THE REPUBLIC OF UGANDA

LOCAL GOVERNMENT FINANCE COMMISSION

ALLOCATION PRINCIPLES, FORMULAE, MODALITIES AND FLOW OF CENTRALGOVERNMENT TRANSFERS

PHASE ONE

Commission Recommendations NO.9 **June 2003**

THE LOCAL GOVERNMENT FINANCE COMMISSION.

Created by the Local Government (Resistance Councils) Statute No. 15 of 1993, Section 44.

Enshrined in the 1995 Uganda Constitution, Article 194.

Enacted in the 1997 Local Governments Act, Sections 75-77.

The Commission was inaugurated in February 1995 by the then Minister of Local Government,
Hon. Jaberi Bidandi Ssali.

MISSION STATEMENT.

To establish an equitable system for allocation of financial resources from the consolidated fund to local governments and promote efficient and effective local revenue mobilization.

ACKNOWLEDGEMENTS.

The role of advising the President on all matters concerning the distribution of revenue between Government and Local Governments; the allocation to each Local Government of money out of the consolidated fund as well as the amount to be allocated as equalization and conditional grants is vested in the Local Government Finance Commission as spelt out in Clause 4 of article 194 of the 1995 Constitution.

In fitting with this constitutional function, the Commission embarked on this study aimed at reviewing and analysing the existing grants and their formulae(Conditional, Unconditional & Equalisation Grants), identifying areas/Grants in need of reforms/adjustments and elaborating principles for the future system of intergovernmental fiscal transfer. This report for this phase provides input for the design issues to be handled by second phase . In performing this task, the Commission saw it fit to involve other stakeholders. These consisted of line ministries; ministries of Finance, Planning & Economic Development and Local Government, local government associations and selected local governments.

The Commission is grateful to all people whose involvement in this work contributed to its success. In particular, we would like to thank the representatives of line ministries whose commitment and work in the initial stages of the study contributed to its success. The Commission is also grateful to its group of technocrats led by the Secretary Mr. Lawrence Banyoya who shaped the big volume of data and information collected by this study into workable recommendations.

In particular, we would like to thank Mr. Musa Basajjabalaba, the team leader for this study, who co-ordinated the study, Mr.Adam Babale, Mr.James Ogwang and Mr Johnson Gumisiriza, who did the analysis AND writing of this report. The Commission is also grateful to Mr. Jesper Steffensen, the International Consultant who provided most technical inputs to this study and Mr. Kevin Curnow, Technical adviser on Fiscal Decentralization Strategy.

Thanks also go to all the Chief Administrative Officers, Town clerks ,Chief Finance Officer and other local government staff of the sample local governments for their co-operation during the data collection process. Similar thanks also go to the entire staff of the Local Government Finance Commission for the support they accorded to the research team during the study.

Last but not least I would like to express gratitude on behalf of the Commission to the Danish Agency for International Development (DANIDA) who funded this work. The Commission is grateful for their continued co-operation and support.

Dr. Dick Odur Kampala, June 2003
Chairman: Local Government Finance Commission

EXECUTIVE SUMMARY

Introduction

One of the major aims of decentralisation is to improve service provision by giving local governments the capacity to plan for themselves as well as mobilise/generate and manage the resources required to implement these plans. However, during the design of the intergovernmental relations, the result of which is sharing of responsibilities among different levels of government, there is usually an imbalance between expenditure responsibilities of local governments and their revenue raising powers, which necessitates transfers from the centre.

Currently there is growing concern that the present Unconditional, Conditional and Equalisation Grants are not serving the purpose for which they were established. In addition, the allocation formulae lack transparency and need to be more closely related to expenditure needs and real cost of service provision in various areas.

Objectives and Methodology

Therefore the general objective of the analysis/study is to improve the effectiveness, promote equity and adequacy of fiscal transfers from the central government to the local governments for poverty reduction.

The specific objective is to establish clear recommendations to Local Government Budget Committee (LGBC) for the review of the allocation formulae of the various conditional, unconditional and equalisation grants.

The scope of the analysis/study was divided into two phases. The first phase covers the following areas: -

?? Review and analysis of the existing grants and their formulae (Conditional, Unconditional & Equalisation Grants).
?? Identify areas/grants in need of reforms/adjustments.
?? Elaborate principles for the future system of intergovernmental fiscal transfers.

The second phase will be a follow-up of the first phase, and will focus on the specific design elements, including: -
?? Design allocation criteria and formulae for each grant.
?? Transfer modalities
?? Institutional issues concerning the grants.

The process of the study/analysis was consultative. A team from Local Government Finance Commission organised consultative meetings and workshops with the stakeholders consisting of technical officials from all line ministries managing conditional grants, the Uganda Local Authorities Association (ULAA), MOLG/Programme Management Unit (PMU), Ministry of Finance, Planning and Economic Development, Ministry of Public Service, NAADS Secretariat, Programme for Modernisation of Agriculture Secretariat (PMA), Royal Netherlands Embassy and USAID to discuss the objectives and how to proceed with of the analysis.

Consultation was also carried out in 40 sample local governments consisting of 20 districts and 20 urban councils. The selection of sample local governments was based on both old and new districts. Geographical coverage and the need to cover stronger and weaker local governments in terms of financial capacity. Each district was selected with its higher urban council.

Summary Findings

The analysis revealed that the PEAP which is Uganda's comprehensive development framework has guides the formulation of Government policy and the corresponding resource allocations since 1997. The PEAP framework consists of four pillars. The 4 pillars are: -

- Fast and sustainable economic growth and structural transformation.
- Good governance and security.
- Increased ability of the poor to raise their incomes.
- Improved quality of life of the poor.

The grant allocation criteria tended to be in line with PEAP to some extent. However, there was insufficient/absence of information on needs of Local Governments

The funds allocated are determined each year for local government grants on a year-to-year basis guided by the Government's long-term view of its poverty alleviation strategy and Sector Medium Term Expenditure Framework (MTEF).

The major problem inherent in the effective allocation of grants is the absence of district level poverty data aggregated for rural and urban local governments.

There are cost variations across the country. These variations particularly affect non-labour items, which have to be transported from Kampala and other locations, such as schoolbooks, medicines, or construction materials.

Recommendations on Allocation Criteria

The study recommends that:

(a) Allocation principle should be in line with sector objectives and Poverty Eradication Action Programme goals.

(b) Allocation criteria should be consistent with the principles of the design of allocation mechanism

(c) Adequate information about the needs of each sector for a LG should be taken into account and this should form the basis of the criteria to be designed for each grant transfer to LGs.

(d) An Established system of financing local governments should be stable in order to enhance stability and predictability to better facilitate local planning and implementation of local government activities.

(e) Poverty indicators as allocation parameters are appropriate because poor households typically rely more on publicly provided services such as health, education.

(f) Allocation of grants should take into account cost variations faced by local governments across the country.

Recommended Principles in the design of Future Grant Allocation Mechanisms in Uganda

The study recommended that for grant system to be relevant and appropriate and sensitive to the needs of the country, the following principles should guide the future design.

(a) Provide revenue adequacy:

(b) Preserving budget autonomy:

(c) Enhancing equity and fairness/Poverty sensitivity:

(d) Stability and predictability:

(e) Simplicity and transparency:

(f) Incentive compatibility:

(g) Focus on service delivery:

(h) Avoid “equal shares”:

(i) Direct Donor intervention to Local Governments should be reflected in the formulae.

Desirable Characteristics of Allocation Factors and Data

(a) Accuracy of data
(b) Regularly updated
(c) Independent source of data
(d) Free of local and national manipulation
(f) Reflects needs or demands
(g) Avoid Double Counting

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Abbreviations

CG:	Central Government
CGR:	Conditional Grants
FDS:	Fiscal Decentralisation Strategy
EG:	Equalisation Grants
LG:	Local Governments
LGBC:	Local Government Budget Committee
LGDP:	Local Government Development Programme
LGFC:	Local Government Finance Commission
UCG:	Unconditional Grants

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Introduction

There has been a growing concern that the present Unconditional, Conditional and Equalisation Grants are not adequately servicing the purpose of establishment of a sufficient level of equity in the opportunities for the local governments to provide their mandatory functions. In addition, that the allocation formulae lack transparency and need to be more closely related to expenditure needs and real cost of service provision in various areas.

Most of the present grants are allocated according to criteria such as number of inhabitants, kilometres of road network, surface area etc, but are not strongly related to the differences in expenditure needs or to reasonably/adequately address the concern of poverty and cost variations.

It was against that background that under the Fiscal Decentralisation Strategy, one of the key activities approved by cabinet is to streamline grants allocation principles and formulae to effectively achieve their objectives under the Poverty Eradication Action Plan. Therefore the study/analysis aims at clarifying the grant allocation principles, review the appropriateness of the present allocation system, the poverty sensitivity of the grant system and the type of data used in the allocation and make recommendations that will guide the design of effective grant allocation formulae.

The report is structured in six chapters, Chapter One provides an overview of all the central transfers to local governments and some of the key reforms under Fiscal Decentralisation Strategy (FDS). Chapter Two, provides the methodology of the study spelling out the objectives of the study, scope of work and the framework for analysis. Chapter three provides the objectives and principles for intergovernmental fiscal transfer systems in Uganda and some international experiences. Chapter four provides a more detailed grant by grant review, Chapter five provides summary of findings and Recommendations while, and chapter Six elaborates on the principles in the design of allocation mechanism.

CHAPTER ONE

Overview of Central Transfers to Local Governments

This section contains an overview of some of the main grants. Chapter four provides a more detailed grant by grant review.

One of the major aims of decentralisation is to improve service provision by giving local governments the capacity to plan for themselves as well as mobilise/generate and manage the resources required to implement these plans. However, during the design of the intergovernmental relations, the result of which is sharing of responsibilities among different levels of government, there is usually an imbalance between expenditure responsibilities of local governments and their revenue raising powers. The result is the inability of local governments to provide adequate levels of public service. Revenue transfers from the central government to local governments must fill the gap. Transfers usually address both vertical and horizontal concerns/objectives. Vertical concerns deals with the distribution of financial resources between the centre and local governments while horizontal concerns deals with the allocation of transfers among local governments.

1.1.1 Central Grants

The Constitution specifies three types of central transfers that are supposed to be given to local governments namely: Unconditional, Conditional and Equalisation grants. At present all are operational, Conditional and unconditional grants in both recurrent and capital/development. The conditional grants are the most dominant contributing, on average, 88% of total transfers to local governments, unconditional grant, 11.6% and equalization grant 0.6%. See table 1 in absolute amounts in thousands and percentages. Development transfers currently (2002/03) constitute 21.2% of total transfers. Of the total development transfers 29.5% are discretional funds (LDG) to local government. The non-sectoral Local Development Grants (LDG) funds are only subjected to accessibility and performance criteria and regular assessments.

1.1.2 History of Central Transfers

Central transfers to local governments began in the fiscal year (FY) 1993/94 with a vote system. Block grants to the local governments were introduced in a phased manner with the first 13 districts in the first phase receiving transfers FY 1993/94. By 1995/96 fiscal year, all the 39 districts by then were receiving unconditional grants for the implementation of a limited range of services devolved to them.

When the 1995 Constitution was promulgated, fiscal decentralization became more pronounced in the law. More services were devolved to local governments (specified in schedule 2 of the 1995 Constitution for central government) and the system of central transfers streamlined. The Constitution in Article 193 provides for the three types of transfers namely; unconditional, conditional and equalisation grants.

1.1.3 Unconditional Grants

This grant is the successor of the block grant. One year after the introduction of a block grant to a local government, it was turned into an unconditional grant. This grant, therefore, became operational in the fiscal year 1993/4 for the first 13 districts in phase one. It is defined both in the Constitution (article 193) and the Local Government Act, 1997 Section 84 (2) as "the minimum grant that shall be paid to local governments to run decentralized services and shall be calculated in the manner specified in the seventh schedule of the Constitution".

The seventh schedule defines the amount paid in a given fiscal year to local government, as the amount paid to them (local government) in the preceding fiscal year for the same items adjusted for general price changes plus or minus the budgeted cost of running added or subtracted services. It caters for both wages and non-wages.

Originally the unconditional grant was distributed based on four parameters given in the table below:

Table1: Distribution of Unconditional Grant

Factor	**Weight**
Child Mortality	40
School going age population	40
General Population	10
Area	10

The formula was in 1998 changed to take into account only population (85%) and surface area (15%). This was done after complaints that the grant formula was unfair and complicated. In addition to the two parameter named above, i.e. population and area, there was also a constant which in 2000/01 financial year was shs. 160 millions per district. The justification for this constant is that the administrative structures in all district local governments are basically the same. For example each district must have a Chief administrative Officer, Chief Finance Officer, District heads of various but standard number of directorates and a District Planner.

Therefore, before the allocation is done based on the 85 % and 15%, the amount of the constant multiplied by the number of districts is subtracted from the total amount available for district unconditional grant. Then the balance is divided into amounts of 85% and 15%. The 85% is then distributed according to population and the 15% is distributed according to area.

The grant has experienced minimal increases in nominal terms, from 40 billion in FY 1995/96 to 77.4 billion in FY 2002/03. Its share in total central transfers has fallen from 34% in 1995/96 to only 11.6% in 2002/03. The grant has in some years not grown according to the legal provision i.e. covering inflation and added or subtracted services.

The ramification of inadequate growth in the unconditional grant has created wage problems for some local governments. From the sample local governments, it has been noted that due to inadequacy in the growth, unconditional grant that is supposed to cover both wage and non-wage is not even adequate for only wages. There are some services for example the local administrative police which consume significant resources in terms of wages but whose responsibility is not clear between the centre and local government. Indeed the sample local governments indicated that this is one of the un-funded mandates.

Information from some local governments experiencing wage problems indicated that some districts have structures that are not sustainable. It was therefore decided by stakeholders that the Ministry of Public service undertakes restructuring of the local governments to provide for structures that the Central Government can ably cater for. However, before the completion of the restructuring by the Ministry of Public Service, and to avoid accumulation of wage arrears, intervention has been carried out for some local governments. Therefore, currently for some local governments that have wage deficits derived from their unconditional grant allocation and their wage bill as reflected in the computerized payroll managed by the Uganda Computer Services have interventions that cover their deficits.

As a long term solution the Ministry of Public Service has now produced a draft of the Restructuring Report. The report provides three model structures. Each local government with technical support from the Ministry of Public Service is supposed to select one which suit its demands. The report is however still under discussion to achieve consensus on critical positions and cost implications. It is expected that when all is agreed, the central government will cover all or an agreed portion of the wage cost of the structures and this cost component will be part of the unconditional grant. It is also hoped that the new structures will take effect in the financial year 2004/05.

It is the view of local governments (sample) that the inadequacy of funding under unconditional grant has affected the operation of district/municipality level departments hence severely eroding the effectiveness of these vital services funded from unconditional grants in enabling local governments tackle poverty reduction programmes.

1.1.4 Conditional Grants

Conditional grants started in the FY 1995/96, with only 4 grants and constituting shs 77 billion i.e. 65% of the total central transfers to local governments.

Currently (2002/03), this grant has grown to 588.17 billion in both recurrent and development expenditures spread in 28 grants and constitute 88.0 per cent of the total transfers. This grant is expected to grow further as has been designed by government as the channel to tackle poverty (PAF).

However, arising from the Fiscal Decentralisation Study carried out and completed in January 2001, a Fiscal Decentralisation Strategy was formulated and approved by Cabinet in June 2002. The Fiscal Decentralisation Strategy (FDS) sets out a framework for increasing autonomy of local governments, improving the effectiveness in local service delivery and sets out the mechanisms for streamlining the financing of local governments.

1.1.5 The key reforms of FDS involve:

- Reviewing holistically the allocation of transfers to ensure that they are equitable, and provide incentives to improve sector service delivery.
- Reduce the number of conditional grants to two per sector at the local government level namely; one recurrent through the recurrent transfer system and one development through the development transfer system.
- Flexibility for local governments to reallocate non-wage recurrent transfers within and across sectors. The current level of flexibility for the pilot local governments is 10%.
- The FDS proposes an integrated, participatory system of planning for sector development grants alongside the local development grant. However, the

medium to long term aim of FDS is to merge the sectoral development grant into the local development grant.

- Broad incentive framework through measuring of sector implementation performance. The general local government assessment also to impact on sector grant allocations.

- Simplified financial accountability and output reporting requirements. The number of bank accounts in local governments will reduce in line with the reduction in grant numbers. Increased focus will be on bookkeeping with a simple system for control of financial commitments introduced to prevent the accumulation of arrears

1.1.6 Sector Conditional Grants

Conditional grants are administered at sectoral levels and below is a summary of grants in each sector. It also includes non sector grants.

Health: There are six conditional grants in the health sector. The non-wage components of these grants are allocated based on three factors namely: Total Population, Donor and NGO spending as well as Human Development Index.

> From the sample local governments (e.g. Sironko), this sector provides off district budget expenditures, which also address district responsibilities. The case in point was the provision of funds to construct 3 health centres, which had not been approved by the district council in the budget. The district council executive thought this was irregular conduct by the Ministry of Health.

Education: There are seven grants disbursed through the district/municipal local governments to the respective recipient institutions. Capitation grants are allocated based on enrolment at fixed rates thus shs. 5,000 for P1 – P3, shs. 8,100 for P4 – P7 per annum and shs. 65 per student per day for secondary schools. Salary grants are budgeted on the basis of centrally determined ratios but actual disbursement are based on teachers in post and on the central payroll.

Roads: This grant until two years ago was only catering for rural feeder roads (district) road maintenance. In 2001/02 it was introduced for urban councils. The grant is allocated based on the kilometres of maintainable roads as well as the terrain (level, rolling and mountainous). The application of the grant now includes rehabilitation, which was not allowed in the past conditionalities. However, the rehabilitation component is not a direct transfer from the ministry of Finance, Planning and Economic Development. It is released by the ministry of works, Housing and Communications.

Agriculture: District Agriculture Extension grant was introduced in the FY 1999/2000. The grant consists of mostly salaries for sub-county-based agricultural extension officers. However, it also consists of a small non-wage conditional grant to operationalise their departments. The wage grant is estimated based on the number of extension officers in post and those expected to be recruited. In the FY 2001/02, NAADS grant was introduced to address extension services with a different mode of service delivery. It is being piloted in some districts and sub-counties. The NAADS grant currently has no allocation formula. It is distributed as uniform per Sub- County, irrespective of size and nature of activity in the local government. PMA non-sectoral conditional grants targeting the production sector has a lot of emphasis on agricultural production. However, PMA being a non-sectoral conditional grant has investment menu, which includes roads, water, bridges etc.

Water: Grants in this sector targets rural water development and small towns water and sanitation. It was introduced in FY 1999/2000, and it is used for expanding water coverage in rural areas and running of small towns water supply systems. The sector has developed an investment plan with a target of providing safe and clean water to 95% of the population nationally by 2015. The rural water grant allocation criteria is not so clear. However, it was pointed out by the Department for Water Development that the grant is allocated to districts based on their water and sanitation needs. The needs have been assessed and an investment plan detailing the resource needs in respect to appropriateness of the technology is in place. The investment plan provides a basis for resource allocation under the principle of **"*some for all and not all for some*"**. Details of how the investment needs were determined are given in section water sector grant.

1.1.7 Non Sectoral Conditional and Discretional Grants

LGDP

Under the LGDP, there is a transfer of non-sectoral grants to LG for investment in infrastructure and service provision. The system has an inbuilt incentive for the LG to spend minimum 80 % of the investments in the PEAP priority areas. LGDP-I or LGDP II is not supposed to equalise all the regional differences in resource endowments and expenditure needs, but as part of the support to the PEAP and in line with the GoU policy, the equity concerns have recently been discussed.

The present horizontal allocation formula for the division of funds between LGs is as follows[1]*:*

Rural:

Districts: Population (85 %) / area factor (15 %)
Sub-Counties: Population (85 %) / area (15 %)
Parishes: Indicative planning figurers (per capita)

Urban:
Urban councils: 100 % based on number of inhabitants.
Divisions: 100 % based on number of inhabitants
IPF for the LLGs based on number of inhabitants

The LDGs are transferred according to these criteria, but vary in size depending on the performance of the LGs (20 % rewards and sanctions). The most well-performing and active LGs in terms of administrative performance, legal compliance etc. tend therefore to receive the highest amount per capita.[2]

Most of the stakeholders consulted during the review supported the aim to review the possibilities of including more poverty sensitive parameters in the horizontal allocation of the LDG. There is a strong wish among many stakeholders to support the poor areas with a low endowment of basic infrastructure and services, and an impression that the present equalisation system alone cannot address this concern. In any case the current equalisation criteria was designed to cover only recurrent costs. This concern has developed over the last years in the light of the fact that districts in the Northern Region have experienced an increase in poverty from 60 % of the population in l997 to 66 % in 2000, while the rest of the country experiences a clear declining trend with an overall average decline in share of people living in poverty in Uganda from 56 % in l992/93 to 35 % l999/2000.[3] The support to poverty sensitive formulae has also been expressed in the various budget speeches and in the background documents to the budget and progress reviews of the PEAP.[4]

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[1] It should be mentioned that the UNCDF supported District Development Project – Pilot (DDP) used another formula namely: Population (20 %), land area (15 %), number of school going age children (25 %), and prevalent child mortality (40%). It is not exactly clear how these weights are calculated, and the data is not available for all districts.
[2] Some of the weaker districts in terms of LG revenues, poverty indicators etc. have managed to perform well and some of the better off areas have had problems with the assessment, indicating that there is not direct link between the economical situation and the "scores" in the assessment system
[3] Cf. "A New Formula for Poverty Eradication ? Part 1: Sectoral Conditional Grants, 2nd consultative draft, PMAU, MoFPED, November 2001.
[4] E.g. Summary of Background to the Budget 2001/02 – Uganda Poverty Reduction Strategy Paper, Progress Report, April 2002, Ministry of Finance Planning and Economic Development. See also Annex 2 of the LGDP Preparatory Work, September 2002.

On the other hand, there is also a widespread wish to maintain a simple and transparent allocation system - both at the LG and CG levels and an increasing concern about the extent to which the large transfers of funds to specific LGs are sustainable and whether the absorption capacity is available at the LG level. Arguments against changing the formula were also expressed. It was argued that the LGDP allocation formula should not be reviewed in isolation but rather be revised as part of the review of all grants to LG. A new LGDP-formula may or may not be in accordance with the results of the coming larger review of the Unconditional Grant (UG), Equalisation Grant (EQ) and other grants as part of the FDS implementation and adjustments to this formula as part of this reform may be needed. Hence, the various formulae are mutually interrelated and should be reviewed in a holistic way, in order to ensure the right balance between equity, efficiency (sustainability), objectivity, and simplicity in the allocation system. According to this line of thoughts, if the grant formulae are not reviewed holistically, it will be a great challenge to ensure the proper balance of considerations.

1.1.8 Dutch Grant

This grant is currently accessed by nine local governments in the northern part of the country namely; Arua, Nebbi, Yumbe, Adjumani, Moyo, Lira, Soroti, Kaberamaido and Katakwi. It is a budget support grant. The allocation to individual local governments was made using the equalisation grant formula. It is expected to be folded into the LGDP II grants from July 2003.

1.1.9 Equalisation Grant

This grant according to Clause 4 of Article 193 of the 1995 Constitution (elaborated on in Section 84 of the Local government Act of 1997) is defined as "..money to be paid to local governments for giving subsidies or making special provisions for the least developed districts; and shall be based on the degree to which a local government is lagging behind the national average standard for a particular service".

It was introduced in 1999/2000 after a study by the Local Government Finance Commission (LGFC) which put in place modalities for identifying beneficiaries and the respective amounts. The study covered all the 45 districts. A similar study was done for urban councils. The principles for both district and urban equalisation are the same. They only differ in the nature of services and the weighting of parameters.

The Commission documented that in Uganda, wide disparities exist in revenue potentials and expenditure needs of local governments and thus in abilities of local governments to provide services. The table below specifies the criteria being used in the equalisation formula on the expenditure needs side.

Table 2: Expenditure Needs Equalisation

Criteria for Expenditure Equalisation	Weight
Total Population	0.3885
Population (5-14 yrs)	0.3978
Population (15-19 yrs)	0.1305
Population (0-4 yrs)	0.0385
Km of District Roads/Per Unit Population	0.0219
District Area	0.0122
Crop Acreage	0.0025
Livestock Population	0.0025
No. of Landing Sites	0.0020

Source: Introduction of Equalisation Grant Report 1999.

The revenue potential equalisation applied the household expenditure per capita as a proxy for income and graduated tax rates in a system of representative tax. Only Graduated tax was used as it contributes about 80% of all locally collected revenue.

Currently 34 out of 56 district and 40 out of 73 urban local governments benefit from this grant. This FY they shared shs. 4.33 million. The amount of the grant payable to each district beneficiary range between 16 million in Sironko and Ushs 244 million for Gulu. For urban councils, it ranges between 4.8 million for Moyo and 70 million in Ntungamo. It is important to note that the spread of the grant is so thin that the impact may not be realised. Therefore the importance of the grant is becoming a concern to various stakeholders.

However, it is important highlight some of the misallocation the grant has encountered. The grant has been misinterpreted by some circles to suit their circumstances. For example it is regarded as one that should absorb all shocks that may come up in local government operations. It has also been given to some districts for financial relief to insurgent areas. It is funding start-up funds for newly set up local governments. It has also provided funds to local governments destabilised by cattle rustling. Finally, the grants is too small to cover the vertical fiscal gaps and the differences in expenditure need across local governments.

There are also some fundamental questions to be considered. For example, what are we equalizing? What is the impact? Can we limit the number of beneficiaries such that a few benefits? What is the monitoring framework? Others stakeholders interviewed found that the formula is complicated and want it simplified. These and other issues are the subject that need to be addressed to streamline the grant in the light of the theory, practice in Uganda and abroad.

1.1.10 Government Grants Focus

In the past, government's focus on poverty eradication was biased towards rural areas where it was believed to be rampant. It was therefore assumed that government should concentrate on programmes in rural local governments in order to make an impact on poverty eradication. However, with the output of participatory poverty assessment exercises, it was realised that urban poverty needed serious attention. For two years now PAF grants have been allocated to urban councils within the field of roads and water and the LGDP grants have also taken the higher investment needs of the urban councils into consideration in the vertical and horizontal division of funds. However, the parameters for allocation of conditional grants to urban areas in general needs to be revisited, as their conditions and focus are quite different from rural local governments. In case of roads, urban councils are categorised in sizes and each local government in a group given same amounts.

It should be noted that the objectives of these conditional grants are all very clear and are meant to guarantee a minimum level of expenditure in each of the five sectors that have been designated as government priority programme areas (PPAs). These include primary education, primary health care, district (feeder) roads, rural water, sanitation and agricultural extension. Recently, functional adult literacy has been added on the list.

However, whatever the justifications for the growth in the conditional grants, the nature of conditionalities inherent in them cause considerably transaction costs both at the local government level and central government level. Often the local governments spend long man-hours on paper work and in meetings with the different teams from the line ministries trying to conform to conditionalities attached to their use. Different bank accounts as well as books of accounts have to be opened for each grant to be in line with the Local Government Financial and Accounting Regulations. The conditionalities for each conditional grant often cover several pages bound into a booklet. Finally, the limited flexibility across the sectors and within the sectors have caused inefficiency in allocation and limited possibilities to adjust the services to the local needs.

These and other problems are what prompted the design of the Fiscal Decentralisation Strategy (FDS). The strategy was designed to streamline transfers to local governments by promoting autonomy, flexibility, participation, and transparency in decisions by local government to effectively and efficiently deliver services.

1.1.11 Overview of the Trend in Grants:

Table 3: Trends in Amount and Share of Central Government Transfers[5]

Grants	FA 1997/1998		FA 1998/1999		FA 1999/2000		FA 2000/01		B2001/2002		B2002/2003	
	UGSH	Share	UGSH	Share	UGSH	Share	UGSH	Share	UGSH	Share	UGSH	Share
Uncond. Grants	54.3	24 %	64.4	23 %	66.8	17 %	79.1	15%	86.5	14 %	77.4	11.6 %
Cond. recur. Grants	168.4	75 %	202.1	71 %	275.2	71%	321.3	63 %	388.9	63 %	434.6	64.9 %
CG–Dev´t. Grants (*	2.2	1 %	18.8	7 %	45.0	12 %	107.8	21 %	133.1	22 %	152.7**	22.8 %
Equal. Grants	0.0	0.0	0.0	0 %	2.0	0.5 %	4.0	0.8 %	4.4	0.7 %	4.3	0.6 %
Total	224.9	100 %	285.2	100 %	389.0	100 %	512.2	100 %	613.2	100 %	669.9	100 %

Sources: MOFPED, ULAA, LGFC, and calculations from the Fiscal decentralisation Study: , LGDP MTR Programme Review February 2002 : Final Account Figures, l997/98, 1998/99, 1999/2000 and budget figures for 2000/01 and 20001/2002. Budget Speech MoFPED, June 2002, MoFPED, Budget Release New Vision July 1, 2002. Rural and urban grant for maintenance classified under recurrent grants. (*) LGDP is a part of the CG Devt. Grants. FA= Final Accounts, (**)50 % of the road grant (50 % of 20.9 B) counted as development.

The table above shows that the relative share of the *discretionary* recurrent funding – Unconditional grants and equalisation grants – is declining over the

[5] Source: LGPD, Preparation of the LGDP, September 2002, Annex 2 Local Development Grant

years from l997/98 to 2002/03, e.g. from 14.7 % in B 2001/02 to 12.2 % in B 2002/03.

The decentralisation of **development grants** started later in the process of fiscal decentralisation, but is gradually being decentralised from approx. 2 % of the transfers in l997/98 to approx. 23 % in B 2002/03. The discretionary development grants account for approx. 32 % of the total development grants.

1.1.12 Conclusions

In conclusion, local governments are receiving the three types of grants. However, the configuration and trend of grants need redress as noted in the Fiscal Decentralisation Study. This initiative therefore needs to redefine the allocation principles that are in line with respective sector objectives and are in line with the Poverty Eradication Action Program goals. The formulae should also address the horizontal imbalances for them to be instruments of targeting absolute poverty eradication. The fundamental problem in the allocation formulae however seems to stem from inadequate information about the needs and revenue potential of each local governments.

CHAPTER TWO

METHODOLOGY

There has been a growing concern that the present Unconditional, Conditional and Equalisation Grants are not adequately servicing the purpose of establishment of a sufficient level of equity in the opportunities for the local governments to provide their mandatory functions. In addition, that the allocation formulae lack transparency and need to be more closely related to expenditure needs and real cost of service provision in various areas.

Most of the present grants are allocated according to criteria such as number of inhabitants, kilometres of road network, surface area etc, but are not strongly related to the differences in expenditure needs or to reasonably/adequately address the concern of poverty and cost variations.

It was against that background that under the Fiscal Decentralisation Strategy, one of the key activities approved by cabinet is to streamline grants allocation principles and formulae to effectively achieve their objectives under the Poverty Eradication Action Plan. Therefore the study/analysis aims at clarifying the grant allocation principles, review the appropriateness of the present allocation system, the poverty sensitivity of the grant system and the type of data used in the allocation and make recommendations that will guide the design of effective grant allocation formulae.

2.1.1 Objective

The general objective of the analysis is to improve the effectiveness, promote equity and adequacy of fiscal transfers from the central government to the local governments for poverty reduction.

The specific objective is to establish clear recommendations to Local Government Budget Committee (LGBC) for the review of the allocation formulae of the various conditional, unconditional and equalisation grants.

2.1.2 Scope of Work

To review/annualise the allocation criteria, the study is divided into two phases. The first phase covers the following areas: -

?? Review and analysis of the existing grants and their formulae (Conditional, Unconditional & Equalization Grants).
?? Identify areas/grants in need of reforms/adjustments.

?? Elaborate principles for the future system of intergovernmental fiscal transfers.

The second phase will be a follow-up of the first phase, and will focus on the specific design elements, including: -

?? Design allocation criteria and formulae for each grant.
?? Transfer modalities
?? Institutional issues concerning the grants.

This Report describes the main findings of the first phase and provides input for the design issues to be handled by the second phase

2.1.3 Consultations with the stakeholders

Team from Local Government Finance Commission organised consultative meetings and workshops with the stakeholders consisting of technical officials from the ministries of Health, Education &Sports, Works, Housing & Communication, Agriculture, Animal Industry and Fisheries, Gender, Labour and Social Development, Water, Lands and Environments, Uganda Local Authorities Association (ULAA), MOLG/Programme Management Unit (PMU), NAADS, Programme for Modernisation of Agriculture (PMA), Royal Netherlands Embassy and USAID to discuss the objectives and how to proceed with of the analysis.

Development and administrating of the questionnaire

Two sets of questionnaires were developed for data collection, one for ministries and central institutions and the other for local governments.

2.1.4 Sample Local Governments

The selection of sample local governments was based on both old and new districts. Geographical coverage and the wish to cover stronger and weaker local governments in terms of financial capacity. Each district was selected with its higher urban council.

Table4 : Sample Local Governments

No	District	Urban
1	Kabarole	Fort Portal Municipality
2	Kisoro	Kisoro Town Council
3	Mubende	Mubende Town Council
4	Luwero	Luwero Town Council
5	Pallisa	Pallisa Town Council
6	Kumi	Kumi Town Council
7	Kaberamaido	Kaberamaido Town Council
8	Busia	Busia Town Council

9	**Apac**	**Apac Town Council**
10	**Masindi**	**Masindi Town Council**
11	**Sironko**	**Sironko Town Council**
12	**Sembabule**	**Sembabule Town Council**
13	**Mbale**	**Mbale Municipality**
14	**Tororo**	**Tororo Municipality**
15	**Mbarara**	**Mbarara Municipality**
16	**Ntungamo**	**Ntungamo Town Council**
17	**Hoima**	**Hoima Town Council**
18	**Rakai**	**Rakai Town Council**
19	**Kamuli**	**Kamuli Town Council**
20	**Iganga**	**Iganga Town Council**

2.1.5 Field visits

To carry out a comprehensive analysis, the Team visited ministries, central institutions and local governments to collect data. A total of twenty district local governments with their higher urban councils were visited between October 2002 and April 2003, to administer the Questionnaires.

2.1.6 Framework for Analysis

In order to analyse the grant systems, the following steps had to be followed :

Identify the Specific Objectives of each type of sectoral conditional transfer

A conditional transfer system can have a number of objectives. Among the common ones are:

?? To encourage a minimum level of expenditures in a particular sector, e.g. a minimum level of health expenditures for all local residents, a minimum level of education expenditures for all students at various levels, a minimum level of maintenance expenditures for all existing roads, etc.

?? To finance a particular sub-sector within the broader sector, e.g. preventive medicine, primary education, agricultural access roads, communal water standpipes in villages, etc.

?? To finance a particular line item within a sector, e.g. salaries of teachers or health care practitioners, medicines, veterinary vaccines, etc.

?? To target particular segments of the population, e.g. households below the poverty line, the elderly, people living in urban slum areas, etc.

Document the Current Allocation Mechanism for Each Type of Sectoral Conditional Transfer Programme

Conditional transfers can be allocated in a number of ways. The second step in conducting an analysis of the system is to document the current method for allocating resources/grants

Allocation can be based on one or more of the following criteria, among others:

?? Availability of resources: this is particularly relevant when an external donor places special conditions on the use of resources, either in terms of the type of expenditures allowed or the geographic areas where resources can be directed.
?? Ad hoc criteria: this means that the allocation of resources is done on a discretionary, often subjective, basis (without fixed allocation criteria) by a particular individual or committee.
?? General need characteristics: these include broad measures of (possible) need, such as population, number of poor households, geographic area size, etc.
?? Specific need characteristics: these come in many forms and can be related to service inputs, outputs, or outcomes, but they are usually sector specific e.g. number of teachers that need to be paid, miles of roads that need to be maintained, number of households currently serviced with water, morbidity rates, literacy rates, etc.
?? Costed norms: this approach tries to define a minimum service level or expenditure level for a particular sector or sub-sector and to attach a "normal" cost that must typically be incurred too provide it.

The current allocation mechanism (s) for the transfer has been *be* documented in each particular sector.

Evaluate the Suitability of the Allocation Criteria Relative to the Intended Objectives of Each Type of Sectoral Conditional Transfer Programme (if stated).

Even a well-specified allocation mechanism is not necessarily appropriate for achieving the sectoral goals. Each transfer needs to be evaluated relative to its intended objectives. This requires answering a number of questions:

?? Are the allocation criteria appropriate to meet the specific objectives of the transfer programme? If poverty alleviation is an intended objective, for example, allocation of a transfer for health services according to the total general population is not likely to achieve this objective. On the other hand, if targeting the most poorly served places is a top priority, then allocation of a development transfer programme for water supply inversely with respect to the percentage of the population served is an appropriate measure for allocation. If objectives are not clearly specified, an attempt should be made to estimate the impact of the allocation criteria on a set of reasonable presumed objectives of a particular sector.

?? Are the allocation criteria adequately transparent and simple, so that all local governments can clearly understand why they receive a particular allocation of resources in a specific sector?

?? Are reliable data available to quantify the variables used in the allocation formula? (The implication is that if reliable data are not available, it may be preferable to use different variables in the formula even if the official ones would best measure need if they were available in a reliable form).

Evaluate the Application of the Allocation Formula Used for Each Type of
Sectoral Conditional Transfer.

Even if allocation formula is appropriately specified to meet the stated objectives Of a transfer programme and reliable data are available to apply it, there is no Guarantee that the formula is being properly used and having its intended Effects. A number of questions are relevant in this regard.

?? Are the defined allocation rules actually followed in practice? If not, what type(s) of deviation(s) from the rules occur?

?? Why do these deviations occur? It could be, for example, that staff members are not properly trained or that political decisions take preference over the allocations that result from application of the allocation formula.

?? What are the likely effects of these deviations? How much do they actually hinder attaining the intended objectives of a transfer system? (Note that in some cases where the allocation mechanism is improperly defined, not following it could result in a preferable allocation of resources).

Assumptions

Analysis is done from data received from sample local governments assumed to be representative of all the local governments in Uganda.

CHAPTER THREE

Objectives and Principles for the Intergovernmental Fiscal Transfer System in Uganda

3.1.1 Introduction

Design of systems of intergovernmental fiscal transfers[6] is generally recognized as being one of the most challenging tasks within public finance. The specific manner in which a transfer system is developed is often based on a complex mixture of political choice, economic principles, historical reasons and country contextual factors (including the size and structure of the system of LGs). The design of appropriate allocation criteria and formulas is probably one of the most daunting tasks within the field of LG finance. Nevertheless, it is of great importance for the achievement of the fiscal decentralization objectives and should be closely realigned with these objectives.

In Uganda, the Constitution, 1995 (Article 193 and the Seventh Schedule) and the Local Government Act, 1997 (Article 84) specify three types of grants from CG to LGs: 1) Unconditional grant (UCG), 2) Conditional Grants (CGR) and 3) Equalisation Grants (EG).

The system of intergovernmental fiscal transfers has been developed gradually since 1995/96 to a system comprising all three types of grants and a variety of other related grants, the so-called "second generation" grants like the development grants (LGDP grants, PMA -Non-sectoral grants, NAAD´s grants and various district support schemes). The LGs have been increasingly dependant on transfers, which now contribute more than 85 % of LG income.

Caused by increasing problems with the existing transfer system, especially lack of LG autonomy, lack of ownership and downwards accountability, proliferation of reporting systems and modalities and related high administrative transaction costs, a comprehensive Study of the present transfer system was completed in January 2001[7]. Following the completion of this Study, the GoU convened a Working Group in order to operationalise the recommendations of the Study. This work was completed by the adoption of the GoU´s Fiscal Transfer Strategy[8] by the Cabinet of Ministers in June 2002. This Strategy outlines the objectives and principles for the future system of intergovernmental fiscal transfers as well as specific adjustments of the existing system. As part of this Strategy is was

[6] The words "transfers" and "grants" are used interchangeable.
[7] " Fiscal Decentralisation in Uganda – The Way Forward", Final Report, January 2001.
[8] " Fiscal Decentralisation in Uganda- The Draft Strategy Paper, March 2002, Prepared by the Fiscal Decentralisation Working Group.

decided to review the overall criteria for the allocation of funds to LGs to ensure that they are more poverty focused, that they enable the achievement of sector goals and that there is a better balance between discretionary and non-discretionary funds.

This present Study – Phase I - will provide the first input to this review by analysing the existing allocation criteria and outlining the general principles behind the future system. A second phase of the Study will design a framework and recommend specific criteria and criteria weights for the future allotment of funds amongst the LGs. The Study will focus on the allotment of available funds (horizontal distribution), not the overall size of pool of resources. [9]

Firstly, this chapter will review the theory, particularly the objectives behind any system of intergovernmental fiscal transfers, provide a theoretical typology of transfers and outline possible allocation criteria. Secondly, the chapter will contain a brief overview of relevant experiences on allocation criteria from various countries which have developed or are developing new transfers systems. Thirdly, the general principles behind the future system will be reviewed, discussed and defined. Finally, the implications of this for the future Ugandan system of intergovernmental fiscal transfers and challenges, expected on the "road" to reform, will also be analysed and basic general design features discussed in a country specific context.

Theory – Objectives , Typology of Grants and Allocation Criteria

Objectives

It is paramount for any system of intergovernmental fiscal transfers that the objectives of the transfer system are clearly spelled out and that the system itself reflect these objectives.

The **objectives** of a transfer system can be grouped as follows[10]:

?? *Correcting or adjusting vertical imbalances* – closing the fiscal gap. The transfers may be used to ensure that LGs have adequate revenues to discharge designated functions (expenditure needs), especially as other types of revenues (taxes, user fees, charges etc.) cannot generate adequate revenue for LGs due to various reasons;

[9] This has been reviewed as part of the Revenue Sharing Study Phase I and II, November 2000 and June 2002. The studies are conducted and published by the Local Government Finance Commission.

[10] Cf. e.g. Performance Grant Agreement in Improving Local Government Service Delivery, Michael Shaeffer, INFUD, Hirokaiki Suzuki, SAFIN, The World Bank, 2000; and "Intergovernmental Fiscal Transfers: Some Lessons from International Experiences" by Richard M. Bird and Michael Smart, University of Toronto, February 2001.

- ?? *Correcting or adjusting horizontal imbalances*[11] – equalisation. Transfers maybe used to "equalise" the LG conditions for service provision and to bring the LGs closer to a situation where all of them, potentially, have about the same ability to provide basic services to the citizens. Extra resources are transferred to LGs with lower tax capacity and/or higher expenditure needs;
- ?? *Correcting or adjusting externalities with public goods provision*. Grants may be used to compensate LGs for services they provide, which impact areas beyond their jurisdictions i.e. where there are positive or negative spill over effects, e.g. grants could be provided to ensure that sufficient educational services are provided, and that the environment is sufficiently taken care of. LGs tend to look only to their own needs, ignoring the impact this may have on other LGs. This lead to a sub-optimal overall provision of services in a country. E.g. the provision of education services in a LG may benefit other parts of the country (positive impact) and environmental pollution may affect areas beyond the LG borders (negative impact);
- ?? *Related to the third objective, coordinating and influencing LG spending with central government goals*. Various forms of grants may be used to stimulate LG spending within national priority areas. It is important to stress that a transfer system should as much as possible ensure budget autonomy and flexibility at the LG level;
- ?? *Ensuring efficiency in LG taxation, financial management and expenditure*. It is important that transfers do not create negative incentives for LG taxation and expenditure management. Grants may be used to stimulate LG performance, e.g. within the area of tax effort and financial management;
- ?? *Providing central government with adequate flexibility to pursue macroeconomic stabilization policy and influence the activity level within the LG sector*. The CG may wish to ensure that the overall activity level in the national economy can be influenced, and the size and distribution of the fiscal transfers may be an important element hereof. This objective should be balanced with another objective, which is to ensure that the transfers are predictable, stable and transparent.

[11] References is made to: The Reform of Intergovernmental Fiscal Relations in Developing and emerging Market Economies, Anwar Shah, The World Bank, 1994, for a review of the importance of LG equalisation systems, especially in developing countries. Equalisation systems equalise net fiscal benefits across LG (promote equity) and discourage fiscally enduced migration, reduce barriers to factor mobility and thereby, if properly designed facilitated economic efficiency

3.1.2 Typology of Transfers

In theory and practise there is no uniform classification of transfers, but the typology below, gives an overview of most applied grants/transfers[12]:

Grants

A) Specific Grants **B) General Grants**

(conditional/earmarked) (Unconditional /Block)

A1) Lump Sum A2) Matching B1) Lump-sum B2) Matching[13]

(Non-matching) (financial contr.) General grants Financial contribution

[12] The classification is a further development of the typology made by Stephen J. Bailley, "Local Government Economics – Principles and Practise", Glasgow Caledonian University, Macmillan, 1999. The focus in this paper is on the allocation principles, but the typology may give a brief overview of some of the key types of grants.

[13] This type is very seldom, but is experienced concerning general purpose development grants, where certain countries demands co-financing up front or along the investments made.

Effort Not effort Effort Not effort Effort Not effort Effort
Not effort
related related related related
related related related related

Closed Open Closed Open closed Open closed open
Ended Ended Ended Ended ended
ended ended ended

The first division is whether the grants are specific, i.e. the grants can only be spent on specific purposes or general, i.e. the grants may be used to finance a broad range of services. Within each of these broad categories[14] there may be an additional division in grants for development (sector-specific and non-sectoral grants) and grants for recurrent (sector specific or non-sector specific). Second, the grants may either be lump-sum, i.e. a fixed amount, or based on the matching principle, implying that the LGs have to cover a given percentage of the expenses, e.g. 5-10 %. In addition both the lump-sum and matching grants may be dependant on the LG effort, e.g. the tax effort or financial management efforts (reporting standards, etc.) or service output measures. The matching grants can be closed ended, i.e. there is an upper limit on the grant or open ended, depending on the actual costs and efforts by LGs.

It is generally accepted that no universal model is applicable to all countries around the World and the best model depends, among other factors, on the:

?? *Objectives of the Government*
?? *Type of local government*
?? *Size of local government*
?? *Type of functions they are going to perform*
?? *Cultural context of the country, historical experiences etc*
?? *The horizontal disparities in fiscal capacity and expenditure needs across LGs*
?? *Administrative capacity at the local level etc.*

Especially the type of *functions* assigned to the LG level is important. Generally, LGs´ functions can be divided into three types:

[14] If grants are defined for use on either specific recurrent costs or capital investments, they may be viewed as specific, but not sector specific. The figure deals with the sector specific – non-sector specific distinction. This means that each of the two strings may be divided in recurrent and development grants.

1. *Agency:, where the LGs perform tasks and services without own influence (or little influence) on the level and quality of the services – they carry out the functions on behalf of the central government as agents (e.g. some types of pensions).*
2. *Partly agency: Here LGgs have only partial influence on the level and quality of services they provide e.g. primary schools in Uganda today, where the LGs carry out the tasks but with a number of norms and standards and where the teachers salaries and many other cost items are financed and controlled by central government);*
3. *Discretionary functions: where the LGs have a strong control over the services and the level and quality of these services themselves (e.g. administration, certain health care functions and local roads).*

The table below illustrates the principle:

Table 5: Relationship between the type of function and their finance:

Type of Function/Financing	**Financed by local government**	**Financed by central government e.g. through grants**
Agency functions (purely)	- (limited own financing)	+ Specific grants to encourage the LG to supply service, especially where certain minimum standards are necessary.
Partly Agency functions	+/- (Partly by own revenue sources)	+/- (Partly by grants, especially specific grants)
“Own decentralised services” The LGs have full discretion on the level and quality of the services	+ (taxes / user charges)	Supplementary funding by general grants with the objective to correct horizontal imbalances

3.1.3 Allocation Criteria

Overall Method and Criteria

The allocation criteria and the weight of the criteria determine the horizontal distribution of the grants across the LGs. In practise intergovernmental fiscal transfers may be divided amongst LGs according to four different methods: [15]

1) Origin of collection, i.e. sharing of the taxes collected within the LG jurisdiction;
2) Formula based, with criteria and criteria weights;
3) Cost reimbursements (partial or total);
4) Ad hoc based (based on decisions made by the granting Government[16].

Although decisions are often influenced by political choice and "common sense" considerations, it is generally accepted that the criteria should be based on the **objectives** below, and that systems based on clear allocation formulas are desirable.

The ***criteria*** in allocation system should generally:

?? Pursue the objective(s) behind each type of grant and try to balance (appropriate trade off) the objectives if some of these are conflicting;
?? Be formula based and based on objective criteria, (contrary to discretionary criteria where the grantor is free to determine the amount paid on the basis of subjective assessment or expediency[17]);
?? Reflect the variations in LG revenue raising capacity (for equalisation grants)
?? Reflect the variations in LG expenditure needs, i.e. there should be a clear link between each of the criteria and the LG need to spend (especially for equalisation grants);
?? Accurately reflect the specific characteristics behind each factor;
?? Be drawn from sources that cannot be manipulated by the CG or LGs; They should generally be neutral for LG choice on the input side (unless there are strong reasons to pursue a particular method of service provision), e.g. the grants should not force LGs to establish new institutions if other means to achieve the same objective are more

[15] Intergovernmental Fiscal Transfers – Concepts, International Practice and Policy Issues (Draft, 2002) by Larry Schroeder, Syracuse University and Paul Smoke, New York University.
[16] Source: Larry Schroeder and Paul Smoke, 2002
[17] Council of Europe, "Limitations of Local Taxation, financial equalisation and methods for calculating general grants", Local and Regional Authorities in Europe, No. 65, Edited by Mr. Jørgen Lotz, 1999, Council of Europe Publishing.

efficient. A LG should not be able to influence the grant it receives by manipulating its expenditure decisions; An exemption from this may be in situations where there are good reasons for establishment of incentives, e.g. to achieve certain service targets;

- Not display a high degree of interdependence and be easy to measure and up-date;
- Be kept simple, transparent and stable from one year to another. It is e.g. generally proved that a few criteria can explain the majority of the variations in LG expenditure needs in many countries and few criteria preserve the simplicity and possibilities to achieve a transparent system. The number of criteria depends on the complexity of the LG tasks and the available data;
- Should respond to the demand for, rather than output of public goods such as infrastructure and/or institutions[18];
- Avoid negative incentives and preferably provide strong incentives for LGs to improve on LG administrative and service provision performance;
- Designed in a way where the criteria work together in a holistic and mutually strengthening manner to achieve the overall objectives, instead of sending conflicting messages and incentives.

Transfer Criteria – A Classification

Generally, most allocation systems reflect one or several of the following features:

A) LG fiscal capacity	***B) Expenditure Needs***	***C) LG effort within various areas, tax etc.***	***D) Equal Shares***

General purpose grants allocation formulas typically encompass criteria on (B) expenditure needs, but may also incorporate criteria derived from (A) Variations in fiscal capacity (especially if the general grants are also having an equalisation purpose) and C) LG effort and D) Equal shares to all LGs. These grants may also be formed to tackle equalisation purposes.

Equalisation grants are often based on criteria from (A) or (B) eventually combined with criteria (C) and (D), but may also include criteria from all four areas.

Sector specific grants, like grants within health care and education, typically include only certain criteria from (B) expenditure needs and sometimes (D). In

[18] This does not mean that output related incentives cannot be introduced in certain areas, but that these have to be introduced cautiously.

practice most transfer systems pursue various forms of horizontal LG equalisation in order to address fiscal disparities and/or differences in expenditure needs and to enable all LGs in a country attain certain minimum capacities for service provision. This may be done by use of various sector grants, by a more holistic fiscal equalisation system or by a combination of these systems.

Transfer: Objectives – Type of Transfers and Criteria

There is a complex relationship between the objectives of the grants, type of grants and the criteria applied in the transfer systems, cf. below:

Table 6: Type of Transfers and Criteria

Purpose of the Grant	**Ideal Type of Grant According to Economic Theory**	**Requirements of the estimation of LG spending needs and revenues**	
		For the Calculation of the total size of the grant	**For the distribution of the grant among recipient LGs** [19]
Compensation of spill over effects and merit goods (purpose is to influence the LG choice in service provision to provide a better coverage of the overall society needs)	Conditional Open-ended matching grants	Estimate of general spending needs in specific areas	Formula measuring activity and output in individual LGs
Equalisation (spending needs)	Unconditional, closed-ended grant (lump sum)	Estimate depends on LG tasks and the complexity	Formula for estimating objective spending needs in LGs based on objective criteria. It is important to avoid compensation for inefficiency. Should be distributed

[19] Cf. also the general principles outlined above, e.g. not to support ineffiency.

Purpose of the Grant	**Ideal Type of Grant According to Economic Theory**	**Requirements of the estimation of LG spending needs and revenues**	
		For the Calculation of the total size of the grant	**For the distribution of the grant among recipient LGs** [19]
			without attached conditions because the aim is to provide the LGs with equal opportunities.
Equalisation (income base) caused by disparities in LG tax base	Unconditional, closed-ended grant (lump sum)	Estimate depends on LG income source and the inequality of tax base	Formula for estimating income base in LGs, various methods like RTS, simple selection of proxy etc.
Economic stabilisation	Unconditional, closed –ended grant (lump sum)	Estimate of cyclical dependency in LG sector	Formula for measuring cyclical dependency in LGs
Support to level out the fiscal gap between LG expenditure assignment and revenue assignments	Unconditional closed-ended grant (lump-sum)	Estimate of general gap between the spending needs and income potential	Formula for distribution of centralised tax base. The formula should be seen in relation to the equalisation grant formula and may or may not be combined with this formula taking into consideration the disparities in expenditure needs and fiscal capacity
Use of LGs as agents for CG service provision	Conditional grants	Estimate of general spending needs in specific areas	Formula for measuring of minimum service levels in selected areas, reimbursements schemes, etc. This may be combined with various

Purpose of the Grant	Ideal Type of Grant According to Economic Theory	Requirements of the estimation of LG spending needs and revenues	
		For the Calculation of the total size of the grant	For the distribution of the grant among recipient LGs [19]
			incentive schemes to perform more efficiently in service provision
Related to the above: Ensuring minimum standards for services across the nation	Conditional non-matching transfers		Cf. above.
Regional development	Capital grants for investments in infrastructure	Estimate of the general need for infrastructure investments	Formula for measuring the need for infrastructure investments in LGs. This may be combined with various incentive schemes.

Source: The table is a **further elaboration** of a model outlined in the publication. "Methods for Estimating Local Authorities´ Spending Needs and Methods for Estimating Revenue, Council of Europe, Local and Regional Authorities in Europe, No. 74, Report by the Steering Committee on Local and Regional Democracy (CDLR) prepared with the collaboration of Professor Jens Blom, December 2000

It is important to note that the *objective* behind the grant should always be the point of departure. In practise these mainly economic objectives must be balanced against other values such as LG discretionary power, democracy, closeness, accountability, transparency and incentive framework. The various grants should be reviewed holistically as the gap filling unconditional grants may also be used to achieve the equalisation objectives, and as the various grants have to work properly together on a mutually strengthening basis. Conflicting and complex multipurpose grants should be avoided.

Criteria to be avoided

In practise the selection of criteria varies greatly from country to country. Nevertheless, there is a common agreement about certain criteria, which should be avoided in all cases. First, criteria, which create bad incentives (called perverse incentives), should be avoided. Examples of these are criteria, which have a negative impact on the LG tax effort or financial management efforts, e.g. CG financing of a LG with fiscal problems caused by malpractice or problems with the financial management procedures and reduction of grants if and when the LGs increase the collected taxes. Second, the availability of infrastructure should not be used as a direct criteria for allocation. If e.g. a higher concentration of schools, classrooms or water facilities cause a reduction in the grants, the LGs will have <u>no</u> incentive to improve service provision as they will be "punished" by a reduction in their grant allocation in the subsequent years. On the contrary, if grant allocation is based on a specific factor like the number of classroom constructed (specific service outputs) the LGs may have an incentive to focus exclusively on this factor (specific part of the services) neglecting other important areas such as schoolbooks, hiring of teachers etc., i.e. leading to a severe distortion of local preferences and allocation efficiency. This may impinges on the whole idea behind decentralisation.

3.1.4 Transfer Criteria – Some Details

Criteria on Fiscal Capacity

The revenue raising ability of LGs is important especially when it comes to general grants and equalisation systems. There is a variety of methods being used to measure LG ability and to incorporate this in the transfer systems. If CG wish to equalise the LG revenue raising capacity and to provide more resource to LG with lower potential to generate revenues, various options exist. There are basically two approaches[20]: 1) The macro-economic approach, which focuses on identifying a single proxy for the revenue raising capacity, like the regional/local GDP or the regional/local personal income which is then used as the criterion. The advantage of this is that it is simple. But the disadvantage are that i) it fails to account for the ability to tax citizens outside of the boundaries of the LGs, ii) it assumes that LGs make an equal effort to collect taxes, iii) it does not consider the variations in types and potential of taxes across the LGs and finally iv) these figures may not be available for all LGs.

The second approach, used in different forms in various countries[21], is to focus on the tax potential for each kind of key LG taxes, also called the representative tax system (RTS) where all major revenue sources of LGs are included. The representative tax system (RTS) consists of national average tax rates applied to all commonly used tax or revenue bases. The tax potential is measured for all

[20] Cf. "Equalisation Across Sub-National Governments, Fiscal Capacity", by Serdar Yilmaz, Public Sector Specialist, World Bank Institute.
[21] E.g. in the present Ugandan EG system uses this in a simple form (GT tax estimated proxy) and Denmark (income and property tax).

key LG taxes and the differences from the particular LG to the average is measured and equalised by grants. The steps are the following: a) Determine the tax sources to be included in the RTS, b) define and estimate the tax bases, c) calculate the representative (average) tax rate and d) estimate the tax capacity e) aggregate the results for all major LG taxes and f) compare the individual LGs with the average tax potential.

It is important that the *tax potential* is applied, as application of the *actual* collected LG taxes will create disincentives to improve on tax administration. In practise, there are often great problems in getting the sufficient statistics and data to apply one of the two approaches and more pragmatic solutions are applied in some countries, like incorporation of some poverty indexes on the expenditure side of the equalisation system, cf. below.

Expenditure Need Criteria

The use of expenditure needs as criteria for allocation of grants to LGs varies typically from sector specific grants to general grants/and or equalisation grants.

For *sector* specific grants, expenditure needs criteria are often measured based on objective expenditure needs within a particular area, e.g. like school facility grants, where number of pupils in the school going age-group may be applied. The criteria should reflect the key impact factor(s) on the size of the expenditure needs without being a subject for LG or CG manipulation (cf. above). Well-designed sector specific criteria often make it easier to elaborate the general grant criteria (and equalisation grants).

For the general grants and the equalisation grants, the LG assignments and the functions, measured as the LG funding responsibilities (after deduction of sector specific grant funding) are the point of departure. The keys steps are typically the following: a) The key LG mandatory tasks should be defined, b) the factors (and weights of these) impacting on the size of expenditure needs for each service area is defined, and the expenditure need (net needs after deduction of sector specific sources) of each LG calculated, c) the expenditure need of the LG is compared with the average expenditure needs for all LGs, d) Equalisation of the expenditure needs may either be carried out by use of the general grant window or by a special system of equalisation grants (as in the present system in Uganda).

Measurement of service costs is far from straightforward and requires clear demarcation of the LG functions, good data and knowledge on the costs of the (standard) service provision, experiences on impact of criteria on the expenditure level, well defined criteria for the service standards (e.g. average services, or certain forms of standard minimum service levels). Ideally a test should be carried out on the reliability of the criteria in terms of impact on the expenditure needs. Statistical estimations to find a relation between possible criteria and expenditure patterns among LGs by use of regression analysis. Data on promising criteria are run against data for expenditure on different functions. This should be applied with cautious as LGs may not have a discretionary choice to decide on the expenditure pattern other factors may disrupt the expenditure pattern, and sufficient data is often missing, etc.

Generally, the allocation criteria and the number of these depend on the functions to be financed by the grants, and the complexity of services to be provided[22], but the allocation of general grants and equalisation grants should be based on **criteria** like:

- *Size of the Population*: This is typically the most important criteria in the allocation formulas for general transfers around the world. The importance of the population-based component in transfer formulas reflects the assumption that a LG's expenditure needs generally grow proportionally or largely proportional with the number of inhabitants in a LG;
- *Demographic composition (population age structure)*: Experiences have shown that the demographic composition has a great impact on the costs of the LG mandatory functions, e.g. a high number of children in the school going age groups has a great impact on the LG costs within the education sector, number of elderly people on the costs within the health sector etc.;
- *Socio*-population structure: Some sections of the population need more support, e.g. in areas of diseases, areas with high unemployment rate, areas with refugees, etc.;
- *Costs of the Service Provision:* The costs of the same amount of services may vary from LG to LG due to other reasons than demographic factors, e.g. due to remoteness, lack of accessibility (geographically larger LGs will have to spend more on transportation, infrastructure and less more access to economies of scale and or bundling of services. The costs of services may also be higher in certain areas with higher demand on the goods (urban areas), and or less supply of labour and various goods, etc. The impact of this has to be measured/ estimated, if possible by construction

[22] As mentioned by Jørgen Lotz "There is a balance between the degree of simplicity of the system and its ability to smooth out important differences on needs. If your criteria are not the best possible, the whole decentralisation will not work. Inefficiencies and personal inequalities will arise and result in political pressure for recentralisation. If the equalisation system cannot be designed to capture the important differences in expenditure needs, the system becomes politically unacceptable", Council of Europe, 1999.

of a cost index reflecting the cost differences of various key LG goods and services across LGs;[23]

- ?? *Variety in level of service demands:* Certain areas or type of LGs may have a need for a higher standard or additional services, like street lightning or solid waste treatment. The opposite may also be the case, e.g. in areas with a high level of poverty, where the need to spend more on water supply, health care etc. may be higher. Sometimes, proxies for this can be applied;
- ?? *Level of Development as the Point of Departure:* Often, the existing distribution of infrastructure varies greatly from the more prosperous to the poorest LGs. This may lead to a wish to equalize the level of services by counting of the number of schools, water taps etc. and provide additional sources to the LGs with the low endowment of specific services. Although the objectives behind this initiative may be noble, this procedure of tying the size of an intergovernmental grant to a particular *level* of infrastructure availability is considered a "bad" practice in design of LG transfers. The reason is that it creates disincentives to improve on the service delivery as improvements will be punished in the following years grant allocation. It is therefore better to develop the other indicators, mentioned above, and/or combine these with proxies for poverty (poverty index) like Human Development Index and income/consumption statistics. In addition, use of physical infrastructure measures should be avoided, e.g. the number of hospital beds or the number school class rooms to allocate grants amongst LGs. The number of classrooms in a LG area is a very poor measure of the educational needs of LGs. Wealthier LGs, with greater resources available for education, would likely have more class rooms and thus receive more compensation per capita under such a scheme, while poorer LGs would receive fewer resources. Thus, allocating resources in proportion to existing capital infrastructure would perpetuate historical disparities over time.

Expenditure need Criteria in Equalisation Grant Systems[24]

Generally, there are two overall methods to the development of an equalisation of the expenditure needs:

1) The expenditure **norm** principle;

[23] These criteria are typically applied at a rather advanced stage.

[24] As mentioned by Anwar Shah: "Expenditure needs should – as point of departure - be defined as the cost of supplying average performance level for the existing mix of state-LG programmes, without applying subjective standards such as "minimum service levels" or "reasonable service levels", Shah, 1994.

2) Expenditure, which actually appear in the LGs budgets and accounts, based on standard/ **average** costs.

Ad 1: Expenditure norm principle[25]

The principle behind this system is that the central government defines the service level for various LG services, the expenditure norms are fixed, defined according to what is expected to be the feasible service level, i.e. the so-called minimum standard service level. A total expenditure norm is calculated as a sum of all the expenditure norms in the various sector areas. This model implies that the central government has formulated fixed standards and detailed costs calculations for all service areas, and types of LGs, or that such standards can be estimated during the course of the work on the allocation criteria. International literature and experiences normally concludes that this model is very challenging and often not feasible. It should also be stressed that the model can lead to a rather centralist model, where the LGs are forced to spend the standard amount on various services despite local variations in wishes/needs, contrary to the basic ideas behind fiscal decentralisation, and leading to wastefulness and inefficiency in resource allocation.

Indicative minimum service standards and costs calculations, might be useful in other areas, e.g. in the development of compensation schemes when tasks are transferred vertically, between levels of governments, in the calculation of the revenue sharing schemes between levels of government and in the current central government – LG dialogue on service targets. A more consultative approach where LGs and CG in common agree on some standard costs for key mandatory services and apply these standards in the criteria allocation systems with defined weights, may be applied, but it is important that these standards and derived criteria should not be applied as rigid demands to spend exactly the minimum amount (e.g. 20,000 UGSH per child on health care) of funds on a particular service area.

Ad 2) Based on actual average expenditure

The actual average expenditure model is applied in a number of countries. The level of sophistication may vary from common sense calculations to very detailed regression analysis, based on more or less detailed data sets. The principle is to review the present LG composition of expenditure across the key sector areas, i.e. education, roads, services for elderly people, social welfare, administration, utilities etc. for the most recent years, and review the percentages of the budget transferred to these areas, e.g. 20 % to education, 10 % on water etc.

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[25] This system has typically been applied in the Federation of Russia and a number of the Russian republics.

The second step is to decide on the standard costs (typically average costs) of these services, e.g. expenditure per children in the primary school for the average LG.

The third step is to find the criteria of importance for the level of expenditure for the specific group of expenditure, e.g. education - is it the number of children in the school going age ?, or are there other factors, which might have a major impact on the expenditure level ? Regression analysis may be applied to identify the exact criteria for expenditure needs and the exact weight of this criteria (to identify links between the criteria and the expenditure levels), or assumptions on this may be laid down from the beginning of the calculations, e.g. it may be assumed that the number of children between 7-18 years old is the most important factor to determine the expenditure level. Many countries use a combination, where common sense considerations play a significant role. Regression analysis is often not feasible if sufficient data is not available or equally important, if the LGs have limited autonomy to decide on the mix of services, and the existing composition is out of tune with the local needs.

In practise the development of expenditure need criteria is not an easy task. The mandatory tasks have to be defined and the expenditure needs of these tasks. The best is to use a detailed break down of the expenditures according to a standard account plan/coding system of LG expenditures.

In the **development of the criteria for expenditure needs** it is important to include the following considerations:

?? The criteria should be *closely related to the tasks* that the LGs are assumed to perform. If various types of LGs have various types of mandatory tasks, the criteria should be different as well (both the numbers of criteria and their weights). [26] In general, only the mandatory tasks should be included in the transfer system.

?? The criteria should be discussed in a close *dialogue* between the central and LGs and decided by an official body, preferably finally by the Parliament with a broad democratic mandate. Second best solution by a key ministry/intergovernmental fiscal body after careful deliberations with the LG stakeholders. It may not be possible to agree with the LG representatives as equalisation implies that some of the LGs will be "winners" and other "losers", but is it is important to involve the expertise from the that level.

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[26] E.g. in Denmark the expenditure needs criteria are not the same for the counties and the municipalities, as their tasks are different, e.g. the municipalities have no hospitals.

?? The criteria should be "*objective*" meaning that they can't be manipulated by the LGs. It should not be possible for the LGs to receive extra funds, just because the LGs choose e.g. to establish artificial places in the kindergartens. Support to specific services or service provision methods (e.g. institutions) might distort (bias) the local priorities away from the most efficient mix of service provision at the local level;

?? There should be a *close relationship between the criteria*, e.g. number of pupils in the primary school, and the *expenditure needs* (causality). The exact relationship can be calculated by use of regression analysis or assumed by common sense considerations and/or pilot tests in various LGs;

?? The *demographic criteria* (size of the population, size of the population across various age groups, children, people in the working age, elderly people etc.) are often the key criteria and may explain most of the variations in the expenditure needs across LGs. Other criteria, such as Km of roads, and population density might also be included. It is often appropriate to use the "number of inhabitants to explain residual expenditure (general administration costs general public service etc.), that cannot be explained by more specific criteria;

?? A *gradual development* of the criteria is often a feasible way. The criteria cannot be more complicated than the information/statistic allows for. As the information, e.g. on the LG service level and needs is developed, the criteria can be further specified. [27]

?? There is always a trade off between the wish to develop a 100 % fair and "ideally correct" system, achieving all its objectives (which can never be fully achieved) with many criteria and the wish to keep it *transparent*, simple and political feasible. It is generally better to explain 90 % of the variation in expenditure needs by use of 5-6 criteria than to explain 97 % with 30 criteria. An appropriate balance should be established between these conflicting objectives. The experience from many countries has shown that 7-10 criteria can explain most of the variations in expenditure needs. The system does not have to be as complicated as some of the experiences in e.g. European countries, as few key criteria, based on number of inhabitants and key demographic criteria often will be able to explain most of the variations in expenditure needs.

[27] E.g the block grants in Uganda are distributed according to two criteria . number of inhabitants (75 % weight) and Km 2 (25 % weight). Other criteria for equalisation grants have just been adopted from l999.

?? The criteria should reflect the *net costs* of service provision, i.e. after deduction of the revenues from various *specific* grants and user charges/fees. Otherwise, the system will contain double counting;

?? LGs with special characteristics should be considered, but might often be most appropriately addressed by use of special grants, e.g. special grants to Islands, and depressed areas.

3.1.5 LG Effort – Tax and other Areas of Performance Criteria

It is well known that grants systems, if not properly designed, may induce poor incentives for LGs to raise own revenues especially when the local taxes constitute such a very small proportion of the total income that a large proportionate increase in local tax bills finance only lead to a very small proportionate increase in LG total spending/services.[28] There are no clear theoretical economic reasons for inclusion of LG tax effort in the transfer schemes. Nevertheless there may be various political and administrative reasons, based on the way the LG political system functions in a specific country context and the LG politicians incentive system. Therefore fiscal effort may be included as one of the criteria in the allocation system in order to encourage LGs to exploit their tax potential. This may be appropriate under certain strict conditions and assumptions[29], among which the most important are: a) The basic data on the LG revenue statistics is available (preferably data detailing the LG utilisation of their tax potential) or at least good statistics on the development in revenues over the years, b) a clear knowledge that all LGs have a great non-utilised tax potential, c) a strong political wish to "boost" LG taxation in cases where the level (public sector) may generally be sub-optimal and provide a sub-optimal level of LG services and d) lack of strong local accountability, i.e. certain country specific conditions deriving from the features of the relationship between the politicians and the constituencies and clear indication that the transfer systems create problems with the tax incentives.[30]

Other performance related criteria, where LGs receive a higher share of resources if they perform well within certain areas, typically related to

[28] Bailey, 1999, p. 205, Yilmaz, p. 38 and Bird, 2001, p. 4 (although the last author is sceptical towards introduction of the tax effort as an criteria due to lack of data and information).

[29] In some of the literature on grants the usefulness of the tax effort as criteria is disputed, cf. e.g. Richard M. Bird and Michael Smart: "Intergovernmental Fiscal Transfers: Some Lessons from International Experience, University of Toronto, January 2001 and Anwar Shah: "The Reform of Intergovernmental Fiscal Relations in Developing Countries and Emerging Market Economies, The World Bank, l994. It should only be used with cautious and under certain conditions.

[30] The system will be introduced in the LGDP II non-sectoral development grants and in other grants as part of the implementation of the GOU Fiscal Transfer Strategy in Uganda. This is also being tested in countries like Ghana, Nicaragua and considered in other countries like Nepal.

administrative performance, have also been piloted in a number of countries and have shown some merits. The Ugandan LGDP model[31] is one of the good examples of this where good performance within areas such as planning, budgeting, accounting and accountability and transparency is rewarded and poor performance sanctioned. In Tanzania similar systems are being tested and other countries are developing the criteria. Typically these criteria are based on certain minimum access criteria such as development plans, approved budgets and accounts and compliance with certain functional capacity requirements and performance measures, which reward good performance and sanctions poor performance. The lessons from these initiatives show that it is important to[32]:

?? Develop the Minimum Conditions (MC) and Performance Measures (PM) in full cooperation with the LGs – both the technical and political level to ensure full understanding and support to the selection;
?? Keep the MC and PM simple to understand, realistic and achievable;
?? Ensure that the areas reflected can be influenced by LGs (endogenous factors), i.e. not dependant on exogenous factors, like legal changes, draught, etc.;
?? Ensure that the MCs and PMs are closely related to the legal framework and supports the compliance;
?? Ensure an appropriate link between the various indicators, avoid overlaps and contradictions;
?? Technically possible to apply (i.e. objective, measurable and information is available);
?? Politically durable – endorsed by councillors as fair and credible to be applied;
?? Easy to interpret in a standardised manner;
?? Ensure that the system is well known tor the citizens and ensure that the system facilitates dialogue and accountability;
?? Ensure that the LGs are supported to improve on the MCs and PMs, e.g. capacity building support from the CG. [33]

[31] The Programme Midterm Review of the LGDP in Uganda found a lot of evidence to show the mutual and reinforcing relationship between the development grants, capacity building grant and the performance incentive system: Programme Review of LGDP, February 2002, Jesper Steffensen, Emmanuel Ssewankambo and Gerhard Van´t Land and Analytical and Preparation Report of LGDP II, September 2002. Other countries like Kenya, Tanzania, Senegal, Nicaragua, Punjab in India, have also introduced performance measures for some of the development grants.

[32] Please also refer to the Report: Incentive Based Allocation of Local Development Funds to Local Authorities: Experiences and Lessons, UNDP/UNCDF SDP Mwanza Region, October – November 2002, by Emmanuel Ssewankambo.

[33] One of the strengths of the Ugandan LGDP has been the linkages between the development grants, the incentive framework and the capacity building grant (and support).

The management of these indicators is a challenge and good organisation, information dissemination, feed back and quality assurance is critical for the success of the system. LGs should be well aware about the criteria and perceive the system as credible and fair. So far systems based on performance criteria have typically been introduced on a project specific basis, related to generic performance and targeted to development grants, but there are plans in various countries, among them Uganda, to extend the principles to other national grants and allow the LGs with better performance within key areas more autonomy over the allocated sources and within certain areas a higher per capita allocation.[34]

Equal Shares Criteria

Equal shares are sometimes applied for general purpose transfers and equalisation systems, in order to ensure a minimum funding of certain key functions, e.g. like administration buildings, certain key functions (executive officers), etc. based on the assumptions that certain functions are necessary for all LGs. Most often these criteria are combined with criteria from expenditure needs and will seldom stand alone[35]. An exaggerated use of equal shares may lead to bad incentives and inefficiency in allocation (as various LGs do not have the same expenditure need) and pressure to create a sub-optimal number of LG units. Secondly, and more importantly, the use of equality as a factor in the allocation formula raises a question of basic fairness. If the equality principal would be used as an allocation factor, regions with fewer residents would receive much larger transfers when expressed in per capita terms. This violates a basic principle of fairness in a democratic system of LG governance.

Capital and Recurrent Allocation Criteria

Most of the general principles for the design of recurrent transfers also apply for the development grants. For development grants, additional criteria or rather conditions may apply such as requirements that LGs have prepared adequate investment development plans and maintenance plans, involved constituencies in the priority making, proved that they are economically viable (co-funding requirements may be one way of indicating this), measures to ensure ownership and sustainability of the investments are in place, e.g. by use of matching grants formulas.

[34] Refer to Fiscal Decentralisation in Uganda- Draft Strategy Paper, March 2002, prepared by Fiscal Decentralisation Working Group, p.12-13. This Strategy has been adopted by the Cabinet for testing in 15 pilot LGs. It is said that: "*a gradual reduction of central government control will be linked to improvements in capacity and performance of individual local governments*".

[35] Equal shares are one amongst other criteria in transfer systems in various countries like Denmark (general grants), Uganda (unconditional grants) and Nepal (part of the grants).

In addition, it is important that there is a certain link between the size of and distribution of the transfers for investments and the size and distribution of the funds for recurrent costs, e.g. it will not be viable and sustainable to transfer large amounts of development transfers to LGs without ensuring sufficient funding of the recurrent costs for maintenance and operations, i.e. certain linkages between the recurrent and development transfer formulas should be considered. Hence, the various formulae are mutually interrelated and should be reviewed in a holistic way, in order to ensure the right balance between equity, efficiency (sustainability), objectivity, and simplicity in the allocation system. According to this line of thought, if the grant formulae are not reviewed holistically, it will be nearly impossible to ensure a proper balance of the various objectives of the transfer system.

Poverty sensitive criteria versus criteria reflecting objectives such as financial viability and financial sustainability

The various objectives need to be balanced in the design of every transfer allocation system, e.g. a highly poverty sensitive formula in the short term may contradict certain objectives on financial sustainability, if large resources in the short term are transferred to areas without capacity to absorb the funds and/or future potential for economic growth. On the contrary, systems entirely focusing on short term financial efficiency may contradict the medium and long term objectives of balanced, sustainable growth and building up of sustainable systems and procedures in the medium and longer term. The table below shows some of the considerations:

Table 7: Poverty sensitive Criteria in the Allocation System

Poverty Criteria	***Advantages***	***Disadvantages***	***Comments***
Poverty sensitive allocation criteria	Is typically in line with the governments´PEAP principles and announcements. Provide more resources to the weaker areas for development and thereby (at least in the short term) supports the objective of a	Put pressure on the absorption capacity in the weaker areas. The investments will not be provided in the high growth areas with negative impact on the efficiency. The challenges with the O&M costs will increase.	The transfer system needs a holistic review to ensure that the various criteria and schemes play together in an optimal way. Transfer systems shouldn't be a stand alone activity to boost economic development in the

Poverty Criteria	*Advantages*	*Disadvantages*	*Comments*
	balanced national development and country-wide reduction in poverty. A single LG fiscal equalization system cannot cope with the large regional inequalities. Therefore the entire transfer system (each grant) has to be geared towards this aim. May attract more donor support from other programmes, and thereby pave the way for better coordination and mainstreaming of the various programmes	Increase the demand for LG co-funding from own sources, which may not be readily available, unless this transfer system is designed in a very well balanced manner. May make the system more complicated and non-transparent. Limited data availability causing problems in the calculations, e.g. on proxies for poverty indicators. Transfer systems cannot alone equalize the economic development, other factors such as growth potential, business development policy, tax policy, natural resource endowments etc. should also be considered, and may be more important for a balanced growth.	poorest areas, but should be linked to other poverty alleviation activities.

The overview below shows that the design of the allocation criteria varies greatly across various countries and the specific context in which the transfers are functioning.

3.1.6 Brief Overview of Some Experience from Design of Transfer Systems

The challenge to identify appropriate allocation criteria is enormous and recognised in all theoretical literature on transfer systems. It is also reflected in the international experiences where the search for the "best possible" allocation criteria is often guided by a mix of common sense, scientific calculations and political choice as the "right" measure is simply not there or data is not available to come close to this. As all countries have a multiplicity of objectives behind their transfer systems, the general picture is very complex and a variety of transfer schemes exist in most countries. Priorities have to be made on the strengths and relationship between the various objectives. Below follows a brief introduction to some of the country specific allocation formulas to provide ideas for the future design in Uganda.

The allocation criteria varies from transfer systems with more than 50 criteria like in Japan to less than 10 in some of the Central and Eastern European countries and 1-2 criteria in some developing countries in e.g. Asia. As mentioned in Section 2, these criteria may always be gradually developed, and the most important is to start with a few simple, fair and objective criteria. Therefore, compromises have been made in most countries, common sense consideration applied along with practical studies and theoretical considerations. Finally, there has been a continued improvement in the systems and the data background in most countries, especially over the last 20-30 years.

A clear classification of the countries in the above-mentioned typology of grants and allocation formulas is not possible as nearly all countries typically have more than one type of grant and allocation formula.

The table below gives an overview of some experiences from transfer criteria in various countries.

Table 8: Overview of the grants and equalisation schemes in selected countries

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
Australia [36]	Equalisation Grants (in brief in the following columns) Special Purpose grants	Uses both fiscal capacity and expenditure needs (for recurrent expenditure) . The standard for any expenditure function is the average per capita spending by all States and the standard in any revenue (income) category is the average per capita revenue (income) raised by all States. The next stage involves reflecting those influences beyond a States control (not a state's relative efficiency) which require the state to spend more than the national average per head of population, or alternatively make greater effort to raise the national average amount of revenue per head of population. These influences are termed *disabilities* and derive mainly from the	The Commission's assessments are based on the principle that the grant to which States are entitled should enable them to provide the national average standard of state-provided public services assuming an average level of operational efficiency and average effort to raise revenue The grant distribution system is intended to be "policy neutral" i.e. unaffected by the policies of individual States, which should not be able to directly	The system is reformed every 5 years based on recommendations from the Fiscal Commission (next time 2004). In some areas where data is not fully available the Commission makes its recommendations based on qualified value judgements, a procedures which has cause some controversies.

[36] An Independent Commission ? A perspective from down under Report, Annex 3 – A Document made available by the long term adviser of the LGFC, Uganda, Mr. Kevin Curnow.

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		examination of average State practices. For example - if it were the case that it is general practice across the States to subsidise electricity services to pensioners, it would be appropriate to use the proportion of pensioners in each State's population as a basis for a disability. There are currently some twenty such disabilities used in this process, examples of the more important ones are set out below : *Socio-Demographic Composition* - which takes account of the differences in the characteristics of State populations such as age, sex, Aboriginality, and income, and their impact on the demand for, and unit costs of State services. *Input Costs* - which allow for differences between States in the price of labour, office accommodation and electricity. *Administrative Scale* - which allows for the	influence grant distribution results by their own actions and policies. Equalisation has played a significant, overt and explicit role within the Australian grant distribution system since 1981. The Australian system aims to adjust for the imbalance between States and Territories' revenue raising capacities, compared against their expenditure commitments. Equalisation takes account of both differences in the capabilities of the States to raise revenues and differences in the amounts required to be spent by the States in providing a	

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		differences in the extent to which Sates can achieve economies of scale in their central office functions and “whole of State” services. *Urbanisation* - which allows for differences in demand for or cost of services arising from the concentration of population in urban centres. *Dispersion* - which reflects the effects of the geographic distribution of populations within each State upon the cost of services. *Economic environment* - allows for the effects on the demand for State services arising from the size or complexity of State economies, or because it is uneconomic for the private sector to provide *services.* *Physical Environment* - which measures mainly the effects of climate on maintenance costs & depreciation. *Isolation* - allows for the higher costs in some States arising from their economic and geographical	standard of service. The general equalisation grant to support the provision of a standard service is not tied to meeting particular social needs or policy aims, the States having the power to decide how to allocate their resources between both regions and functions, and the distribution of general revenue grants cannot overcome any perceived deficiencies in that direction. Direct influence by the national Government in support of national objectives is done through the special purpose payments	

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		isolation from the main interstate sources of supply in S.E. Australia. *Cross -border* - reflects the services that each State provides to residents of other States. As disabilities are measured against States and Territories positions relative to each other, they give rise to positive or negative needs when expressed as a ratio to the national average. If disabilities are shown to exist the Commission will normally seek to apply the equalisation process to remedy this, but it is important to note that it may choose not to if: A disability is insignificant; no community service objective can be identified; if the activity is of an economic development character; differential needs are met by specific payments from the national Government. The process involves first the Commission considering the expenditure and income		

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		activities of the 8 State and Territory governments against a standard framework of expenditure and income *categories.* The framework consists of 41 expenditure categories and 18 revenue sources, examples of which are detailed in the table below. Standards are developed, derived from the States budgets, against which the revenue raising capacities and expenditures of each State can be compared. The standard for any expenditure function is the average per capita spending by all States, and the standard for any revenue income category is the average per capita revenue raised by all States. Examples are shown below: *Expenditure Categories* Pre-School Education, Secondary Education, Hospitals, Nursing Homes, Mental Health, Police, Administration of Justice, and Family & Child Welfare.		

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		Income Categories Vocational Education & Training, Property Titles, Road User Charges, Hospital Patient Fees Public Safety User Charges, Fees & Fines.		
Denmark [37] (The system contains a vast number of transfer schemes and the schemes vary across types of LGs. Only the main national systems are mentioned here)	a) Unconditional block grants b) Conditional grants (reimbursements) c) Equalisation grants (various schemes for various types of LGs, counties, municipalities,	According to the tax base (no equalisation impact) Reimbursements (open ended) Formula based. Tax base (from income tax and land values) – Percentage of the difference between the tax base of the LG and the average tax base is	Fill up the fiscal gap, compensate when new tasks are transferred vertically Reimburse/co-finance expenditure within areas where the LG acts as agent or has limited control on the level of expenditure, contribute to the financing of areas where the LG discretion is limited Ensure more equal	The percentage of each reimbursement scheme is carefully designed to ensure neutrality between various activities, and proper incentives There are

[37] Source: Municipalities and Counties in Denmark – Tasks and Finance, Danish Ministry of the Interior, January 1999. The systems in Norway and Sweden are based on many of the same basic criteria, cf. Council of Europe, 2001.

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
	municipalities in the Metropolitan area), here only information on the national municipal system is given	equalised, nationally approx. 80-85 % of the difference is equalized. Expenditure needs (45 % of the difference between the average needs and the LG is equalised). The factors measured are: a) Basic equal share grant to each LG (approx. 1 mill. USD) b) 11 Age derived criteria (total 80 weight), i.e. criteria which has been identified as having an impact on the expenditure needs c) 5 social criteria, e.g. i) number of children with single parents, ii) number of people in the age group of 20 – 59 without employment in excess of 5 %, iii) number of foreigners from developing countries.	opportunities to provide services by bringing an more uniform relationship between taxes and services LGs with low tax base and /or high expenditure needs compared to the average are compensated (the two EG systems are combined). LGs finance this basic system themselves (the so-called “Robin Hood approach”). In addition, the CG finances the support the LGs with the weakest tax base.	various schemes for counties, municipalities and counties in the Metropolitan area. Equalisation is higher in the Metropolitan area (approx. 80-85 % of the variation). The system has been revised several times and is always a subject for discussion and improvement.
	Grants to specific LGs with special features and needs	Specific grants to smaller islands Specific grants to LGs with special social problems	To support LGs which cannot be fully captured by the equalisation system	These grants constitute less than 5 % of the total transfers from CG.

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
Germany [38] Various systems at regional level (between Lander and vertically between Bund authorities and Lander and horizontally on the local level grants from the Land authorities to the municipalities	Lander (larger regions): Targeted on differences in resources not expenditure needs Grants to Lander with special needs in special geographical areas Equalisation of the LGs (municipalities) at the lower tier of Government	The Landers are Guaranteed a minimum of 95 % of the average financial strength (revenue potential) Based on criteria such as emergency areas, costs of political leadership (small areas), Transitional grants Expenditure needs and fiscal capacity (the system differs from Lander to Lander), but typically criteria on size of the population, unemployment rate, number of pupils are applied. The expenditure need is compared to the estimated fiscal capacity (potential) and the grants cover a part of the difference. The percentage of the coverage of the gap varies from Lander to Lander.	Objective: To fill up the fiscal gap and support the weaker areas. Basic view is that every unit should have financial capacity which will compare with its expendi-ture needs Each Lander decide on the grant and equalisation system and the revenue sharing model for the relationship between the Lander and the municipalities in the Lander	Currently considering the criteria to be applied to assist the financial weaker Lander
Russia,	Grants to fill	Minimum standards	Objective: To	The minimum

[38] As per 2000. Source: Regional and Local Governments in the European Union, Responsibilities and Resources, Committee of Regions, European Communities, 2001.

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
City of St. Petersburg[39] (a Region with 111 LGs) (as per 2000)	up the fiscal gap between LG own revenues and the expenditure needs and provide a minimum level of service standards	(norms) based on cost of various services calculated for each sector area, which are mandatory for the LGs to cover. LGs have to ensure that the minimum standards of spending are adhered to in the City of St. Petersburg and that the LGs have sufficient revenue to provide the minimum standards. LGs divided in 7 groups (not transparent) according to certain historical reasons and the various tasks they perform. Approx. 60 out of 111 LGs receive grants to bring them up to the minimum standard guaranteed service level (the own tax revenues and the grants are added up and compared to the cost of delivering services to the required standards). Among the 7-10 standards or what can be seen as criteria in the allocation system are: (vary from group	support the LGs with a low tax potential and high expenditure needs. The standard norm system has a number of flaws, among them unclear criteria, disincentives for some of the LGs to improve on the tax system, and problems with the grouping of LGs.	standards are very low and some LGs have several times more funding available and can keep this amount of funds for own discretion. The poorest LGs can only spend the funds on the specific minimum standards and have no flexibility.

[39] Source: "Annex on Local Government Finance – Key findings and Recommendation" (Jesper Steffensen) to the Report from NALAD, 2000 on the System of Local Government in St. Petersburg, cooperation programme under the Danish Ministry of the Interior and the City of St. Petersburg.

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		to group of LGs): Cemeteries: No.of rubbles per M2 Memory parks: No. of rubbles pe M2 Orphans: No. of Rubbles per child Environment: No. of Rubbles per inhabitant Social services to school children from families with many children: No. of rubbles per child per year Green areas: No. of rubbles per inhabitants.		
Portugal as per 1999[40]	Transfer to the Financial Compensation Fund (FEF)	15 % allocated equally between 305 municipalities, 40 % allocated according to Number of inhabitants and the average number of nights spent in hotels and campsites, 5 % number of inh. Under the age of 15 year, 15 % area, 5 % fiscal compensation index, 10 % length of road network, 5 % number of parishes and 5 % geographical accessibility.	Fill the gap and provide a degree of equalisation by evening out the spending requirements 60 % of the transfer has to be used on capital investments Min. 10 % has to be transferred to the parishes	The system was changed in 1999 to provide direct funds to each level of government (municipalities and parishes)
Philippines[41]	Fixed percentage (CG shares 40	Population, land area and an equal share component.		The equal share component has been

[40] Committee of Regions 2001.
[41] Source: Yun-Hwan Kim, Asian Development Bank and Paul Smoke, New York University, draft received December 2002 (informal information).

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
	% of the national internal revenues) IRA Small number of capital transfers			questioned
Pakistan (note 21)	Size based on the Finance Commission (significant part of the LG resources) In addition there is a number of smaller support schemes	Entirely on basis of population, although with a special grant targeted to the two backward provinces. A number of the smaller schemes have no clear criteria and seem to be impacted by political considerations. Small matching grant for provincial resource mobilisation that rewards to a certain limit provincial revenue effort in excess of their historical average growth rate.	Fill up the gap between revenues and expenditures (generally no equalisation impact)	In reality the provinces often get only 75 % of the supposed grants and they are often delayed
Indonesia (note 21)	The support from CG (DAU) represent a min. 25 % of the National Budget and accounts for approx. 75 % of the LG revenues	Both fiscal capacity and expenditure needs in formula The grant has a component based on salary, but there is not a separate grant programme for this purpose.		Despite the attempt to deal with fiscal imbalances, these remain significant. There has been an attempt to streamline the vast number of

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
	No explicit system of development transfers (but grants may be partly used on devt.)			different grants.
Nepal[42]	75 % of LG revenue derives from grants from CG. There are three types of grants a) administrative grant, 2) General purpose block grant and 3) conditional grant. [43]	Districts Administrative grant is based on the salaries and allowances from the centrally posted staff and supplementary staff hired by the LGs, based on standard administrative norms (number of staff positions based on categories of districts, pay scale, allowance rate, welfare contribution etc. (this covers 25% of the total transfers) Block Grant: This is an unconditional development grant (approx. 30 % of the transfers). The formulae is not transparent and contains some disincentives to improve on LG revenue sources.	Cover the costs of the basic administration. More block grants are transferred to the hilly and poor regions, but there is no clear and transparent formula, and there is no equalisation grant Fill up the gap between assigned revenues and expenditures.	The transfers are unpredictable and not based on objective, transparent criteria. There are great differences in unit costs of service provision, but the transfer system does not take this into consideration. Adm. grants: There are no incentives to save funds on administration as they cannot be transferred to other places. There is a

[42] Source: An Overview of the Intergovernmental Fiscal Relations in Nepal, Working Paper 02-05, April 2002 by Mr. Manoj Shrestha.
[43] Until last year there were grants for district roads and one for suspension bridges, but these have not been merged with the general block (development) grant.

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		In addition some funds are kept aside and distributed during the course of the year For the districts: In addition a district road grant and a grant for suspension bridges. <u>Villages:</u> Each village gets an equal grant irrespective of the population, area and price level. <u>Municipalities:</u> No clear criteria for distribution of the funds		reform group working on a new formula for the block grant, based on objective criteria like population, land, costs of service provision /cost index, proxies for poverty (Human Development Index) and tax effort. There are plans to introduce performance incentive measures in the grants system to improve on tax effort and administrative performance Sector grants to cater for decentralisation of sector assignments to LGs are being developed
Nicaragua[44]	Development grants	Matching grant. The collected tax revenue is matched by a Stimulus	Contribute the general sources for	Previously (I997-2000) the system was

[44] Information received from Phillip Bøttern, LG-DK.

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
		Development Fund on a dollar to dollar basis (since 2001)	development and support incentives to collect taxes	based on the LG´s utilisation of the tax potential, and LGs with a high utilisation rate received more. This system was rejected as it was seen by everybody to be too complicated).
Tanzania	Conditional grants with little flexibility	Based on infrastructure and existing services, e.g. funding of school teachers	Provide key services, fill in the fiscal gap	A number of performance related allocation criteria are being tested and under development (by the UNCDF programme and by the Fiscal Decentralisation Task force). A LGDP like programme is to be developed with non-sectoral development grants and related incentive systems. The system is a subject of major ongoing reform with revission of all

Country	Main Transfer Schemes	Allocation Criteria	Objective and other features	Comments and coming reforms
				the grants and the allocation formulas.
Ghana[45]	Many of the transfers are sent directly to deconcentrated departments for personnel emoluments and administrative costs based on the payroll Common fund for capital investments	Based on number on the payroll – centrally administered Size: Not less than 5 % of total public tax revenues. Formula approved by Parliament, includes criteria such as equal shares, status of the development, tax effort compared to the projected revenue, expenditure needs and contingency (floods, droughts etc.)	Finance the staff Ensure equitable development of infrastructure	The system is a subject for reform. Decentralisation has taken root on the development side but not the recurrent transfer side.

The review of international experiences on transfer allocation criteria shows that among the countries using measures of expenditure needs, most countries are using indicators on population. In addition, many other countries are using varies proxies for costs of the service provision, like the density of the population/land area, cost indexes. etc. Thirdly, few countries, are using various poverty indices and measures for the backwardness of certain areas. Finally, a number of countries use performance related measures e.g. Uganda[46] (performance measures applied in the allocation of development grants), Kenya (performance on introduction of new financial management and accounting reforms), Tanzania (administrative performance/pilot testing with certain districts), Ghana (tax effort), Pakistan (tax effort), Nicaragua (tax effort). Others are planning to introduce a link between the size of the transfers and the administrative/financial performance of the LGs in order to provide stronger incentives to improve on administration and / or service provision e.g. Nepal introducing tax effort and financial management performance as criteria. Most developing countries have

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[45] Ghana Fiscal Decentralisation Project, Design Report, CIDA project 400/1878, September 2002 and Central Government Transfers and Local Government Revenue, SNV, 2002 papers on transfer systems.
[46] The Ugandan LGDP – Performance Assessment System is probably one of the most sophisticated examples on these new grant systems where administrative performance as a direct impact on the size of the received transfers.

very few criteria (often 1-4 criteria for the major grants) due to lack of data and administrative capacity and a wish to keep the system transparent and simple. Allocation criteria have been reformed and /or are being reformed in a great number of countries after acquiring more experience and better data.

3.1.7 Principles Behind the Future System of Transfers in Uganda

Based on the Constitution, 1995 and the Local Government Act, 1997 and the principles and practice of sound design and management of public finances, the following principles should be watched closely when reforming the transfer system in Uganda[47]. The principles should underpin the specific design features of improved **transfer systems** as follows :

1. Keep the objectives clear and transparent and design the system accordingly, and keep the number of objectives behind each grant to the bare minimum;
2. Contributing adequately to the funding of the vertical fiscal imbalance between assigned tasks and own revenue sources, i.e. both address the *fiscal capacity* and the *expenditure needs* of the LGs;
3. Supporting, not undermining, decentralisation and local revenue raising;
4. Ensure a minimum number of different systems of transfers and transfer modalities;
5. Transparent, formula and needs-based allocation across local governments enhancing horizontal equity (pro-poor);
6. Stable, predictable and timely transfers;
7. Enabling LG flexibility & initiative within national policy;
8. Involving and strengthening the whole LG structure;
9. Ensure Upward, Downward & Horizontal Accountability. This will include simple, targeted, and consolidated reporting systems;
10. Achieving public participation and transparency;
11. Based on the availability of data and kept as simple as possible;
12. Ensure proper <u>incentives</u> to improve on administrative performance and service provision, i.e. rewarding proper initiatives and penalising inefficiency;
13. Linked to other LG reforms and initiatives, especially the LG finance system (taxes, user charges) and the capacity building activities;
14. Keep track on the actual implementation of the system, i.e. the transfer flow;
15. Adjustable to new LG structure, tasks and responsibilities and ensure proper transitional schemes.

[47] The principles are largely drawn from the Report: Fiscal Decentralisation in Uganda – The Way Forward, Final Report, January 2001.

The transfer system should <u>not</u>:

1. Base the transfers on the existing infrastructure and services (service outlets);
2. Bring about sudden and large changes and should ensure that LGs are held nearly harmless during the transition;
3. Be subjected to political interference in the allocation of funds during the FY;
4. Cover deficit and financial mal-practise as such a grant will create disincentives to improve on financial management;
5. Be solely based on an equal share approach as this does not consider various needs in various LGs.

As mentioned, some of these principles may require significant time to implement in practise, e.g. the wish to improve LG incentives and reward good performance, but it is important that the formulas are not penalizing LGs, which have managed to improve own revenue generation and have made an effort to improve on the service provision and infrastructure. It is also important to note that it may not be possible to achieve all the principles simultaneously and that conflicts may emerge and trade-offs needed, e.g. a flexible system adjustable to new LG functions may not be fully stable and predictable and strong incentive systems may to a certain extent contradict equity objectives.

3.1.8 Implications for the Future System of Transfers in Uganda

The choice of the future transfer allocation principles will depend on the type of LG fiscal system and transfers in Uganda. The present system of transfers in Uganda is very complex and comprise a large number of transfer schemes (>30) and allocation criteria, which were not previously reviewed holistically.

Legal framework Compared to the Overall Theory and International Practice

The Ugandan Constitution, 1995 and the LG Act, 1997 comprise – in international comparison - one of the most detailed description of the transfer system.

The *Constitution* specifies three types of CG transfers that are supposed to be given to LGs namely:

1) Unconditional,
2) Conditional and
3) Equalisation Grants.

The *unconditional grants* (Art. 193) are defined in the Constitution as :"the m*inimum grant that shall be paid to LGs to run decentralised services and shall* *be calculated in the manner specified in the seventh schedule of the Constitution".* The seventh schedule defines the amount paid in a given fiscal year to a LG, as the amount paid to it (LG) in the preceding fiscal year for the same items adjusted for general price changes plus or minus the budgeted costs of running added or subtracted services.

Initially, the grants were distributed taking into account four factors: Child mortality (40 %), school age population (40 %) general population (10 %) and area (10 %), but was changed to the reflect only population 85 % and Surface area (15 %) and is now – in practise - heavily influenced by the existing staffing level, size of the salary costs and the arrears, cf. chapter 4.

Concerning the *conditional grants*, it is mentioned that: "*Conditional Grants is the minimum grant that shall be paid to local governments to finance programmes agreed upon between the Government and the local governments, and shall be expended only for the purpose for which it was made and in accordance with the conditions agreed upon"*.

Again the criteria are not specified. It is only important to note that the conditions should be "agreed upon" with the LGs.

Concerning the equalisation grant, clause 4 of Art. 193 of the Constitution (elaborated on in Section 84 of the LG Act, 1997) defines the EG as *"Money to be paid to LGs for given subsidies or making special provision for the least developed districts; and shall be based on the degree to which a LG unit is lagging behind the national average standard for a particular service."*

It is further emphasised that districts shall be obliged to indicate how conditional and equalisation grants obtained from Government are to be passed onto the lower levels of LGs.

The legal framework suggests several things about the grant allocation formula:

The selection of criteria for the equalization and conditional grants are not detailed in the legal framework and should be based on the principles outlined;

?? The unconditional grant is allocated to run the *decentralised ser*vices, but these services are defined or specified e.g. basic administration, the sector related staff, the new functions etc. This is open for interpretation, and has been changed several times, cf. chapter 4;

?? The unconditional grants have to be *adjusted* for new services and increases in prices (well in accordance with the theory);

?? The conditional grants need to be *negotiated* between central and local government. In future, the LGBC may be a forum for this. The conditional grants and the description of these can be perceived to resemble the theory outlined above;

?? The legal framework on the equalisation grants defines that the grants should be transferred to LGs which are least developed and to the degree these LGs are "lagging behind" the national average standard for a particular service. A direct word by word interpretation may pose problems with the exiting LG fiscal system in Uganda and may also contradict the economic theory on transfers, but a more broad interpretation leaves room for a proper design. First, The national standards have not yet been designed in Uganda and generally pose a fundamental challenge[48]. Secondly, a design based on a word by word interpretation of the Constitution may lead to incentives for LGs not to improve on LG services to avoid subsequent reduction in grants, cf. the theory outlined above. Notwithstanding, the EG should support more equal LG opportunities to provide services to a minimum standard level.

?? A more broad interpretation of the EG clause, as per the present method for EG, deems more appropriate, where proxies to define the "lagging behind" districts are applied, both in terms of LG revenue generation capacity and expenditure needs. It is important that this is related to the services, which the LGs are supposed to perform.[49]

?? The new so-called "second generation" of grants, like the PMU-Non sectoral grant, the LGDP Local Development Grant, the NAADs grants etc. are not directly dealt with in the legal framework, but may be evaluated in this light, cf. below;

?? Performance measures are not mentioned in the legal framework but can be agreed upon between CG and LGs.

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[48] The attempt to develop and use national service standards internationally have generally not been very successful (Tanzania, Russia etc.).

[49] For a historical description, please refer to Fiscal Decentralisation and Local Government Finance in Relation to Infrastructure and Service Provision in Uganda, Main Report, EPRC and NALAD, Obwona, Steffensen, Trollegaard, Mwanga, Luwanga, Twodo, Ojoo and Segya, World Bank/Danida, May 2000, P. 155-160.

The Present System and its Relationship with the Typology of Grants

In Uganda there are 32 different transfer schemes. These can be divided into 5 overall types:

General Purpose (non-sector unconditional grants)

1) General purpose, mainly recurrent transfers (unconditional grants). These are lump sum, closed ended and non-matching.

General Purpose (equalisation grants)

2) General purpose mixed recurrent and development grants (equalisation grants). These are lump sum, close ended and non-matching.

General Purpose (non-sectoral grants, but with various specified conditions)

3) General purpose (with certain restrictions and conditions) non-sectoral development grants (LGDP – LDG, PMU NSCG, etc.). Some of these are typically effort related, lump sum, but with a certain open ended share (e.g. a higher allocation if certain measures are achieved), and often based on a matching principle either cash or in-kind.

Specific Purpose (sector conditional grants):

4) Specific purpose, recurrent transfers (conditional grants), non-matching close ended and typically not effort related
5) Specific purpose, development transfers (conditional grants), non-matching, close ended, and not effort related (with the exception of SFG)

In addition, there is still a number of area specific transfers from donors to LGs for development and capacity building, typically with certain matching requirements. These may be either specific or general purpose grants[50].

The allocation criteria of these present transfer schemes are described in Chapter 4 of the Report.

Main allocation principles for the future transfer systems

All grants should preferably comply with the overall principles for any transfer system as outlined in Sections 3 and 4. The FDS is an attempt to bring the criteria closer to these objectives and the main ideas are discussed below followed by a review of the relationship between the criteria and each type of grant.

[50] For an overview of these support programmes, cf. the Programme Midterm Review of the LGDP, February 2002.

The Fiscal Decentralisation Strategy 2002

The Fiscal Transfer Strategy, March 2002 adopted for testing in 15 pilot LGs by the Cabinet of Ministers in June 2002, was a result of a comprehensive review of the existing transfer systems and the remedies. The Strategy (FDS) deals with the overall transfer system and the key principles, without detailing the specific allocation criteria. According to the Strategy the following allocation principles should be pursued:[51]:

- Be more poverty focused and take into account the LG expenditure needs in various areas, (p.22);
- The allocation formulas should take into account the various costs of provision of services in different areas of the country;
- Provide better possibilities to achieve sector goals;
- Provide direct financial incentives for LGs to increase LG revenue and ensuring that local revenue contributes meaningfully to local development;
- Co-funding requirements (matching grant) should be the same across all the sector development grants based on a study of the optimal level (P. 22);
- Provide better incentives for LG performance by introduction of a system which provides more flexibility on the utilisation of the transfers for well performing LGs (p. 12);
- The incentive system from LGDP will be mainstreamed and adjusted into the sector development policies and guidelines;
- Basic minimum access criteria for development grants should be developed;
- Increase the discretionary powers of LGs and increase the discretionary funding via the UCG and EG;
- The allocation formulas need to be reviewed holistically (p. 22).

[51] The Strategy, p. 11.

Based on these principles (poverty focused, co-funding, performance incentives, flexibility, streamlining etc.), the new Background Document to the Pilot Budget Guidelines under the FDS Pilot[52] has outlined some of the future features of the co-funding and the performance incentive system.

New Principles for Co-Funding

According to this analysis, the system should include a level of general co-funding which is affordable and a level, which is equal to all LGs. The system should be facilitated by a more significant level of equalisation grants and a more focused utilisation.

As funds for LG revenue and *equalisation* grants are interchangeable (often used to finance the similar tasks), and as the main objective behind the EG is to support service provision and infrastructure in the financially weaker districts, in particular to support the funding for development projects, the districts should be allowed to use equalization grants to co-finance development programs. This is seen as a very efficient way to ensure that the major part of the EG is spent on real development.

If districts are allowed to use equalisation grants[53] for co-financing purposes, this will significantly improve the potential for co-funding, although the affordable level is still rather limited. Analysis shows that uniform co-financing requirements will require that the present level of co-financing for the LDG is reduced to approx. 3%.[54] However, if it is decided that the existing development grants, e.g. the allocation of the local development grants, should be more poverty sensitive, this will further increase the demand for the weaker districts to provide co-funding.

The best way to ensure that weaker districts can afford the same level of co-financing as the financially stronger districts is to increase on the future EG in combination with support to further capacity building on tax enhancement[55]. Therefore, it is not recommended to solve the fiscal differences across LG in a piece-meal way, including introduction of variation in co-funding requirements, with lower co-financing for poorer districts. This will make the entire administration very demanding and will not ensure a proper holistic view on the strengths and weaknesses of LGs. A more feasible way is to increase the size of the equalisation grants, with due consideration to all other grants and their

[52] Please refer to Fiscal Decentralisation Strategy: " Background Document – Design Elements and Implementation Issues, November 2002.
[53] It is expected that this is already taken place in some districts as the revenues are pooled together.
[54] Even this level requires an improved effort concerning LG taxes as the figures areas based on the tax-yield from 1999/2000.
[55] Both in terms of the size and the allocation criteria.

impact. If the equalisation grants were to be increased by 75% this would enable a 5% level of co-financing to be affordable by most LGs. [56] According to the proposals, uniform co-financing should be expanded to cover all development grants from 2004/05. Given preliminary analysis, it has been recommended that all LGs be required to make a co-financing contribution of 5% of the total value of grants and that size of the Equalisation Grant be increased by 75%.

In the reform of the grant allocation system, and other reforms, special districts like Yumbe District, should be further reviewed and measures taken to improve on their financial capability. Few of the districts appear to have specific problems with low LG own revenues compared to the size of the development grants thus posing severe sustainability risks.

Modalities for Local Contributions - The co-financing requirements will be a future minimum condition for the transfers of sector development grants. During the yearly national assessment of the minimum conditions and performance measures in August /September, the LGs will have to prove that they have:

a) Complied with the co-financing requirements for the previous Fiscal Year

b) Budgeted for the co-funding requirements for the current Fiscal Year and

c) ensured and proved that the required co-financing percentage for the first quarter of the current FY is available.

This has a number of ramifications for the budgeting process, among these that the LG revenue sources should be perceived as a crucial part of the "mandatory" tasks if the LG should attract funds for development activities.

The priority given to budgeting for co-financing will be similar to components like budgeting for permanent staff and other mandatory expenditure areas. The budgeting for co-financing has to be an integrated part of the Budget Framework Paper. The co-financing requirements should also be given priority when disbursing funds during budget execution process and ensure that investments can take place.

[56] References is also made to the analysis made in the "Preparation of LGDP II, Annex 2", August 2002, document. In the preparation of the design of the LGDP II estimates where made of the maximum size of the co-finance for LDG, and this is included in the present draft model. Introduction of co-funding requirements on other grants – in the short term – will require an adjustment of the co-funding level within the LGDP-II, LDG.

3.1.9 New Principles for the Incentive Framework

Essential to the new FDS transfer system is an incentive system, which encourages good performance in terms of efficient LG administration and service delivery. The reward and penalty system will be linked to a clear, transparent, objective, simple, fair and acceptable performance assessment and incentive system (system of rewards and sanctions).

In addition to the performance incentive systems around the Local Development Grant, new sets of incentives and penalties will be introduced under the FDS:

Incentives concerning the ***development grants***

There will be two types of incentives:

a) Variation in the LG *autonomy*/discretion available to a local government, i.e. the flexibility in the way the transfers are budgeted for and utilised (both in terms of the % flexibility in the recurrent transfer budget and the size of the Local Development Grant).
b) Increase or decrease in the *size* of the sector development grants if LGs are performing well. This is in addition to the already existing incentives concerning the LDG grants, and withholding access to Sector Development Grants.

The national Local Government Assessment process will be central to the whole system, which will take place in August/September. The assessment will feed into the indicative grant allocations provided by the MFPED to Local Governments in early October.

a) Minimum conditions for accessing development grants:
A subset of these LDG minimum conditions should be further defined in order to get access to the sector development grants. Some of the key MCs should be:

?? The Budget Framework Paper is in place following the guidelines
?? The annual work-plan and budget in place
?? Draft Final Accounts in Place
?? Accountability for the previous quarters funds both in terms of financial and output performance made

b) Performance criteria
Sector specific performance criteria and measurement processes need to be developed, along with a scoring system in line with the national assessment process. Local Governments would be required to assess and score their own sector service delivery, by a certain date. Central government would then take a

sample of these internal sector assessments and verify their accuracy. The performance criteria should focus on budget efficiency – i.e. the link between the budget and outputs. When *sector* specific performance criteria have been developed, the results of the annual assessment will have an impact on the future size of the sector grants (rather similar to the present system within the LGDP).

The size of the total sector grants for all districts will be fixed, but the LGs will be ranked according the efficiency in the utilisation of these grants and will be rewarded/sanctioned accordingly. The top 10 districts/municipalities will then receive a reward (e.g. 10-20 % extra sector grants) and the lowest scoring 10 districts/municipalities a 10-20 % reduction (total zero-sum) to ensure stability in the national budgeting process and sufficient incentives to improve on the administrative performance and competition amongst the LGs. Any LG, which fails to conduct the internal sector assessment in time, would automatically receive a 10% reduction in sector grant allocations.

This system has to be further elaborated, and the rewards and sanctions will therefore not be applied to sector grants for the first year of the FDS piloting (2002/03) but be applied only for the LGDP, LDG. Sector specific performance measurement systems should be developed and agreed upon, to enable the first assessment to take place in September 2003. For those sectors unable to put in place an acceptable performance measurement system, the generic LGDP criteria can be applied in the first years of the FDS, i.e. the generic performance criteria will have an impact on the sanctions and rewards concerning the sector specific grants.

3.1.10 Budget Incentives and Penalties Concerning the Recurrent Grants

a) Minimum Conditions for Access and Disbursement of Recurrent Grants:
The following will be the conditions for accessing Recurrent Transfers:

- The Budget Framework Paper is in place and consistent with the guidelines;
- The Annual work-plan and Budget have been presented to and approved by council;
- Accountability for the previous quarter's funds both in terms of financial and output performance.

b) Minimum conditions for 10 % flexibility
There should also be Minimum Conditions to be complied with in order to be eligible for the 10 % flexibility across sector grants and budget lines. These

Minimum Conditions for flexibility should be defined as the Minimum Conditions for the LDG in the LGDP II. These include (among others)[57]:

- ?? A fully updated BFP/DDP in place with involvement of the council;
- ?? Evident linkages between planning and the budgeting;
- ?? Draft final accounts for the previous FY produced as per LGA, section 87[58];
- ?? Co-financing for the development grants complied with.

c) Performance criteria:
10% additional flexibility will be provided if the LGs receive performance rewards for scoring highly under the LGDP national performance assessment. This increase in flexibility will remain, so long as the LG's score in the assessment does not decline in future financial years.

Future Implications:

- ?? There is a need to develop, as part of the sector policy reviews, sector specific performance measurement systems (a few simple measures for each sector areas) upon which the LGs will be assessed and rewarded/sanctioned within each sector area.
- ?? The existing generic LGDP II indicators (when finally agreed upon) may be applied to determine the rewards and sanctions concerning the sector development grants until sector specific performance measures are developed.

New Principles for each Type of Grants
Concerning the specific grants, the following should be pursued:

Conditional Sector grant should reflect the objectives behind these grants– i.e. enable LGs to provide services within a particular sector, e.g. for the expenditure needs of the LGs within the area of primary education the number of pupils in the school going age, is a good point of departure. These basic features should be combined with the above mentioned incentives for improved performance within each sector.

The general formula for calculating expenditure need within an area (here e.g. education) could e.g. be: Ni= Measurement Unit * Average Per Unit Costs * Adjustment Index * Performance Index

- ?? "i" is standards for the expenditure category within e.g. education,

[57] Please refer to the Annex Assessment Manual to the Draft PIP, LGDP II December 2002.
[58] The added condition of final accounts in place within the statutory deadline ahead of the start of the budget process in October.

?? Measurement unit equals number of units (here number of children in the school age)
?? Average costs per unit refers to the country's per capita public expenditure on primary education
?? Adjustment index: e.g. a) ratio of teachers salary, b) ratio of studies with physical disabilities in the LG compared to the average and c) percentage of studies from low-income families. [59]
?? Performance Criteria (when developed)

General purpose/unconditional grants: Should cover the basic LG administrative costs - and will be based on the principles on measurement of the cost needs of the basic administration. It is important not to fix the LG to a specific (from local perspective) inefficient administrative structure but to allow LGs to decide on their own administrative structure. They receive a grant, sufficient to cover certain standard needs, but they may use the grants to design their own structure. A Decision on size of the UCG should be pending the results of the extension of "the Study on General Administration costs". The size of the UCG may also be influenced by incentive measures. Basic formulas around the following components seems appropriate: A) Equal share, B) in addition to A, measures for expenditure needs, like size of the area, proxies for poverty (index), and C) performance incentive (tax effort and other performance measures, cf. above).

Equalisation grants: Should incorporate criteria from both a) LG revenue raising capacity (note: not the actual collected revenues) and b) expenditure needs (the proportion of the expenditure, which LG is mandatorily responsible for, i.e. after deduction of the sector specific grants). Criteria as revenue potential (measured by certain proxies), demographic composition (various age groups), size of the LGs/area should be the main basis for this grant. Minimum conditions such as planning, budgeting and accountability should be attached to this grant. The grant should be sufficiently big to equalise a major portion of the differences across LGs in expenditure needs (the service areas, which are not already taken care of by the conditional grants) and the taxing capacity of the LGs. It should enable LGs to provide an approximate average level of services at an approximate average level of tax and tax effort. The bigger and more equalising the conditional grant, the less the need for the expenditure side of the equalisation grant, but the revenue equalisation system is equally important. The expenditure side should measure the differences in expenditure needs and costs, but not differences attributed to inefficiency or overspending.

Development grants

[59] Refer to : "Intergovernmental Fiscal Transfers: A Comparison of Nine Countries", by Jun Ma, May 1997, The World Bank.

Concerning the criteria for the allocation of sector development grants there are some emerging issues, which need to be addressed in the final design.

First, the sector development grants should gradually be mainstreamed and merged with the LDG under the LGDP scheme. Until this takes place, these should be based on objective criteria for investment needs, like number of inhabitants, size of the territory, and if possible poverty sensitive criteria representing the stage of development.

The non-sectoral development grants should be merged into one non-sectoral development grant with incentives to spend the lions share on service provision.

Second, the transfer allocation formulas cannot be seen in isolation from other components of the system of LG finance and from other sources of LG revenues. This is especially important concerning the development grants. The size and the allocation of the development grants needs to consider the LG capacity to maintain and operate the infrastructure. More poverty sensitive development grant formulas will increase the burden for some LGs to maintain and operate the infrastructure, and need to be backed up by improved LG administrative capacity, increase in LG revenue sources and/or increase in other grants for recurrent cost areas (UCG and or EG) , especially for the poorest LGs. Otherwise, there may be a great risk that these investments are lost within a few years due lack of operation and maintenance of the physical infrastructure.

Third, the transfer allocation criteria have to consider the other funds transferred to LGs from various programmes and projects, especially larger support schemes like NUSAF[60] and various district support programmes. Some of these programmes will be folded into the LGDP LDG, but others, e.g. the Belgium supported districts and some EU programmes will continue to support some of the LGs within the coming years.

Fourth, and this goes for both recurrent and development grant formulas, the system cannot be more complex and detailed than the basic data availability allows it to be. The formula should be simple, transparent and valid data should be available.

Finally, any changes of the system should consider inclusion of transitional schemes and use of an incremental approach to avoid shocks in the system.

[60] NUSAF and the question of poverty allocation formulas is a bit of "chicken and the egg dilemma". One of the reasons for NUSAF was to provide more sources to the North as the existing grant system was not sufficiently addressing the special problems in this area. A general system, which does not address special problems, may risk continuing to create the demands for special (out of budget) schemes, but the specific support may also be an argument for not changing the general ("on budget") system.

Large fluctuations cause problems with the budgeting, cause problems with operation and maintenance of the existing stock of infrastructure and services, staffing problems (how to get rid of the redundant staff and adjust the costs) and political problems in adjusting the service level within a short time. New criteria may be incorporated over a certain time-span and/ or the weight of the new criteria introduced gradually.

CHAPTER FOUR

STUDY FINDING

4.1.1 GENERAL GOU OBJECTIVE ON TRANSFER CRITERIA

4.1.2 Poverty Eradication Action Plan

The PEAP is Uganda's comprehensive development framework. The PEAP has guided the formulation of Government policy since 1997; the country is being transformed to a modern economy in which agents in the sectors can participate in economic growth. The 4 pillars of PEAP are: -

- Fast and sustainable economic growth and structural transformation.
- Good governance and security.
- Increased ability of the poor to raise their incomes.
- Improved quality of life of the poor.

Financing PEAP: Re-prioritizing existing Government Spending

a) The role of PAF

One of the fundamental reasons for the progress that has been made over the last four years in implementing PEAP has been the increased availability of funds arising from debt relief. In 1998, the Government of Uganda created PAF to act as a conduit for the financial resources saved as a result of debt relief under the HIPC initiative. The Government of Uganda voluntarily earmarked <u>all</u> the savings from debt relief to fund substantial increases in spending in PEAP areas that directly affect the poor, namely: -

- Primary education
- Rural feeder roads
- Agriculture extension
- Rural water and sanitation
- Primary Health Care
- Gender
- And other areas like security and environment are being proposed to be included in Poverty Action Fund

b) Long Term Expenditure Framework

Under PEAP, the Medium Term Expenditure Framework has become an essential tool, enabling sectors to reprioritise their plans in line with likely level of resources for each sector and so develop reliable year-by-year budget plans.

4.1.3 Poverty Action Fund (PAF)

In 1998 the Government of Uganda was granted debt relief from donor countries and multinational agencies under the Highly Indebted poor countries (HIPC) initiative. This led to the formation of Poverty Action Fund (PAF) in order to channel the additional government funds resulting from HIPC debt relief initiative and mobilize further donor resources towards the key sectors identified in the Government Poverty Eradication Action (1997) namely increasing incomes of the Poor and Quality of life through improving Rural Feeder Roads, Primary Education, Implementation of land Act, PHC, Agriculture Extension, Water and Environmental Sanitation, Micro- finance/Restocking and Adult Literacy.

The PAF is also being used to accelerate the process of decentralization for maximum involvement of the beneficiaries and hence the majority of PAF funds are being channeled directly to the districts and urban authorities as conditional grants addressing most of the key sectors above. Conditional grant system is being used to ensure that the funds are all used on the key programs in the PEAP. This trend will continue with the enhanced HIPC debt relief.

The current configuration of conditional grants per sector are presented in table 1 below for 2002/03. The table also indicates the non-sectoral conditional grants, equalisation and unconditional grants.

Table 9. Type of Grants and Respective Amounts in the FY 2002/03

No.	Sector	Conditional Grant	Amount '000'	Percentage of total grant
1	Health	PHC wage (recurrent)	43,860,683	6.54
		PHC non-wage (recurrent)	19,665,789	2.94
		NGO PHC (recurrent)	15,750,443	2.35
		PHC NGO Doctors' wage (recurrent)	862,555	0.13
		District Hospitals (recurrent)	8,714,000	1.30
		PHC development	7,577,353	1.13
2	Education	UPE Capitation (recurrent)	41,533,533	6.20

		Primary Teacher's Salaries (recurrent)	185,072,250	27.62
		Secondary Teacher's Salaries (recurrent)	58,249,700	8.69
		Secondary Capitation (recurrent)	7,733,931	1.15
		Tertiary Salaries (recurrent)	13,424,331	2.00
		Health Training (recurrent	1,888,542	0.28
		School Facilities Grant (Development	53,883,202	8.04
3	Roads	District Roads (dev/recurrent)	16,305,749	2.43
		Urban Roads (dev./recurrent in the share of approx. 50 /%50 % partly isn´t it ?)	4,479,502	0.67
		Workshop (recurrent)	2,500,000	0.37
4	Water	Urban Water (Recurrent)	1,285,913	0.19
		Rural Water (Development)	24,492,003	3.66
5	Agriculture	Agriculture Non-wage (recurrent)	2,820,863	0.42
		Agriculture wage (recurrent)	3,060,808	0.46
		NAADS (Development)	5,658,837	0.84
		Agriculture Development Centres	100,000	0.01
6	Gender, Labour and Social Development	Functional Adult Literacy (recurrent)	1,423,060	0.21
7	Accountability and Statutory Bodies	Statutory Boards (recurrent)	7,416,060	1.11
		Monitoring (recurrent)	4,821,234	0.72
8	Non Sectoral	LGDP (development)	41,900,065	6.25
		PMA Non Sectoral, non	4,986,882	0.74

		wage (development)		
		Dutch Grant (development	8,710,000	1.30
	Sub Total			**87.79**
	Other Grants			
	Unconditional Grant	Districts		10.83
		Urban		0.72
	Equalisation Grant			0.65
	TOTAL			**100%**

Specific Grants

Below is provided a brief overview of the objectives of some of the main grants.

4.1.4 Unconditional Grant

Purpose of the Grant

It is a minimum grant that is paid to LGS to run decentralized services, it covers both wage & non – wage. This grant is supposed to provide a substantial amount of policy discretion to LGs in spending the funds to council priorities.

Current Allocation Formulae

The current allocation criteria are Population and Area with the weight of 85% and 15% respectively.

Evaluation of Allocation Criteria

Adequacy

The grant is not adequate in all the districts. In some LGS like Kamuli, Moyo, Jinja, Kapchorwa,Tororo, Busia, Kumi, Apac T.C and Luwero are not able pay their wage bill out of the un-conditional grants. For example the table below show the status of Kamuli district in FY 2001/2002.

Table 10: Monthly Collection/Allocation for Kamuli: FY 2001/2002 Figs in Mil Ushs

Local Revenue	32.4
Unconditional Grant	141.7
Unconditional + Local Revenue	174.1
Councillors Allowances	6.5
Total Wage-bill	149.4
Discretionary Funds	18.2

Kamuli district had a total of Ushs 174.1 millions when both local revenues and unconditional grant are combined. When the council pays wages, Salaries, Councillors allowances it is left with only Ushs 18.2 millions compared to the required Ushs 84.0 millions per month to run council activities. This has resulted in lack of resources to other departments (the matter is more serious to non-PAF sectors), failure to pay gratuity and pensions, and meeting co –funding obligations.

Local Governments visited expressed concern that annual salary increment has been effected over the years, with no corresponding increases in the unconditional grant This inadequacy has resulted into accumulation of salary arrears. Therefore, it is important to consider wages and salaries in the allocation criteria.

Grant Allocation Criterion Relative to Intended objective

The main purpose of the grant was to provide policy discretion to LGs to enable the councils to allocate funds to their priority sectors. Unfortunately, this has not been the case because of inadequacy of the grant. Most of the funds covered wages & Salaries of workers, which almost translate the grant into "a conditional grant".

Application of the Grant**.**

As already indicated data has been a problem in the application of this grant. This study has shown that at times the population and area were not used in allocating the funds. What used to happen is to calculate the growth in the grant in the current year, distribute it in the pro-rata basis to all LGs and add the result to the previous year's allocations. The implication of this is that it can create a "visible" short fall over time especially when population growth far exceeds the growth in the grant.

In application of the formulae, we have been considering population growth and ignored other factors like migration. This has been a big problem to LGs neighbouring the Sudan. But caution must be taken to distinguish between internal local migration and international migration, as the later may need extra funding of the grant.

The allocation has not been putting in consideration the district/LGs under insurgency and those that are affected as the result of subsequent migration migrations. Should it remain relevant for district say Gulu district to get the grant for the people who had fled to Gulu municipality or consider giving the equivalent to the municipality? What can be a constant expenditure is salary in the affected areas, but the rest may vary because of the migration of inhabitants.

There has been double counting in allocation of this grant in favour of the district with urban population still counted as part of the district.

Local Government has experienced unexplained shortfalls. The matter is made worse for Local Governments because they were not aware of the specific central institutions responsible for allocation of this grant. (LGFC, MOLG or MoFPED).

In the past creation of new town councils has impacted negatively on the allocation to old towns because there was no corresponding transfer of funds from the mother districts.

The effect of the creation may not be seen if there is huge growth in the grant but if the grant does not grow or the growth is less than what is required to finance (unconditional grant) the new councils, then the cut would be visible.

The unconditional grant according to schedule seven of the Constitution, 1995 is to provide for both wage and non-wage expenditures in local governments. However, the inadequate growth in the unconditional grant has created wage problems for some local governments. From the sample local governments, it has been noted that due to inadequacy in the growth, unconditional grant that is supposed to cover both wage and non-wage is not even adequate for only wages (see table 11 below).

It is also important to note that while the unconditional grant is generally inadequate, some local governments have structures that are difficult to account for. For example in the table….. below indicating wages charged on the unconditional grant for March 2002, Apac district had 1,023 employees while Mbarara which is relatively bigger in terms of population and area had 693 employees. Some other cases in that category with unsustainable structures include Arua, Tororo, Lira, Kumi, Kamuli, Pallisa etc.

It was against that background that the restructuring study by the Ministry of Public Service was commission to streamline structures of local governments which are comparable.

Table11: **DISTRICT WAGES CHARGED ON THE UNCONDITIONAL GRANT**

District	March-2002 No. Staff	March Payroll Amount	Total Unconditional	Monthly Release
ARUA	1,042	152,072,919	1,994,477,737	166,206,478
GULU	553	78,862,695	1,621,918,108	135,159,842
LIRA	860	150,076,981	1,950,975,776	162,581,315
MBALE	588	97,852,982	1,728,876,808	144,073,067
TORORO	918	141,327,266	1,405,531,538	117,127,628
JINJA	492	85,889,419	1,189,924,457	99,160,371
MUKONO	892	145,686,300	2,414,633,748	201,219,479
MPIGI	574	76,243,865	1,362,787,396	113,565,616
MASAKA	339	66,759,717	2,299,670,907	191,639,242
MBARARA	693	114,160,049	2,764,326,597	230,360,550
KABAROLE	410	56,461,276	1,150,751,367	95,895,947
KABALE	511	79,544,287	1,413,264,410	117,772,034
RAKAI			1,724,383,148	143,698,596
APAC	1,023	145,196,679	1,708,770,227	142,397,519
BUSHENYI	668	103,753,210	2,081,914,646	173,492,887
HOIMA	412			78,249,494

		63,814,011	938,993,929	
IGANGA	570	104,257,680	1,743,462,968	145,288,581
KAMPALA	122	21,511,134	2,378,950,271	198,245,856
KASESE	605	89,247,771	1,406,213,832	117,184,486
KISORO	281	52,019,083	732,075,854	61,006,321
KITGUM	375	53,540,606	1,052,590,773	87,715,898
LUWERO	692	112,020,039	1,465,379,549	122,114,962
MOYO	316	45,461,639	548,369,629	45,697,469
MUBENDE	491	77,401,017	1,913,819,167	159,484,931
NEBBI	530	76,651,984	1,194,051,580	99,504,298
RUKUNGIRI	419	62,377,142	913,372,704	76,114,392
SOROTI	517	81,233,799	1,191,526,499	99,293,875
KALANGALA	85	18,773,470	540,103,180	45,008,598
KIBALE	475	70,083,343	960,877,173	80,073,098
KIBOGA	328	54,205,251	736,466,623	61,372,219
KUMI	525	79,006,612	984,679,119	82,056,593
MASINDI	453	70,904,841	1,272,262,235	106,021,853
KOTIDO	620	95,887,376	1,312,994,165	109,416,180
MOROTO	386	55,609,839	737,704,274	61,475,356
NTUNGAMO	376	57,959,324	1,059,399,585	88,283,299
KAPCHORWA	368	60,624,558	574,634,785	47,886,232
KAMULI	814			141,790,892

		121,579,687	1,701,490,700	
BUNDIBUGYO	346	55,368,730	605,854,182	50,487,849
PALLISA	633	100,406,976	1,320,187,604	110,015,634
ADJUMAN	157	27,079,322	651,065,801	54,255,483
BUGIRI	185	32,955,283	1,072,587,520	89,382,293
BUSIA	196	29,887,422	663,464,695	55,288,725
KATAKWI	340	55,531,255	761,540,591	63,461,716
NAKASONGOLA	88	14,073,180	644,692,015	53,724,335
SEMBABULE	53	9,285,964	662,626,548	55,218,879
MAYUGE	195	31,250,805	989,714,133	82,476,178
SIRONKO	142	24,859,716	843,800,180	70,316,682
YUMBE	146	22,718,618	553,994,699	46,166,225
WAKISO	412	62,923,338	1,943,420,141	161,951,678
KAYUNGA	101	17,520,016	941,254,595	78,437,883
KYENJOJO	193	31,373,798	1,054,497,176	87,874,765
PADER	185	29,130,732	964,364,688	80,363,724
KAMWENGE	94	16,683,338	848,025,883	70,668,824
KABERAMAIDO	127	20,676,216	563,900,026	46,991,669
KANUNGU	148	22,769,204	742,058,717	61,838,226
NAKAPIRIPIRIT	228	32,616,473	685,831,091	57,152,591

4.1.6 EDUCATION SECTOR

The Current Education Policy in Decentralised Service Provision

The mission of the Ministry of Education and sports is: “to provide for support, guide, co-ordinate, regulate and promote quality education and sports to all persons in Uganda for national integration, individual and national development”.

The sector as reflected in the mission is one of the four pillars of PEAP as it strives to improve the quality of life of the people.

According to second schedule of the Local Governments Act,1997, education services, which cover nursery, primary, secondary, trade, special and technical education are decentralised. However, the practice is quite different, some areas like secondary education are partially decentralised, while trade, special and technical are not clear at all. The policy direction in line with decentralisation is also not clear.

Under the Education Sector Investment Programme (ESIP) framework, the strategic policy objectives of the ministry include:

Ensuring universal access to primary education,

Improving quality of primary education,

Ensuring equity of access to all levels of education,

Forging a stronger partnership between the public and the private sector,

Building the capacity of the ministry and the districts to provide public services and to effectively enable private service delivery,

Broad target for the medium term is to maintain at least 31% of total Government discretionary recurrent spending being allocated to education sector. Allocation within the sector to be as follows: primary, 65%, secondary, 14%, BTVET, 8%, tertiary, 10% and others, 3%.

The grant system in the Sector

Currently conditional grants in the education sector are allocated by the ministry of Education and Sports in collaboration with districts (by providing data), Ministry of Finance, Planning and Economic Development, Ministry of Public Service and Ministry of Local Government. There are currently seven conditional grants in the sector. Six of these are recurrent transfers while one is for development activities (SFG). These are:

UPE Capitation

Salaries for Primary teachers

Secondary School capitation

Salaries for secondary school teachers

Salaries for Tertiary institutions

Health training, and
School Facilities Grant.

All tertiary institutions receive their wages in form transfers to their respective local governments while their capitation is disbursed as subventions from the centre.

UPE Capitation Grant

This grant is provided by Government through the Ministry of Education and Sports to improve equitable access to basic education by removing the burden of paying school fees from the parents and enhancing quality of primary education by providing schools with resources (instructional and co-curriculum materials) necessary to run them. The grant caters for annual tuition fees for only Government aided primary schools at a fixed rate of shs 5000 per pupil for P1 - P3 and shs. 8,100 per pupil for P4 - P7. The grant caters for basic items that are vital for the learning of the child. The allocation criterion is based on the level of enrolment in schools. Last financial year an attempt was made to revise the allocation criteria. The formula that was designed to bring about equity, gender responsiveness etc was abandoned in the first quarter of the FY 2001/02.

The Ministry of Education intends to revisit the formula for possible application in the FY 2003/04. The formula, which had been developed, had two components namely, the threshold or fixed grant (TG) and the variable grant (VG) and also making a distinction between urban and rural schools. However, in all the following parameters were included as policy allocation variables:

Enrolment
Gender,
Number of disabled children,
Location on the rural/urban axis (given as a constant),
Cost of living index (takes care of inflation)

Mathematically the formula is expressed as follows:

The fixed or threshold component (TG) of the grant was expressed as follows:
TG (rural schools) = TE x 600/= x 1.05 x 1.13
TG (urban schools) = TE x 600/= x 1.05 x 1.10

Where: TE is given total enrolment, 600/= is a fixed average cost per pupil per month, a cost of living index of 5%, a 13% location parameter for rural schools and a 10% location parameter for urban schools.

The variable component (VG) of the grant is calculated as follows:
VG = 600/=(b + 1.25g + 0.33d) x 1.05

Where: 600/= is again the average cost per pupil per month, b is the number of boys, g is the number of girls, d is the number of children with disabilities. The VG provides a 25% mark up for girls, 33% mark up for the disabled children and a 5% cost of living index.

In the study that led to the formula, it was noted that the new formula introduces three significant policy instruments in the overall government of Uganda well-established affirmative policies on;

girl child education,

education of the disabled child, and

focus on rural development.

It is important to note the initiative was welcome in as far as trying to streamline and make the allocation criteria more efficient and transparent. It points out issues that are central to the management of UPE funds and within the terms of reference tried to recommend the way forward.

However, in our opinion it is important to note the following on the recommendations:

It was reported in the UPE Tracking Study of Nov. 1999-February 2000 that many schoolteachers inflate enrolment figures in order to get more money. The recommendation on the formula does not address this issue of false data. In any case if all the data required to implement the formula is to be submitted by the individual beneficiaries, false reporting may worsen.

The option here may be that allocation to districts can be based on a determined school going and at the district level allocation can be based on the enrolment and other parameters.

It was not clear on what items eligible for UPE capitation, the expenses of girl child are more than that of boys by 25%. If it was not merely for affirmative action for the girl child. However, this could be a positive move if only we can clearly identify items among the four eligible items for expenditure in the guidelines, namely, extra instructional materials, co-curricular activities, school management and administration, expenditure on the girl child exceed that of a boy.

How the coefficients of the model for UPE capitation were arrived at needed to be clarified further.

When it came to the allocation, the amounts indicated significant differences in relation to the previous year. The big changes in amounts if implemented were bound to create problems in the system. If the formula was agreed as more efficient, then a mechanism to introduce it with a view to minimise disruptions would have been put in place.

More importantly the formula addressees the present service level and support per pupil, instead of supporting according to the needs, i.e. the number of pupil in the school going age. This important feature has to be thoroughly considered.

Salaries for Primary Teachers Grant

The allocation of this grant to respective local governments is determined by the enrolment in reference to a centrally set pupil teacher ratio. But the actual disbursement depends on the number and value of teachers on the payroll in the Ministry of Public Service and Uganda Computer Services of Ministry of Finance, Planning and Economic Development.

The problem with the current system of allocation is that in many cases the allocations have not been in line with what is on the ground. To the effect that the Ministry of Finance has had to create corrigenda to address the shortfall in wage obligations.

Accessing of teachers on payroll though improving is still a problem within the system, which happens to run from individual schools to the Ministry of Public service. As a result many stakeholder have been advocating for the decentralisation of the payroll management.

Secondary School Capitation Grant

Government allocates this grant to cater for items that are vital for the learning of the student. The allocation to each local government is determined by the enrolment. It is noted that in theory, the actual amount allocated is computed at a rate of shs. 65 per child per working day for both day and boarding schools. However, the growth of the grant has not marched with that of student enrolment resulting into the per student rate actually received to be lower than the prescribed rate.

The grant as a matter of reform need to address the present service level and support per student, instead of having a fixed rate for many years. This important feature has to be thoroughly considered.

Currently there seems to no clear policy direction in the provision of secondary school education in the school. As a matter of streamlining the delivery of secondary education, a clear secondary education policy needs to be developed.

Salaries for Secondary School Teachers Grant

The actual number of teachers in post for each district determines the allocation to each district. The Ministry of Education determines the load for each teacher in various disciplines. The Education Service Commission recruits and the Ministry of Education and Sports appoints and deploys/posts to the needy schools. The salaries for teachers are handled by the Ministry of Public Service. However, it is important to note that like all facility based transfers, local governments with more schools receive more teachers.

Salaries for Tertiary Institutions Grant

These grants are to meet the salaries of primary teachers colleges, technical colleges and institutes, and rural trade schools. The actual number of teachers determines the amounts allocated to each district. The Education Service Commission establishes the staffing norms and recruits. The appointing and deployment authority is the Ministry of Education and Sports. The salary administration is done by the Ministry of Public Service together with the respective local governments.

Since the grant is facility based, its allocation is largely unequal across districts. The district with more facilities will definitely receive more in allocation that those with less or without. However, just like any other education institution in Uganda accessibility to these institutions is not limited to residents of only those in the district. However, it would be of good intention to improve on equity in the distribution of the institutions especially at the lower levels to be more uniform.

Health Training

This activity was until the recent reform in government structures under the ministry of health. It is now being managed by the ministry of Education just like other training institution in agriculture, fisheries, co-operatives etc. There seems to be no clear allocation criteria of this grant known to the ministry of education and sports. It is apparent that the allocation is based on historical data from the ministry of health. Currently the ministry of finance, planning and economic development does provide the transfers. However, the debate in on whether to 'return' this activity to the mother ministry or what strategy need to be put in place to improve performance.

Subventions in some Specialised Institutions

All institutions under BTVET receive their capitation grant from the Ministry of Education directly. Some of these institutions receive their wage grants through the tertiary institution grant given above. Allocations of non-wage are allocated to schools based on a defined rate per student per day. The technical schools receive shs.600 per day per student for all days at school. The technical institutes receive shs.850 per day while Uganda Technical Colleges and Uganda Colleges of Commerce receive shs.1,100 per day per student. The latter two categories of institutions are not decentralised. However, the form of disbursement on non-wage is similar.

The non-wage funds are basically for food, but in practice, the institutions have utilised them for expenditures, which are not food items. Like capitation for primary and secondary education, these rates given per student are not sensitive to inflation. The rates have not changed for over 5 years.

School Facilities Grant

According to Ministry of Education and Sports guidelines (December 2002), it is designed to assists most needy school communities to build new classrooms, supply furniture for classrooms constructed, build latrines as well as teachers houses. The target of the grant is to achieve the classroom: pupil ratio of 1:55; desk: pupil ratio of 1:3; latrine: Teacher/pupil ratio of 1:40 and at least four (4) teachers' houses per school.

The grant is allocated according to need. The need is calculated based on the Pupil: permanent classroom ratio. The higher the ratio, the higher the need hence more funds allocated. Fifteen per cent (15%) of the allocated amount to individual district/municipality is allowed for construction of teacher's houses.

The Ministry of Education has introduced certain incentives schemes for the best performing districts, but these have not been fully transparent for the local governments.

Comments on the Current Grant System in Education Sector

One of the major problem facing the grant transfers in the sector is data i.e. the statistics used in the allocation. Mechanisms need to be put in place to guard against use of false data. The Commission wishes to have a collaborative approach with stakeholders and agree which data to use. For example the use of potential demand i.e. age ranges in case of disbursement from the centre while utilise enrolment and other parameters when allocation to schools from the districts.

In education the national status in indicators such as the pupil to teacher, classroom and textbooks have a strong influence on allocations between programmes within the sector. MoES uses the status of sector indicators as a means of reducing the variation of service delivery levels between local governments. For example in classroom construction allocations are based on the prevailing classroom to pupil ratio in a local government. The intention is for LGs with a lower status to allow worse of LGs to "catch up", reducing the disparity of sector outputs within the country. However, allocations solely on the basis of the status an output/service level indicator actually creates perverse incentives, which undermine rather than promote budget efficiency. This leads to a situation where LGs receive higher grant allocations the worse the classroom to pupil ratio is and the worse services they are producing. If a local government wants to maximise future revenues, it is its interest either to use the funds inefficiently, or to understate the stock of classroom, and overstate enrolment. Justifying allocations in terms of outcome indicators, instead of output indicators, avoids the perverse incentives to increase budget inefficiency, as the use of inputs does not directly effect outcomes. [61]

The system of channeling operational funds to Tertiary Institutions needs transparency, as it is not reflected in transfers to local governments. It is only the salary, which is shown.

There also needs to be a review of the reasons why some areas, supposed to be decentralized, are still operating under the Ministry of Education.

A closer analysis of the grant allocation seem to indicate that there is weak relationship between UPE capitation and Salaries for primary teachers, yet both have a great bearing on enrolment. For example in the FY 2000/01, Mubende District was allocated shs. 760,656,000 as Capitation grant and shs. 4,028,406,000 as salaries for primary teachers compared to Kasese with an allocation of UPE capitation of shs. 1,053,816,000 and shs. 3,331,651,000 for primary teachers salaries.

A review of the possibilities to provide better incentives to improve on the services linked to assessment of performance and linkages to the amount of grants transferred – cf. the FDS.

[61] Cf. example, Tim Williamson, Targets and Results in Public Sector Management, Draft.

4.1.7 HEALTH SECTOR

The mandate of the Ministry of Health is to improve on the quality of health, reduce morbidity and mortality, and attainment of good health standard. Health sector takes 1.7% share of GDP and 9.6% share of National budget for the 2002/2003 financial year. The sector transfers to local governments three conditional grants, wages and salaries to district referral hospitals. The policy documents used by the ministry to guide in the utilisation of these sector grants, includes:-

?? National health policy.
?? Health sector strategic plan.
?? Guidelines for management of funds.
?? District transfers.
?? Guidelines for work plan preparation at the districts.

Conditional grants in the health sector
Poverty Action Fund (PAF) Grants
?? Primary Health Care(PHC)- recurrent non -wage
?? Primary Health Care(PHC – Capital Development
?? Primary Health Care(PHC)- Non Wage NGO
?? Primary Health Care(PHC) – Wage
?? NGO Doctors - Wage
Non- Poverty Action Fund (Non-PAF) Grants
?? District and Regional Referral Hospitals

PHC Non-Wage

This is a recurrent non-wage grant and with the objective of delivering minimum health care package through provision of the operational costs of the health facilities, procurement of drugs and general administration of the office of the District Director of Health Services.

The ministry expects that utilization of this grant should increase the immunization coverage to 50%, and 100% of the people to attend Out Patient Department (OPD) at least once a year, increased number of deliveries, drugs and improved supervision and monitoring by management

Current Allocation criteria for PHC Non-Wage

Funds to the districts are allocated based on:
?? Distance from the centre to the districts
?? Human poverty index
?? Special health needs of a district
?? Flat rate for general administration

The allocation of Funds for the District Director of Health Services is allocated as:

?? General Administration-50% of funds
?? Area of the district (Shs 1,769 per square km) –20% of funds
?? Infant mortality rate (cost per infant not to die: Shs. 2,629) –20% of funds
?? Epidemic control (Shs. 8 per person) –10% of funds

Funds for the lower level units

At least fifty percent of the funds for the lower level units are for drugs and medical supplies. The allocation of the other fifty- percent is distributed among health centres II and III are based on the following:
?? Per capita subdivision between Health Sub- District
?? Allocation ratio HCIII/HCII =3/1, which means that a HCIII receives three times more than a mounts received by HCII.

The utilization of funds by Lower level units is as:
?? Allowances for outreach activities – 40 %
?? Transport (fuel, maintenance of vehicles)- 30%
?? Facility and property costs (maintenance of buildings and minor repairs, compound, utilities, stationery and maintenance of equipment, purchase of charcoal, paraffin)-30%.
Health centres IV are mini-hospitals and amounts to run them are defined every financial year. Fifty percent of the funds is for purchase of drugs, while the other 50% is used as follows:
?? Allowances for outreach activities- 30%
?? Transport (fuel, maintenance of vehicles)- 30%
?? Facility and property costs (maintenance of buildings and minor repairs, compound, utilities, stationery and maintenance of equipment, purchase of charcoal, paraffin)- 40%

Allocation Criteria to Municipal council

Allocation to Municipal Council is based on Population and Human poverty index PHC Non -Wage for Municipal council past through the districts

Poverty focus of the current criteria of PHC Non-Wage

The Human Poverty Index is fair in addressing poverty aspects but should be highly rated to focus on poverty. Since 50% of this fund is for drugs, which have to be procured from the National Medical Stores in Entebbe, distance from the centre and general administrative expenses may vary. For the Municipalities, Human Poverty Index is poverty focused though the population figures may be considered in the urban areas.

Allocation to Health III &II needs to revised in that the criteria does not bring out clearly the basis behind the ratio between HCIII&II of 3/1. The allocation should be based on need derived parameters.

PHC Capital Development

This is development grant with the purpose of providing infrastructures, equipment and training of health personnel. Through this grant the ministry expects infrastructure in place and medical personnel trained.

Current allocation criteria for PHC Capital Development Grant

The allocation is on a discretionary basis, every financial year, the ministry spells out what goods and services will be purchased centrally or locally.
The funds are allocated to bridge the gaps in infrastructure development (theatre, generator house and doctor's house) and human resource development.

Poverty focus of the current allocation criteria for PHC Capital Development Grant

Population un-served is evaluated to be poverty-focused criteria but needs to be supported by clear statistical data(an inventory of all infrastructure) for the local governments. the criteria may create disincentives to improve the situation as funds will be reduced in the sub-sequent years. in addittion,the fund is too little to cover all the needs.

PHC Non Wage NGOs

This is a grant for NGO Hospitals and lower level NGO units
The purpose of the grant is to support the delivery of minimum health package by supplementing NGOs Health Units .

Current allocation criteria for PHC Non Wage NGOs

The allocations to NGO Hospitals are based on the following aspects and a proportion of the funds is allocated basing on the human poverty indices of the districts they are situated. The aspects are:

- Workload
- socio-economic condition

?? training facilities of the health units
?? referral nature of the health unit
?? strong outreach services
?? access to Jinja power

No details on the specific criteria and weights is available

The allocation to lower level units is based on human poverty indices of the districts they are situated and their categories.

Poverty focus of the current allocation criteria for PHC Non Wage NGOs

The allocation criteria for PHC –NGO is poverty focus by considering workload, socio-economic status, strong outreach, facilities and referral nature of the hospitals.

PHC Wage

The PHC Wage is for salaries and wages of the medical personnel in local governments.

District Hospital Recurrent Non-Wage Grants

Table 12: Distribution of the funds at the district is as follows

Expenditure	**Percentage**
Staff allowances, transport and training and Administrative Costs	15%
Drugs and medical supplies	30%
Food supply (including firewood)	5%
Medical and office equipment	5%
Vehicle and generator operation & maintenance	10%
Utilities (electricity, water, telephone)	15%
Cleaning of buildings and compound	5%
Maintenance of medical equipment and buildings	5%
Others(including domestic arrears)	10%
Total	100%

General Comment

Nearly all the PHC Grants are not fairly poverty focus except PHC –NGO Grant that has a strong poverty focus because of the use of Human Poverty Index and special health needs of a district in the criteria. The allocation to lower level based on the Human Poverty Index and the workload makes it highly poverty focused. The allocation benefits the poor districts more than the rich ones, this enhances the quality of life of the poor, which is in line with the PEAP objectives.

The health sector grants have shortfalls in their releases and no accompanying explanation is forwarded for the shortfall, late release of the grant to the district. Mechanisms for collections of data do not routinely address issues or capture data for vulnerable groups of society and output indicators don't separate the poor and non poor.

The view of most of stakeholders is that in future all the PHC Grant allocation criteria should be based on workload and case definition handled by the hospitals and funds to lower level units be allocated according to the Human Poverty Index of each district and their sizes. To improve further on the allocation criteria, the cost of providing health services has to be estimated. This is open for discussion as the actual workload may not reflect the needs of the population to use the health facilities- an issue which has to be dealt with during the design phase.

4.1.8 WATER SECTOR

District Water and Sanitation Grant

Purpose of the Grant

The purpose of the District Water Sanitation Grant is to enable the Water Sector to achieve its goal of supplying and provision sanitation facilities, based on management of responsibility and ownership by the users, within easy reach of 65% of the rural population by the year 2005 with an 80-90% effective use and functionality of facilities. The long term objective is to cover 100% of the rural population by the year 2015

Current Allocation Formulae

The allocation formula of the District Water and Sanitation is complicated. The allocation to districts is based on their rural water and sanitation investment needs. These needs have been determined through a detailed investment plan, which is based on the policy principle **SOME FOR ALL AND NOT MORE FOR SOME**. The following criteria were used to determine the investment plan

1. Population of the district, projected from the 1991 census (using individual district growth rates)
2. The target is set to raise the current water coverage progressively to 95-100% by 2005. District with low service coverage and the un-served communities were targeted and given priority
3. Villages with scattered population (less than 2,000 people) are to be served by point water sources and small towns/rural growth centers with population between 2,000 and 5,000 are to be served by simple piped water systems
4. Water technology mix/options for point sources of particular district were determined, this depends on the water resources endowment, including quality and quantity
5. Hygiene Education and Community Mobilization is budgeted for as a component of water supply intervention
6. Sanitation in existing primary schools and Public Latrines in rural growth centers are in the budget/plan. Household sanitation is not funded.

Evaluation of Allocation Criteria

Adequacy of the grant

In 2000/2001, about 22 billion were allocated to district through the district Water and Sanitation Grant and 24.4 billion in 2001/2002 and 2002/2003 respectively. The table below show the allocation against the assessed need of rural water.

Table13: Allocation against the assessed need of rural water
Figs in billion UShs

FY	Assessed need	Actual Allocation	%age Gap
2000/2001	23.9	22	3.7
2001/2002	30	24	20
2002/2003	35.9	24.4	32

As shown in the table above, the water sector is being constantly under funded. This inadequacy has reached 32% in FY 2002/2003.

For instance if the original plan was to provide two pipes to connect two water points but the district is able to secure money for only one, What will happen?

Grant Allocation Criterion Relative to Intended Objective

The allocation criterion seems suitable to achieve the intended objective. Although the incentives to improve the water supply has to be reviewed. However, meeting the grant objective was more subjected to availability of funds. As indicated in the table above, despite the formulae giving the needed funds, the ministry of Finance allocated less to the Grant.

Transparency

The approach is not transparent, consultants in 24 piloted districts did the process of need assessment, and this meant that the investment plan for the other district was made on the assumptions made from the pilot district. As already observed there is a wide variation in cost in delivering water & Sanitation services among district due to a number of factors like technology- mix, therefore the precision of these estimates are far from real. What should be done to individual district assessment to establish the reality?

It was not clear whether district were consulted or informed whenever the ministry make changes in the plans due to some factors like inflation. The investment plan depended on availability of funds therefore it would have been made clear to LGs on how to address short falls.
In the plan it was indicated that population was projected and there was plan to update these projection for the 2002-population census. But other factors, which can bring changes in expenditure need like changes in technology – mix due to say depletion of water table were not mentioned.

Application of the formulae/Grant.

In cases where, the funds allocated to this sector is not sufficient, the actual allocations are based on the following principles

a) Districts were allocated a portion of the required investment, taking into consideration donors and major NGOs already in the district. For example, the RUWASA supported districts were allocated funds for institutional capacity development and limited water supply provision, while the rest of the water and sanitation activities were funded under Danida assisted projects.

b) The investment plan need to be revised to take into consideration the current census results and also prepare district specific plan (to ascertain whether the assumption made in National study still hold in specific district)

Urban water and Sanitation Grant

The objective of the grant is to improve operation, management and financial performance by providing by providing funds to bridge the gap between total costs and revenue collection, expansion of the revenue base and encouraging better planning, fulfilment and adherence to expansion of the revenue base and encouraging better planning, fulfilment and adherence to business plan.

Current Allocation Formulae

Government resolved, as intermediate measure, to provide financial support to enhance growth up-to breakeven point, commensurate with the reasonable shortfalls in the respective operational budgets, but to be used strictly for specific, result enhancing areas.

Therefore this grant is a temporary subsidy for operation of urban water supply and sewage systems to be used especially for system improvements and increasing coverage, but not as a substitute to efficient revenue generation and management.

Subsidy = Revenue - Costs

For the urban council to get the grant Costs must be greater than the revenues otherwise LGs are advised to invest the surplus in opening up new water points.

Work-plans

The following are the details of what is included in the annual work plan, which provide the basis for calculating the subsidy.

a) Background
b) Technical Description and Guidelines
   - Technical Description
   - Analysis of Supply and Demand

c) Financial Analysis

- ✍ Existing arrangements
  - Method of supply
  - Tariff structure
  - Revenue collection and efficiency
- ✍ Costs
  - Detail of manpower and other overhead
  - Power utilisation
  - Pipe work. Chemicals and other consumables
  - Other expenses

d) Management

Grant Allocation Criterion Relative to Intended Objective

The criteria seem suitable to fulfil the intended objective, but it is subjective to availability of funds and realistic revenue projection. The criteria may also cause disincentive to improvements of the water supply, as the gap filing method, "penalise" future improvements in cost recovery- if not properly designed

Transparency

The criteria seem to be transparent because most local governments visited indicated their involvement in the formulation of their business plans.

Application of the formulae/Grant.

Revenues are projected to meet the projected costs. This is the problem area in application of this criteria, if one does not base the estimates on reasonable assumptions. It is important therefore that to study the trends of revenue performance in last three years to serve as the basis for projection.

Since this is regarded as a subsidy to LGs its application should re-aligned towards improvement of revenue collection and reduction on reliability on subsidies. Therefore, in preparation of the work-plans one must consider the strategies for improvement of revenue by

a) Metering of existing connections
b) Improvement in methods of billing and collection
c) Minimize of fixed cost
d) `Extension of Service
e) Improvement in reliability and availability of supply
f) Encouraging new connections

4.1.9 AGRICULTURE SECTOR

Agriculture Extension Conditional Grant

Introduction

The mandate of the ministry is to support, promote and quid the production of crops, livestock and fisheries so as to ensure improved quality and increased quantity of agriculture produce and products for domestic consumption, food security and export. Agriculture is one of the identified priority areas in the PEAP. The agriculture extension is a priority program in the agriculture sector hence Agricultural Extension Conditional Grant under PAF is being used to finance recurrent costs of decentralized agricultural advisory services.

Wage Component

The wage component is for the payment of salaries for the recruited sub – county graduate extension staff. The identification of graduate agricultural services staff is guided by the needs of respective districts for decentralized agricultural services. The number and type of staff depended on the types and intensity of several of agricultural advisory services identified as priorities by respective local government. This grant is phasing out in areas where NAADs is taking root.

Non – Wage component

Objective of the Grant

The grant is to be used to facilitate the provision of agricultural extension services; the Local Government sector objective should be consistent with the overall objective of NAADS. The overall development objective of NAADS is to assist poor men and women farmers to become aware of, and to be able to adopt improved technology and management practices in their farming enterprises so as to enhance their productive efficiency, their economic welfare, and the suitability of their farming operations.

Existing Allocation Formulae

The allocation of funds to the districts is based on

Population	60%
Area	20%
Poverty	20%

Comments on the formulae

1. This Grant is phasing out to be replaced by NAADs Grants.

2. Population Parameter is used as the proxy for no of farmers, it may be applicable in rural areas, but not in urban centres.

3. The formulae does not provide extra assistance to bigger district to cater for added costs of delivering services in sparsely populated areas

4. It is certainly appropriate to include poverty indicator but the method how that indicator was calculated is not known. The available is dis - aggregated by region; therefore it is difficult to get a precise estimates the error level may be high.

5. Poverty focused index should be used. The present poverty index is not fully transparent.
6. No scientific method was used to arrive at the weights.

NAADS Conditional Grant

The purpose of the grant is to ensure that farmers apply improved husbandry and management practices, and identify and solve their technical and marketing problems using appropriate and modern knowledge and technologies.

Existing Allocation Formula

NAADS funds is channelled under conditional modalities, that is:

- NAADS conditional grants to the Districts
- Conditional transfer of funds to NAADS Executive for the national level programs, under NAADS Executive budget voter

The formula has not yet been clearly established, the NAADs secretariat has formed a task force to come out with the criteria. However, there are current basic criteria for allocation among eligible district and sub-counties. Additional resources provided to poor districts and, in particular sub-counties, will allow locally-decided targeting of resources for measures addressing specific needs of particular groups, which otherwise would benefit less from NAADS services.

The NAADs funds are allocated to districts, based on the consolidated farmer groups plan and budget, submitted by each Sub- county Farmer Forum to the

NAADs Executive and the Ministry of Finance within a maximum ceiling. The allocations are subject to annual performance against work-plan and accountability criteria, whereby the amount in the following year can be reduced in the following year by 20%, or, at worst, suspended completely.

To benefit from the program, District and Sub – Counties have to meet the NAADS minimum condition of which counterpart contribution is one. Sharing of NAADS funds between the National, District and Sub- county-levels is based on population and area, but with an element of bias to the poorer district.

PMA Non – Sectoral Conditional Grant

Objective of the Grant

This is a development grant; the purpose of the grant is to financially empower LGs to be able to plan and implement poverty focused programs in their localities.

Existing Allocation Formula

The allocation to the district is based on the population and area with weighting of 85% and 15% respectively.

Adequacy

The grant is not adequate, but even if it was adequate, it will not make meaningful impact because the grant is not elaborated as an integrated part of the related pillars of PMA the related. For instance increasing farmer's production without increasing the markets of their products will not improve farmer's incomes. The seven pillars of PMA are Research and Technology, Agricultural Advisory Services, Agricultural Education, Access to Rural Finance, Agro – Processing and Marketing, Natural resource & utilization and infrastructure development.

Grant Allocation Criterion Relative to Intended objective

It is appropriate to base allocation on the number of people in the district to approximate the number of farmers and to provide extra assistance to bigger district to cater for added cost of delivering services in sparsely populated areas. But it would be certainly more appropriate to include poverty index, to increase poverty focus. It is also important to identify the poor of the poor and the land less. The co – funding requirement of this grant may not be good for this grant to considered in order for this grant to realise its objective, as it is on record that in most cases poor district find it difficult to meet the requirement.

Transparency

Several reports have recommended a merging of the LGDP and the PMA non-sectoral grants as they mainly targeted some of the same investments and as this will provide more discretion and less transaction costs for local governments. this may require a review of the investment menu and the incentive systems related to the two systems . The modalities for an improved linkage and eventual merging of the two grants have to be worked out as a matter of urgency.

Application of the Grant

Application of this grant is difficult because the government is implementing a number of programs in this sector. Therefore, there are contradicting government policies. For instance PMA requires beneficiaries to pay some fee, UCDA is distributing seeds for free.

4.1.10 FEEDER ROAD MAINTENANCE PROGRAMME

Objective of the programme

Strategic objective (for roads): Improve accessibility to rural and urban areas of the country on a sustainable basis by having at least 80% of national road network and 50% in a fair-to-good motorable condition by year 2006.

The roads sector receive grants both recurrent and development. The recurrent one is for maintenance.

Maintenance:

Routine maintenance: periodically maintain the road network in a usable/ passable condition - light works eg cutting grass, cleaning drainage and filling potholes.
Periodic: when works seem to be heavier, especially after say one to three years of normal routine maintenance then periodic maintenance can be carried out on the road.
Rehabilitation: Re-instate the poor road into a passable condition. This is re-opening and construction of roads.
Rehabilitation should be development. However, funds are first given to maintenance then the balance is for Rehabilitation and the latter's allocation has no clear criteria.

The Ministry also carries out an annual inventory, viz, Annual District Road Inventory Condition Survey (ADRICS).

Evaluation of the suitability of the allocation criteria relative to the intended objective

Factors used
weight

Length maintainable network of roads in the LGs.................... ... 1.0

Then a consideration is made for the condition of the road to determine whether it should be chosen for Periodic or for Routine Maintenance. Whether Routine or Periodic Maintenance the amount allocated for each then depends on the terrain of the road length identified.

The cost of maintenance for each road is then derived from basis given below:

Terrain	cost/km to be maintained
Hilly -----------	ushs 800,000=
Rolling --------	ushs 720,000=
Flat ------------	ushs 500,000=

Thereafter the amount for Rehabilitation are determined by considering the proportion the
Un maintainable road length of the LG out of the national total. This proportion is multiplied through by the amount available and meant for Rehabilitation at the Ministry.

Observations:
Soils affect roads very much especially maintenance. Its very difficult for someone to do simple works named routine maintenance when there are frequent land slides, big cracks in the road, loose soils and rock giving way all the time, clay making the road slippery during rains, etc Unfortunately this factor of soil texture is not included in the criteria!

The items like bridges, culverts, murram excavation, swamp filling seem not specifically be catered for yet we are handling roads in villages where there are variations in landscape everywhere.
The Criteria no. 1 - the proportion of the maintainable roads in the LGs: this seems to leave out most NGO/ Donor supported road developments in the LGs. So it should be revisited.
Allocations for rehabilitation: The share of the un-maintainable network in Uganda is calculated for each district. This share is then used to allocate resources for each district to cater for rehabilitation. Old LGs have big networks and they seem to be favoured by the allocation criteria for maintenance while others are marginalised! It would be more appropriate if positive discrimination was made such that more funds are given for rehabilitation in areas currently under-served.

Poverty sensitive

The principle on which the allocation is based, viz; maintaining the maintainable and then rehabilitating a fraction of the un maintainable road length in the LG, **is valid**. Because the idea is to protect the investment and where possible go further to rehabilitate those portions which are un maintainable**.** Here, it is assumed that the length of network in each LG reflects the needs of the people and that the data in use was collected through an objective assessment.
Apparently this has not been the case.

The size of the road network of a LG in Uganda did not come about through an objective assessment of the needs of each LG but is a result of historical and political processes. This is illustrated by an example of Sembabule in the West which has a total road network that is 66% bigger than that of Kitgum in the North yet the latter has an area which is 12 times and a population one and a half times that of the former! Consequently, the principle of reducing the un-maintainable network has a bias in favour of the districts which already have a big network.

However recent analysis shows that although poverty wasn't explicitly used as criteria in the formula the result is surprisingly showing that the group of poor LGs benefiting from the grant are getting 39% more per capita than the rich LGs group…. Nov. 2001 Poverty Monitoring and Analysis unit MoFPED. So this is by coincidence but not by design, because a quick look at the criteria shows that it is poorly weighted and doesn't include a parameter that addresses poverty.

Further more, the predominant condition for utilisation, according to the guidelines, is that funds should be for labour based routine maintenance of feeder roads by contractors; probably with the aim of promoting employment in those areas. This is unfortunately frustrated by some politicians when they want quick works especially towards election time.

Transparent

The study has revealed that many staff in the districts know something about it.

Simplicity

The criteria are very simple**.**

Evaluation of the application of the allocation criteria

Allocation for urban areas still have no clear criteria. There is a mention of giving preference to the Proportion of the population not served but this is not relevant to all. Allocation in Urban areas is basically for Periodic Maintenance only; ***see the table on allocation for the Urban roads, given below***. This currently excludes the Tarmac portions. It has been noted that for Kampala City and the thirteen Municipal Councils the backlog of un maintainable roads that should be Rehabilitated is overwhelming and should probably be funded separately.

It has been observed that most Town Councils have not had structural plans and designs to handle this work properly. The MoW guidelines show that the Urban Councils accessing these funds should have the structural plans and designs. Therefore it has been suggested and recommended that Town Councils should prepare their requests in this respect and submit to Ministry of Works for possible assistance.

The allocation is meant for merely maintenance of the already existing roads. In fact the data of the road stretches in the targeted areas is still inadequate; besides some of the roads in say Urban areas have never been surveyed.
Old data is in use. Many LGs have had many roads opened using the community efforts, NGO/CBO and Donor support, therefore many Kms of the road network in LGs seem not captured.
The LCIII level has a big responsibility of maintaining and rehabilitating community roads using their 65% retention which is extremely inadequate.

Suggestions for other factors/ criteria

The following criteria may be considered in future
Density of traffic
Population size
Nature of activities, Nature of what is hauled on the road,
Soil texture of the area. This is still a big challenge: with poor soils you simply have to periodically purchase and transport the right soil to the damaged place and land slides can at times be dangerous to human settlement; it is unfortunate that SOIL TEXTURE is never considered critically as a basic criteria when it comes to allocation. The black cotton soils of Kabarole are an example of poor soils for a road.

SIZE OF THE GRANT AND NEEDS

Table14: DRAFT ALLOCATION OF FUNDS FOR ROADS IN URBAN COUNCILS FY 2002/03

Category I		
Serial No.	Name of Urban Council	Amount (Ushs)
1.	Kampala City	370,000,000
Category II		
Serial No.	Name of Urban Council	Amount (Ushs)
1.	Arua	100,000,000
2.	Entebbe	100,000,000
3.	Fort Portal	100,000,000
	Gulu	100,000,000
	Jinja	100,000,000
	Kabale	100,000,000
	Lira	100,000,000
	Masaka	100,000,000

	Mbale	100,000,000
	Mbarara	100,000,000
	Moroto	100,000,000
	Soroti	100,000,000
	Tororo	100,000,000
Sub Total		**1,300,000,000**
Category III		
Serial No.	Name of Urban Council	Amount (Ushs)
1.	Busia	90,000,000
2.	Kasese	90,000,000
3.	Lugazi	90,000,000
4.	Mityana	90,000,000
5.	Mukono	90,000,000
Sub Total		**360,000,000**
Category IV		
Serial No.	Name of Urban Council	Amount (Ushs)
1.	Apac	75,000,000
2.	Bushenyi - Ishaka	75,000,000
3.	Hoima	75,000,000
4.	Iganga	75,000,000
5.	Kitgum	75,000,000
6.	Kumi	75,000,000
7.	Kyotera	75,000,000
8.	Lyantonde	75,000,000
9.	Nebbi	75,000,000
10.	Njeru	75,000,000
11.	Packwach	75,000,000
12.	Paidha	75,000,000
13.	Rukungiri	75,000,000
14.	Wobulenzi	75,000,000
Sub Total		**1,050,000,000**
Category V		
Serial No.	Name of Urban Council	Amount (Ushs)
1.	Adjumani	60,000,000
2.	Bundibugyo	60,000,000
3.	Ibanda	60,000,000
4.	Kamuli	60,000,000
5.	Kapchorwa	60,000,000
6.	Kayunga	60,000,000

7.	Kisoro	60,000,000
8.	Luwero	60,000,000
9.	Masindi	60,000,000
10.	Moyo	60,000,000
11.	Mpigi	60,000,000
12.	Mubende	60,000,000
13.	Ntungamo	60,000,000
14.	Pallisa	60,000,000
15.	Rakai	60,000,000
Sub Total		**900,000,000**
Category VI		
Serial No.	Name of Urban Council	Amount (Ushs)
1.	Bombo	30,000,000
2.	Bugiri	30,000,000
3.	Buwenge	30,000,000
4.	Kaberamaido	30,000,000
5.	Kabwohe – Itendero	30,000,000
6.	Kalangala	30,000,000
7.	Kamwenge	30,000,000
8.	Kanungu	30,000,000
9.	Katakwi	30,000,000
10.	Katwe- Kabatoro	30,000,000
11.	Kibaale	30,000,000
12.	Kiboga	30,000,000
13.	Kigorobya	30,000,000
14.	Kiryandongo	30,000,000
15.	Koboko	30,000,000
16.	Nkokonjeru	30,000,000
17.	Kotido	30,000,000
18.	Kyenjojo	30,000,000
19.	Lukaya	30,000,000
20.	Mayuge	30,000,000
21.	Nakapiripiriti	30,000,000
22.	Nakasongola	30,000,000
23.	Pader	30,000,000
24.	Sembabule	30,000,000
25.	Sironko	30,000,000
26.	Wakiso	30,000,000
27.	Yumbe	30,000,000
Sub Total		**810,000,000**
SUMMARY (ALL URBAN COUNCILS)		

Category	Amount (Ushs)
Category I	370,000,000
Category II	1,300,000,000
Category III	360,000,000
Category IV	1,050,000,000
Category V	900,000,000
Category VI	810,000,000
Total	**4,790,000,000**

Source: Ministry of Works Housing & Communications, 2002.

From the tables given above:

Allocation had no parameters to follow apart from merely classifying the Urban Councils in categories I – VI; possibly basing on the size and level of activity in the Urban Council.

THE ROAD SITUATION IN DISTRICTS, URBAN COUNCILS AND COMMUNITIES:

Table 15: District, Urban and Community Access Roads (DUCAR) network length and condition

Road Classification	Surface Type	Length (Km)	Condition (km and % age of total)							
			Good		Fair		Bad		Poor	
			km	%	km	%	km	%	km	%
District	Gravel/ Earth	22,300	4,460	20	8,900	40	6,690	30	2,230	10
Urban	Bitumen	600	150	25	150	25	240	40	60	10
	Gravel	600	120	20	120	20	240	40	120	20
	Earth	1,600	80	5	80	5	960	60	480	30
Community	Gravel/ Earth	30,000	600	2	1,500	5	4,500	15	23,400	78

Source: White paper on sustainable Maintenance of DUCAR, MoWHC, June 2001

From the table above:

District roads: Only 60% had been worked on, leaving 40% in a desperate situation. Bearing the fact that even those worked on require continuous maintenance.

Urban Council roads: an average of 25%had been worked on; ie 50% of the Bitumen roads, 40% of the Gravel roads, and a miserable 10% 0f the Earth roads in towns had been worked on!

Common roads: only 7% had been worked on, leaving 93% in a desperate situation.

Action Plan for Rehabilitation and Maintenance: in the short term and medium term the Government is aiming at creating a network of District and Urban roads where at least 85% of the network is in a fair to good condition and maintain all community access roads in a passable state, ie more than 50% in a fair to good condition.

The reduced rehabilitation and maintenance programmes are summarised in the 2 tables below:

Table16: Summary of Reduced Rehabilitation and Maintenance Programme (Km)

TYPE	Activity	FY01/02	FY02/03	FY03/04	FY04/05	FY05/06	FY06/07	FY07/08	FY08/09	FY09/10	FY10/11	Total
District	Rehab	1,095	192	815	715	2,130	8,120	9,520	11,240	12,770	13,950	60,547
	Maint	17,111	17,441	18,640	19,415	22,835	23,235	23,240	23,240	23,240	23,230	211,637
Urban	Rehab	89	11	0	0	27	65	59	56	56	48	411
	Maint	1,770	1,778	1,778	1,908	1,983	2,023	2,240	2,360	2,465	2,590	20,905
Comm-unity	Rehab	7,481	7,481	7,481	7,481	7,481	7,481	7,481	7,481	7,481	7,481	74,840
	Maint	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	150,000

Source: Review/ Update of feeder roads Rehabilitation and Maintenance Strategy, Africon Ltd October 1999 (extended to FY 2010/11)

Note: Rehabilitation includes full rehabilitation, spot improvement and culverting. Maintenance includes periodic, routine and emergency maintenance.

Table17: Summary of funding requirements for Reduced Rehabilitation and Maintenance of DUCAR (US $ million)

Type	Activity	FY01/02	FY02/03	FY03/04	FY04/05	FY05/06	FY06/07	FY07/08	FY08/09	FY09/10	Fy10/11	Total
District roads	Rehab	4.45	0.77	3.01	2.66	8.11	29.03	35.15	42.05	47.25	52.00	224.5
	Maint	18.35	21.43	24.30	26.68	35.63	35.79	30.85	30.85	30.85	30.85	285.6
Sub total		**22.80**	**22.20**	**27.31**	**29.33**	**43.74**	**64.82**	**66.00**	**72.90**	**78.10**	**82.85**	**510.0**
Urban roads	Rehab	3.20	0.40	0	0	0.97	2.34	2.12	2.02	2.02	1.73	14.8
	Maint	8.333	6.35	4.25	4.95	4.55	3.45	3.95	4.45	4.65	5.25	50.2

Sub total		**11.53**	**6.75**	**4.25**	**4.95**	**5.52**	**5.79**	**6.07**	**6.47**	**6.67**	**6.98**	**65.0**
Community*	Rehab											
	Maint	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	2.0
Sub total		**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**2.0**
TOTAL		**34.5**	**29.1**	**31.8**	**34.5**	**49.4**	**70.8**	**72.2**	**79.6**	**84.9**	**90.2**	**577.0**

Source: Review/ Update of feeder roads Rehabilitation and Maintenance Strategy, Africon Ltd, October 1999 (extended to FY 2010/11).

Note: Rehabilitation includes full rehabilitation, spot improvement and culverting. Maintenance includes periodic, routine and emergency maintenance. Rehabilitation and maintenance of Community Access Roads has been restricted to overall US $ 2.0million.

There is a strategy to encourage Labour- Based Road works.

Table18: Annual percentage coverage of Labour-based Road Works of DUCAR (%)

Type	Activity	FY01/02	FY02/03	FY03/04	FY04/05	FY05/06	FY06/07	FY07/08	FY08/09	FY09/10	Fy10/11
District Roads	Rehabilitation	40	50	55	60	60	65	70	70	75	80
	Maintenance	90	95	100	100	100	100	100	100	100	100
Urban Roads	Rehabilitation	20	20	25	30	40	45	50	55	60	60
	Maintenance	30	40	40	45	50	50	55	60	70	70
Community Roads	Rehabilitation	50	60	60	70	80	90	100	100	100	100
	Maintenance	100	100	100	100	100	100	100	100	100	100

Source: Review/ Update of feeder roads Rehabilitation and Maintenance Strategy, Africon Ltd, October 1999 (extended to FY 2010/ 11).

4.1.11 Local Government Development Programme

The LGDP Programme, Phase I 1999-2003 and the coming LGDP, Phase II contain two type of grants:

Types of available grants under the arrangement:
Local Development Grant (LDG) - Development grant
Capacity Building Grant (CBG) - Recurrent grant

Objective of the Grant

Objectives:
To support creation of infrastructures in Local Government. In addition it is an instrument to test out devolution of the development budget

Expected outputs :
Guidelines on devolution of development budget
Improved infrastructures in local governments

The grant system is managed under MoLG/PMU, and the grants are transferred from MoFPED to each eligible local government on a quarterly basis.

According to the Operational Manual, April 2001, the present system of vertical division of grants from LGDP is as follows :

Rural Areas:
35 % to the districts (based on 85 % population and 15 % area (size of the LG territory))
65 % to the sub-counties (based on 85 % population and 15 % area)

This section has benefited from the LGDP Preparatory work, Annex 2, Final Report September 2002.

30 % to parishes as indicative planning figures out of the (65 %) sub-county share (based on population)

Urban Areas:
50 % to the City or Municipal councils on a pro rata basis based on population
50 % to the Division Councils on a pro rata based on population
30 % of the 50 % Division share should be earmarked for the parish/village, based on population as indicative planning figures.

The Horizontal Allocation System in LGDP

The present horizontal allocation formula for the division of funds between LGs is as follows :

Rural:
Districts: Population (85 %) / area factor (15 %)
Sub-Counties: Population (85 %) / area (15 %)
Parishes: Indicative planning figurers (per capita)

Urban:
Urban councils: 100 % based on number of inhabitants.
Divisions: 100 % based on number of inhabitants
IPF for the LLGs based on number of inhabitants

The LDGs are transferred according to these criteria, but vary in size depending on the performance of the LGs (20 % rewards and sanctions). The most well-performing and active LGs in terms of administrative performance, legal

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It should be mentioned that the UNCDF supported District Development Project – Pilot (DDP) used another formula namely: Population (20 %), land area (15 %), number of school going age children (25 %), and prevalent child mortality (40%). It is not exactly clear how these weights are calculated, and the data is not available for all districts.

compliance etc. tend therefore to receive the highest amount per capita. The aim of this system is to provide strong incentives to improve the legal compliance, the possibilities for sustainable investments, administrative performance and reduce the fiduciary risks.

As part of the preparation of LGDP II, a detailed study was made of the advantages and disadvantages of more poverty sensitive formula was made. It was shown that the present formula to certain extent transfer more funds to the less endowed regions per capita due to the area criterion. It was also documented that more poverty sensitive formulae could be applied although the data availability set certain limits for this. It was recommended that the future formulae should be part of a more comprehensive overhaul of the entire system of grants and equalisation system in order to ensure sufficient links between the various grants, especially the recurrent and capital grants.

As it appears from the Annex 2 of the Preparatory work of the LGDP II, most of the stakeholders consulted during the design phase supported the request formulated during the MTR workshop, to review the possibilities to include more poverty sensitive criteria in the horizontal allocation of the LDG (note a decision was not taken at this point of time to the extent to which LGDP should include the results of these reviews or change the formula). There is a strong wish among many stakeholders to support the poor areas with a low endowment of basic infrastructure and services, and an impression that the present equalisation system alone cannot address this concern . This concern has developed over the last years in the light of the fact that districts in the Northern Region have experienced an increase in poverty from 60 % of the population in l997 to 66 % in 2000, while the rest of the country experiences a clear declining trend with an overall average decline in share of people living in poverty in Uganda from 56 % in l992/93 to 35 % l999/2000. The support to poverty sensitive formulae has also been expressed in the various budget speeches and in the background documents to the budget and progress reviews of the PEAP.

Some of the weaker districts in terms of LG revenues, poverty indicators etc. have managed to perform well and some of the better off areas have had problems with the assessment, indicating that there is not direct link between the economical situation and the "scores" in the assessment system

The support for more poverty sensitive formulae have gradually increased along with deepening of the problems in the weaker districts and the establishment of various programmes (parallel to the LG structures) to address these issues. Especially the LGFC and the Poverty Monitoring and Analysis Unit of the MoFPED have strongly supported the attempt to make all grants more poverty sensitive.

Cf. "A New Formula for Poverty Eradication ? Part 1: Sectoral Conditional Grants, 2nd consultative draft, PMAU, MoFPED, November 2001.

E.g. Summary of Background to the Budget 2001/02 – Uganda Poverty Reduction Strategy Paper, Progress Report, April 2002, Ministry of Finance Planning and Economic Development

On the other hand, there is also a widespread wish to maintain a simple and transparent allocation system - both at the LG and CG levels and an increasing concern about the extent to which the large transfers of funds to specific LGs are sustainable and whether the absorption capacity is available at the LG level. Arguments against changing the formula were also expressed. It was argued that the LGDP allocation formula should not be reviewed in isolation but rather be revised as part of the review of all grants to LG. A new LGDP-formula may or may not be in accordance with the results of the coming larger review of the Unconditional Grant (UG), Equalisation Grant (EQ) and other grants as part of the FDS implementation and adjustments to this formula as part of this reform may be needed. Hence, the various formulae are mutually interrelated and should be reviewed in a holistic way, in order to ensure the right balance between equity, efficiency (sustainability), objectivity, and simplicity in the allocation system. According to this line of thoughts, if the grant formulae are not reviewed holistically, it will be a great challenge to ensure the proper balance of considerations .

Evaluation of the suitability of the allocation criteria relative to the intended objective

The criteria used in the LGDP are objective and clearly understood and measured. LGDP it itself is not supposed to equalize between the wealthy and the poor districts, but is attempting to establish a sustainable system for future improvement in infrastructure and service provision, tested in some local governments to be applied national wide from 2003. As part of the GOU transfer system, the overall GOU objectives, such as especially the PEAP should be considered in the light of the elaboration of the future allocation formulas.

The performance incentive system has largely fulfilled the objectives as several reviews of the LGDP have proved the strong impact of the system on the incentives and outputs in terms of improved administrative and legal compliance. This system is very depending on the credibility and objectivity of the assessment system, and a number of improvements have been planned in this respect for the second LGDP, commencing in July 2003.

It has been out of scope to review all allocation formulae and their relationship with LGDP (and also redundant as this will be included in the implementation of the FDS), but an attempt to create such as overview has been conducted by the MoFPED over the last year published in: A New Formula for Poverty Eradication ? Part 1 Sector Conditional Grants, November 2001. Hence the Design Team has focused at various models for the LGDP to provide input for the coming decisions on the formula.

Poverty sensitive

The existing formula is not designed to be particularly poverty sensitive, although the area criterion aims to support the larger, remote and more less population density areas and thereby also some of the poorer areas. Nevertheless, most stakeholders from CG and LG levels perceive that the present formula is not sufficiently poverty sensitive as population and land area are not sufficiently targeting the problems of inadequacy of basis services and differences in infrastructure endowments and poverty across the regions. It should be noted that other considerations, such as sustainability of the investments, possibilities for co-financing and possibilities for the LG to sustain the recurrent and maintenance costs implications of the investments have been relevant for the design of the present formula.

Transparent

The formulas have been developed and disseminated in a transparent manner.

Simplicity

The formula is simple to understand and apply.

Evaluation of the application of the allocation criteria

<u>Minimum Conditions:</u>

The LGDP development grants have a number of minimum requirements to ensure sustainability and proper management of the resources. These conditions may naturally lead to reduction of grants or halt of grants to certain local governments until the conditions are complied with. As these sanctions are targeting the weaker as well as the stronger LGs in terms of financial capacity and as there is no direct link between financial strengths and the actual performance, the system is aimed at creating proper incentives for improvements.. In order to avoid that lack of capacity should exclude LGs over the time from accessing the development grant the system is back up by a significant capacity building effort, both in terms of grants and special support to improve capacity. Co-funding:

The principle of co-funding has been supported by most stakeholders during the preparation and design of the LGDP, but the exact level for the affordable and sustainable level has been disputed. On one hand there is a wish to ensure that all LGs can afford the co-funding requirements, on the other that the investments are sustainable and that the LGs have sufficient sources for maintaining the recurrent implications of the investments.

<u>Suggestions for other factors to be used in the criteria</u>

Various new criteria have been suggested and tested for the LGDP II. Especially the
Household Consumption Index (HCE) seems applicable and the data is available, although not fully up-to-date. To make the criteria more poverty sensitive, there has been astrong suggestion to include Household Consumption Index (HCE).Its being suggested that: the formula will be moderately changed:

Population: 70 %, area: 25 % and HCE: 5%

4.1.12 Capacity Building Grant

<u>Objectives</u>:

The overall *objectives* of the Local Government Capacity Building for LGDP II are to:

Enhance the capacity of LGs to fulfill their mandates;

Develop and test a system for sustained capacity building and training of LGs to meet the capacity building needs of individuals as well as organizations.

This grant also moves alongside LDG & so its very supportive of the latter's objectives.

Current allocation mechanism for the grants transfer and weights

During the LGDP I, the CB grants was calculated as 20%, 10% and 5% of the LDG allocated to the LG for FY2000/01, FY2001/02 and FY2002/03 respectively; i.e. the arrangement includes LDG criteria. Notably the LDG allocated in FY x+1 is usually greater than FY x by a reasonable figure.

Evaluation of the suitability of the allocation criteria relative to the intended objective

However, it complements other efforts of training and building capacity in LGs. The CB grants do not include an overall capacity building need assessment of the LGs as this is assumed to be carried out (and have been carried out in most districts already) as part of the current capacity building activities and part of the yearly assessment, which assist in the identification of administrative gaps. The LGDP II will also include significant support to development of a HR function in the LGs to assist these in identification of needs and planning of CB effort.

Poverty sensitive **As per the comments for the Development Grants**
Transparent? **Yes**
Simple? **Yes** .

Evaluation of the application of the allocation criteria

Currently there seems to be both positive and negative perceptions about how the fund is being utilized. While the allocation can be easily calculated and become available for a LG some higher LGs don't seem to be willing to allocate this fund to respective LLGs.

There is also evidence that some of the LGs both HLGs and LLGs are not using it as appropriate. Generally most LGs are not utilizing it according to its guidelines. However, the has activities carried out noticeable especially when the assessment is carried out and it is found that the capacity built has enabled the LGs to achieve the Minimum Conditions and maintain them even the following financial years. In order to address some of the weaknesses identified in the LGDP I, the LGDP II will make a number of significant changes in the design and implementation of this component.

Challenges:

The specific capacity building need of the local government is not the basis for the allocation of the grant (this would also pose a significant challenge in terms of data availability and may provide incentives not to improve the capacity).

A number of remedies in the previous system is being addressed by a new Capacity Building Unit under MoLG, which will elaborate standards, training material , certification of providers etc.

Eligibility and Access Criteria for CBG

The CB-grant remains available (as for LGDP-I) even for LGs that do not qualify for the LDG as long as minimum conditions for the use of the CB-grant are in-place, i.e. a three years CB-plan and accountability for the utilisation of the previous funds.

4.1.13 GENDER, LABOUR AND SOCIAL DEVELOPMENT SECTOR

The mandate of the ministry Gender, Labour and Social Development is to promote the empowerment of communities especially the poor and vulnerable, industrial peace and decent employment for all and gender equality, human rights and cultural growth. The policy documents used by the ministry to guide the utilisation sector grant are:
National Adult Literacy Strategic Plan (2002/2003-2006/2007)
Guidelines on the implementation of Functional Adult Literacy conditional grants
CBR Conditional Grant Implementation Guidelines (2002/2003-2006/2007)

Conditional grants in sector
There are two conditional grants so far:
Functional Adult Literacy Conditional Grant-FAL
Community Based Rehabilitation Conditional Grant –CBR
Community Development Assistance-CDA

Functional Adult Literacy Conditional Grant-FAL
The ministry Gender, Labour and Social Development transfers functional Adult Literacy conditional grant to local governments. The Ministry, through FAL Programme Secretariat provides policy framework and the overall supervision of the FAL programme according to the principles, roles and approaches in the guidelines.

According to the Uganda poverty status Report (2001) the current literacy rates stand at 63% of the population. The literacy rate for women is 51% compared to 77% for the male. The majority of the illiterate are therefore target beneficiaries of FAL Programme, who are rural and urban poor engaged in agriculture and low paying commercial activities. The Government of Uganda has identified functional adult literacy as one of the priority areas under Poverty Eradication Action Plan (PEAP) to access funding from Poverty Action Fund (PAF)

Purpose of FAL Grant
FAL grant is transferred to facilitate the functional adult literacy programme, with purpose of achieving a 50% improvement in levels of adult literacy by 2007.

Expected outputs from FAL Grant

?? At least 3,500,000 literacy learners reached (70% women, 30% men) proficient in reading, writing and numerate.
?? At least 10% of newly literate learners proficient in basic oral and written English.
?? At least 56 district and 930 sub-county local governments able to plan and manage local adult literacy programmes
?? At least 85% of the proficient learners supporting their children in universal primary education

Comments on expected output

Output of the literacy learners to be proficient in reading, writing and numerate, should be expanded to knowledge in productive health, Nutrition and commercial planning to be more poverty focus. It seems the urban council are totally forgotten in the functional Adult Literacy Programme.

Current allocation criteria for FAL Grant

The functional adult literacy grant is allocated according to:-
?? Literacy levels in the district
?? Poverty levels
?? Area (administrative coverage)
?? Number of learners
?? Number of instructors
No criteria weights were available for these factors

Comments on allocation criteria for FAL Grant

Although allocation to districts is based on the levels of poverty and literacy of districts, which is poverty focus, the actual transfers does not reflect the allocation criteria. According to 2002/2003 allocation of grants to the districts, The districts were clustered for allocation and a uniform amount was allocated to each districts in the clusters, which approximation is not at all-appropriate for poverty tackling. See the table below;

Table 19: Allocation of FAL grant to districts

District		2002/2003	District	2002/2003	District	2002/2003
Category I			**Category II**		**Category III**	
1	Adjumani	38,150,000	Bugiri	27,100,000	Hoima	18,500,000
2	Apac	38,150,000	Bundibugyo	27,100,000	Kabale	18,500,000
3	Arua	38,150,000	Bushenyi	27,100,000	Kabarole	18,500,000
4	Gulu	38,150,000	Busia	27,100,000	Kamwenge	18,500,000
5	Kitgum	38,150,000	Iganga	27,100,000	Kanungu	18,500,000
6	Kotido	38,150,000	Jinja	27,100,000	Kiboga	18,500,000
7	Lira	38,150,000	Kaberamaido	27,100,000	Kisoro	18,500,000
8	Moroto	38,150,000	Kamuli	27,100,000	Kyenjojo	18,500,000
9	Moyo	38,150,000	Kapchorwa	27,100,000	Masindi	18,500,000
10	Nakapiripirit	38,150,000	Kasese	27,100,000	Mpigi	18,500,000
11	Nebbi	38,150,000	Katakwi	27,100,000	Mukono	18,500,000
12	Pader	38,150,000	Kibaale	27,100,000	Ntungamo	18,500,000
13	Pallisa	38,150,000	Kumi	27,100,000	Rukungiri	18,500,000
14	Tororo	38,150,000	Mayuge	27,100,000	Sembabule	18,500,000
15	Yumbe	38,150,000	Mbale	27,100,000	Sironko	18,500,000
			Mbarara	27,100,000	Soroti	18,500,000
					Wakiso	18,500,000
	Category IV					
1	Kalangala	3,000,000				
2	Kampala	12,000,000				
3	Kayunga	12,000,000				

4	Luweero	12,000,000				
5	Masaka	12,000,000				
6	Mubende	12,000,000				
7	Nakasongola	12,000,000				
8	Rakai	12,000,000				

In this allocation the poor and rich districts are not differentiated. Also data for classification of the district seems to be unrealistic in that smaller districts receive same amounts as larger districts, whereas one of the parameters is area (Administrative coverage). The number of instructors could be replaced by adequacy of the instructors, because this depends on the relative number of learners.

Poverty is a multidimensional phenomenon influenced by culture, social, political, economic, physical, communication and educational factor. The multidimensionality of poverty implies that non-literate people become hard-to-reach, they get isolated from rapid information and communication advances and become marginalised in powerful modernizing process.

Illiteracy is a form of inequality in Uganda between individuals, gender, districts and even regions. The use of literacy and poverty levels of districts makes the criteria more poverty sensitive. Training the adult and community empowers them and enhances their quality of life and ability to raise income.

Community Based Rehabilitation (CBR) Conditional Grant

This grant is use to facilitate the provision of community Based Rehabilitation Service.

The overall development objective of CBR is to assist people with disability (PWD) to become aware of, and be able to adopt improved skills and knowledge so as to enhance their productive efficiency, their economic welfare, and the sustainability of their livelihood in all spheres of life.

Costing of Community Based Rehabilitation Activities

Districts and Sub-Counties develop workplans for their social development sector in a participatory manner involving the PWDs. The districts and sub counties identify activities with their objectives, these activities are then quantified and costed. The overall cost of all these activities is the sum of all the individual activity cost.

Community Development Assistance-CDA

CDA was introduced in the financial year 2003/2004 to improve the financing of the activities of Community Development workers at the sub-county level. The grant has a wage and non-wage components, the wage component given to 24 PMA districts, is for payment of salaries new sub-county Community Development staff recruited to fill existing vacant positions and the new positions that will be created as a result of the ongoing process of restructuring in the local government staff structure.

The non-wage component is to facilitate sub-county Community Development staff in all the 56 district local governments to cater for their operational costs during the implementation of community development activities.

4.1.14 Equalization Grant

Objective of the Grant

Funds allocated to Local Governments for giving subsidies or making special provisions for the least developed; and are based on the degree to which a Local Government Unit is lagging behind the national average standard for a particular service.

Current allocation mechanism for the grants transfer and weights

The Equalisation Grant introduced in 1999/2000 financial year has two basic parameters of identifying beneficiaries and the amount that is due to them. These are:

Local Revenue Potential, and
Expenditure Needs.

(a) Local Revenue Potential

Local Revenue Potential is based on the per capita income of individual districts and the number of potential eligible GPT taxpayers. Potential GPT taxpayers are estimated to be the male population aged between 20 and 59 years. The annual per capita income is the base for determining an average tax rate, which is multiplied by the number of taxpayers to give the potential local revenue. Basically Local Governments are expected to be capable of collecting all their potential local (GPT) revenues. Those local governments that lie below the national average per capita local revenue potential qualify for Equalisation

The amount for Equalisation under local revenue potential is arrived at as follows:

? (The national average potential GPT per capita ? Potential GT per capita for a particular local government) x The population of the particular local government

Expenditure Needs

Expenditure needs are based on the major services delivered by local governments and the factors that influence expenditure levels. For example while the Ministry of Education uses school enrolment to determine the amount for each local government, under Equalisation, the number of school going age children determines the level of funding. *<u>Therefore, under Equalisation potential demand for services is used as the benchmark</u>*. The demand for services is the one that translates into expenditure needs.

The demand for all services are aggregated into expenditure needs per capita figure for each district/local government and compared with the national average figure. Those local governments that lie above the national average qualify for Equalisation.

The amount for Equalisation under Expenditure needs is arrived at as follows:

? (The expenditure need capita for a particular local government ? The average National Expenditure need per capita) x The population of the particular local government

The results of (a), the local revenue potential and of (b), the expenditure needs are combined (added together) to arrive at the amount to be allocated to each beneficiary local government.

It is important to note that a local government may be a beneficiary under potential local revenue and not under expenditure needs and vice versa. In such a case it is the result after combining both parameters that determines the position of each local government.
The criteria has weights; Revenue potential 50% while Expenditure needs is 50% also. However, the subsequent components under each criteria have their weights as below shown:

Expenditure needs:

Components:	**criteria**
Total population	0.3885
Population (5-14yrs)	0.3978
Population (15-19yrs)	0.1305
Population(0-4yrs)	0.0385
Km of District Roads/ per unit Population	0.0219
District Area	0.0122
Crop Acreage	0.0025
Livestock population	0.0025
No. of Landing sites	0.0020

Revenue potential:

The Revenue Potential applied to the household expenditure per capita as a proxy for income and graduated tax rates in a system of representative tax. Only graduated tax was used as it contributes over 80% of all the locally collected revenue.
Currently 34 out of 56 districts and 40 out of 73 Urban local governments benefit from this grant.

The amount of grant payable to each district beneficiary range between ushs16 million in Sironko and ushs 244m. For urban councils, it ranges between ushs 4.8m for Moyo and ushs 70m for Ntungamo. It is important to note that the spread of the grant is so thin that the impact may not be realized. Apparently it's a concern to stakeholders.

Evaluation of the suitability of the allocation criteria relative to the intended objective

Sometimes the grant has been used to handle disasters and insurgency in LGs. In its application it was found necessary to include LGs affected by insurgency like, Kasese, Bundibugyo which possibly wouldn't have otherwise benefited and hence distorted the allocation.

The formulation was based on recurrent budgets but excluded development budgets of local governments because the latter had not yet been decentralised

The spread in terms of the number of the benefiting LGs is a matter of concern,in addition the grats have not been adjusted for the recent developments in the economic potential and expenditures needs in the districts.
All the allocated grant must go to PAF areas yet there other pressing needs especially for LGs where PAF grants had an impressive impact.

The allocation criteria includes potential GPT (graduated personal tax) as basic in estimating Revenue potential yet Local Governments are collecting other revenues like market dues, licences, fees, royalties, etc. So using GPT revenue source alone especially currently when the other sources have been found to be more lucrative, is insufficient.

Poverty sensitive

Yes it is; one of the criteria is on the amount of local revenue a LG has an opportunity to collect. This means a LG should collect that revenue wholesome after which it is gauged whether its below the line or not. And if its below the line then this is an indicator of poverty therefore such a LG should be assisted to improve services with the grant.

Similarly was done for another parameter ie expenditure needs of a LG. This is determined by the potential demand for the service.
But inadequacy of funds meant taking on fewer LGs than was targeted during the formulation. According to the study Ushs 12bn had been proposed but only Ushs 3bn was available for this grant!
*Equalisation addresses a considerable inequality in terms of horizontal equity and/ or is used to stop a situation which would result into undersupply of certain decentralised services in the poorest regions of the country.

*Without equalisation decentralisation would result in unacceptable that would soon make central provision the most feasible solution for public sector.

Transparency: **Yes but complex.**

Simpilicity: **No.**

Evaluation of the application of the allocation criteria
The process of its application is interrupted by:
The objectives of the Grant were completely misunderstood in the course of implementation,especially by the MoFPED. The grant has been used a contingency fund and to support various other objectives. Especially when it comes to catering for start-up funds for newly created LGs.
It is been put under pressure by the condition of co-funding on certain (development) grants in LGs. combined with the low revenue sources in some of the LGs and the small size of the equalization grant, this has created problems in some of the poorest LGs.
Data for the parameters used is either out of date and/ or inadequate

Utilisation

There is hardly any Monitoring of its utilization. Very little efforts has ever been put on monitoring how its being used by LGs. The centre stops at ensuring that a workplan is submitted to the relevant central government line ministry.
Poor administration of the grant has rendered the benefiting LGs unable or delay to access the grant.

CHAPTER FIVE

5.1 SUMMARY FINDINGS AND RECOMMENDATIONS

FINDINGS	RECOMMENDATIONS
THE BASIC ALLOCATION CRITERIA The principles behind the present allocation criteria have been tested. Generally most of these have made attempts to pursue PEAP, but several without any clear consistency. Especially there are insufficient/absence of information on needs of Local Governments	**BASIC PRINCIPLES** Allocation principle should be in line with sector objectives and Poverty Eradication Action Programme goals. Allocation criteria should be consistent with the principles of the design of allocation mechanism as outlined in Chapter 3. Adequate information about the needs of each sector for a LG is something we can't afford to overlook again. This should form the basis of the criteria to be designed for each grant transfer to LGs.

VERTICAL ALLOCATION OF RESOURCES The amounts to each year for local government grants are determined on a year-to-year basis guided by the Government's long-term view of its poverty alleviation strategy and Sector Medium Term Expenditure Framework (MTEF).	**VERTICAL ALLOCATION OF RESOURCES** We recommend that a more stable system of financing is established with better and more advanced announcements of the planning figures for the local governments in order to enhance stability and predictability and thereby local planning and implementation. In the longer term, it might be considered to establish a fixed share of the grants in relation to the overall economy/ e.g the total public revenues. However immediate introduction of this vertical funding rule seems to be counter-productive on the part of local governments since the pool of local government grants is currently not stationary and increasing.
POVERTY: Ministry of Finance, Planning & Economic Development Study on poverty reduction: Review of Formulae reveal that local governments' resources are generally allocated in a slightly pro-poor manner. But the major problem in this regard is the absence of district level poverty data aggregated for rural and urban local governments. What is available is poverty incidence at the regional level, what we could suggest is that stakeholders should come in agreement on the	Therefore it is further recommended that "poverty levels" as an allocation factor would be appropriate because poor households typically rely more on publicly provided services (such as health, education, etc) while at the same time the provision of local government Better district based date should be developed as the first step in this process.

use of regional poverty rate for the districts within the region, but this measure will not account for intra-regional variation in poverty, and more district based data need to be developed. c**) REGIONAL COST VARIATION** It was observed in the meetings with local governments that there are cost variations across the country. These variations particularly affect non-labour items, which have to be transported from Kampala and other locations, such as schoolbooks, medicines, or construction materials. The proxy for such regional variation which is used by the Ministry of Education and Sports and Ministry of Health is the distance from Kampala. However, the team observed that the distance from Kampala would actually not be a very good measure of regional cost variations, as this measure fail to take into account the fact that what matters is not just sheer distance but accessibility. (For instance it cost you 12,000/= in public transport from Kampala – Kalangala a distance of 360 km while you pay 8,000/= to go to Bushenyi district a distance of 450 km).	**c) REGIONAL COST VARIATION** c) Therefore, we recommend that a better measure of cost variations faced by local governments across the country would more directly rely on the actual variations in the cost of local government service provision. We could for instance use regional price indices based on specific prices of items/commodities say diesel.

FINDINGS	RECOMMENDATIONS	ASSESSMENT OF KEY PRINCIPLES
PRIMARY HEALTH CARE GRANTS **General Comment** Nearly all the PHC Grants are not fairly poverty focussed except PHC – NGO Grant that has a strong poverty focus because of the use of Human Poverty Index and special health needs of a district in the criteria. The allocation to lower level based on the Human Poverty Index and the workload makes it highly poverty focused. The allocation benefits the poor districts more than the rich ones, this enhances the quality of life of the poor, which is in line with the PEAP objectives. The health sector grants	The view of most of stakeholders is that in future all the PHC Grant allocation criteria should better be related to the actual needs and with incorporation of certain indexes for poverty.	The principle of " focus on service delivery; whereby the transfer formulae focuses on needs/ demand rather than the inputs/and infrastructure/ supply" should be pursued. Some efforts have been put but not sufficient. This principle should be adhered to the latter.

have shortfalls in their releases and no accompanying explanation is forwarded for the shortfall, late release of the grant to the district. Mechanisms for collections of data do not routinely address issues or capture data for vulnerable groups of society and output indicators don't separate the poor and non poor.		
FUNCTIONAL ADULT LITERACY GRANT **Comments on expected output** On the Output of the literacy learners to be proficient in reading, writing and numerate It seems the urban council are totally forgotten in the functional Adult Literacy Programme. Although allocation to	It should be expanded to knowledge in productive health, Nutrition and commercial planning to be more poverty focus. The allocation to urban councils should be considered The allocation criteria for Functional adult literacy grant should be based on and stick to the current allocation criteria based on :	The principle of "avoiding equal shares" was contravened when some LGs were grouped together to receive similar allocations

districts is based on the levels of poverty and literacy of districts, which is poverty focus, the actual transfers does not reflect the allocation criteria. According to 2002/2003 allocation of grants to the districts, The districts were clustered for allocation and a uniform amount was allocated to each districts in the clusters, which approximation is not at all-appropriate for poverty tackling In this allocation the poor and rich districts are not differentiated. Also data for classification of the district seems to be unrealistic in that smaller districts receive same amounts as larger districts, whereas one of the parameters is area (Administrative coverage). The number of instructors	Literacy levels in the district Poverty Area (administrative coverage) Number of learners Number of instructors But there should be more focus on literacy and poverty levels in the districts, the number of instructors could be replaced by adequacy of the instructors, because this depends on the relative number of learners.	

could be replaced by adequacy of the instructors, because this depends on the relative number of learners. **Community Based Rehabilitation (CBR) Conditional Grant** This grant is use to facilitate the provision of community Based Rehabilitation Service. The overall development objective of CBR is to assist people with disability (PWD) to become aware of, and be able to adopt improved skills and knowledge so as to enhance their productive efficiency, their economic welfare, and the sustainability of their livelihood in all spheres of life. **Costing of Community Based Rehabilitation**		

Activities Districts and Sub-Counties develop workplans for their social development sector in a participatory manner involving the PWDs. The districts and sub counties identify activities with their objectives, these activities are then quantified and costed. The overall cost of all these activities is the sum of all the individual activity cost.		
EQUALISATION GRANT The objectives of the Grant were completely misunderstood especially by the MoFPED. In practice, the EG has been used as contingency fund. Especially when it comes to catering for start-up funds for newly created LGs.	The right explanation be given to LGs on the purpose of the grant and more so if a LG is a beneficiary. The grant should not be used to handle disasters or insurgency, instead a particular fund be designed for such Issues of co-funding .	The principle of " incentive compatibility" is contravened because there is no in built incentive to enhance local revenues.

The formulation was based on a measurement of the recurrent budgets but excluded the features of development budgets of local governments because the latter had not yet been decentralised at point of time for the development of the formulae. The spread in terms of the number of the benefiting LGs is a matter of concern as well as the lack of adjustment of the number of LGs to be eligible for the grants when the economic and other developments change. The allocation criteria includes potential GPT (graduated personal tax) as basic in estimating Revenue potential yet Local Governments are collecting other revenues like market dues, licences,	The formulation of the grant should bear in mind all parts of the LG budget, recurrent and Development The formulation of the grant should bear in mind the need to capture new beneficiaries and drop some overtime. The allocation criteria currently includes potential GPT (graduated personal tax) as basic in estimating Revenue potential but this time the revised one should look into possibilities of other big revenue sources like Fees and Licenses especially for the urban areas Data Bank should be revamped, periodic assessment of LGs are necessary to improve the allocation mechanism of the grant	

fees, royalties, etc. So using GPT revenue source alone especially currently when the other sources have been found to be more lucrative, is insufficient. Data for the parameters used is either out of date and/ or inadequate **Utilisation** There is hardly any Monitoring of its utilization. Very little efforts have ever been put monitor how its being used by LGs. The centre stops at ensuring that its workplan is done and submitted to the relevant central departments. Poor capacity to make commendable workplans and poor accountabilities render the benefiting LGs unable or delay to access		

the grant.		
Feeder Road Maintenance Grant Length of maintainable network of roads in the LGs is used as the basic criteria. This parameter seems insufficient. Soils affect roads very much especially maintenance. Its very difficult for someone to do simple works named routine maintenance when there are frequent land slides, big cracks in the road, loose soils and rock giving way all the time, clay making the road slippery during rains, etc Unfortunately this factor of soil texture is not included in the criteria! The items like bridges, culverts, murram excavation, swamp filling	Other parameters should be developed to improve the allocation criteria, viz; Density of traffic Population size Nature of activities, Nature of what is hauled on the road, Soil texture of the area. This is still a big challenge: with poor soils you simply have to periodically purchase and transport the right soil to the damaged place and land slides can at times be dangerous to human settlement; it is unfortunate that SOIL TEXTURE is never considered critically as a basic criteria when it comes to allocation. The black cotton soils of Kabarole are an example of poor soils for a road. Some way of designing the formulae to include items like bridges, culverts, murram excavation, swamp filling which are not specifically catered yet we are handling roads in villages where there are variations in landscape everywhere. **The size of the road network of a LG in Uganda should be determined through an objective assessment of the needs of each LG but not as a	The principle of "focus on service delivery" is not observed. The criteria looks at inputs/ infrastructure rather than the outputs/ clients

seem not specifically be catered for yet we are handling roads in villages where there are variations in landscape everywhere. The Criteria no. a) - the proportion of the maintainable roads in the Local Governments: this seems to leave out most NGO/ Donor supported road developments in the Local Governments. So it should be revisited. Allocations for rehabilitation: The share of the un-maintainable network in Uganda is calculated for each district. This share is then used to allocate resources for each district to cater for rehabilitation. Old Local Governments have big networks and they seem to be favoured by the allocation criteria for maintenance while others	result of historical and political processes. some criteria has to be developed for allocation to urban council roads Rehabilitation of most urban roads should probably be funded separately. Therefore it has been suggested and recommended that Town Councils should prepare their requests in this respect and submit to Ministry of Works for possible assistance	

are marginalised! It would be more appropriate if positive discrimination was made such that more funds are given for rehabilitation in areas currently under-served. d) Allocation for urban areas still have no clear criteria. There is a mention of giving preference to the Proportion of the population not served but this is not relevant to all. Allocation in Urban areas is basically for Periodic Maintenance only; This currently excludes the Tarmac portions. It has been noted that for Kampala City and the thirteen Municipal Councils the backlog of un maintainable roads that should be Rehabilitated is overwhelming and should		

probably be funded separately. e) It has been observed that most Town Councils have not had structural plans and designs to handle this work properly. The Ministry of Works guidelines show that the Urban Councils accessing these funds should have the structural plans and designs. In fact the data of the road stretches in the targeted areas is still inadequate; besides some of the roads in some Urban areas have never been surveyed. f)It is assumed that the LCIII level should take the responsibility of maintaining and rehabilitating community roads using their 65%		

retention which is extremely inadequate.		
	Suggestions for other factors to be used in the criteria The possibilities to include more poverty sensitive criteria should be considered. A candidate for extra criterion is the household consumption index(HCI). Among the suggestions raised have been the following formula: ***Population: 70 %, area: 25 % and HCE: 5%***	The principles of "preserving budget autonomy" (providing discretionary powers to allocate) and "incentive compatibility are seen to operate"
Local Development Grants	**Developments in the process on allocation of the Grant:** In the near future this grant (in LGDP-II) a significant part of the CBG provided to Local Governments would have to be used within a menu of specific courses. The development of standardised training courses and the elaboration of a short-list of qualified national training providers will be co-ordinated by the LG Capacity Building Unit and the specific Technical Working Group on Standardised Training. The short-list of qualified training	

	providers will be updated semi-annually. Among the providers on the shortlist, Local Governments will be able to purchase training courses according to their Capacity Building Plan. The grant will be restricted to non-sectoral, generic training and skills development. A reform is ongoing to improve on the entire framework of capacity building at the local governments level, including the CB grants.	
WATER Water sector is being constantly under funded. This inadequacy has reached 32% in FY 2002/2003. Transparency: The approach is not transparent, consultants in 24 piloted districts did the process of needs assessment, and this meant that the investment plan for the other districts was made on the assumptions made from the pilot district. As already observed there is	What should be done is to assess individual districts and establish the facts on the ground The investment plan need to be revised to take into consideration the current census results and also prepare district specific plan (to ascertain whether the assumption made in National study still hold in specific district)	The principle of "predictability/ stability" is seriously contravened here

a wide variation in cost in delivering water & Sanitation services among district due to a number of factors like technology-mix, therefore the precision of these estimates are far from real. It was not clear whether district were consulted or informed whenever the ministry make changes in the plans due to some factors like inflation. The investment plan depended on availability of funds therefore it would have been made clear to LGs on how to address short falls. In the plan it was indicated that population was projected and there was plan to update these projection for the 2002-population census. But	These factors like changes in technology – mix due to say depletion of water table were should be considered. It is important therefore that to study the trends of revenue performance in last three years to serve as the basis for projection**.**	

other factors, which can bring changes in expenditure need like changes in technology – mix due to say depletion of water table were not mentioned. **T**he current criteria is suitable to fulfil the intended objective, but it is subjective to availability of funds and realistic revenue projection. <u>Application of the formulae/Grant</u>. Revenues are projected to meet the projected costs. This is the problem area in application of this criteria, if one does not base the estimates on reasonable assumptions.		
AGRICULTURAL		

EXTENSION GRANT Existing Allocation Formulae The allocation of funds to the districts is based on Population 60% Area 20% Poverty 20% Comments on the formulae This Grant is phasing out to be replaced by NAADs Grants. Population Parameter is used as the proxy for no of farmers, it may be applicable in rural areas, but not in urban centers. The formulae does not provide extra assistance to bigger district to cater for added costs of delivering services in sparsely populated areas		The principle of "focus on service delivery" is poorly followed

It is certainly appropriate to include poverty indicator but the method how that indicator was calculated is not known. The available poverty indicator is dis - aggregated by region; therefore it is difficult to get a precise estimates the error level may be high. No scientific method was used to arrive at the weights. **NAADS** The purpose of the grant is to ensure that farmers apply improved husbandry and management practices, and identify and solve their technical and marketing problems using appropriate and modern knowledge and	**NAADS** **NAADS secretariat is developing a formula**	The principle of "avoiding equal shares" I need to be adhered to. The current allocation in PMA doesn't effectively promote the principle of "Incentive compatibility"

technologies. The formula has not yet been clearly established, the NAADs secretariat has formed a task force to come out with the criteria. However, there are current basic criteria for allocation among eligible district and sub-counties. Additional resources provided to poor districts and, in particular sub-counties, will allow locally-decided targeting of resources for measures addressing specific needs of particular groups, which otherwise would benefit less from NAADS services.	It is appropriate to base allocation on the number of people in the district to approximate the number of farmers and to provide extra assistance to bigger district to cater for added cost of delivering services in sparsely populated areas. But it would be certainly more appropriate to include poverty index, to increase poverty focus. It is also important to identify the poor of the poor and the land less. The co – funding requirement of this grant may not be good for this grant to realize its objective, as it is on record that in most cases poor district find it difficult to meet the requirement.	
PMA Non – Sectoral Conditional Grant This is a development grant; the purpose of the grant is to financially empower Local	The PMU NSCG needs to be reviewed in relationship with the LGDP Local Development Grants as they are partly overlapping	

Governments to be able to plan and implement poverty focused programs in their localities. The allocation to the district is based on the population and area with weighting of 85% and 15% respectively. Adequacy: The grant is not adequate, but even if it was adequate, it will not make meaningful impact because the pillars of PMA are not implemented at the same level yet they are related. For instance increasing farmer's production without increasing the markets of their products will not improve farmer's incomes. The seven pillars of PMA are Research and Technology, Agricultural Advisory Services, Agricultural Education,		

Access to Rural Finance, Agro – Processing and Marketing, Natural resource & utilization and infrastructure development. Application of the Grant Application of this grant is difficult because the government is implementing a number of programs in this sector. Therefore, there are contradicting government policies. For instance PMA requires beneficiaries to pay some fee, UCDA is distributing seeds for free.		
EDUCATION The Ministry of Education intends to revisit the formula for possible application in the FY 2003/04. The formula, which had been developed, had two components namely, the	The option here may that the allocation to districts by the centre be based on school going age and then the allocation to schools be based on the enrolment and other parameters as will have been agreed.	The principle of "focus on service delivery" is not well followed and the basic desirable characteristics like Accuracy of data, the data being free of manipulation are not observed.

threshold or fixed grant (TG) and the variable grant (VG) and also making a distinction between urban and rural schools. However, in all the following parameters were included as policy allocation variables: Enrolment Gender, Number of disabled children, Location on the rural/urban axis (given as a constant), Cost of living index (takes care of inflation) In the study that led to the formula, it was noted that the new formula introduces three significant policy instruments in the overall government of Uganda		

well-established affirmative policies on; girl child education, Education of the disabled child, and focus on rural development. It is important to note the initiative was welcome in as far as trying to streamline and make the allocation criteria more efficient. It points out issues that are central to the management of UPE funds and within the terms of reference tried to recommend the way forward. However, in our opinion it is important further to improve on the grant formulas to achieve its objectives. **Salaries for Primary Teachers Grant**	The grant as a matter of reform need to address the present service level and support per student, instead of having a fixed rate for many years. This important feature has to be thoroughly considered	

The allocation of this grant to respective local governments is determined by the enrolment in reference to a centrally set pupil teacher ratio. But the actual disbursement depends on the number and value of teachers on the payroll in the Ministry of Public Service and Uganda Computer Services of Ministry of Finance, Planning and Economic Development. The problem with the current system of allocation is that in many cases the allocations have not been in line with what is on the ground. To the effect that the Ministry of Finance has had to create corrigenda to address the shortfall in wage obligations.	It would be of good intention to improve on equity in the distribution of the institutions especially at the lower levels to be more uniform.	

Accessing of teachers on payroll though improving is still a problem within the system, which happens to run from individual schools to the Ministry of Public service. As a result many stakeholder have been advocating for the decentralisation of the payroll management. Just like in the proposed allocation of UPE capitation, the concept of threshold need to be extended to teachers allocated per school. **Secondary School Capitation Grant** Government allocates this grant to cater for items that are vital for the learning of the student. The allocation to each local government is determined by the		

enrolment. It is noted that in theory, the actual amount allocated is computed at a rate of shs. 65 per child per working day for both day and boarding schools. However, the growth of the grant has not matched with that of student enrolment resulting into the per student rate actually received to be lower than the prescribed rate. **Currently** there seems to no clear policy direction in the provision of secondary school education in the school. As a matter of streamlining the delivery of secondary education, a clear secondary education policy needs to be developed. **Salaries for Secondary School Teachers Grant**	The allocation should be in reference to the potential needs if we are to provide an incentive for encouraging all school age children to go to school. And this provides for the near future so that we are not constantly building more classrooms every two years on the same school location.	The principle of "Reflecting needs/ demands" lacks somehow because of the kind of data used as input and its accuracy.

The actual number of teachers in post for each district determines the allocation to each district. The Ministry of Education determines the load for each teacher in various disciplines. The Education Service Commission recruits and the Ministry of Education and Sports appoints and deploys/posts to the needy schools. The salaries for teachers are handled by the Ministry of Public Service. However, it is important to note that like all facility based transfers, local governments with more schools receive more teachers. **Salaries for Tertiary Institutions Grant** These grants are to meet		

the salaries of primary teachers colleges, technical colleges and institutes, and rural trade schools. The actual number of teachers determines the amounts allocated to each district. The Education Service Commission establishes the staffing norms and recruits. The appointing and deployment authority is the Ministry of Education and Sports. The salary administration is done by the Ministry of Public Service together with the respective local governments. Since the grant is facility based, its allocation is largely unequal across districts. The district with more facilities will definitely receive more in allocation that those with less or without. However,		

just like any other education institution in Uganda accessibility to these institutions is not limited to residents of only those in the district. **Health Training** This activity was until the recent reform in government structures under the ministry of health. It is now being managed by the ministry of Education just like other training institution in agriculture, fisheries, cooperatives etc. There seems to be no clear allocation criteria of this grant known to the ministry of education and sports. It is apparent that the allocation is based on historical data from the ministry of health. Currently the ministry of finance, planning and		

economic development does provide the transfers. However, the debate in on whether to 'return' this activity to the mother ministry or what strategy need to be put in place to improve performance. **Subventions in some Specialized Institutions** All institutions under BTVET receive their capitation grant from the Ministry of Education directly. Some of these institutions receive their wage grants through the tertiary institution grant given above. Allocations of non-wage are allocated to schools based on a defined rate per student per day. Students in technical schools receive shs.600 per day for all		

days at school. Students in technical institutes receive shs.850 per day while students in Uganda Technical Colleges and Uganda Colleges of Commerce receive shs.1,100 per day. The latter two categories of institutions are not decentralized. However, the form of disbursement on non-wage is similar. The non-wage funds are basically for food, but in practice, the institutions have utilized them for expenditures, which are not food items. Like capitation for primary and secondary education, these rates given per student are not sensitive to inflation. The rates have not changed for over 5 years. **School Facilities Grant**		

According to Ministry of Education and Sports guidelines (December 2002), it is designed to assists most needy school communities to build new classrooms, supply furniture for classrooms constructed, build latrines as well as teachers houses. The target of the grant is to achieve the classroom: pupil ratio of 1:55; desk: pupil ratio of 1:3; latrine: Teacher/pupil ratio of 1:40 and at least four (4) teachers' houses per school. The grant is allocated according to need. The need is calculated based on the Pupil: permanent classroom ratio. The higher the ratio, the higher the need hence more funds allocated.		

Fifteen per cent (15%) of the allocated amount to individual district/municipality is allowed for construction of teacher's houses. This is insufficient to address the problem of teacher's houses. The ministry has also established a kind of an incentive system, where some of the LGs are getting more if they perform better, the experiences have shown that this is not yet fully transparent		
Unconditional Grant Purpose of the Grant It is a minimum grant that is paid to LGS to run decentralized services, it covers both wage & non – wage. This grant is supposed to provide a	The design of the formula of this grant should be two part; for wage and no-wage both of which are variables and expected to grow differently overtime but not necessarily eating into each other. The factors should not leave out the basic issue of the threshold; ie each LG must operate	The principles of: “Avoiding Double counting”, ”Preserving budget autonomy”, and “ focus on service delivery” have been heavily affected by the current mechanism

substantial amount of policy discretion to Local Governments in spending the funds to council priorities. The current allocation criteria are Population and Area with the weight of 85% and 15% respectively. Adequacy: The grant is not adequate in all the districts. In some LGS like Kamuli, Moyo, Jinja, Kapchorwa,Tororo, Busia, Kumi, Apac T.C and Luwero are not able pay their wage bill out of the conditional grants. Local Governments visited expressed concern that annual salary increment has been effected over the years, with no corresponding the increases in the	therefore allocation to each begins with the basic minimum.	

unconditional grant did not those the salary increments. This inadequacy has resulted into accumulation of salary arrears. Therefore, it is important to consider wages and salaries in the allocation criteria. Grant Allocation Criterion Relative to Intended objective The main purpose of the grant was to provide policy discretion to Local Governments to enable the councils to allocate funds to their priority sectors. Unfortunately, this has not been the case because of inadequacy of the grant. Most of the funds covered wages & Salaries of workers, which almost translate the grant into "a conditional grant".		

Application of the Grant**.** As already indicated data has been a problem in the application of this grant. The Study revealed that sometimes the population and area were not used in allocating of the funds and the data was not up-dated. What used to happen is to calculate the growth in the grant in the current year, distribute it in the pro-rata basis to all LGS and add the result to the previous year's allocations. The implication of this is that it can create a "visible" short fall over time especially when population growth far exceeds the growth in the grant. In application of the formulae, we have been considering population growth and ignored other	It was against that backgrounds that the restructuring study by the Ministry of Public Service was commissioned to streamline structures of local governments which are comparable.	

factors like migration. This has been a big problem to Local Governments neighboring the Sudan. But caution must be taken to distinguish between internal local migration and international migration, as the later may need extra funding of the grant. The allocation has not been putting in consideration the district/Local Governments under insurgency and those that are affected as the result of subsequent migration migrations. Should it remain relevant for district say Gulu to get the grant for the people who had fled to Gulu municipality or consider giving the equivalent to the municipality? What can be a constant expenditure is salary in		

the affected areas, but the rest may vary because of the migration of inhabitants**.** There has been double counting in allocation of this grant in favour of the district with many urban council; this has led to higher per-capita grant allocation to the councils with many town councils. Local Government has experienced unexplained shortfalls. The matter is made worse for Local Governments because they could not even know specific central institutions responsible for allocation of this grant.(LGFC ,MOLG or MoFPED). This needs to be made clear to Local Governments. Creation of new Local Governments especially		

the recent creation of towns will have an effect in allocations of other towns, the grant allocation for other urban will have to be reduced by the amount required by this councils as unconditional grant, yet the ideal situation would have been if Kiira has been curved off from Wakiso, it looses both land and population which make it automatically looses the equivalent of unconditional grant. *In practice Wakiso district will remain with the same allocation despite the fact that it lost area and land. This led to the application of the formulae meaningless.* The effect of the creation may not be seen if there is huge growth in the grant		

but If the grant doesn't t grow or the growth is less than what is required to finance (unconditional grant) the new councils, then the cut would be visible. It is also important to note that while the unconditional grant is generally inadequate, some local governments have structures that are difficult to account for. For example Apac district had 1,023 employees while Mbarara which is relatively bigger in terms of population and area had 693 employees indicating wages charged on the unconditional grant for March 2002,. Some other cases in that category with unsustainable structures include Arua, Tororo, Lira, Kumi, Kamuli, Pallisa etc.		

CHAPTER SIX

6.1 PRINCIPLES IN THE DESIGN OF A ALLOCATION MECHANISM

Generally, the principles in the Chapter 3 should be the point of departure for the future design of the grant allocation formulas. More specifically, the allocation formulas should be based on:

Provide revenue adequacy:

A transfer formula should provide a source of adequate resources to local governments to achieve its policy objectives.

Preserving budget autonomy:

A transfer system should preserve budget autonomy at the local level within the constraints provided by national priorities.

Enhancing equity and fairness/Poverty sensitivity:

The transfer mechanism should support allocation of resources in a equitable and fair way. E.g the formulas should consider the subjects for equity concern – should the system be fair to children, parents or both?. Equity of what?, equity concerns can focus on equity in outcomes, outputs, inputs and/or access. An important decision is what exactly is meant by "equal treatment" equity in education outcomes such as earnings or life satisfaction, or out puts such as achievements in learning or equity of resources such as teachers, books, etc or equity in access to similar programs.

Stability and predictability:

Transfer should be provided in a predictable manner in a dynamic sense. If you refer to report analysis .It was observed the current transfer system was generally stable but un predictable and not up-dated. It don't factor in the element of inflation, wage changes, changes in the assignment of tasks etc

Simplicity and transparency:

Transfer formulae should be simple and transparent and should pursue one objective at a time. However it should avoid over simplification, for instance in the meeting with the Local Governments and ULAA executives it was observed that the formula (Area and Population) was over simplified. There are number of factors which affect the ability of Local Governments to deliver public services, some of these factors need to be factored in these formula.

Incentive compatibility:

The transfer system should not create negative incentives for local revenue mobilisation and should not induce inefficient expenditure choices.

Focus on service delivery:

Transfer formulae should focus on the demand (client or outputs) rather than the supply (inputs and infrastructure) of local governments' services. For instance Ministry of works is using road km as the criteria of allocating grants. Local Governments with historical big net-work will definitely get more money. The ideal situation would have been to use social economic factors to reflect demand for funds.

Avoid "equal shares":

Equal share principals as a major allocation factor should be avoided in the design of an allocation formula. In MOH PHC Non – wage and NAADS grants are distributed based on population at the district level and within the district they use equal shares to health centres and sub-counties respectively. This creates differences in per-capita allocations within the district.

Donor Interventions

Direct Donor intervention to Local Governments should be reflected in the formulae. This demands current updating of the figures and a good overview of the donors support.

DESIRABLE CHARACTERISTICS OF ALLOCATION FACTORS

Accuracy

The variable should accurately reflect the specific characteristics and should be statistically sound, The Government has been using generated statistics to allocate grants often without proper up-dating and adjustments. Therefore we need to emphasise the use of prudent statistical methods and data in order to have precise estimates.

Regularly updated

The variable should be regularly updated in the future. The study shows that for most of the grants the data used is not regularly updated, eg Ministry of Health was using IMR and MMR of 1997 surveys! And most date is not disaggregated at the district and other lower councils levels.

Independent source

The variable should come from an independent source respected by all stakeholders. For instance UBOS has been providing data on Population and area based on census projections and surveys. This institution is regarded as being independent of the Centre and the Local Governments.

Free of local manipulation

The variable should be drawn from a source that cannot be manipulated by local governments (unless where the Government has adequate capacity to monitor and verify locally reported statistics). Ministry of Education Sports has been using school enrolment to distribute UPE capitation grant, although this has been regarded as a good criteria, the Ministry has no adequate capacity to monitor and verify the accuracy of this data as reported by the district or the schools.

Reflects needs or demands

The variable should reflect needs or demands for public goods (for example, the number of potential clients in demand of services rather than outputs such as infrastructure).

Avoid Double Counting

Minimise double counting in the Application of the formula because this has created a number of problems in distributing unconditional grant based on population and area. It was found that there is double counting for the Urban population as the citizens are counted as part of both the district and the urban centres.. Example: the recent creation of new towns like Kiira and others will definitely create "artificial" population. Therefore in the coming year allocations.

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