and transparent.

- Predictability - Transfers should ensure predictability and limit fluctuations/sudden changes.

- Flexibility - Transfers should be flexible to accommodate unforeseen changes in the fiscal situation of the recipients.

- Incentive compatibility - The design of transfer systems should provide incentives for sound local fiscal management and avoid perverse incentives.

- Focus on service delivery - Transfer formulas should focus on the demand (clients or outputs) rather than the supply (inputs and infrastructure) of local government services.