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Commission

Providing EU budget support in decentralised contexts

A methodological
note



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Introduction

The purpose of this note is to provide complementary analytical guidance for the design of European Union (EU) budget support operations in decentralised partner countries⁽¹⁾. It is based on the principles developed in the European Commission's *Budget support guidelines* of September 2012 and the forthcoming guidance on 'Supporting decentralisation reforms and local/territorial development in partner countries'. The current note complements these guidelines with additional specific technical input.

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

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

This note aims to provide guidance on aspects to be taken into consideration with regard to three types of operations.

- **Budget support to decentralised public service delivery (Type 1 operation):** this corresponds to a 'standard' budget support operation to implement a central government sector policy at the local level and within a given decentralisation arrangement.
- **Budget support to decentralisation reforms and local authority system development (Type 2 operation):** this corresponds to a budget support operation focused on deepening the decentralisation arrangement.
- **Budget support to local authority territorial development policies (Type 3 operation):** this targets implementation of local authorities' own place-based development policies in situations where a sub-national authority enjoys extensive political, administrative and fiscal powers, such as in a federal system. This type of support implies particular risks and preconditions, and experience with it is so far very limited.

Budget support in decentralised contexts should be decided on a case-by-case basis. Before embarking on budget support — particularly support to local authorities' own development policies — Delegations should carefully examine the opportunities and risks involved, including of possible default of sub-national governments. They should also examine the implications of an intervention at the decentralised level on policy dialogue with the central government and on the Delegation's human resource capacities. Type 3 operations

⁽¹⁾ A decentralised country is one that has chosen to undertake a decentralisation reform process of varying scope and depth, is at some stage of the process and maintains some commitment to the reform process. After more than two decades of worldwide decentralization reforms, a large number of EU partner countries fit this broad definition.

should be undertaken only in exceptional cases. They should be submitted to the Budget Support Steering Committee for guidance.

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

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

- **Chapter 1** discusses why budget support operations should help support partner countries' decentralisation reforms and effective local authority systems and sets out the EU policy context.
- **Chapter 2** outlines three typical budget support approaches in decentralised contexts, based on a review and elaboration of the typology suggested by the *Budget support guidelines*.
- **Chapter 3** highlights the specific issues on which to focus when conducting an assessment of the eligibility of budget support operations in decentralised contexts.
- **Chapter 4** highlights the issues that arise when formulating budget support operations in decentralised contexts, including policy dialogue, mobilisation of domestic resources, capacity building, performance assessment frameworks, risk management and accountability mechanisms.

Chapter 1

Why should budget support operations include local authorities?

1.1 Rethinking decentralisation and the developmental role of local authorities

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

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

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

These shifts have in turn shaped a new understanding of local authorities as development actors. As indicated by the above quote from the Busan Outcome Document, local authorities are no longer characterised as just **managerial entities** delivering a set of specific services, but are increasingly recognised as **political bodies** through which local communities exercise their right to local self-government and which are mandated both to help implement national policies in the localities and to develop and implement their own local policies, programmes and projects. As a consequence, local authorities are increasingly seen as critically important **partners** of central government which could both implement and supplement national development efforts.

1.2 Giving equal attention to policies and institutions

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

Past evaluations of budget support operations have pointed to an often ‘missing middle’ in the service delivery system⁽¹⁾ and have called for (i) better understanding of downstream institutional constraints to effective service delivery, (ii) strengthening front-line agents’ capacity and (iii) improving accountability to service users. In decentralising contexts, this also means performing a dynamic assessment of how local authorities could become an **effective component of a multi-actor, local public sector system** and contribute to better and more accountable service delivery.

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

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

1.3 Ensuring EU policy coherence

Budget support operations in decentralising contexts also raise **issues of policy coherence** for both the EU and the international community at large. Relevant EU policy documents emphasise the importance of local authority empowerment. The Commission Communication ‘The future approach to EU budget support to third countries’ (EC, 2011) highlights the need to strengthen the capacity of local authorities to act as an essential component of the state domestic accountability system, thus helping enhance government’s capacity to deliver services to final beneficiaries. Beyond that, the EU has also made a broader commitment to help developmental local authorities. The Commission Communication ‘Empowering local authorities in partner countries for enhanced growth and more effective development outcomes’ (EC, 2013) calls for enhanced political, administrative and fiscal autonomy of local authorities. Decentralisation is seen as an instrument (rather than an end in itself) to unlock the potential of local authorities as a catalyst for local development.

⁽¹⁾ See ODI CAPE (2011); for information on budget support and the role of local authorities as service delivery channels, see ODI (2010).

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

Chapter 2

Approaches to budget support in decentralised contexts

2.1 Options for programming

Based on the typology of interventions presented in Section 2.3.2 of the EU *Budget support guidelines*, three types of budget support operations in decentralised contexts can be identified (see synthesis table in Annex 1).

- **Type 1:** budget support to decentralised public service delivery
- **Type 2:** budget support to decentralisation reforms and local authority system development
- **Type 3:** budget support to local authority territorial development policies.

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

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

2.1.1 Type 1: Budget support to decentralised public service delivery

Under this option, budget support is provided within a given decentralisation framework to help partner countries design and implement **sector** policies and programmes that **rely on decentralised, multilevel delivery systems** and dynamically invest in building such systems.

These programmes seek to develop front-line service delivery capacities across the whole spectrum of the sub-national public sector and would, where feasible, combine (i) the **de-concentration** of programme management responsibilities to sub-national branches of central agencies with (ii) effective forms of contractual **delegation** of key planning and implementation tasks to local authorities. Such programmes thus operationalise the concept of multilevel governance and allow local authorities to bring their comparative advantage (i.e. understanding local priorities and mobilising local resources) to bear in the achievement of national goals. Delegation arrangements might also be an effective way to build local capacities ahead of full **devolution** of specific functions and tasks.

Considerable investment in capacity building is needed to overcome operational difficulties in implementing a national political and policy commitment to decentralised service delivery. Such delivery requires central agencies to shift from a direct implementation role to planning, financing and monitoring programme administration and delivery by de-concentrated agents and local authorities, respectively. It also requires local authorities to act as both partners and agents of the state and to take on a broader development role beyond their more traditional and limited responsibilities, in line with the objectives of the Busan Outcome Document.

2.1.2 Type 2: Budget support to Decentralisation Reforms and local authority system Development

Under this option, budget support is provided to help decentralising partner countries implement decentralisation reforms and strengthen developmental local authority systems.

The scope of these programmes is potentially quite broad, but may vary greatly in practice depending on the political rationale behind the decentralisation reforms, the partner government's understanding of and commitment to genuine local development,⁽¹⁾ and the desired features of the intergovernmental system. Programme objectives may therefore be limited to the development and adoption of national decentralisation strategies and related legislation. Conversely, they may include changes of variable scope and depth with respect to (i) the architecture of the sub-national system of governance and public administration and related accountability relations, (ii) functional assignments, (iii) resource assignments across all levels of government and (iv) human resource management systems and responsibilities. Importantly, programme objectives might also include financial support to performance-based intergovernmental grant mechanisms that enable local authorities to undertake meaningful local development planning and budgeting exercises and build related institutional capacities.

2.1.3 Type 3: Budget support to local authority Territorial development Policies

Under this option, budget support operations help design and implement **place-based policies** to promote local/territorial development⁽²⁾. They support sub-national actors to enable them to plan, finance and implement their own strategic and integrated territorial development plans in situations where a sub-national authority enjoys extensive political, administrative and fiscal powers, such as in a federal system. In designing these budget support operations, dialogue on (i) the policies to be supported, (ii) the capacity-building support needed and (iii) the appropriate performance assessment framework is carried out jointly with the relevant sub-national authorities and the ministry of finance and other relevant agencies representing the central government. Partner government financing and transfer mechanisms should ensure that resources are fully programmable locally.

This option localises budget support and promotes central-local contracts for the development and implementation of place-based development strategies. It can help partner countries tackle increasing spatial and social inequalities and enhance social cohesion and political stability.

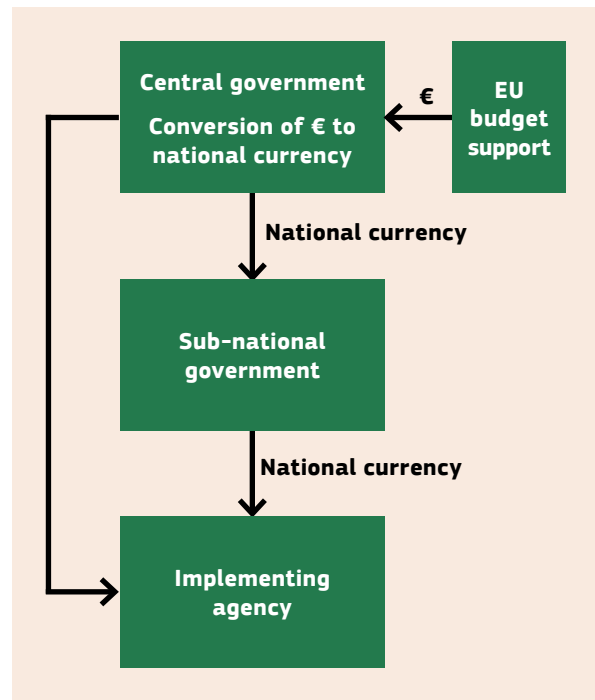
This option requires important conditions to manage the fiduciary and other risks that accompany an advanced level of decentralised responsibility. Specifically, not only is a strong **national policy commitment to local development** needed, but also a well-established sub-national government system with a relatively high degree of **local autonomy and capacity and effective mechanisms for local authority accountability**, including well-developed institutions for financial compliance and effective controls. It is therefore feasible only in relatively more advanced contexts and to benefit larger, more capable, local authorities. Particular attention needs to be paid to rigorous eligibility analysis.

⁽¹⁾ Understood as a necessary complement to national development efforts. For the definition of local development, see the forthcoming EU guidance on 'Supporting decentralisation reforms and local/territorial development in partner countries'.

⁽²⁾ This note uses the definition of place-based policy advanced in an independent report commissioned by the EU Directorate-General for Regional Policy: 'a long-term strategy aimed at tackling persistent underutilisation of potential and reducing persistent social exclusion in specific places through external interventions and multilevel governance. It promotes the supply of integrated goods and services tailored to contexts, and it triggers institutional changes' (Barca, 2009, page vii).

In Type 3 budget support programmes, roles and responsibilities for central and sub-national governments need to be clearly defined. The financing agreement should be signed with the central government (e.g. the ministry of finance), and budget support tranche payments transferred via the central bank to the central government treasury account. Funds should then be transferred within the existing budgetary circuits of the partner country and registered in the budget of the sub-national entity (Figure 2.1).

Figure 2.1 Flow of funds (applicable to all cases)



2.2 Selectivity and flexibility in designing budget support

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

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

2.3 Relevance and suitability of different types of budget support contracts

Different types of contracts may have distinct comparative advantages in providing budget support in decentralising contexts.

- **Sector reform contracts (SRCs)** are broadly applicable to all three types of budget support options and are likely to be the choice in most circumstances. In formulating an SRC, policy dialogue has to take into account both central and sub-national government levels, depending on the type of budget support operation. Meaningful participation of sub-national authorities would typically be operationalised by involving the national associations of local authorities in the policy dialogue on budget support operations. The scope and modalities of such involvement may differ depending on the extent to which local authorities are recognised as **autonomous** partners of state governments.

SRCs may help specific sectors in partner countries (with varying degrees of decentralisation) develop a more effective system of front-line service delivery through a mix of de-concentration, delegation and devolution arrangements. Also, SRCs may assist partner countries in developing their sub-national authority system. SRCs are suitable in the many cases where a local authority system is already in place and is

de facto assimilated to a sector of the national administration. An SRC allows for greater EU involvement in the operationalisation of the relevant national policy and a deeper policy dialogue. It might also be used to support the implementation of territorial development policies of selected local authorities. Policy dialogue on territorial development policies, as well as the scope and modalities for financial transfers, performance assessment and capacity development, will need to be discussed and agreed upon primarily with the beneficiary local authorities jointly with the core ministries/agencies of the central government.

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

- **Good governance and development contracts (GGDCs)** are particularly suited to situations where partner countries need help in embarking on a process of substantial changes in their sub-national governance and public administration system. GGDCs can help in designing decentralisation reforms and establishing the policy, legal and regulatory framework within which local authorities operate. They support improvements in sub-national public financial management and oversight as well as appropriate mechanisms for state support and supervision to local authorities. To the extent that it also seeks to empower sub-national administrations with financial resources, a GGDC supports unconditional transfers and other local authority fiscal empowerment measures to finance local authorities' general mandate for the welfare of their communities, rather than specific service delivery responsibilities.

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

- **State building contracts (SBCs)** are primarily relevant to ensure continued public service delivery to beneficiaries in a post-conflict, fragile or transition situation and to stabilise the regional security environment (Box 2.1). SBCs have a short-term perspective of usually one to two years' duration. Caution is advised regarding the extent and depth of decentralisation reforms that an SBC can support, as the political and administrative complexity of the reforms may overstretch the capacities and limited time frame of governments in fragile and transition situations. However, in some cases of structural fragility and given a pre-existing institutional basis at the sub-national level, SBCs could support improved local governance and local development. This use is possible where

Box 2.1 Mali: State building in a decentralised context

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

The redeployment of local administration in the previously occupied territories of the North constituted a short-term priority to stabilise the region and allow for a return of displaced populations. The SBC made it possible for the government to allocate substantial additional resources to the National Support Fund for Local Government (FNACT), which increased from FCFA 2.5 billion to 10 billion (2013) and 14 billion (2014). These funds allowed local governments to resume their activities and restart essential service provision to the local population.

In parallel, the SBC supported the redeployment of de-concentrated central government services in the North, particularly in the areas of justice administration, water supply, health and food security. Also, local private small and medium-sized enterprises were involved in a road maintenance programme that created around 6 000 temporary employment opportunities for the population in the North.

the empowerment of sub-national authorities may contribute to extending the presence of the state in the regions and to help build the state 'from below'.

Chapter 3

Subnational aspects of eligibility criteria

3.1 Eligibility criteria

According to the 2012 *Budget support guidelines*, approval of all budget support programmes is subject to their meeting a set of eligibility criteria which are defined as the relevance and credibility of:

- the specific national/sector public policies the operations are meant to support
- the macroeconomic policy framework
- the public financial management reform programme
- budget transparency and oversight institutions.

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

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

The *Budget support guidelines* stress that the assessment of eligibility criteria is mandatory for all budget support operations, but that 'the focus may vary according to the specific objectives of the programme'. This chapter seeks to complement the guidelines by highlighting the **specific sub-national issues on which to focus** when assessing eligibility for budget support in decentralised contexts.

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

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

Type 3 operations of support to local authority territorial policies would primarily focus on the sub-national level for public policy, public financial management and budget transparency. Some central aspects may also be of importance, and the analysis has to take into account the division of roles and responsibilities between the central and sub-national levels and their articulation in practice.

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

3.2 Assessing eligibility against the public policy criterion

The 2012 *Budget support guidelines* indicate that all ‘national, sectoral or transversal policies’⁽¹⁾ that are the subject of a budget support operation must help achieve the general objectives of ‘poverty eradication, sustainable and inclusive economic growth, and consolidation of democracies’ and that ‘[t]he effectiveness of a budget support operation is therefore dependent on the relevance and credibility of the policy it supports’. It follows that the relevance and credibility of the public policy to be supported as an instrument to achieve the above general objectives is the first criterion for eligibility that a related budget support operation should satisfy.

Understanding the role that decentralisation may play in poverty alleviation, sustainable and inclusive economic growth and democracy consolidation is a complex task. Country contexts matter, and generalisations are neither warranted nor useful. The conceptual framework to guide such understanding is detailed in a separate guidance document (EC, forthcoming, Chapter 2). In summary, it states that decentralisation reforms (and related changes in local governance systems) in any given country include both **political and developmental considerations**. The immediate objective of the former is political stability (with or without consolidation of local democracy), while that of the latter is local development. The analysis should recognise both dimensions and focus on strengthening possible synergies between the two, depending on the specific country context.

In practice, assessment of the relevance and credibility of a policy, and related budget support operation, for poverty reduction, economic growth and democracy consolidation will need to address a number of programme-specific issues, whose relevance may differ depending on the type of operation being considered. While the specific policy focus may be different (government sector policies or overall decentralisation policy, depending on the type of operation), some overall sub-national determinants of policy relevance and credibility in a decentralised context can be identified. Generally there should be an assessment of the following.

⁽¹⁾ According to the guidelines, typical transversal policies are ‘public sector reform policies’, of which decentralisation is obviously a major example.

3.2.1 Policy framework

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

3.2.2 Policy relevance

- Are the political drivers of decentralisation reforms compatible with and/or supportive of the consolidation of local democracy?
- Is the proposed policy likely to lead to more inclusive and better informed local political deliberations and more participatory policymaking and implementation? How does the policy address the risk of capture of the benefits of decentralisation by local/regional elites?
- Are planning and budgeting processes inclusive in terms of gender equality and the most vulnerable, and do they facilitate the participation of all stakeholders?
- Is the electoral system likely to favour or constrain the emergence of better local political representatives and innovative local development leaders?
- Is the proposed policy likely to reduce or increase territorial imbalances in economic development and social cohesion?
- Is there a national policy commitment to local development as an important complement to national/sector development policy? Does the policy create space for autonomous and accountable local authorities to promote local development?
- Does the policy support localisation of national/sector development goals, policies and programmes? How does it create the incentives and capacities necessary for state agencies to devolve, delegate and monitor implementation of national/sector policies and programmes by local authorities?

- To what extent does the policy support more integrated and effective performance of the local public sector as a whole, as well as the intergovernmental cooperation mechanisms necessary for effective service delivery in a multilevel governance setting?
- How do the functional and resource reassignments supported by the proposed policy deliver greater value for the money in the public service delivery process?
- To what extent does the proposed policy support the establishment of robust mechanisms of local authority accountability to both the state and constituents?

3.2.3 Policy credibility

- What has been the country's track record in implementing decentralisation reforms, local authority system development and local development promotion prior to the design of the proposed policy/programme?
- Does the policy follow a 'whole-of-government' or a sectoral approach to implementation of decentralisation reforms? To what extent do its management arrangements offer a credible approach to resolving inter-ministerial differences and bureaucratic resistance to implementation?
- To what extent is the proposed policy compatible with other national commitments, including both macrolevel and sector policy agreements with the International Monetary Fund and other international development partners?
- Is the policy financing strategy consistent with the country's budgetary framework, and to what extent are the fiscal decentralisation measures it supports realistic and sustainable?
- To what extent does the policy address weaknesses in statistical systems and generate quality data, disaggregated at the sub-national level and, where feasible, for gender and age, to support the effective management and evaluation of decentralised development planning and financing systems?

3.2.4 Policy monitoring and evaluation framework

- Do the performance assessment framework and its review documents issued by the responsible authority provide a sufficient basis for monitoring progress in policy implementation? Depending on the type of operation, the performance assessment framework could cover three categories of results: (i) policy and legal framework development outputs, (ii) national and sub-national institutional development outputs, or (iii) sector/service delivery outputs.
- What analytical products is the programme expected to deliver? Are any additional studies needed?
- Are measures in place to analyse the impact of allocations on gender as well as on inequalities (spatial, rural/urban, income or between specific population groups)?
- Through what modalities is the policy performance assessment framework going to be managed? To what extent might this effectively support policy dialogue and the assessment of budget support disbursement conditions?

3.3 Assessing eligibility against the macroeconomic stability criterion

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

3.3.1 Potential sources of macroeconomic instability

A programme relying on a decentralised arrangement for service delivery or supporting decentralisation reforms and local development may affect macroeconomic conditions in multiple ways. Issues often arise because the central government policy may generate or aggravate a mismatch between responsibilities and resources across levels of government. Relevant questions to be examined include the following.

- **Is decentralisation of expenditures matched by adequate resources?** In certain cases, the centre cannot provide additional revenues (often because it is itself facing fiscal imbalances), limiting the ability of local authorities to meet their new obligations. This situation may certainly apply in the case of a programme supporting a decentralisation process, as this would necessarily require a reassessment of the resources available to sub-national entities. But the same consideration may also be relevant for a programme relying on an existing decentralised arrangement. Indeed, in both cases, sub-national governments may face serious difficulties.
- **Are there fiscal rules or spending limits in place to ensure sub-national fiscal stability?** In the absence of clear fiscal rules (e.g. a balanced budget rule or borrowing and spending limits) from the centre, or a lack of enforceable penalties and/or performance incentives, sub-national governments may adopt a 'soft' budget constraint. The result may be that upward pressures on sub-national public spending translate into unsustainable deficits in expectation of central government bailouts. A key question then is whether the reassignment of fiscal powers that the policy supports is sufficiently large to have a potentially significant impact on the country's fiscal balance and whether effective mechanisms to coordinate central and local fiscal policy (e.g. internal stability pacts) are in place.
- **Is there central government support for local revenue autonomy?** A lack of support would limit the ability of local authorities to increase their own sources of revenue (both tax and non-tax) and create an over-reliance on transfers. This would in turn reduce incentives to internalise the cost of expenditures and adopt responsible fiscal practices and budgetary discipline. A key question is whether the reassignment of fiscal powers supported by the policy is matched by local political incentives and administrative capacities to effectively and efficiently assess and collect local tax revenue, and whether efforts to build such incentives and capacities are included in the policy.
- **Is the design of the equalisation grants mechanism adequate?** Inadequate provisions, including ex post gap filling that incentivises local overspending and the dependence of the grant pool from one or a few sources highly dependent on the economic cycle, may lead to sub-national pro-cyclical spending. More generally, the key question is whether the political system — and the national policy commitment

— provides the necessary autonomy and incentives for local authorities to promote active citizenship and involve civil society and the private sector in local development planning and financing.

- **Do sub-national authorities have the authority to borrow and contract debt?** Even when sub-national levels of government gain greater autonomy, the centre nevertheless maintains some form of financial responsibility for their activities. As a precautionary measure, it is important to assess the monitoring and analytic capacity of sub-national levels. Restrictions should sometimes be introduced on the modalities of their borrowing instruments, possibly through an enforceable ‘golden rule’ (e.g. borrowing should not exceed the level of investment) or the joint assessment and implementation of capital and current expenditures (especially where administrative capacity at the sub-national level is limited). Borrowing in foreign currency by sub-national levels should also be monitored closely, as the centre would bear the foreign exchange risk.
- **May sub-national authorities enter into contingent liabilities that affect future fiscal stability?** In addition to debt, the provision of guarantees by lower levels of government can create difficulties for the centre when an investment fails (this could apply to failed public-private partnerships). Implicit or explicit contingent liabilities eventually assumed by the centre could be extremely high and could be present in essential activities such as heating, water supply, production of electricity, and public transport. A transparent approach to contingent liabilities is critical.

Once an investment has gone astray, there should be mechanisms to address the resulting financial crisis. A formal crisis resolution procedure should be transparent with regard to societal cost and could involve a number of steps, including court appointment of a trustee to take over the financial management of a sub-national government in financial distress. A number of countries have found that a formal procedure for resolving municipal financial crises decreases the societal costs of municipal default. It might also be necessary to curb municipal borrowing, or make borrowing dependent on ministry of finance approval, for an extended probation period while analytical capacity is improved.

A critical question at the central level, especially in the context of a policy that aims at increasing decentralisation, is whether a loss of central control over monetary and fiscal policy — due to far-reaching fiscal decentralisation and/or excessive rigidity in the system of legislated central grants — may **deprive the centre of a sufficiently large share of revenues and expenditures** as to influence aggregate demand or compromise the flexibility needed for macroeconomic policy responses during a fiscal crisis.

3.3.2 Contribution to strengthening macroeconomic resilience

A policy supporting decentralisation and local development may — or may not — help strengthen macroeconomic resilience, depending on context and programme design. Issues that require attention include the following.

- Is the policy expected to contribute to sustainable and inclusive **economic growth** in the given country context, and through which channels? The literature on decentralisation and growth is notoriously inconclusive, making a contextual assessment critical.
- Does the policy reflect, and help operationalise, a national commitment to a **spatially balanced economy**, and how is such a commitment reflected in (i) a national urban agenda supporting the role of cities as economic drivers and (ii) a rural/regional development policy supporting selective spatial integration and urban-rural linkages?
- Does the policy support a greater role of local authorities in promoting **local economic development** as a key instrument to maximise the economic potential of localities, mobilise local resources and enhance national macroeconomic resilience?

3.4 Assessing eligibility against the public financial management criterion

A sound public financial management system is essential to the effective implementation of policies and the achievement of intended outcomes by supporting aggregate fiscal discipline, the strategic allocation of resources and efficient service delivery. With respect to the public financial management eligibility criterion, the specific question posed by a programme that either substantially relies on decentralised public services or supports decentralisation reforms and local development is whether, and to what extent, sub-national public financial management systems may affect the relevance and credibility of the country's overall public financial management programme. Public financial management eligibility assessment must include both central and sub-national aspects. In cases of budget support to sub-national authority territorial policies, a separate, full-fledged analysis of public financial management eligibility at the sub-national level should be undertaken (following the template in Annex 5 of the *Budget support guidelines*).

The sub-national dimensions of public financial management eligibility for budget support involve (i) a public financial management system diagnostic to identify major weaknesses and establish a baseline, and (ii) sub-national aspects with regard to the evaluation of the government's public financial management reform programme.

When assessing eligibility against the public financial management criterion — in particular for the public financial management system diagnostic — EU Delegations draw substantially on information produced by the public financial management performance measurement framework, developed and periodically updated by the Public Expenditure and Financial Accountability (PEFA) Secretariat⁽²⁾. Application of the PEFA Framework at both the national and sub-national levels should provide essential information for assessing eligibility for budget support. Sub-national PEFA assessments should be encouraged where budget support in decentralised contexts is envisaged (see Box 3.1).

In addition, Delegations should take into account other sources of diagnostic work that may inform the assessment of sub-national systems, such as the World Bank's Public Expenditure Tracking Surveys (PETS) of front-line service providers or local governments⁽³⁾. Reports from Supreme Audit Institutions should also be analysed regarding issues related to sub-national entities and follow-up conducted at the sub-national level.

The first basis for the assessment of the sub-national public financial management system is preparation of a **sub-national profile**, as recommended by the PEFA guidelines prior to application of the framework (see template in PEFA, 2016). The profile ensures that assessors understand the legal and regulatory environment within which the sub-national government operates as well as intergovernmental relationships in terms of transfers, revenue and expenditure assignments, borrowing powers and service delivery mandate. The profile should provide an overview of:

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

Based on these facts, assessment of the sub-national aspects of public financial management eligibility then looks at two issues:

⁽²⁾ PEFA Secretariat, 'Supplementary Guidance for Subnational PEFA Assessments', 2016; <http://www.pefa.org/sites/pefa.org/files/SNG%20PEFA%20guide%20revised%2016-03-10%20edited.pdf>.

⁽³⁾ <http://go.worldbank.org/84C1RUHTDO>.

Box 3.1 Sub-national PEFA assessments

Almost 100 sub-national applications of the PEFA methodology had been conducted as of mid-2015, either as part of an overall assessment of public financial management in a country or as a stand-alone exercise for one or more sub-national entities. While there is only one framework, the PEFA programme has produced supplementary guidelines for applying the PEFA Framework for sub-national governments to ensure consistent and appropriate application of the indicators and to provide a sound basis for interpreting findings at the sub-national level; these guidelines are applicable either to an individual sub-national government or to a sample of sub-national governments within a country.

These guidelines address application of the indicator set (to the level of individual dimensions) and propose modifications and additions to the performance report; they also offer suggestions for sampling and aggregation of results. To the extent possible, they attempt to address the wide variety of sub-national government structures that exist. With one exception, the sub-national guidelines follow the definitions set out in the International Monetary Fund's *Government Finance Statistics Manual 2001*, which provides for three levels of government: central; state, provincial or regional; and local. Sub-national government by definition is anything below the national level and thus includes state and local government sectors, but with a provision that these entities 'must be entitled to own assets, raise funds, and incur liabilities by borrowing on their own account. They must also have some discretion over how such funds are spent, and they should be able to appoint their own officers independently of external administrative control' (IMF, 2001, page 14). The exception to this definition is that for the purpose of a PEFA assessment, the right to borrow is not a requirement.

- the **quality** of the system of sub-national expenditure and revenue management, in particular to determine if sufficient assurance exists to justify the provision of budget support at a decentralised level;
- the **dynamics** of public financial management reform policy at the sub-national level, particularly in terms of local commitment and reform implementation and to what extent this enhances or compromises overall country-wide public financial management reform.

3.4.1 Quality of sub-national public financial management system

- **Credibility of the budget:** Is there a coherent regulatory and institutional framework in place for budget management at the decentralised level? What is the process of budget formulation and its articulation with the central-level budget process? Are local authority budgets realistic and implemented as intended? Is there consistency between budgetary allocations and the functional mandates of sub-national entities in accordance with the legal framework for fiscal decentralisation?
- **Comprehensiveness and transparency:** Are local budgets comprehensive, or do extra-budgetary funds exist? Is local fiscal and budget information appropriately accessible to the public? Have local organisations, including women's and children's rights organisations, been consulted on policies and budgets?
- **Policy-based budgeting:** Are sub-national development plans linked to decision making of sub-national deliberative bodies? Are central and sub-national policies reflected in the sub-national programming and budgeting framework? Do medium-term expenditure frameworks exist at the sub-national level? Are they consistent with the medium-term fiscal forecasts at the central level? Are annual budgets consistent with the medium-term budget framework? Are gender and inequality policy priorities integrated in fiscal planning tools such as the medium-term expenditure framework?
- **Predictability and control in budget execution:** Does the sub-national government have the mandate to collect own **revenues/local taxes**, or is the budget entirely financed by transfers from the central

government? What are the different roles and responsibilities (e.g. determination of tax base, tax collection, final benefit of tax receipts) of different levels of government (central administration, de-concentrated services, local government administration), and what are the possible consequences for the incentive structure? Does a revenue-sharing and -redistribution mechanism exist to prevent the widening of inequalities between regions/sub-national entities? What are the **procurement procedures**: do sub-national authorities have their own procurement agencies, or is procurement handled by the de-concentrated services of central ministries? Is there adequate transparency and control over procurement decisions? How is **treasury management** at the sub-national level organised? What is the circuit of financial transfers between the central and sub-national levels, the state of the local banking system, the possibility of and time needed for bank transfers, etc.? Do effective systems for **internal control** of expenditures both with regard to financial compliance and to performance of services exist at the sub-national level?

- **Accounting, recording and reporting:** What is the quality of and capacity for local data production? What is the degree of automation of local data production and the state of information technology infrastructure? How are local data systems linked with central databases (e.g. integrated financial management information system), and how is consistency ensured? Do sub-national authorities produce adequate records and financial reporting on budget execution? Does reporting on budget execution include data and indicators related to gender and inequalities?
- **External scrutiny and audit:** What arrangements exist at the sub-national level for scrutiny of public finances and related accountability of local authorities? Is the sub-national level adequately covered by central control institutions (court of auditors, national parliament), or does it have its own external control mechanisms? Does external audit include financial control as well as performance of services? Do local deliberative bodies and social auditing institutions exercise effective control and stewardship in the use of public funds? Is there an active civil society at the sub-national level contributing to budget processes and oversight?

3.4.2 Subnational aspects of public financial management reform programmes

Relevance of public financial management reform

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

Credibility of public financial management reform

- What is the degree of political ownership of public financial management reform? What are the political drivers, obstacles and interests at the sub-national level?
- How are fraud and corruption being addressed? Do policies and systems effectively reach out to the sub-national level? Do sub-national authorities take an active stance to combat corruption and improve systems?
- What local accountability mechanisms have been put in place?

- Are institutional provisions functional and effective, in particular with regard to clear mandates and definition of responsibilities as well as vertical (from the central to the sub-national level) and horizontal (between different entities at the sub-national level) coordination?
- What is the level of institutional capacities at the sub-national level? What are the priority needs for strengthening capacities?

Dialogue

- What is the quality of the public financial management dialogue at and with the sub-national level?
- What are the entry points, and who are the interlocutors?

3.5 Assessing eligibility against the budget transparency and oversight criterion

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

Some specific issues require additional attention with regard to decentralisation reform policies.

- Is the policy going to affect the transparency and oversight of the **national budget management process**? For example, will it support the establishment and operation of a broad-based local finance commission with representation from the local authority sector? Is it going to improve the transparency of fiscal transfer formulas and related conditions of access/performance?
- Is the policy going to improve the transparency and oversight of the **local budget management process**? For example, will it support local-level participatory budgeting practices, social auditing, and/or appropriate mechanisms of central support and supervision of the local budget formulation and implementation process? Is civil society (including women's and children's organisations) engaged in monitoring, including using media for raising awareness on poor/good performance?
- Are sub-national budgets and timely information on budget execution **accessible to the public**? Are court of auditor reports disseminated? In cases where the local population lacks access to information technology infrastructure, what alternative modalities for transparency have been created at the sub-national level?

Chapter 4

Aspects of budget support formulation in decentralised contexts

4.1 Policy dialogue

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

With respect to **process**, a critical issue is management of the relevant policy by the partner country. Typically, for programmes of budget support to decentralisation reforms, policy dialogue should be carried out at the highest political level and requires the establishment of high-level programme management structures (e.g. in the office of the president or prime minister) as well as active inter-ministerial platforms, where bureaucratic resistance that often threatens policy implementation might be addressed and overcome.

On the other hand, dialogue around a policy to devolve or delegate specific service delivery functions (a Type 1 operation) might take place primarily within the relevant sector ministry, with the finance ministry involved as a key interlocutor. The involvement of the national agency supervising the local authority system is also needed.

When the policy being supported is one of promoting and co-financing local authority place-based territorial development strategies (a Type 3 operation), appropriate platforms will need to be devised for a multi-actor policy dialogue involving the central government and the local authorities which ultimately benefit from the budget support operation.

More generally, local authorities should be able to participate, through their national associations, in policy dialogue on all types of budget support operations in decentralised contexts. The scope and modalities of such participation must be agreed upon when defining the budget support policy dialogue process. The partner government (central or local, depending on the type of operation) should take a strong lead in coordination.

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

With respect to **content**, the policy dialogue should above all be informed by a political economy analysis of the country's efforts to decentralise. The purpose is to understand the political drivers, the opportunities these may open for promoting local autonomy and local development, and the political and bureaucratic resistance that might exist.

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

- Improve the **policy, constitutional, legal and regulatory framework** within which autonomous and accountable local authorities may be able to operate. This may include formulating/revising national decentralisation policies and strategies, undertaking constitutional revisions, and developing local authorities' organic legislation and related detailed regulations.
- Improve the **institutions of sub-national governance and public administration** to fulfil the potential developmental role of local authorities, under given constitutional and legal frameworks. This may include building the local policymaking and implementation institutions (organisations and procedures of local deliberative bodies and administrations). At the outset, priority should be given to improving local resource management (planning, programming, budgeting, procurement, accounting, auditing).
- Improve **sector development outcomes** through better resourced and more capable local authorities. This may include empowering local authorities both to localise and implement national sector programmes and to deliver their own local development policies. The aim is to improve the efficiency of national sector programmes in the locality, and to mobilise additional local resources for investments in local economic development and other local priorities.

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

Specific guidance on policy dialogue in budget support operations is currently being elaborated in the form of an annex to the *Budget support guidelines*. Given the multidimensional and transversal nature of policy dialogue in the framework of budget support in decentralised contexts, there must be close cooperation among the different sections within the Delegations, as well as systematic planning and clear documentation of results of the policy dialogue in order to create and preserve institutional memory (see Box 4.1).

4.2 Financial transfers

All EU budget support operations (including those in decentralised contexts) involve the transfer of financial resources to the general budget (national treasury) of a partner country, upon that country's compliance with the agreed-upon conditions for payment. A substantial share of the national budget is meant to end up on the revenue side of local authorities' budgets to enable them to assume their developmental responsibilities. In practice, national budget systems may foresee different types of financial transfers.

- **General-purpose, fiscal transfer mechanisms**, which, added to own source revenue, enable local authorities to operationalise their general mandate for the welfare of their constituencies and undertake autonomous processes of local development planning and financing.
- **Specific-purpose, conditional and/or matching transfer mechanisms**, providing the means and incentives for local authorities to carry out specific functions (administrative or service delivery) that might be devolved to them.
- **Financial transfer mechanisms associated with a variety of contractual agreements between national and local authorities**, whose scope may range from (i) delegation to local authorities of

Box 4.1 Dominican Republic: multi-actor policy dialogue informed by a sound monitoring system at the local level

The PASCAL Programme (2012–2017) was initially designed as a €14 million SRC to support a national policy aimed at reforming municipal administration in the Dominican Republic, particularly with regard to human resource management. The creative way in which the various budget support inputs were used (i.e. the performance assessment framework, policy dialogue, capacity development, complementary measures) made it possible for the programme to unleash much broader change dynamics. It transformed financial support for managerial improvements into a domestic process of iterative review of municipalities' overall performance in the wider intergovernmental system with all relevant actors and stakeholders involved.

Four factors explain this broader impact. First, from the outset, the policy dialogue was embedded in domestic policy and dialogue processes involving both 'supply-side' organisations (i.e. the Ministry of the Public Administration, different directorates providing technical backstopping) and the 'demand side' (i.e. a network of civil society associations and the association of local authorities, supported through complementary measures). Second, the policy dialogue is being nurtured with empirical evidence provided by SISMAP Municipal, a software tool for monitoring municipal performance against various criteria. This tool soon transformed the nature and scope of the programme as it brought **all** factors affecting the performance of Dominican Republic municipalities (beyond the issue of human resources) and fed this information back into the multi-actor domestic dialogue process. It was thus discovered that many weaknesses at the municipal level originate in the wider intergovernmental system or in inadequate central procedures (e.g. regarding procurement). Third, the EU Delegation staff in charge played an effective role as a trusted facilitator and broker of compromises to move the process forward in an inclusive and transparent way. Finally, PASCAL invested in innovative communication to socialise the content and potential impact of the reform supported for the day-to-day life of citizens.

implementation of specific national programmes or components thereof to (ii) the establishment of broader local development contracts under which territorial development strategies developed and managed by local authorities are co-financed by the central level. These mechanisms have the potential to both effectively localise national development goals and give national visibility and support to local development strategies, thus building effective intergovernmental partnerships for development.

Contractual arrangements differ from the other two categories (general- and specific-purpose mechanisms) on the following grounds.

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

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

4.3 Domestic resource mobilisation at the sub-national level

While decentralisation advocates often stress the potential efficiency gains on the expenditure side of public finances, an equally important rationale for decentralisation policies is their potential to help on the revenue side, improving domestic revenue (and, more broadly, resource) mobilisation. However, while the existence of stable resources is important to local development, these resources also need to be well managed and well spent by local authorities, and capacities to collect and administer own funds must exist. Therefore, a progressive approach should be privileged. An appropriate legal framework for domestic revenue mobilisation at the sub-national level must be in place and should be accompanied with actions to improve local systems for tax administration, and expenditure management and control; to fight against corruption; and to ensure accountability towards taxpayers.

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

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

Meaningful **autonomy** and adequate incentives for local authorities to reach out to communities, civil society and the local private sector may mobilise additional resources for local development through forms of community co-provision and co-production of services, including in-kind contributions, as well as effective public-private partnerships (see Box 4.2).

Box 4.2 Local resource mobilisation beyond local taxation by local authorities

Since 2011, in Yemen, the Empowerment for Local Development programme of the Social Fund for Development has helped local authorities (district councils and administrations) mobilise resources for local development above and beyond revenue from local taxation or fiscal transfers. These additional resources are then applied to projects that enhance the welfare of local communities, protect the environment and promote local economic activity.

As of March 2015, in 51 operating districts out of the 72 eventually targeted by the Empowerment for Local Development programme, and through 640 uzlla development committees and 3 983 village cooperative councils, 12 939 projects costing about USD 7.2 million were identified, included in district plans, financed entirely through local community contributions, and implemented through community contracting modalities. Also, under a district-level 50%-50% co-financing scheme with local communities, 38 public works projects (paving secondary roads, building water tanks and cisterns, rehabilitating and furnishing classrooms and teachers' quarters, etc.) requiring a programme contribution of USD 120 000 mobilised community contributions in materials and labour of about USD 135 000; this exceeded 50% of the total cost.

The future of the Empowerment for Local Development programme will ultimately depend on establishing peace and related security conditions across Yemen. But its early implementation clearly points to the potential that exists, given effective central support and incentives, for empowered local authorities to become key developmental actors and mobilise a wide range of local resources — not least of which, local social capital — bringing them to bear, as a true additionality, in the financing of a country's development efforts.

Source: Yemen Social Development Fund, Empowerment for Local Development annual reports.

Effective empowerment of local stakeholders has the potential to contribute to less costly and more sustainable service delivery by local authorities.

4.4 Capacity development

Capacity development is an essential component of budget support operations. The 2012 *Budget support guidelines* suggest that such support includes a dialogue with partner countries to develop ‘shared views on key [capacity] constraints and [capacity development] opportunities’ as well as ‘providing access to knowledge’.

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

- **Local capacity** itself must be understood as the result of an enabling policy and legal framework, appropriate policymaking and development management institutions, and appropriately skilled and motivated human resources. It follows that capacity development cannot be limited to training efforts. It should also be recognised that despite their interdependence, these dimensions could still be addressed through partial and specific efforts that may not be as comprehensive and coordinated as the ideal case would require.
- The **scope** of capacity building must be understood as covering both the capacity for informed, evidence-based deliberations by elected local councils; and capacity for development management by local executives and administrations. A critical issue in many contexts where decentralisation reforms are incipient or incomplete is the lack of an effective connection and accountability between local policymaking and local executive and administrative action. Efforts to strengthen such linkages should be an important part of local capacity development efforts.
- The **potential beneficiaries** of capacity development efforts are in no way limited to local authorities. Beneficiaries might also include civil society organisations whose capacity to move from confrontation to cooperation with elected local authorities should be supported. A number of core and sector ministries are another critical set of beneficiaries, as their inadequate capacity to appropriately support and supervise local authorities and to manage innovative service delivery delegation contracts is one of the greatest stumbling blocks to the operation of autonomous, accountable and effective local authorities.
- When capacity development efforts are directed to **local administrations**, these should not aim to reproduce locally the structures and functions of the central state administration. Organisational models of local authority administrations may vary depending on the organisation of the local public sector at large, and there is often considerable room for innovating and enhancing public sector efficiency when designing them.
- Similarly, there are no blueprints with respect to the **content and sequencing** of capacity development efforts. Experience shows that, in most situations, capacity development should begin with devising a technically sound, yet participatory and inclusive, cycle of public resource management. This is the bedrock on which capacity for improved service delivery and development management can then be built, in parallel with the capacity to reach out to local populations, civil society organisations and the private sector to involve them in local development planning, finance, implementation and evaluation.
- When developing the capacity development component of budget support operations, a balance should be struck between **supply- and demand-driven approaches**. The former may be necessary to a limited

extent and for specific purposes, but experience shows that its generalisation would be costly and ineffective. Capacity development objectives would be better served by a demand-driven approach by which local authorities could determine their own needs and invest in their own capacity development, accessing as necessary purpose-specific financing windows set up as a component of the national financial transfer system.

- Finally, it is important to note that considerable, and continuing, **field-based experimentation** may be necessary to devise and improve capacity development programmes. Such experimentation might be better carried out through preparatory or complementary project aid operations.

4.5 Performance assessment

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

These indicators should, wherever possible, be outcome (or results) indicators. Input/process indicators and (direct) output indicators may also play a useful complementary role, especially when the programme targets the regulatory framework or when outcome statistics are not considered sufficiently reliable. Impact indicators are, in general, not considered appropriate for conditionality given the potential importance of external factors and possible time lags. The selected indicators must be in line with existing policy data and indicators (i.e. the partner country performance assessment framework) and be coherent with the Directorate-General for International Cooperation and Development (DG DEVCO) results framework. Examples of indicators for budget support in decentralised contexts are provided in Annex 2.

The choice of indicators is obviously crucial for successful implementation of a budget support programme. Only those indicators should be selected for which realistic medium-term targets can be defined. Indicators must also be chosen so that there is no possibility of controversy when results are evaluated. Therefore, only objectively verifiable indicators should be selected in the matrix of results. In all cases, the methodology to collect data needs to be clearly defined. Measuring development results is often complicated by inadequate national statistical systems, which lack capacity for data collection and processing and cannot provide accurate, timely and appropriately disaggregated information. In decentralising contexts, the lack of disaggregated statistical information affects both (i) the ability of national authorities to tailor programmes to local realities and (ii) the ability of local authorities to carry out evidence-based deliberations and undertake sound local development planning. To address such difficulties, some countries have experimented with **local performance assessment systems** that rely on 'bottom-up' community-based data collection and processing. Others have piloted localisation of national statistical systems and indicators⁽¹⁾. Whatever the approach, an effective local data collection and processing system must be part of any realistic sub-national public policy. In this context, it is also important to strengthen capacities for the inclusion of horizontal issues — notably with regard to gender and inequalities — in the collection of data and the use of performance indicators.

Assessing policy performance in decentralised contexts includes measuring progress in creating a regulatory environment which promotes the autonomy and accountability of local authorities, and in building systems and capacities for local democracy and good local governance. Monitoring and evaluating progress along these 'softer' dimensions requires adopting specific and realistic assessment frameworks. This may be facilitated by over two decades of efforts made by the international community to clarify normative principles and develop

⁽¹⁾ See, for example, the ECOLOC programme in West Africa.

assessment frameworks based on them⁽²⁾. The adoption, by partner countries and the EU, of country-specific decentralisation policy and local governance assessment frameworks — and the endorsement of the normative principles which should guide them — can only be the result of sustained, in-depth policy dialogue.

4.6 Risk assessment

Preparation of any EU-funded budget support operation must be informed by a country-level risk management framework which focuses on country systems and aims to identify the risks that may impede achievement of the **general objectives** common to all budget support operations: eradication of poverty, sustainable and inclusive economic growth, and consolidation of democracy. The 2012 *Budget support guidelines* therefore suggest that ‘As the risks are assessed according to the general objectives of budget support in a country, it is not necessary to provide different assessments for different types of BS [budget support] operations’.

However, in order to inform the policy dialogue during the preparation and implementation of budget support in decentralised contexts, it is important to identify in the action document the **specific risks** that may be associated with the emergence of a decentralised, multilevel system of governance and public administration, drawing on the results of the eligibility assessment. Specific risks at the sub-national level could also be identified in the narrative part of the overall risk management framework for budget support. Care should be taken to assign risks to the appropriate level (central versus sub-national) in order to identify potential conflicts and obstacles.

Annex 3 provides a detailed overview of typical risks in decentralised contexts based on the risk categories and dimensions of the country-level risk management framework.

4.7 Accountability

Governments of partner countries should be accountable to both external partners and domestic constituencies for the process and outcomes of all externally funded budget support operations. It is thus essential that effective domestic accountability mechanisms be in place at the local level, and that these be strengthened — as necessary and appropriate — through specific activities that may be included in the budget support operation or carried out through a separate project. These activities would be aimed at supporting national legislative and oversight bodies, internal audit and control institutions, and associations of sub-national authorities and civil society organisations to contribute — as appropriate — in shaping, monitoring and evaluating budget support in decentralised contexts.

In addition to supporting national-level domestic accountability mechanisms and promoting the level of local autonomy necessary for genuine local development to occur, budget support should specifically aim at (i) clearly defining local authorities’ accountability relations, (ii) strengthening state capacity for effective support and supervision of the local authority sector, and (iii) strengthening institutions of public participation and social auditing for local policymaking that enable local constituencies to hold their authorities accountable.

In practice, attention should be given to three types of accountability relations; these may take different forms in different contexts.

⁽²⁾ For a comparative review of local governance assessment frameworks, see UNDP (2009). A decentralisation Diagnostic Framework is also currently being developed by DEVCO-B2.

- **Accountability of local authorities to the state**, which calls for balancing autonomy and accountability, and enabling the state to provide facilitation services and technical assistance, exercise legal and/or opportunity controls, and monitor local authority performance (see Box 4.3). Experience shows that this is often made problematic by overlapping responsibilities and bureaucratic competition between multiple central government agencies.
- **Accountability of local authorities to their constituencies**, which calls for the establishment of participatory planning, budgeting and implementation of local development and service delivery, and for building the capacity of local communities to monitor and audit local authority action.
- **Internal accountability of local executives and administrations to elected councils**, which entails ensuring the connection between policymaking and policy implementation through locally accountable executive and administrative structures. This may be problematic where decentralisation reforms create elected councils, but either fail to provide them with minimal administrative capacity or to assign de-concentrated structures of the state (whose primary accountability remains indeed to the state) the task of formulating and implementing local development policies.

Box 4.3 Peru: mutual accountability for results at the national and regional levels

The EU has provided sector budget support in Peru for implementation of national strategies promoting social inclusion, particularly in the areas of health and child malnutrition. The government sought to creatively integrate the local dimension into the process, taking into account the existence of huge territorial inequalities in the country. In response, it was decided to 'regionalise' the budget support operation. The Ministry of Economy and Finance remained the beneficiary of the budget support and in charge of implementation, yet the measurement of the indicators foreseen for the variable tranche focused on 54 districts of the three poorest regions in Peru. This approach made it possible to adapt indicators to diverging territorial realities and to actively engage regional authorities and other stakeholders around delivery of programme objectives.

To underpin the approach, the Ministry of Economy and Finance concluded specific contractual arrangements with the three regions to establish them as partners in the implementation of the national policy and create relations of mutual accountability to achieve the expected results. The central government thus integrated the local dimension and strengthened sub-national authority responsibility for improving services. The regionalised budget support included complementary measures that focused on strengthening local PEFA assessments and other supporting institutional infrastructure.

Other issues of accountability may need attention in the policy dialogue on budget support in decentralised contexts. For example, a common issue is whether national legislation is aligned with the **principle of non-subordination**, which makes all local authorities accountable to the state (unitary or member of a federation), but no one accountable to another local authority (of higher rank). However, regional or provincial councils are often given the final say on policy decisions made by lower-level districts or municipalities. The implications for local autonomy are obviously very different.

With respect to government accountability to aid providers, budget support in decentralised contexts implies that accountability is effectively **joint**, committing both central and local authorities. This arrangement calls for a forum for policy dialogue on design and implementation of budget support, in which local authorities are effectively represented by their national association or selected/designated authorities, depending on the scope of the programme.

Conclusions

Decentralised countries are here defined as those which have chosen to undertake a decentralisation reform process of varying scope and depth, are at some stage of the process and maintains some commitment to the reform process. After more than two decades of worldwide decentralisation reforms, most EU partner countries fit this broad definition.

EU budget support operations in decentralised countries need to be consistent with the EU policy commitment to strengthen the developmental and democratic role of local authorities. This support may be operationalised through the three types of budget support operations in decentralised contexts identified in Chapter 2. This note also provides a framework within which to assess the eligibility of budget support operations, in terms of four standard EU criteria (policy relevance, macroeconomic sustainability, quality of public financial management system and budget transparency) and reviews general issues of process and content that need to be addressed when preparing these budget support operations.

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

DEVCO B2 (Civil Society and Local Authorities) and DEVCO A4 (Budget Support and Public Finance Management) can support this work by offering expertise through on-site missions and/or remotely from Headquarters and by providing external expertise and consultants for those Delegations requesting these.

Annex 1

Typology of budget support in decentralised contexts (synthesis)

Characteristic	Type 1: Budget support for decentralised service delivery	Type 2: Budget support for decentralisation reforms	Type 3: Budget support for local territorial policies
Objective	Effective front-line service delivery	Reforms and institutional aspects	Implementation of local development/sector policy
Policy to be supported	National sector policy (health, education, etc.)	Decentralisation reform policy	Development policy of local authority
Scope/stage of decentralisation arrangement	Different stages possible; typically, some administrative decentralisation	From initial stages of decentralisation reform	Advanced stages (including political decentralisation) — pre-requirements
Budget support dialogue	Central and sub-national	Central and sub-national	Mainly sub-national
Eligibility assessment	Central and some sub-national aspects	Central and sub-national aspects	Macro: central; public policy, public financial management, transparency: mainly sub-national
Type of contract	SRC; in certain cases, SBC	SRC, GGDC or combination	SRC

Annex 2

Examples of indicators relating to budget support in decentralised contexts

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

The indicators are presented in different sets:

- those common to all types of budget support in decentralised contexts
- those specific (to the greatest extent) to each of the three main types of budget support operations — decentralised service delivery, decentralisation reforms and support to territorial development policies of local authorities

Expected result	Indicator	Data source
Common indicators in decentralised contexts		
Legal environment promoting good local governance and local development	<ul style="list-style-type: none"> ● Legislation and regulation on sub-national authority governance structures, functions and autonomy 	<ul style="list-style-type: none"> ● Legislative records ● President (council of ministers) decisions/ records
Empowered, autonomous local authorities	<ul style="list-style-type: none"> ● Scope of powers and functions assigned to local authorities: List of types of assigned powers and service provision responsibilities ● Degree of local authority autonomy in terms of resource allocation decision making, power to decide on local revenue bases and rates 	<ul style="list-style-type: none"> ● Legislative acts and/or regulations records ● Surveys and assessments ● Local authority activity reports
Local authorities adequately funded	<ul style="list-style-type: none"> ● General-purpose fiscal transfer mechanism in place ● Additional (purpose-specific) fiscal transfer mechanisms in place ● Local own-source revenue system in place (consistent with relevant good practices) ● Increase of own-source revenue share in local authority total budget ● Increase in share of discretionary resources in local authority budgets ● % increase of fiscal transfers to local authorities in total national budget appropriations ● % of fiscal transfers actually disbursed to local authorities ● % of disbursed fiscal transfers actually spent by local authorities 	<ul style="list-style-type: none"> ● Legislative acts and/or regulations records ● Surveys and assessments ● Local authority activity reports ● Public finance records ● Local authority budgets and financial statements
Institutions and capacity for local public expenditure management	<ul style="list-style-type: none"> ● Local planning procedures designed ● User-friendly planning manual developed and used ● Financial management rules and procedures enacted, covering the entire public expenditure management cycle (budgeting, procurement, accounting, cash management, internal control, reporting, etc.) ● Gender- and inequality-responsive budgeting process in place ● % of local authorities with data records on tax assessment bases ● % of local authorities which periodically update their local tax assessment bases 	<ul style="list-style-type: none"> ● Regulations records ● Procedures manuals ● Surveys ● Local authority reports ● Ministry of local government reports ● Ministry of finance reports

Expected result	Indicator	Data source
Adequate operational support and monitoring of institutions and arrangements in place	<ul style="list-style-type: none"> ● Adequate support arrangements recognising local authority autonomy ● Systems of local authority performance monitoring ● Rules and procedures for legality controls of local authorities ● Independent audit of local authority accounts in place and operational ● Anti-corruption mechanisms in place and enforced 	<ul style="list-style-type: none"> ● Official government records ● Procedures manuals ● Performance monitoring and legality controls reports ● Audit reports
Institutions and capacity for democratic participation, transparency and accountability	<ul style="list-style-type: none"> ● Legal provisions to enable citizen participation in governance of local affairs (planning, budgeting processes, social auditing, etc.) ● % of local authorities which enable effective participation of citizens in local authority planning and budgeting ● Arrangements for social auditing of local authority enforced ● % of local authorities which adopted a charter ● % of local authorities disclosing their budgets and financial reports as per established schedules and formats ● % of local authorities disclosing tenders and awarded contracts 	<ul style="list-style-type: none"> ● Official government records ● Planning and budgeting manuals (procedures) ● Local authority performance monitoring manuals (procedures) ● Surveys ● Local authority reports
Specific indicators: Decentralised service delivery		
Enhanced participation of local authority in formulation and implementation of sectoral policies and programmes	<ul style="list-style-type: none"> ● Number of sector policies and programmes involving local authority in their design and implementation ● % of sectoral service delivery budget resources managed by local authority under delegation arrangements 	<ul style="list-style-type: none"> ● Sector policy and programme documents ● Sector ministry reports ● Local authority reports
De-concentrated front-line delivery agents of sector ministries strengthened	<ul style="list-style-type: none"> ● Sector ministry branches established country-wide ● Sector de-concentrated branch activities reflected in sector annual budgets under separate lines ● Coordination mechanisms between local authority and sector de-concentrated branches developed and applied 	<ul style="list-style-type: none"> ● Sector ministry charts ● Sector budgets ● Sector activity reports
Local authority empowered to contribute to design and implementation of sector policies and programmes	<ul style="list-style-type: none"> ● Policy and legislation supporting a multilevel public service delivery system in place ● Sector regulations revised/adjusted to accommodate participation of local authority in sector service delivery ● Specific sectoral service delivery responsibilities delegated to local authority ● Contractual delegation arrangements (local authority-sector) developed and applied ● % of local authorities which have entered into contractual arrangements with sector ministries 	<ul style="list-style-type: none"> ● Sector policy and programme documents ● Functional assignment legislation and/or regulations ● Contracts between local authorities and relevant sector ministries ● Local authority and sector activity reports ● Surveys

Expected result	Indicator	Data source
Specific indicators: decentralisation reforms and local authority system development		
Increased (improved) decentralised public service delivery	<ul style="list-style-type: none"> ● Share of decentralised expenditures in total public finances 	<ul style="list-style-type: none"> ● National budget ● Public finance statements
Public financial management rules and regulations adjusted to account for local authority functions, autonomy and operating modalities	<ul style="list-style-type: none"> ● Evidence of revised public financial management rules and regulations 	<ul style="list-style-type: none"> ● Government records ● Local authority budgets and reports
Sound local governance structure with adequate capacities	<ul style="list-style-type: none"> ● Legal assignment to local authority of (i) a general mandate for local development and (ii) specific local service delivery functions ● Legal empowerment of local authority with meaningful administrative and financial autonomy ● Legal requirements for local authority accountability upwards (to the state) and downwards (to local constituencies) ● Legal requirements for local authority to promote public participation in local policymaking and implementation ● Framework/process for consulting civil society organisations (including women's and children's organisations) in place ● Sound system of local authority performance monitoring (including sanction and reward arrangements) ● Legal requirements for local authority transparency (right to public information, handling of citizen complaints, anti-corruption efforts) 	<ul style="list-style-type: none"> ● Legislation and regulations records
National programme to operationalise decentralisation reform	<ul style="list-style-type: none"> ● National programme adopted ● Institutions foreseen in the national programme established and operational 	<ul style="list-style-type: none"> ● Government records ● National programme document ● Surveys
Enhanced decentralisation process	<ul style="list-style-type: none"> ● Changes to: <ul style="list-style-type: none"> – sub-national governance system architecture – functional assignment across levels of government – resource assignment across levels of government 	<ul style="list-style-type: none"> ● Legislation records ● National budget records
Increased local authority investment in service delivery infrastructure and local development	<ul style="list-style-type: none"> ● Establishment of local authority investment grant financing instruments ● Increased investment budget execution by local authority 	<ul style="list-style-type: none"> ● Legislation/regulations records ● Local authority reports

Expected result	Indicator	Data source
Specific indicators: territorial policies		
Enhanced, equitable territorial development	<ul style="list-style-type: none"> ● Change in per capita investment by local authority across territories ● Change in per capita local authority expenditures across territories ● Establishment of an instrument to measure citizen and business satisfaction with local service delivery ● % increase in number of new local businesses ● Local authority investment in developing economic infrastructure 	<ul style="list-style-type: none"> ● Government statistics ● Local authority reports ● Surveys
Local service delivery improvement	<ul style="list-style-type: none"> ● Types of services being delivered by local authority ● Service coverage (number of citizens disaggregated by age and sex within delivery reach) ● Number of affirmative action measures introduced 	<ul style="list-style-type: none"> ● Government records and statistics ● Local authority activity reports ● Surveys
Local authority capacity to promote territorial development	<ul style="list-style-type: none"> ● Territory-based sub-national planning system designed and applied ● Capacity-building programme for territorial development designed and applied ● Institutions and/or arrangements for supporting local authority in applying territory-based local development adopted and applied 	<ul style="list-style-type: none"> ● Government documents ● Surveys ● Local authority activity reports
Local economic development	<ul style="list-style-type: none"> ● Types of local authority services and investments that are centred on business development ● % of local authorities marketing their territory (business attractiveness) ● % of local authorities entering into partnership with local businesses ● % of local authorities involving communities and the private sector in local service production and/or delivery 	<ul style="list-style-type: none"> ● Government statistics ● Local authority plans and budgets ● Local authority reports ● Surveys
Local environmental management	<ul style="list-style-type: none"> ● Environment-related services provided by local authority ● Capacity-building provided to local authority on mainstreaming climate change in local planning and budgeting processes ● Local authority spending on climate change adaptation and local natural resource management 	<ul style="list-style-type: none"> ● Government records ● Local authority plans and budgets ● Local authority financial statements and reports ● Surveys

Annex 3

Risk management framework

The following table presents an overview of typical risks to decentralisation reform, local governance and local development policies and programmes; the risks listed are indicative, not comprehensive.

Category	Dimension	Risk
Political	<ul style="list-style-type: none"> • Human rights • Democracy • Rule of law • Insecurity and conflict • Gender equality • Children's rights 	<ul style="list-style-type: none"> • Risk of inter-jurisdictional inequalities in the interpretation and upholding of human rights (especially women's and children's rights), particularly in countries with significant ethnic, religious and cultural diversity • Risk of creating pockets of weak local democracy where entrenched local power structures may restrict political contestation and/or participation and the rule of law • Risk of contributing to insecurity and conflict because of inconsistencies and delays in the reform process, which may push regional/local minorities in search of greater autonomy to initiate insurgencies or secessionist movements
Macroeconomic	<ul style="list-style-type: none"> • Macroeconomic policy and financial sector • Debt sustainability • Vulnerability and exogenous shocks 	<ul style="list-style-type: none"> • Risk of mismatch between responsibilities and resources across levels of government, resulting in difficulties in containing public sector spending and reducing public indebtedness • Risk of failure to enforce a hard budgetary constraint for local authorities, resulting in additional pressures on total public spending and/or unsustainable local deficits • Risk of loss of central control over monetary and fiscal policy, due to fiscal decentralisation reforms that may deprive the centre of a share of revenues and expenditures sufficiently large to influence aggregate demand during a fiscal crisis or in the face of external shocks
Developmental	<ul style="list-style-type: none"> • Public policy • Government effectiveness 	<ul style="list-style-type: none"> • Risk of reducing the potential of decentralisation to promote local development by denying effective powers of autonomous policy-making to decentralised authorities • Risks associated with delays and inconsistencies in central-to-local transfer of resources and responsibilities • Risks associated with the lack, or limitation, of capacity of multiple central agencies (ministries of finance, planning and local government, as well as sector agencies) to effectively share and carry out state responsibilities to support and supervise local authorities

Category	Dimension	Risk
Public financial management	<ul style="list-style-type: none"> ● Budget comprehensiveness ● Controls in budget execution ● Procurement ● External audit 	<ul style="list-style-type: none"> ● Risks (both fiduciary and developmental) associated with bureaucratic resistance to new regulations of local planning and financial management that would enable local authorities to be both more autonomous and more accountable ● Risk of inadequate in-house local authority capacity for policy-based planning and budgeting, and supply and demand constraints on securing planning and technical services from other providers in the public, private and non-profit sectors ● Risk of complex or inadequate public procurement rules, which may impede efficient local procurement of goods and services, or even lead to sub-optimal local spending choices in order to circumvent the more burdensome aspects of the regulations ● External scrutiny and audit — Does the programme help establish the appropriate arrangements for scrutiny of local public finances and related accountability of local authorities?
Corruption/ fraud	<ul style="list-style-type: none"> ● Corruption and fraud 	<ul style="list-style-type: none"> ● Risk of elite capture of decentralised governance institutions and related suppression of social participation and auditing institutions, leading to an increase in corruption ● Risk that decentralisation reforms (which may increase opportunities for corruption) are not accompanied by an opening of the political system and a corresponding increase of local political competition (which makes it easier for citizens to detect corrupt officials)

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