

Back-to-Office-Report

“Experience Capitalization Workshop on Local Development Funds (LDF)“

Ulanbaator, Mongolia, 6-10 July, 2015

I. Mission Objectives and Activities

Terms of reference of the duty trip. Per the signed TOR (attached), the objective of the duty trip was to participate as resource person and SDC representative in the “*Experience Capitalization Workshop on Local Development Funds (LDF)*”. The event was conducted during 7th to 9th July 2015 in Ulaanbaatar, Mongolia. Preparatory work for the event took place on July 6th, and follow-up activities were planned on July 10th.

Workshop participants. The workshop was organized by LOGIN which is a South and East Asia centric multi-stakeholder learning network supported by the Swiss Agency for Development and Cooperation (SDC). The event was coordinated by Preeta Lall (LALPR) and the LOGIN team from the Delhi office.

The event was attended by representatives from the following countries: Afghanistan, Bangladesh, Bhutan, Cambodia, India, Laos, Myanmar, Nepal, and Pakistan. Kenya was also represented as a non-Asian country. The resource persons were Jesper Steffensen (consultant), T.R. Raghunandan (consultant), Suresh Balakrishnan (UNCDF), and myself. Attached is the participant list.

Workshop objectives. Most of the 10 countries represented within LOGIN have introduced and gradually developed variants of LDF over the past decades. To this end, the 2nd General Assembly of LOGIN held in December 2014 had mandated the network to provide regional sharing of experiences. With this background per the attached agenda the workshop identified:

- good practices, innovations, methods, and lessons learned that may further contribute to the effectiveness of local development funds in respective countries;
- the main themes for a forward-looking agenda that would enable countries to work on critical design elements.

Activities and Tasks. Besides participating in the conference and engaging with country representatives, my tasks included:

- delivering a presentation on uses of LDF and resource allocations (attached);
- moderating a panel discussion on the current situation of LDF and the forward-looking agenda;
- leading the group work on capacity strengthening;
- assisting the Afghanistan representatives for their interventions.

II. Findings and Conclusion

The workshop led to the following findings and conclusions: (i) objectives of LDF; (ii) design elements; (iii) country applications; (iv) challenges; (v) future design options of LDF.

(i) Objectives of LDF

The objectives of LDF and therefore design elements vary across countries and are adjusted over time. This challenges a proper classification of LDF. The workshop concluded that the most reasonable way of defining the core objective of LDF is “to provide unconditional funding for small-scale infrastructure”. There is no standard definition across countries or

LDFs with regards to the type of infrastructure which falls into this category. In most cases this refers to community-level works (water; sanitation; rural roads; school infrastructure; primary health care infrastructure; electricity) which can be financed out of recurrent grant schemes. A newer generation of LDFs also includes climate change activities.

The specific objectives of LDF are to:

- provide financial resources for pro-poor development activities and service delivery at local government and community levels;
- facilitate planning and management of development resources at the local council and community levels;
- involve citizens in planning, budgeting, decision-making and implementation;
- enhance accountability of local governments to their constituents;
- strengthen the capacity of local governments, and associated units at the national level, particularly with regards to planning, PFM, and procurement.

(ii) Design Elements

With these specific objectives and institutional arrangements, LDFs display design elements that deviate from the core or “traditional” intergovernmental fiscal approaches. The attached document titled *“Comparison: Approaches in Local Development Funds and Intergovernmental Finance”* which was prepared as a conclusion of the discussions of the workshop provides a contrasting analysis of these types of finance.

The differences are particularly notable with regards to:

- **approaches in horizontal allocation**, given LDF often not only include needs and poverty criteria but also a considerable percentage distributed based on “equal shares”; this is to implement an “entitlement” objective in resource distribution and which facilitates political agreements; however, such distribution implies substantial per capita inequities across local governments. ;
- **the focus on the lowest level of government** (municipalities, local governments, other) as executing level for provision of infrastructure, while regional or higher levels of government may rather be involved in planning and coordination;
- **the treatment and financing of maintenance expenditures**; a series of LDF do exclude them, but recent funds incorporate them explicitly as eligible expenditures;
- **the flow of fund arrangements**, given LDFs are often donor financed.

More recently, a series of LDFs have incorporated performance elements which reward the achievements of certain targets: either at the level of core governance capacity targets (planning; budget execution and investment capacity); or coverage of infrastructure and achievements of service delivery targets.

Most LDFs are based on an scaling-up approach which increases coverage across local governments. The workshop concluded that while advance and progress varies, most LDFs are already passed the stage where local planning, investment and prioritization within subnational governments has to be “jumpstarted” and initiated from scratch.

(iii) Country Applications

The flexible and adaptable design allows LDF to operate in most varied intergovernmental systems and arrangements. Countries in Asia exhibit a variety of features, covering both federal and unitary systems; subnational governments with elected and non-elected mayors or governors; a coexistence of deconcentrated levels with autonomous levels of government; and

some discrepancies between *de jure* design and *de facto* operation in several important areas, particularly expenditure assignments and responsibilities of subnational levels. Establishing a proper country classification of countries with regards to intergovernmental models was not objective of the seminar, however one can conclude that LDFs are being applied and used in the most varied circumstances, which is a remarkable achievement.

Nevertheless, a critical aspect is the extent to which LDFs are embedded and integrated into the intergovernmental system. In many countries this remains a significant challenge, particularly also as the intergovernmental system (all non-LDF elements) are being adjusted or remain, as noted above, informal to some extent. This is most notably the case with regards to the roles and responsibilities of local governments, particularly with respect to infrastructure provision and public investment management. The seminar concluded that further integration with regards to the different objectives of existing transfers would be desirable. LDFs themselves struggle to prioritize resource allocation between distributing for equity objectives versus providing resources to those subnational governments where institutional capacity are relatively low—these criteria often present tensions and cannot easily be matched. The extent to which such integration is possible or necessary also depends on the relative size and “fiscal foot-print” which can vary; further data development on this topic would be necessary to come to a more robust conclusion on this topic.

(iv) Challenges

The workshop identified a series of challenges related to LDFs. The relevance of these challenges vary across countries and types of LDF applied.

- **Sequencing with regards to defining responsibilities of subnational governments:** LDFs often face the challenge of operating in intergovernmental frameworks where the responsibilities of the different levels are not yet clearly defined in law or in practice; the unconditional nature of funding creates the challenge of introducing conditionalities in later stages.
- **Alignment with other financial flows and transfers:** a related problem is that LDFs may require further integration in the intergovernmental fiscal architecture with regards to transfer objectives, particularly with regards to (i) equity criteria, and (ii) conditionalities and earmarking:
 - **(i) equity criteria** would need to be aligned between the different funding flows, in order to set appropriate financial incentives and set conditions for quality service delivery; accelerating urban and rural development trends which shift the parameters for service delivery would require a tailoring to the associated and emerging fiscal disparities.
 - **(ii) conditionalities and earmarking:** some level of conditionalities over subnational spending may be warranted to balance multi-level planning and signal national priorities; this may be particularly warranted to ensure deliveries of basic social services (health, water, education); as well as ensure transparency principles.
- **Maintenance expenditures:** incentives and possibilities for local governments to finance with their budgetary resources the operation and maintenance expenditures vary substantially. This is problematic as efficient management of infrastructure critically relies on proper maintenance. This can create an inefficient cycle of “build-decay-rebuild” of infrastructure assets.
- **Roads investments crowd out other sector expenditures:** the large size of road investment often impact the availability of resources for other sectors.

- **Intergovernmental planning and priority setting, including with communities:** local (including community level) planning is often not sufficiently embedded or iteratively dealt with in intergovernmental planning processes; this misalignment can lead to problems in project approvals but also frustrated local planning exercises.
- **Possible fragmentation of investment expenditures:** given prevalence of local demands investments may not always add up to appropriate scale, with fragmentation of infrastructure spending being a risk. The mentioned planning processes can also reinforce this trend.

(v) Alternative Design Options

The workshop analyzed a series of options for LDFs to address above-mentioned challenges. There is broad consensus that any future role of LDF be played and aligned with the intergovernmental system, and the related political priorities of countries. While future analytical work and policy dialogue is necessary to come to more robust conclusions, the workshop discussed three broad directions:

- **Broader focus on service delivery:** this alternative would consider LDFs to foster a more comprehensive approach to service delivery. It would imply overcoming the more narrow focus on infrastructure. This is particularly relevant for the social sectors, where infrastructure assets (hospitals; schools) are just one among other inputs for service delivery in health and education. This is clearly less relevant for infrastructure constituting and end-service in itself (roads, for example), however in these cases network aspects would still need to be emphasized.
- **Local or regional LDF:** another alternative is to re-design LDFs such that they are managed and directed on behalf of individual subnational governments for a specific locality or region. In light of limited financial size this alternative was seen as a way to not disperse resources and weaken impact. Given some LDFs have already in place “cascading” formulas for allocating resources (that is, decisions for horizontal allocations are done at the regional level), the establishment of a regional/local fund could be a consequential second step in some cases.
- **Performance transfer:** a series of LDF have already incorporated performance elements. One option would be to redesign LDFs such that they constitute a performance transfer for the intergovernmental system as a whole and with nationwide coverage. While the financial size is an important variable to assess the viability of this alternative, it is clear that performance transfers can with limited levels of resources induce sensible changes in behavior in subnational governments, and therefore increase impact on subnational spending.

III. Next steps

LOGIN activities. The planning exercise conducted with workshop participants led to the following list of prioritized activity lines. These activity lines refer both to the future role of LDFs as well as broader intergovernmental topics, a linkage which would need to be ensured:

- (i) Public Financial Management with public financial accountability
- (ii) Local Fund Audit
- (iii) Local taxation
- (iv) Inter-governmental fiscal relations- functional and revenue assignments
- (v) Decentralized public procurement

A consultant report on LDFs titled “Concept of Local Development Fund and Experiences from Performance-Based Grants” is being elaborated.

Supporting LDFs on behalf of Development Partners. Ideally, a consolidated reform agenda would have advanced among countries before committing additional external financial support. The following are therefore preliminary criteria that could be taken into consideration and adapted to the country context:

- LDFs should be neatly inserted into the structure and processes of intergovernmental relations of partner countries. This particularly concerns the role and responsibilities of subnational governments and related funding flows.
- There is a tension between fostering capacity of local governments and emphasizing horizontal distribution and equity objectives. Trade-offs for these different objectives and therefore design elements should be discussed with national counterparts up front in the planning process of new support.
- As the current focus of “unconditional funding for small-scale infrastructure” is likely being revisited in a series of countries, it would be wise to take into account alternative design options. Such options require political choices – development partners would need to support decision-making in these areas with appropriate technical inputs highlighting consequences and requirements for these alternative designs.
 - *(i) if LDFs are to provide conditional funding*, some of the alternatives that could be considered are co-financing modalities among national and subnational governments; as well as sector financing windows which allocate resources towards individual service delivery areas. The main feature of these co-financing mechanisms are to establish percentages of funding for discrete investment projects which would apply for each of the national and subnational levels. Percentages would allow to signal spending priorities in each of the sectors (water, roads, etc..), offering a menu of choice for subnational governments. It would also allow a targeted technical assistance to the self-identified subnational governments.
 - *(ii) If in turn LDFs continue to provide unconditional funding*, the distribution objectives and related horizontal allocation criteria are likely to gain additional weight as design elements. Under this scenario weight would be given to criteria such as per capita allocations or poverty. Distribution in “equal shares” would need to be avoided given undesirable effects on equity. Gaps in subnational capacity would need to be addressed by the respective technical support mechanisms, keeping the distribution of resources focused on the equity objective.
- The level of financial support needs to assess the proper financial impact (“fiscal footprint”) that can be achieved locally; to this end, partnering among donors should be given consideration in order to achieve funding levels which can act as an effective lever to incentivize the choice for development priorities, while also ensuring joint analysis, policy dialogue and implementation in a complex field of resource distribution and service delivery.

Attachments:

- 1.) Concept for LOGIN Seminar
- 2.) Program overview
- 3.) Participant list
- 4.) Country presentations
- 5.) Presentation in forward-looking session – Jonas Frank
- 6.) Comparison of LDF and intergovernmental fiscal approaches – Jonas Frank
- 7.) TOR for duty trip