EXPLORING AFGHANISTAN'S SUBNATIONAL FISCAL ARCHITECTURE: Considering the Fiscal Linkages between Villages, Districts, Provinces and the Center

Executive Summary

Although the Afghan Constitution provides a framework for a unitary and highly centralized public sector, the Constitution also recognizes the importance of subnational governance. Among other provisions, the Constitution (chapter 8, article 2) mandates that the government shall delegate certain authorities to provincial administration units for the purpose of promoting economic, social, and cultural affairs, and increasing the participation of people in the development of the nation.

The country’s formal policy framework for subnational governance and intergovernmental relations is contained in the Sub-National Governance Policy (SNGP) which was adopted by Cabinet in March 2010. By and large, however, the SNGP itself was not supported by a broad political and institutional consensus at the time of its adoption, which has hampered the implementation of significant parts of the policy’s vision.

Nonetheless, within the context of the sub-national governance policy framework, numerous efforts are underway to strengthen different aspects of sub-national governance and service delivery. Most recently, as part of the Tokyo Mutual Accountability Framework (July 8, 2012), the government has made specific commitments in the area of subnational governance, including a commitment (1) to enact a legal framework to clarify roles, and responsibilities of government agencies at national, provincial and district levels, in line with the 2010 Sub-National Governance Policy; and (2) to develop a provincial budgeting process that includes provincial input into the relevant ministries’ formulation of budget requests, linked to a provincial planning process in which Provincial Councils have their consultative roles.

Despite considerable efforts over the past few years by the government and its development partners, only limited progress has been made on improving the effectiveness as well as the inclusiveness of subnational governance and service delivery. As international military forces are set to draw down in 2014 and as the international development community is increasingly handing the responsibility for public service delivery over to the Afghan public sector, it is clear that the current pace and scope of subnational governance reforms is inadequate and that

1 This background document was prepared by Jamie Boex, Senior Research Associate at the Urban Institute Center on International Development and Governance in December 2012. The author is thankful for feedback on earlier drafts from Richard Hogg, Lorena Vinuela, Yongmei Zhou, and several other reviewers. Final Revision: May 2013.
concrete steps towards minimally effective subnational governance, financing and service delivery arrangements are urgently required.

Although the overall vision for a more effective and responsive public sector set forth in the SNGP is laudable, in practical terms, the SNGP and the ensuing implementation efforts have fallen short from the envisioned transformation of the subnational public sector. **The most fundamental obstacle to progress on subnational governance reforms in Afghanistan is the absence of consensus—among government officials, policy makers, and development partners alike—on the organizational and budgetary status of subnational entities at the provincial, district and village levels, and the fiscal linkages between these levels.** As a result, efforts to improve public service delivery at the subnational level in Afghanistan have been hampered by two obstacles: first, the inability to improve public services due to lack of subnational discretion over financial resources, and second, the absence of effective (public and social) accountability mechanisms to hold subnational entities accountable for their performance.

In the absence of any real institutional or budgetary authority at the subnational level (as is currently the case, as illustrated in figure 1 below), it is essentially impossible for provincial departments, districts or villages to be meaningfully empowered. As a result, little or no improvement in the responsiveness or effectiveness of public service delivery at the subnational level will be possible unless broad-based agreement is reached on significant strengthening of the country’s subnational institutional and fiscal architecture.

**Subnational fiscal architecture: options and lessons from international practice**

Conceptually, three institutional and budgetary options are available for subnational governance entities in Afghanistan below the central government level. The first option for provincial departments (and in principle, for public sector entities below the provincial level) is to continue the status quo by continuing to function as deconcentrated, non-budgetary organizational entities. This means that provincial line departments have neither a legal (governance) status separate
from their respective line ministries, nor are they recognized in the Chart of Accounts as formal (secondary) budget entities within their respective ministries (i.e. they are not a sub-organization in the organizational classification scheme). Under this scenario, provincial line departments are fully under the institutional and budgetary control of their respective line ministry, making it impossible for provincial line officials to be empowered in any meaningful way.

A second option for provincial departments is to be accorded the status of deconcentrated budgetary entities within their respective line ministries. This means that while provincial line departments would continue to function as an integral (hierarchical) organizational part of their respective line ministries (i.e. without their own legal status), they would be recognized in the Chart of Accounts and in the national budget as formal secondary budget units (i.e., sub-organizations) within their respective line ministries. This option would allow provincial line officials to be delegated a degree of discretion over the financial resources needed for them to implement the responsibilities that would be assigned to them in accordance with the Constitution.

A third option would be for provincial line departments to be given a legal and/or budgetary status that is typically reserved for devolved provincial governments. In the most restricted version of this option (limited budgetary devolution), provincial officials would be given the authority to make certain financial transactions in bank accounts that are held outside the national treasury system. In the most extreme case of devolution, this approach would imply that provinces would become separate legal entities that would be allowed to prepare, adopt and manage their own budget plans. This option is not consistent with Afghanistan’s current constitutional and legal framework, and is therefore the least likely to be politically and practically viable in the near future (and not further pursued here).

Although the policy environment in Afghanistan is unique in some ways, there are scores of countries around the world that have pursued subnational governance reform under difficult circumstances. As such, getting Afghanistan’s subnational institutional and fiscal architecture right, and deciding how to sequence its implementation, can be meaningfully informed by this body of international practices. Five specific lessons regarding subnational governance and intergovernmental fiscal architecture that can be drawn for Afghanistan based on international experiences in similarly situated countries include:

1. In the process of state building, subnational administration and governance systems matter for effectiveness, accountability and legitimacy reasons.
2. Many post-conflict countries rely on a deconcentrated state administration system with budgetary deconcentration.
3. Deconcentrated systems evolve from the top down; creating an effective district level is the work of decades, not years.
4. Deconcentrated countries tend to have a responsive village level at the bottom of the formal public sector.
5. Intergovernmental fiscal reforms are inherently political and typically incremental, as reforms require a careful alignment of champions in order to succeed.
Towards dialogue, consensus and implementation

Despite an abundance of lessons from international practice in other fragile and conflict countries, progress on the implementation of Afghanistan’s subnational governance agenda has been slow in coming. While the initial draft of the Sub-National Governance Policy was circulated in September 2008, the policy was not adopted by Cabinet until Spring 2010. To date, little tangible progress has been made in the implementation of the subnational governance policy.

The dialogue on subnational governance and finance in Afghanistan so far has been different from many other fragile and conflict states in that the domestic political voice has been largely absent from the policy dialogue, while the voice from the international community has been very significant, yet has lacked consensus. It appears that (at least) three trends—immature institutions and inter-ministerial power politics; a deficit of attention from the international community on sustainable governance reforms; and the inexperience of technical implementers who failed to recognize the political economy aspects of subnational governance reforms—have contributed to the relative lack of progress on subnational finance reforms.

With the expected transition of military forces and aid modalities imminent in 2014, it is important to seize the current window of opportunity in order to implement concrete improvements in subnational institutions and mechanisms in order to enhance the effectiveness, responsiveness and legitimacy of the public sector. Options and recommendations are considered for strengthening fiscal linkages at the provincial, district, municipal and village levels.

Implications and recommendations for the provincial level

In principle, there is little disagreement that in a textbook sequence, the first step towards a stronger role of the provincial level is to enact a legal framework to clarify roles, and responsibilities of government agencies at the provincial level (versus the roles and responsibilities of central and district level entities). In fact, many subnational governance reforms start off on the wrong track when they fail to get the assignment of functional responsibilities to the provincial level right (both in terms of the process, as well as the resulting assignments). Achieving consensus on the functional role of provincial departments is proving to be an obstacle, as the assignment of functional responsibilities is not only a technical process but is inevitably also highly political. Although political economy constraints will most likely prevent the emergence of a high-level consensus of the formal assignment of functional responsibilities to different administrative levels, it may be possible to move forward in a more low-key manner by clarifying the functional responsibilities of provincial line departments in a de facto manner (for instance, as part of Provincial Budgeting Guidelines) without requiring a formal legislative or regulatory assignment of functions and responsibilities to the provincial level.

A second constraint is the fact that the delegation of functional responsibilities to the provincial level—as mandated in the Afghan Constitution—cannot be realized unless provincial line departments and their lead officials are provided with the organizational and fiscal space to administer their delegated responsibilities with some degree of separation from their respective line ministries. Within the context of a deconcentrated public sector structure, international experience suggests that provincial line departments need to be given, first, recognition in the budget structure as budgetary (sub-)entities and, second, some degree of discretion or control.
over the budgetary resources provided to them. Without these two elements as building blocks it is impossible to give subnational officials the balance of discretion and accountability within which they would have incentives to perform.

While the preparation of provincial-level (and district level) development plans has been a long-standing element of provincial development interventions in Afghanistan, the preparation of these plans has taken place completely outside the scope of the country’s budget framework. The preparation of provincially prioritized “wish-lists” raised false expectations that the budget process would be re-oriented to provide funding for subnational development priorities outside the scope of national priorities, which are implemented through central line ministries and other central government structures. The first step towards a greater role for provincial stakeholder in public sector budgeting and service delivery will require a shift away from the previous focus on participatory, bottom-up provincial planning towards the deconcentration of budget authority within key ministries to the provincial level.

Creating the space for provincial budget authority within a vertically deconcentrated budget structure is technically easy to do and already possible under the current Financial Regulations: line ministries could be required by Cabinet to recognize their provincial line departments as secondary budget units (sub-organizations of their respective line ministries) by amending the organizational codes within the Chart of Accounts.

It should be noted that pursuing vertical budget deconcentration (by which provincial line departments are given a degree of budget authority but fully remain within the hierarchical structures of their respective line ministries) is fully in line with Afghanistan’s constitutional and legal framework and would continue to allow the central government to set overall budget priorities between (as well as within) sectors and programmatic priorities, while at the same time allowing provincial line officials greater flexibility and control over their service delivery responsibilities. The key challenge in this regard will be to align the necessary champions in order to overcome the political economy obstacles that have prevented this reform from being implemented until now.

**Implications and recommendations for the district level**

Experiences from other countries (e.g. Cambodia, Mozambique) suggest that forming a deconcentrated district level is a difficult and expensive proposition which takes many years to accomplish. Beyond the implementation challenges and expenses that would be involved with staffing almost 400 district offices, none of the subnational fiscal “plumbing” is in place for district-level line offices to become deconcentrated budget units. Furthermore, districts are further removed from the center of decision-making in Kabul than the provincial level, which would make it almost impossible for government systems to be responsive to their needs. An excessive focus on the district level would risk fragmenting scarce public sector management resources too thinly across too many jurisdictions. As a result, building and strengthening a full-fledged deconcentrated district level should be considered a long-term intervention, and hence, a relatively low priority on the subnational governance agenda in Afghanistan at this time.
Implications and recommendations for municipal governments
Municipalities in Afghanistan have a constitutionally-mandated role in Afghanistan’s subnational governance structure in urban areas. Until now, however, financial support to municipalities has largely been limited to in-kind transfers of infrastructure and other support under donor-funded projects such as the USAID-funded RAMP-UP projects. This projectized approach is increasingly unsustainable, especially in light of the shifting security situation post-2014. It would be much more efficient, transparent and appropriate to funnel support to municipalities through an on-budget municipal grant scheme.

The introduction of formula-based, performance-based municipal grants would be an important step towards increasingly responsive governance and increasingly effective municipal service delivery. If well-designed, even relative small annual municipal grant scheme—$20 million per year, for instance—could have a substantial impact on urban governance and services if the right participation, financial management and accountability mechanisms are put in place. While the World Bank and other development partners have extensive world-wide experience with the introduction of formula-based (and even performance-based) municipal grants to strengthen urban infrastructure and urban service delivery, the MOF has been hesitant to support the introduction of municipal grants despite the inclusion of such a municipal grant scheme in the SNGP.

Implications and recommendations for the village (or community) level
A final element of the subnational institutional and fiscal architecture that remains to be decided is the institutional and fiscal nature of the village or community level. Although the constitution conceives of villages as a consultative level of the state administration, in reality, the state administration is not able to effectively reach the grassroots through hierarchical, deconcentrated structures below the provincial level. Nonetheless, international experience suggests that there are substantial potential gains in legitimacy, social capital and effectiveness (in terms of the public benefit to the community) that can be achieved by steering some public funding as close as possible to the grassroots. In the short run and medium term—in the absence of a functioning district administration—this means creating an institutional and financial modality that can reach the grassroots level.

A leading option at the village or community level would be to replace Afghanistan’s National Solidarity Programme (NSP) with a mainstreamed Village Development Grant. The preferred option would be to transform groups of current CDCs across the country into formalized Village Councils, where Village Councils are elected under the supervision of the Independent Electoral Commission. In order to become the recipients of Village Grants, however, such Village Councils would have to become corporate bodies legally capable of opening their own bank accounts and managing their own finances.

If the establishment of (essentially) devolved village councils is not a politically or legally viable option, a secondary option would be to fund these community-level activities by continuing to treat CDCs (or preferably, groups or clusters of CDCs consolidated into larger jurisdictions) as

2 The Public Financial and Expenditure Management Law currently allows for the provision of deficit grants by the Ministry of Finance. It is unclear how this provision is currently being executed.
quasi-government entities—which are formally outside the public sector and legally equivalent to NGOs—but which would otherwise operate as local public sector entities and which would be provided Community Development Grants through the national budget.

Implications for the way forward
Until recently, the implementation of subnational governance and financial reforms has been pursued from two competing technical angles: one that has emphasized the importance of participation and bottom-up planning and another that has advocated for the gradual vertical deconcentration of budgetary functions from the top down. These two camps are separated by underlying political, institutional and philosophical divisions with regard to the extent to which (and how) top-down budget processes should accommodate plans that were prepared in a bottom-up fashion. The resulting deadlock has prevented the government (along with its development partners) from achieving a clear consensus on the institutional and budgetary nature of the subnational public sector. Nothing is gained, however, from failing to address these institutional and political economy obstacles.

Given the desire to achieve more responsive, efficient and accountable public service delivery in Afghanistan, what steps can be taken to strengthen the fiscal linkages between the central government’s budget processes on one hand and expenditures at the provincial, district, village and municipal level on the other hand? Rather than competing for power and resources with central line ministries, the ability of these subnational entities to play a stronger role in the responsive and effective delivery of public services will depend to a large extent on their ability to position themselves as effective facilitators of national policy objectives “close to the people”. In this context, the subnational governance debate should refocus away from the question whether to “decentralize or not” (or which specific decentralization model should be pursued), and to look at ways to improve capacity and coordination among public stakeholders at different levels of government to increase efficiency, equity and sustainability of public spending (Charbit, 2011).

This is a dialogue that involves not only a select group of officials from IDLG or the Ministry of Finance, but rather, these are policy questions that require broad-based consensus among all these key stakeholders from across government (including key line ministries), the development community and civil society. Informing the discussion about the role of the sub-central public sector in improving public service delivery –by identifying the binding constraints on the effective delivery of public services at the subnational level- could serve as a useful starting point to begin to achieve a consensus on Afghanistan’s subnational (fiscal) architecture and the establishment of effective linkages between the center, provinces, districts and villages.
<table>
<thead>
<tr>
<th>Acronyms</th>
<th>Description</th>
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<tr>
<td>AFMIS</td>
<td>Afghanistan Financial Management Information System</td>
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<td>ARTF</td>
<td>Afghanistan Reconstruction Trust Fund</td>
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<td>ASGP</td>
<td>Afghanistan Subnational Governance Programme</td>
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<td>ASOP</td>
<td>Afghanistan Social Outreach Programme</td>
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<td>BPHS</td>
<td>Basic Package of Health Services</td>
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<td>CDC</td>
<td>Community Development Council</td>
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<td>DDA</td>
<td>District Development Assembly</td>
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<td>DDP</td>
<td>District Delivery Programme</td>
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<td>DRRD</td>
<td>Department for Rural Rehabilitation and Development</td>
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<td>EMIS</td>
<td>Education Management Information System</td>
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<td>EQUIP</td>
<td>Education Quality Improvement Program</td>
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<td>FILL</td>
<td>Fund for Local Investment Initiatives (Mozambique)</td>
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<td>GIRoA</td>
<td>Government of the Islamic Republic of Afghanistan</td>
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<td>HLP</td>
<td>Horticulture and Livestock Project</td>
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<td>IDLG</td>
<td>Independent Directorate for Local Government</td>
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<td>IEC</td>
<td>Independent Electoral Commission</td>
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<td>LGCDG</td>
<td>Local Government Capital Development Grant (Tanzania)</td>
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<td>LGDG</td>
<td>Local Government Development Grant (Uganda)</td>
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<td>MAIL</td>
<td>Ministry of Agriculture, Irrigation and Livestock</td>
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<td>MENA</td>
<td>Middle East and North Africa</td>
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<td>MOE</td>
<td>Ministry of Education</td>
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<td>MRRD</td>
<td>Ministry of Reconstruction and Rural Development</td>
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<td>NABDP</td>
<td>National Area-Based Development Programme</td>
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<td>NPP4LG</td>
<td>National Priority Program for Local Governance</td>
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<td>NRAP</td>
<td>National Rural Access Program</td>
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<td>NSP</td>
<td>National Solidarity Programme</td>
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<td>O&amp;M</td>
<td>Operation and Maintenance</td>
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<td>OPG / PGO</td>
<td>Office of the Provincial Governor</td>
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<td>PAA</td>
<td>Provincial Administrative Assembly</td>
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<td>PBGF</td>
<td>Performance Based Governance Fund</td>
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<td>PC</td>
<td>Provincial Council</td>
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<td>PDC</td>
<td>Provincial Development Committee</td>
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<td>PDP</td>
<td>Provincial Development Plan</td>
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<td>PETS</td>
<td>Public Expenditure Tracking Survey</td>
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<td>PFM</td>
<td>Public Financial Management</td>
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<td>RAMP UP</td>
<td>Regional Afghan Municipalities Program for Urban Populations</td>
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<td>SLGU</td>
<td>Strengthening Local Governance in Uruzgan</td>
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<td>SNGP</td>
<td>Sub-National Governance Policy</td>
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<td>SPAD</td>
<td>Strengthening Provincial Administration and Delivery</td>
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<td>TMAF</td>
<td>Tokyo Mutual Accountability Framework</td>
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<td>VDC</td>
<td>Village Development Committee (Nepal)</td>
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EXPLORING AFGHANISTAN’S SUBNATIONAL FISCAL ARCHITECTURE:
Considering the Fiscal Linkages between Villages, Districts, Provinces and the Center

1. Background

Although Afghanistan is a highly centralized state, considerable recognition is being given to the importance of strengthening sub-national systems of service delivery and governance in order to make the public sector more effective, responsive and accountable to the needs of the people. While numerous efforts are underway to support different aspects of sub-national governance and service delivery, however, the existing subnational or intergovernmental (fiscal) systems do not provide adequately strong fiscal linkages between the central government in Kabul with the country’s provinces, districts, and villages where the people live and the bulk of public services are provided.

As international military forces are set to draw down in 2014 and the international development community is increasingly handing the responsibility for public service delivery over to the Afghan public sector, many are looking for workable public sector arrangements and intergovernmental fiscal models that would provide the funding and flexibility to subnational administrative entities necessary to deliver public services in a minimally effective manner.

The current policy environment for subnational governance

The official policy framework for subnational governance and intergovernmental relations is defined by the Sub-National Governance Policy (SNGP) which was adopted by Cabinet in March 2010. The policy is supplemented by the Independent Directorate for Local Government’s (IDLG) SNGP Implementation Strategy as well as by the National Priority Program for Local Governance (NPP4LG). As part of the Tokyo Mutual Accountability Framework (TMAF, July 8, 2012), the government made specific commitment on subnational governance, including (i) to enact a legal framework to clarify roles, and responsibilities of government agencies at national, provincial and district levels, in line with the 2010 Sub-National Governance Policy; and (ii) to develop a provincial budgeting process that includes provincial input into the relevant Ministries formulation of budget requests, linked to a provincial planning process in which Provincial Councils have their consultative roles.

Although the overall vision for a more effective and responsive public sector set forth in the SNGP is laudable, in practical terms, the SNGP and the ensuing implementation efforts have fallen short from the envisioned transformation of the subnational public sector. Perhaps most significantly, the policy document fails to determine the budgetary or fiscal status of subnational administrative jurisdictions and departments. Without clarifying the budgetary status of (deconcentrated) provincial bodies, setting up processes to obtain “provincial input” into the formulation of ministerial budgets (as is committed to as part of the TMAF) is a meaningless
exercise that will do little or nothing to improve the responsiveness and effectiveness of public service delivery unless provincial entities are given some degree of budget authority.\(^3\)

Some positive steps have been made over the past few years with regard to the implementation of a more effective and responsive subnational governance system. By and large, however, the SNGP itself was not supported by a broad political and institutional consensus. As a result, the initial iterations of its implementation agenda were not based on an realistic timeframe, in part by failing to recognize that subnational governance reforms involve a significant political economy aspect. IDLG (along with some of its supporters in the donor community, such as ASGP) initially pursued a technocratic ‘big bang’ approach to implementing subnational governance reforms that followed a textbook sequence, whereas other central government stakeholders –the Ministry of Finance in particular- were unwilling to jump in with both feet.\(^4\)

Without an authoritative and implementable policy agenda, the implementation of the SNGP has been refocused over the past three years to its most doable elements, recognizing along the way that to the extent that the political economy context in Afghanistan allowed progress on subnational governance and finance to be made at all, progress was only possible on a more gradual and incremental basis based on learning-by-doing and planning, financial management and accountability mechanisms that can be demonstrated to be effective. Since many of the policy details in the SNGP have \textit{de facto} fallen away as authoritative policy guidance, it would be fair to say that subnational governance reforms are currently being prioritized and implemented without the benefit of a clear formal blueprint of the underlying subnational or intergovernmental architecture that is being pursued.

\textbf{The opportunity to learn from international experiences}

Although the policy environment in Afghanistan is in some ways unique, there are scores of countries around the world that have pursued subnational governance reform under difficult circumstances. Indeed, one of the first lessons is that measures to strengthen PFM in subnational entities are often not an early post-conflict priority in most post-conflict countries. At the same time, however, it appears that the limited reach of public sector reforms into the subnational level (and within the sectors) limits the impact of public sector reforms on improved front-line service delivery outcomes. (World Bank, 2012) A rapidly expanding literature in the topic suggests that many fragile and post-conflict countries either faced -or are currently facing- the same technical complexities and the same types of political economy dynamics that are being faced in the implementation of Afghanistan’s subnational governance reform agenda. Getting Afghanistan’s intergovernmental institutional and fiscal architecture right, and deciding how to sequence its implementation, can be meaningfully informed by this body of international practices.

\(^3\) Improvements in subnational service delivery are brought about by providing subnational officials with a combination of incentives, discretion and accountability (Yilmaz and Yilmaz, Beris, and Serrano-Berthet, 2008; World Bank, 2009). Neither subnational discretion nor accountability will materialize as long as provincial plans and priorities can be changed unilaterally by central ministry officials.

\(^4\) Such a stance is not inappropriate, since the Ministry of Finance is the steward of the country’s public finance and seeks to protect the stability of the country’s PFM system from fiduciary risks.
Completing the subnational governance policy agenda: defining Afghanistan’s intergovernmental fiscal architecture

International experiences can help inform the most prudent pace and sequencing of the country’s subnational governance reforms. But first, informed by international experiences, policymakers in Afghanistan should take a step back and envision the structure of the public sector that they would like to see in place in the country in ten or twenty years’ time. This will involve answering a number of key policy questions about subnational institutions and governance that hitherto have been largely been unresolved. For instance, within the constitutionally-defined organizational structure of Afghanistan’s public sector, what legal, administrative, governance and budgetary arrangements should govern each subnational level or tier? What specific functions or service delivery responsibilities should be assigned to each governance level or administrative tier? Through what budgetary structures and mechanisms should the different layers of sub-national administration be financed? A concrete next step for Afghanistan’s intergovernmental reforms will be to define the functional responsibilities and the degree of budget authority that should be assigned to the provincial level.

Additional questions to be answered specifically deal with the public sector jurisdictions closest to the people. What should the role of municipalities be in the intergovernmental (fiscal) architecture? How should future Districts or Village Councils be structured and financed? For instance, when future block grants from NSP dry up, how can CDCs be integrated into the formal public sector (as nascent Village Councils?) and how can the sustainability of the village level be assured? Should District and Village councils receive regular grants from the center?

Towards dialogue, consensus and implementation

The dialogue on subnational governance and finance in Afghanistan is different from many other fragile and conflict states in that the domestic political voice has been largely absent from the policy dialogue, while the voice from the international community (both from the military and civilian sides) has been very significant, yet lacks consensus.

As referred to above, progress on the implementation of Afghanistan’s SNGP has been slow in coming. The initial draft of the policy was circulated in September 2008, while the policy was not adopted by Cabinet until Spring 2010. To date, little tangible progress has been made in the implementation of the subnational governance policy. It appears that three factors have contributed to the relative lack of progress on subnational governance and finance reforms.

First, it is not unusual for fiscal decentralization or subnational finance reforms to be stymied by institutional competition and ministerial turf battles, predominantly between the ministry responsible for finance and the ministry responsible for subnational governance or subnational administration. These turf battles in Afghanistan (predominantly between IDLG, MoF and MRRD), were exacerbated by the immaturity of the country’s political institutions as well as by the hyper-political environment in Afghanistan, driven by ongoing instability, open conflict and power politics. From 2007 (when IDLG was established by Presidential Decree) through President Karzai’s re-election in 2009, the debate surrounding subnational governance reform was caught to a large extent in a power struggle between the presidential palace (aligned with IDLG and the Provincial Governors) on one hand and Cabinet (representing the interests of the line ministries and the Ministry of Finance) on the other hand. A case can be made that the inter-
ministerial politics in Afghanistan is slowly maturing, improving cooperation between the key central ministries involved in the relevant subnational reform processes (especially MoF, IDLG and MRRD), and providing the potential foundation for a unified, consensus government position on key subnational governance and finance issues.

Second, from the side of the international community, the focus of a considerable share of the international community’s development activities until the end of 2010 was on stabilization and counter-insurgency efforts, not on governance or sustainable service delivery improvements. This meant that the prevailing modality for achieving improved subnational services was formed by (often military-led) development interventions at the PRT-level, and similar efforts at the district-level. These projectized efforts were typically unconnected or poorly connected to the country’s (formal) subnational governance system. Only more recently (with the troop drawdown in sight), the bulk of the attention of the international community has shifted towards improving the effectiveness of Afghanistan’s government systems in order to achieve more responsive and sustainable service delivery.

Third, in addition to the changing policy focus of the international development community, a change in tactics is taking place within international development assistance in Afghanistan. Whereas oversized, bold initiatives were an effective way to implement the major infrastructure and development interventions that characterized development activities during the first few years of post-Taliban transition, sustainable governance reforms require a more nuanced approach in order to succeed. Inexperience with governance reforms and the failure of technical implementers to adequately recognize the political economy dimension of subnational governance reforms considerably hampered initial subnational governance reform efforts. As international forces are drawing down and development resources are scaling back, development interventions are increasingly being pursued in a more gradual and pragmatic manner, reflecting more nuanced thinking about sustainability and government ownership.

With the expected transition of military forces and aid modalities imminent in 2014, it is important to seize the current window of opportunity in order to implement concrete improvements in subnational institutions and mechanisms in order to enhance the effectiveness, responsiveness and legitimacy of the public sector.

Objective and structure of this study
The primary purpose of the current study is to stimulate and inform discussions and debate on the adequacy and effectiveness of intergovernmental (fiscal) systems in Afghanistan. It is not the primary intent of this study to be evaluative of previous subnational governance efforts, but rather, to be forward looking in terms of the country’s optimal subnational and intergovernmental (fiscal) architecture and subnational governance trajectory.

The first step in this discussion is a review of the current state of practice and the current state of the policy debate regarding subnational governance and finance in Afghanistan (Section 2). Next, a comparative analysis of international experiences (Section 3) guides the options that Afghanistan faces in terms of its subnational territorial-administrative structure and the subnational assignment of functional responsibilities.
Since the SNGP does not set forth an explicit assignment of functional responsibilities, the analysis in Section 4 considers what functions or roles the different subnational levels could play—within the legal and practical constraints of Afghanistan’s policy environment—in order to achieve a more legitimate, effective, responsive and accountable public sector.

Section 5 focuses specifically on providing options and recommendations for the role of—and linkages between—the center and the provincial level, and what intergovernmental fiscal mechanisms and systems might be used to provide adequately financial resources—as well as adequate budgetary discretion—to subnational administrative entities. Section 6 deals with options and recommendations for the role of districts, villages and municipalities.

A final concern to be addressed (Section 7) is how the World Bank and other donor partners could align and integrate their programs into structures that are part of the formal public sector, rather than contributing to semi-formal parallel structures. In particular, the study will provide options on how to revolve concerns about the sustainability of NSP, with one option being the possible transformation of CDCs into formal Village Councils.

It is worthwhile to note upfront, that by and large, the ideas floated in this document are consistent with IDLG’s SNGP Implementation Strategy as well as by the National Priority Program for Local Governance (NPP4LG). What the study tries to do, given the current ongoing efforts in the area of subnational governance and finance, is to establish the broad outlines of a subnational and intergovernmental (fiscal) architecture that provides a framework for more efficient and responsive public services, while at the same time ensuring that the subnational governance framework is achievable in a sustainable manner given projected external funding trends.

2. Afghanistan’s sub-national public sector structure: an overview

According to the Afghan Constitution, the public sector in Afghanistan is generally organized in a unitary and centralized manner. The starting point for an exploration of Afghanistan’s subnational institutional and fiscal architecture in this document—which considers the fiscal linkages between villages, districts, provinces and the center—is an overview of the current subnational systems and structures, including the fragmentation of the current planning and budget systems. It should be noted that this section is intended as a general overview of Afghanistan’s public sector structure, rather than as a comprehensive description or assessment of subnational governance institutions in Afghanistan. It is also not the intention of the current section to provide an evaluation of recent subnational governance reforms in the country.

**Defining subnational bodies and subnational structures**

Decentralization has been commonly defined as the process of “bringing the public sector closer to the people.” Traditionally, decentralization has been pursued through one of three strategies,

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5 This section relies on World Bank (2008) and other sources. It is intended as an overview of Afghanistan’s public sector structure, rather than as a comprehensive description or assessment of subnational governance institutions in Afghanistan.
notably, devolution, deconcentration and delegation.\(^6\) For the purpose of this analysis, we consider that below the central level, public sectors are typically composed of three types of subnational bodies: (1) subnational (regional or local) governments, (2) deconcentrated budgetary entities, and (3) deconcentration organizational units. In this process, care should be taken to accurately define the nature of the different types of subnational bodies.

Although many countries pursue decentralization by devolution (i.e., decentralization by transferring powers, responsibilities and resources to elected local governments), few guidance documents actually define what constitutes a local government. For our purposes, a devolved subnational or local government is an entity that: (i) is a corporate body; (ii) engages in governance activities at the subnational level; (iii) has and approves its own budget; and (iv) has its own (elected or appointed) political leadership. Note that this definition is somewhat broader than the IMF (2001) definition of a local government, which imposes more stringent requirements on local governments, including the ability to raise own revenues; the ability to borrow; and essentially complete local control over local staff.

The definition and measurement of deconcentration has received even shorter shrift in the decentralization literature. Nonetheless, the institutional nature of deconcentrated entities is a critical element in the success of failure of deconcentrated system. Following Boex (2012), we define a deconcentrated budgetary unit as an entity that (i) is an organizational part of the national (state) administration; (ii) delivers public services or performs its functions in accordance with a territorial mandate; and (iii) is a formal budgetary entity in the Chart of Accounts. Note that this definition accommodates both horizontal (or territorial) deconcentration, as well as vertical (or sectoral) deconcentration, as discussed further below.

Finally, a deconcentrated organizational unit is an entity that (i) is an organizational part of the national (state) administration; (ii) delivers public services or performs its functions in accordance with a territorial mandate; (iii) is funded from the national budget but is not a formal budgetary entity in the Chart of Accounts. This type of entity is institutionally the weakest of all subnational entities: while being placed at the subnational level, a deconcentrated organizational unit does not have any formal political, administrative or fiscal power or authority. Instead, it is fully at the mercy of the center.

Although these three subnational entities or units provide the key institutional building blocks for subnational governance and intergovernmental finances, not all countries rely on devolution or deconcentration in their “pure” forms. Local jurisdictions or entities in many countries are formed by combinations or permutations of the ‘pure’ forms of devolved or deconcentrated entities defined above, and rely on mixed or hybrid types of local entities. For instance, in some countries elected local councils do not form the political leadership of a local government body as they would in a devolved system; instead, their role may be to merely to serve as a platform for public participation and to monitor the performance of locally deconcentrated administrative units. In other countries, local governments may be corporate bodies that are led by an elected

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\(^6\) Litvack and Seddon (1999) present an overview of the traditional definitions of the decentralization literature. A more recent and more detailed review of local public sector concepts and measurement issues is provided by Boex (2012).
council but have a chief executive that is appointed by the central government. As such, it is important to fully understand the legal/institutional, political, administrative and fiscal aspects of each type of local public sector entity or jurisdiction.

A final distinction should be made with regard to deconcentration that will be helpful in classifying and understanding Afghanistan’s public sector structure vis-à-vis the public sector structure of other countries. Conceptually, a deconcentrated administrative system can be organized either as a vertically (or sectorally) deconcentrated system or as a horizontally or territorially deconcentrated system.

Under the vertical or sectoral approach to deconcentration, each line ministry operates ‘vertically’ in a deconcentrated manner, with limited or no harmonization of planning and budgeting at the provincial or district level. From an institutional and budgetary viewpoint, this means that every line ministry follows a ‘silo-structure’ from the central level down to the province level, and possibly further down to the district level to the front-line service delivery unit). Vertical deconcentration conceptually allows line ministries a strong role in the planning and implementation of public services within their ministerial remit. At the same time, however, it tends to be difficult for central line ministries to practically control sectoral service delivery, since the central administration relies on hierarchical top-down controls to supervise provincial, district and front-line staff (and these top-down controls become weaker as the distance from the center grows).

In contrast, under horizontal or territorial deconcentration, sectoral departments at each administrative level are administratively subordinate to the Provincial Governor or to the District Governor, respectively. While this allows for greater coordination at the territorial level, this structure may weaken the links between the subnational line departments and the respective line ministries. This organizational arrangement is reinforced if there is strong accountability at the subnational level, for instance, through elected subnational leaders. Furthermore, horizontal deconcentration is facilitated if the line departments within the subnational administrations are funded from a unified provincial or district budget rather than from vertical budget allocations from each sector line ministry.

**Afghanistan’s overall intergovernmental (fiscal) architecture**

Chapter 8 of the 2004 Constitution provides the primary legal foundation for the public sector’s subnational administrative structure. Chapter 8, Article 1 declares that the administration of the Islamic Republic of Afghanistan shall be based on central and local administrative units, where the central administration is defined to comprise the ministerial level (“The central administration is divided into a number of administrative units, each of which shall be headed by a minister”), while the ‘local’ administrative unit of the state is defined as the province. The choice for a relatively centralized, non-devolved public sector structure was informed by concerns that an elected provincial government level—given the prevailing ethnic divisions in the country—would contribute to centrifugal forces that could challenge the unity of the Afghan state.

With respect to the assignment of responsibilities to the different levels, the Constitution states that “[t]he government, while preserving the principle of centralism, shall delegate certain
authorities to local administration units for the purpose of expediting and promoting economic, social, and cultural affairs, and increasing the participation of people in the development of the nation” (Chapter 8, Art. 2).

With little further specific guidance provided in the constitution on the intergovernmental arrangements and institutional structures at the provincial level, in practice, Afghanistan’s public sector has been structured as a vertically (or sectorally) deconcentrated system, where provincial departments are organizationally deconcentrated units of their respective line ministries. The Public Finance and Expenditure Management Law defines central administration units (“state administrations”) as the only budgetary units that are recognized in the budget process and the only entities that receive appropriations from the national budget. In contrast, provincial administrations are not recognized either as primary budgetary units in the Chart of Accounts (i.e., provinces are not recognized as top-level budget organizations alongside ministries), nor are provincial line departments recognized as budgetary sub-organizations within their respective ministries.7

Next, “[i]n order to organize activities involving people and provide them with the opportunity to actively participate in the local administration, councils are set up in districts and villages in accordance with the provisions of the law” (Chapter 8, Art. 5). It should thus be noted that constitutionally, district and village councils are not necessarily intended as a separate deconcentrated administrative level in themselves, but rather a modality to involve people and provide them with the opportunity to actively participate in the local (i.e., provincial) administration. Although some administrative officials reside at the district level, in practice, there are no representatives of the central government at the village level at this time. Therefore, it could be argued that the organization of the state administration in Afghanistan comprises three different administrative tiers: the central government level, the provincial level, and the district level. This three-tiered administrative structure –which downplays the role of the village level- seems to be the focus of IDLG’s subnational reform efforts (for instance, as expressed in NPP4LG).

In addition, as further discussed below, urban local bodies (municipalities) have a constitutionally-defined place in Afghanistan’s subnational governance structure. This leads to an overall public sector profile (covering the country’s territorial-organizational governance

7 It should be noted that in the common English translation of the Constitution, the term “delegation” is used when stating that “Government shall delegate certain authorities to local [provincial] administration units (chapter 8, article 2). The constitutional application of the term is somewhat different from the traditional definition of delegation, which defines delegation as the transfer of responsibility for decision-making and administration of public functions from central government to semi-autonomous organizations not wholly controlled by the central government, but ultimately accountable to it (World Bank, 1999). By this definition, the current administrative structures and intergovernmental budgetary systems in Afghanistan do not adhere to the constitution requirement. As neither a corporate bodies (i.e., separate legal entities) nor as deconcentrated subnational budget entities, but rather as hierarchically controlled deconcentrated organizations, provincial administrations in Afghanistan cannot be characterized as “semi-autonomous organizations not wholly controlled by the central government”, nor do provincial administrations or departments have the institutional or budgetary scope to bear any responsibility for decision-making and administration of public functions. In the remainder of this document, we will use the broader interpretation of the term “delegation” as implied by the Constitution.
structure, administrative-budgetary structure and functional profile) as shown in Figure 1 (next page).

Note: In the territorial-governance profile, dark blue indicates a territorial entity or level with elected political leadership; light blue indicates an administrative level with an elected advisory council. In the administrative-budgetary profile (pyramid), red segments indicate local bodies that have the features of devolved local government entities; grey segments indicate administrative tiers that are recognized as budgetary units; while white segments indicate local bodies that do not have their own administrative-budgetary status. Functional assignments represent the de facto assignment of responsibilities.

The remainder of this section discusses each level or tier of the public sector structure in somewhat greater detail. The reader should be reminded that the intent of the current section is merely to give a cursory overview of Afghanistan’s public sector structure as a background for the discussion in subsequent sections of this study, rather than providing a comprehensive or evaluative review of subnational governance systems in Afghanistan.

**The Central Administration Level**
Constitutionally, the executive branch of Afghanistan’s central government is divided into a number of central administrative units, each of which is headed by a minister. The country’s central administration level currently consists of 50 government ministries, departments, agencies, offices, independent directorates, and other budgetary units. These central government ministries and institutions are considered primary budgetary units, and the respective budgets of these entities are determined by the annual budget law.

The Independent Directorate for Local Government (IDLG) is the main champion for subnational governance reform and responsible for the overall system of intergovernmental relations, including provincial, district, village and municipal affairs. In addition to IDLG, the Ministry of Finance has a clear stake in the debate surrounding intergovernmental fiscal relations, as it is the steward of the country’s public finances. In this role, it executes the

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8 As discussed further below, many line ministries have constituent departments at the provincial level which are an integral part of the vertical structure of the respective ministry. Since these provincial departments are not separate budget units, the budgets of these provincial units are fully included in the central government budget at the central administration level.
national budget across the central and provincial administrative levels, and would have to execute (either directly or indirectly) any intergovernmental transfers to the local government level. The Finance Ministry is currently pursuing several initiatives related to the provincial level, including a provincial-based budgeting pilot, as well as efforts to strengthening the role of the provincial treasury offices (Mustofiats) in financial administration in the context of the AFMIS integrated financial management system.

Box 1: Ordinary versus Development Budget – Implications for Subnational Budgeting and Finance

In terms of fiscal administration, Afghanistan has three different budgets within the National Budget. The level of participation, discretion, and responsibility of the central line ministry versus their provincial administrations differs widely depending upon whether the fiscal resources are to support running costs (Ordinary Budget), donor-earmarked projects (Non-Discretionary Development Budget), or projects that directly GIRoA priorities (Discretionary Development Budget).

The Ordinary Budget includes salaries (Code 21), goods and services, or operations and maintenance (O&M) (Code 22), and acquisition of assets (Code 23). The ordinary budget generally accounts for slightly more than half of the National Budget. These funds are administered through the line ministries’ provincial administrations and the provincial treasury office (the Mustofiats), with the latter making disbursements from the Government accounts maintained in the provincial branch of Da Afghanistan Bank (DAB, the Central Bank). The line ministry’s role is limited to assuring that the aggregate provincial expenditures do not exceed their respective appropriation. They manage this risk through allotment releases (spending authority); this commitment authority is accompanied by a supporting cash release through the Government banking system to make payments at the provincial level. The line ministries can only monitor the expenditures of their provincial departments ex post through AFMIS (Afghanistan Financial Management Information System) reports and internal audits of their provincial offices. Except for the adoption of AFMIS in the reconstruction period, the administrative structures of the ordinary budget have remained unchanged since the mid-1960’s.

Services are delivered when civil servants have sufficient funding to enable them to perform their responsibilities. The size of the ordinary budget has increased over the past six years, primarily due to the increase in the size of the civil service and due to the implementation of pay and grade reform. The total amount of provincial expenditures for Code 22 has remained relatively flat in recent years, and accounts for slightly more than 10 percent of the total ordinary budget. The ability of provincial departments to deliver public services is therefore not only constrained by a lack of formal budgetary authority at the provincial level, but also due to the fact that the financial resources available through the ordinary budget are insufficient to fund the desired level of public services.

The development budget focuses on (infrastructure as well as non-infrastructure) projects intended for the reconstruction and development of Afghanistan. Within the development budget are projects earmarked by donors (non-discretionary) and those projects that GIRoA has identified to meet their priorities (discretionary). Although the proportion of the discretionary budget is increasing, the non-discretionary budget remains well over half.

The provincial role in the development budget is more problematic. This has less to do with the existing GIRoA legal and regulatory framework, than in the unique requirements associated with the Afghanistan Reconstruction Trust Fund (ARTF), and individual funding agreements between donor partners and GIRoA. An important (and often unacknowledged) constraint on increased participation of provincial administrations in the development budget is the willingness of donors to either increase their grants to the discretionary side of the development budget or to reduce their prescribed control and reporting requirements on their earmarked projects.

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9 The description of Afghanistan’s budget structure draws heavily on comments received from Lynda Roades (AusAid).
In addition to IDLG and the Ministry of Finance, line ministries have an important stake in the intergovernmental fiscal system, as the delivery of public services largely takes part at the provincial level, and is partially funded through allotments and disbursements to the provincial level. Among line ministries, the Ministry of Reconstruction and Rural Development (MRRD) plays an important role in rural development in the provinces.\(^\text{10}\)

**The Provincial Administration Level**

Territorially, Afghanistan is divided into 34 provinces, the latest two of which (Dikondy and Pansjer) were created in early 2004. With an average population of almost 800,000 residents, provincial jurisdictions have an awkward population size: provinces are too small to function efficiently as a purely intermediate governance level or administrative tier (due to scale economies), while their average jurisdiction size is too large for provinces to function in a participatory and responsive manner as the main subnational platform for front-line local service delivery. Beyond these structural concerns, the functioning of provinces in Afghanistan’s intergovernmental system is not always clear, particularly as there are several relevant actors and stakeholders at the provincial level, including Provincial Governors, Provincial Councils, and Provincial Line Departments.

The main point to bear in mind is that the Constitution defines provinces as administrative units of the central government (or state administration). Consistent with this understanding, and the definitions set forth above, provinces are deconcentrated units of the central government rather than a separate level of government. In addition, it is important to note that provinces are merely deconcentrated *organizational* units, rather than deconcentrated *budgetary* units of the state administration, meaning that provincial line departments (and other provincial entities) are not recognized in the Chart of Accounts as budgetary sub-organizations of their respective line ministries. As such, provinces and provincial organizational units (such as provincial line department) not only lack their own budgets, in fact, they do not have any formal designated space within the budget structure. Any control or influence provincial officials have over public resources must therefore come either through their ability to shape the national budget (which is fully under the control of the respective line ministries) or through their influence on budget execution at the provincial, to the extent that resources actually flow through the provincial level.

Provinces are assigned gradations by IDLG (from Grade 1-3), which is determined largely by their population size. The grade of a province guides the size of the jurisdiction’s administration (i.e., the Governor’s Office), as well as the grade levels of the staff. This formal provincial staffing structure is complemented by capacity building initiatives through IDLG, PRTs, and other initiatives. Although exact figures are difficult to come by (as the staff of district offices are formally included in the headcount of the Governor’s Office), the provincial governor’s office typically has a staff of between 20-55. In general, governors’ offices also have limited capacity, particularly in terms of managerial capacity, organizational infrastructure and systems.

\(^\text{10}\) As discussed further below, two key ‘subnational’ programs implemented under MRRD include the National Area-Based Development Programme (NABDP) which supports institutional development below the provincial level, and the National Solidarity Programme (NSP), which promotes local development and governance through the establishment and funding of Community Development Councils (CDCs).
**Provincial Governors.** Consistent with the deconcentrated nature of the provincial level in Afghanistan, Provincial Governors are appointed by the President as his representative in the province. Governors report to the center through IDLG. Governors predominantly have a coordination and oversight function at the provincial level, as provincial line directors technically report to—and form an integral organizational part of—their respective line ministries. As such, Provincial Governors do not have a direct service delivery mandate.

In practice, however, a dual subordination of provincial line departments exists as Governors have considerable political and administrative powers, including signatory powers over most procurement that takes place at the provincial level and certain powers of appointment. Furthermore, the Governor has significant authority over the police in the province, and direct authority over the district governors. Likewise, municipalities are required to have budget approved by IDLG through the Provincial Governor.

**Provincial Councils.** In contrast to the status of provincial governors as appointed officials, Provincial Councils (PCs) are in fact elected. Despite their status as elected representative bodies, Provincial Councils have only limited powers. Their functions are largely limited to oversight of the Provincial Governor and the provincial line departments.

**Provincial Line Departments.** Most key central line ministries have representation at the provincial level in the form of provincial departments. For instance, each province in Afghanistan has a Provincial Education Department which is an integral part of and reports to the Ministry of Education. The budget of the provincial line department is included in the overall budget of its parent ministry. While some provincial line departments follow a standard structure and size across the provinces, the composition of other departments varies across provinces. Most provincial departments are led by a department head (a grade 1 or 2 official), with deputies under him/her responsible for different areas.

**Provincial Treasury Office.** Similarly, each province has a provincial finance department or treasury office (known as a ‘mustofiat’) and a provincial planning department, which are part of the Ministry of Finance and the Ministry of Economy, respectively. The main function of the provincial mustofiat is to process financial transactions within the province as part of the Ministry of Finance’s central treasury system. The provincial department of the Ministry of Economy is in charge of coordinating the preparation of the Provincial Development Plan (PDP).

**Provincial Administrative Assemblies (PAAs) and Provincial Development Committees (PDCs).** Provincial Development Committees (PDCs) are chaired by the Provincial Governor and include the directors of the provincial line departments, as well as representation from the PC. PDCs have only limited coordinating and planning functions in the preparation of provincial plans and the budget requests of provincial departments. There is significant duplication and overlap in the planning and implementation responsibilities of the various entities at the provincial level (for instance, between the PDC, the PC and the PAA). The overlapping responsibilities at the provincial level add to the major challenges encountered in ensuring proper central-provincial coordination.
**The District Level**

For administrative purposes, provinces are further subdivided into districts. There are 398 districts in Afghanistan, of which 34 districts are considered provincial urban centers while 364 districts are classified as rural districts. Provinces range considerably in population, geographical size and administrative structure, containing from 4 districts (Laghman, Nimroz) to 27 districts (Badakhshan). The average population size of a district (approximately 67,000) suggests that the jurisdiction is quite small to serve efficiently as the main administrative platform for the delivery of key sectoral services.\(^{11}\)

The Constitution is vague on the legal nature of district entities, other than to specify that “[c]ouncils shall be established to organize activities as well as attain active participation of the people in provincial administrations in districts and in villages” (chapter 8, article 5). However, elections for District Councils that were originally intended for 2010 have been postponed to an unspecified future date (AREU, 2011).\(^{12}\)

In the absence of elected district councils, the district level mainly manifests itself as an administrative level by the presence of District Governors and other organizationally deconcentrated units at the district level. District governors report to the provincial governor, and represent IDLG at the district level. While until 2010 district governors were politically appointed, since 2011 appointment to this position was changed to reflect recruitment on a merit basis. The role of district governors is primarily to represent the government at the district level and to coordinate ministerial activities at the district level. They are also responsible for civil registration of births, deaths and marriages. Although they do not have primary authority over the district police (who report to the provincial police chief), they may also assist in conflict resolution, through referral to the police or the local council (shura).

The District Governor is organizationally and budgetarily part of the Office of the Provincial Governor. The administrative structure of other line ministries below the provincial level are likewise fully integrated into their respective provincial organizations and thus run vertically parallel to the District Governor. As such, it is even difficult to classify districts as organizationally deconcentrated entities in their own right. As a result, many districts have few or no staff and no real operating budget.

While a variety of development programs have sought to strengthen the district level from a variety of different angles over the past several years, in general, districts continue to be poorly resourced (especially through on-budget mechanisms) and capacity at the district level continues to be weak. In reality, most activities at the district and village level have been conducted and funded through a variety of donor-led programs and other *ad hoc* organizational structures (discussed further below), which are not well integrated into the overarching subnational governance framework.

\(^{11}\) Many countries at a similar population size and level of economic development as Afghanistan rely on service delivery jurisdictions (e.g., districts) of approximately 150,000 – 250,000 residents.

\(^{12}\) As noted below (as part of the discussion of the village level), the constitutional status of district-level entities is unclear: are they intended as corporate bodies that organize their own activities, or are districts deconcentrated sub-entities of their respective provinces?
The Village Level
As referenced above, the status of the village level in Afghanistan’s constitutional structure is unclear. Does the fact that village councils “shall be established to organize activities” mean that village councils will have their own legal status of semi-autonomous local governance units (e.g., corporate bodies)? Or does the fact that village councils shall be established to “attain active participation of the people in provincial administrations” indicate that village councils should only have an advisory or monitor role with regard to public services delivered within their local jurisdiction?

There are currently no formal local administrative entities or governance institutions at the village level. In rural areas, however, villages form the territorial level where communities come together –whether formally or informally- and where certain key public services are delivered. Villages and communities among others, through Community Development Councils (CDCs) and other local councils- play the role of quasi-local government entities and provide basic community services and community infrastructure.

The small size of villages and the resulting fragmentation of the village level is a considerable obstacle in having village jurisdictions play a more prominent role in the formal public sector. Although different government sources cite different numbers, Afghanistan has approximately 36,500 villages, with an average population ranging somewhere from 700 – 1000 villagers per jurisdiction. International experience suggests that this is well below the range where effective formalized public service delivery is possible for most types of public services.

Municipal governments
In contrast to provincial, districts and (potentially) village institutions, municipalities are constitutionally recognized as local government entities, created to manage urban affairs. As such, municipalities have their own, separate budgets and provide a potential platform for bringing the public sector closer to the people. According to Chapter 8, Article 6 of the Constitution, the mayor and members of the municipal councils are elected by free, general, secret, and direct elections, and the affairs related to municipalities are regulated by law. The incorporation of elected local governments in urban areas into the structure of the public sector (but not in rural areas) constitutes an implicit recognition of the fact that perhaps the most important subnational territorial asymmetry in Afghanistan is not between different regions or provinces per se, but rather, between urban and rural areas.

Despite the Constitutional recognition of the importance of having urban local governments managing urban affairs, municipal elections have not taken place over the past ten years. Although a post-Taliban Municipal Law has been in the making for several years, municipalities virtually operate in a legal vacuum. In practice, urban affairs are managed in a rather top-down manner by IDLG’s General Directorate for Municipal Affairs: mayors are centrally appointed, municipal budget and municipal staff positions (tashkeel) have to be centrally approved. Although municipalities will not be the main focus of the report, it is important that municipalities are conceptually integrated into the governance of the local public sector.
Municipalities are administratively divided into two main categories: provincial municipalities and rural municipalities. Each of the 34 provinces has a provincial municipality, of which six municipalities have a population exceeding 500,000 (Jalalabad, Herat, Kabul, Kandahar, Kunduz, and Mazar-i-Sharif). There are approximately 119 rural (non-provincial) municipalities in Afghanistan, which have a population of 5,000 or more, although the exact number of municipalities is somewhat unclear as the number has been steadily increasing. While all municipalities formally report to IDLG, in some provinces the provincial municipality supervises (or even controls) the activities and finances of rural municipalities.

Specific functions and revenue sources are assigned to municipalities in the Municipalities Act (2000), the City Charges Act, and several other related Acts and decrees. Fiscally, municipalities are largely self-sustaining entities that fund the provision of urban services (trash collection, recreation and parks, and other such services) with local revenue collections from property taxes, local service charges and retail licenses. Despite this high degree of fiscal autonomy, all municipalities are required to seek approval for their annual budgets and staff establishments (municipal ‘tashkeel’) through the Provincial Governor’s Office from IDLG (and hitherto, from the Ministry of Interior).

Beyond the approval of their annual budgets, municipalities are supposed to be (largely) fiscally autonomous and operate independently. In practice, however, municipalities receive considerable in-kind and other donor-funded support from civilian as well as military projects. The Public Financial and Expenditure Management Law (2005) further permits municipalities to receive deficit grants from the Ministry of Finance, although the extent to which municipalities have been receiving such grants is unclear.

**Experiences with parallel mechanisms at district and village level**

In recent years, a number of development efforts have sought to strengthen the link between the central government and the majority of Afghans, particularly at the district and village levels. Many of these efforts were part of a broader counter-insurgency strategy, which recognized that the presence of the formal public sector was the weakest at the level closest to the people. Although well-intended, the mushrooming of governance efforts institutions at the district and village levels has resulted in an increasingly uncoordinated and complex web of semi-formal government structures, locally elected bodies (which are not formally recognized as local governments), donor-conceived and funded initiatives, and formal and informal local institutions of service delivery and accountability.

Some of these are the responsibility of the IDLG, such as ASOP Councils. Other institutions, such as CDCs and District Development Assemblies (DDAs) were established under the auspices of the Ministry of Rural Rehabilitation and Development (MRRD)’s. Yet other programs or initiatives—such as the District Delivery Programme (DDP)—were piloted or implemented only in selected parts of the country. This has often meant competing institutional

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13 A large majority of the country’s urban population resides in these six municipalities, and the administrative capacity of these municipalities should be considered higher than most other municipalities in the country. Of these major municipalities, Kabul Municipality has a special legal status: the mayor of Kabul is directly appointed by the President, which serves as a Cabinet-level position.
agendas and a lack of an overall strategic framework for addressing accountability issues at local level.

3. Subnational governance and intergovernmental fiscal architecture: International experiences and lessons

The exploration of Afghanistan’s intergovernmental institutional and fiscal architecture in this document aims to use comparative analyses and international experiences of other (post-conflict) countries that are pertinent to the situation in Afghanistan. In addition to lessons drawn from recent studies on subnational governance and public sector reforms in fragile and post-conflict countries, it is particularly worthwhile to explore the subnational governance reform trajectories which provided specific examples of relevant (positive and negative) country experiences including Bangladesh, Cambodia, Egypt, Mozambique, Nepal, Sierra Leone and Uganda.

The selection of these comparative countries was guided by a number of factors. First, many of the comparative country experiences reflect fragile or post-conflict countries: while some of the selected countries are generally considered to have made (or are making) a successful exit out of fragility (e.g., Cambodia, Mozambique, Sierra Leone, Uganda), others seem to be have been less successful (so far) to overcome fragility and strife (Bangladesh, Egypt, Nepal). Second, by and large, these countries are roughly at the same level of socio-economic development as Afghanistan, and many are more or less similar in population size. Third, the majority of selected countries have a formally deconcentrated public sector structure, similar to the public sector structure mandated in Afghanistan’s Constitution. It should be noted that the lessons drawn are not exclusively limited to the experiences of the countries listed above.

Despite the fact that the selected countries are different in terms of their geography, administrative traditions, economic structure, and conflict dynamics, a comparison of the subnational governments structures and intergovernmental fiscal architecture of these countries reveals some clear lessons and patterns that provide specific lessons or options for consideration in Afghanistan. This section draws general conclusions about the strengths and weaknesses of subnational governance structures and the intergovernmental fiscal architecture of countries seeking to transition out of fragility. These international experiences reveal things not only about the technical aspects of subnational governance reforms, but the review also reveals the importance of understanding the political economy of intergovernmental (fiscal) reforms.

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15 In fact, neither Bangladesh nor Egypt should be considered ‘best practices’. However, even in their failures (or partial successes), their experiences are illustrative and relevant for Afghanistan.

16 Whereas Uganda and Sierra Leone are pursuing devolution, their systems retain strong features of deconcentration.
Lesson 1. In the process of state building, subnational administration and governance systems matter for effectiveness, accountability and legitimacy reasons

In the immediate post-conflict period, the reform efforts with the highest and most immediate impact tend to be reforms that are pursued in a centralized manner. For instance, measures to reform subnational governance or efforts to strengthen capacity of subnational entities to engage in sound public financial management are often not an early post-conflict priority. A number of reasons for the limited initial focus of public sector reforms at the subnational level often exist. First, the most urgent priority of a weak central regime is to ensure its own survival by focusing on building its own central capacity and legitimacy. Second, centralized public sector structures are frequently pursued in the aftermath of conflict in order to counteract centrifugal forces; for instance, building strong national military and police forces (in order to establish public order and ensure safety) and gaining central control over public sector finances are often important themes in post-conflict public sector reforms. Third, centralized public sector interventions sometimes provide the opportunity to achieve quick wins, whereas engaging sectoral ministries and subnational entities typically requires substantially more time and effort. A fourth important reason why subnational governance reforms often take a backseat during the initial years of a state-building process is that key policy choices about the nature of the future system of intergovernmental relations—which are an inherent reflection of power relations—often remain in flux during the years following the conflict.

Although subnational governance and intergovernmental finances are not typically themes that are addressed in the initial post-conflict period, the absence of a well-functioning subnational public sector generally limits the responsiveness, effectiveness and legitimacy of the national government. Indeed, international experiences confirm quite consistently that a legitimate and effective state needs well-functioning subnational administration and governance systems. Indeed, in all country cases reviewed, a meaningful effort was made to bring the public sector closer to the people through subnational administration or governance reforms. Even in Bangladesh, which is arguably one of the most centralized countries in the world, some political, administrative and fiscal space is yielded to Union Parishads and Pourashavas (rural and urban local governments) in order to try to enhance the responsiveness of the public sector to the needs of the people.

It should be noted that subnational administration and governance reforms matter not only for the improvement of public service delivery directly, but also in order to demonstrate the accountability and legitimacy of the public sector (UI, 2011). Generally, the more administrative and fiscal discretion that is provided to subnational entities, and the more extensive and stronger the accountability mechanisms on subnational institutions and actors, the better the public sector seems to function (Yilmaz, Beris and Serrano-Berthet, 2008).

In contrast, failure to engage the local public sector in a meaningful way could result in a return to violence and/or regime change. For instance, excessive centralization of decision-making

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17 In conflict environments where local governance and the vertical division of power are expressly a component of the peace settlement, local government reform is often pursued in a more urgent manner.
18 Legislative reforms pursued since 2008 in Bangladesh have significantly expanded the de jure scope of elected local governments, even though implementation of the new legislative framework is lagging significantly.
authority and financial resources by politicians and the central bureaucracy in Nepal—
even following the passage of the Local Self-Government Law in 1999—was one of the roots of the
ensuing civil war. Its ongoing failure to improve public service provision at the grassroots level
and the impasse surrounding its stated objective to decentralize decision-making and financial
resources as part of a federal constitution continues to be an obstacle in its exit of its fragile,
post-conflict state.

Lesson 2. Many post-conflict countries rely on a deconcentrated state administration
system
As already noted, many fragile and post-conflict countries start out highly centralized during the
initial post-conflict period. This said, many countries recognize the importance of moving the
public sector closer to the people, and while devolution perhaps offers a conceptually superior
approach to decentralization, not many regimes subsequently pursue the whole-sale devolution
of state functions and state administration to elected levels of subnational government.

Instead, in order to bring the public sector closer to the people, the first main step for most post-
conflict countries is to pursue deconcentration of the state administration. Deconcentration
allows countries to reap some of the benefits of decentralization, but without opening a political
space at the subnational level that could potentially result in centrifugal forces, destabilize the
country, or provide political competition to the national government. Given the fact that regimes
in post-conflict countries are often hesitant to broadly empower locally elected bodies for
political economy reasons (as this could empower the opposition and destabilize the balance of
political power), the political economy reality in many fragile and post-conflict environments
suggests that deconcentration is often a politically more viable option than devolution.

Out of the seven countries considered as comparative experiences, four countries (Bangladesh,
Cambodia, Egypt, Mozambique, and Nepal) rely on deconcentrated or hybrid administrative
entities—rather than devolved local governments—for the provision of key public services, such as
basic education and primary health services. Cambodia, Egypt and Mozambique have
budgetarily deconcentrated administrative units. Bangladesh has a fully centralized budget
structure (without budgetary deconcentration) but is currently exploring budget deconcentration
to the district level, whereas district administrations in Nepal are a hybrid between a local
government and a local administrative entity. Within the MENA region, reliance on
deconcentrated state structures is universal (Tosun and Yılmaz, 2009).

In this light, it should be noted that, especially among post-conflict countries, whole-sale or “big
bang” devolution reforms—such as took place in Indonesia or South Africa in the 1990s—are the
exception of decentralization reform rather than the rule. Instead, most countries pursue
decentralization in a more gradualist manner, and rely more heavily on deconcentrated systems
(and on a hybrid systems) than on devolution.

Out of the seven comparative international practices considered, only two (Sierra Leone and
Uganda) have pursued (or are pursuing) decentralization by devolution, and have assigned key
public sector service delivery functions to elected local government. However, both countries’
systems retain strong elements of deconcentration. For instance, despite the fact that key public
services in Sierra Leone are the remit of elected local governments who receive
intergovernmental fiscal transfers from the center to cover operation and maintenance expenditures, virtually all local salary and wage expenditures in Sierra Leone are contained in the national budget, rather than being funded through local government budgets themselves. Similarly, even though all local government budgets are prepared and adopted at the local level in Uganda, district-level budgets are subsequently included in the national budget as separate budget votes and voted on by national parliament.

**Lesson 3. Deconcentrated systems evolve from the top down; creating an effective district level is the work of decades, not years.**

When moving from a fully centralized public sector, international experience suggests that establishing provincial budgetary deconcentration from the top on down is almost always the ‘next big step’ towards a more responsive state administration.

All countries reviewed –with the sole exception of Bangladesh- have provided some type of budget authority to the highest sub-central administrative tier or subnational governance level. Cambodia and Egypt follow vertical budget deconcentration, so that the budgets of line ministries that deliver front-line public services are divided into two portions: central administration and local (provincial or governorate) administration. As such, parliament makes appropriations not only by line ministry, but also to these line ministries’ subnational departments, thereby ensuring a reasonable ‘vertical’ allocation of resources (between the central administration and the subnational level).

Neither Cambodia nor Egypt currently has a budgetary level below the provincial level, although Cambodia is pursuing a democratization and decentralization policy that envisions an increasingly important role for the district level in public service delivery, and that seeks to establish the district level as a separate (organizational and budgetary) deconcentrated level. As such, Cambodia has adopted a 25-year implementation strategy to gradually build up district-level institutions and put in place the intergovernmental fiscal plumbing for the district level.

Mozambique essentially has a horizontally (or territorially) deconcentrated budget structure, by which provincial administrative entities (line departments) report to their respective ministries for technical purposes, but are part of their respective provincial administration for administrative and budgetary purposes. Bottom-up planning and budget requests find their way up from the front-line service delivery units to the district level, through the provincial level, up to the national government, after which budgetary ceilings are determined for departments and agencies for jurisdictions at each administrative level. As such, Mozambique’s national budget presents all national expenditures by level of administration (central, provincial and district level), by jurisdiction, and by function and department or agency. As such, the budget books as well as treasury reports in Mozambique provide a highly detailed overview of total public sector spending by level of administration, and across provincial and district jurisdictions.

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19 Since provincial line departments are budgetary sub-organizations of their respective ministries, line ministries are mandated to present their annual budget request broken down by provincial line department, thereby ensuring a more equitable and transparent ‘horizontal’ allocation of budgetary resources.
Mozambique offers a good example of a recent reform that created district-level deconcentrated budgetary units. In Mozambique, provincial administrations are budgetary sub-organizations that already hold a degree of subnational budget authority. As already noted above, Mozambique has a national budgeting and treasury system that provides the public financial management infrastructure for central, provincial and district administrations. Although the Law on Local Organs of the State was introduced in 2003 that assigned the district level as the “the principal territorial unit of the organization and functioning of the local administration of the State and the base of the planning of the economic, social and cultural development”, it has taken numerous years to transform district administrations in Mozambique into territorially deconcentrated budget entities. Inclusion of the district level into the budget structure is allowing increased resources to be assigned to the district level in a highly transparent manner.

Box 2: Example of a (horizontally) deconcentrated budget structure: Mozambique

Mozambique’s subnational and intergovernmental structure is quite similar to Afghanistan. Mozambique has a deconcentrated administrative structure with provinces (11) and districts (128). In addition, Mozambique has elected municipalities (43) in the urban areas of the country.

Unlike Afghanistan, however, Mozambique has a detailed deconcentrated budget structure: line departments at the provincial and district levels are recognized in the Chart of Accounts as subnational budget entities at their respective territorial level. This allows the national budget and treasury system to be prepared with a high level of detail, greatly enhancing the transparency of the national budget. For instance, budget tables are prepared showing total expenditures by administrative level and by province (inset). Similar tables are also prepared by sector or function.

Another difference between the nature of deconcentration in Afghanistan and Mozambique is that whereas Afghanistan follows a vertical approach to deconcentration (whereby provincial line departments are part of their respective line ministries), Mozambique follows a horizontal or territorial approach to deconcentration. This means that administratively and budgetarily, provincial line departments are officially part of their subnational administrative unit (i.e., the province) rather than being formally part of their respective line ministry.

The transfer of budgetary resources from (deconcentrated) provincial budgets to (deconcentrated) district budgets is a gradual process that has been taking place over a multi-year
period, both for political-institutional as well as for technical reasons. During 2006 and 2007, only cross-sectoral capital allocations from the Fund for Local Investment Initiatives were made to district-level budget accounts. In 2008, O&M allocations for front-line service delivery in key sectors (such as basic education and health) were transferred from provincial-level budgets to the district level budgets. It is envisioned that gradually, over future years, salary expenditures and infrastructure spending for front-line service delivery will be deconcentrated to the district level.

Since Sierra Leone and Uganda have pursued decentralization by devolution, the dynamics of their reforms has been somewhat different than in the before-mentioned deconcentrated countries. However, in both Sierra Leone as well as in Uganda, districts are the highest elected local government level below the center and in both countries, district budgets (the budget prepared and adopted by the local authority itself) reflects the lowest level of budget authority in the public sector structure, with no meaningful budget authority residing below the district level. In other words, the budgetary systems in these two countries have also evolved from the top down.

Although Bangladesh is the only country among those reviewed that does not pursue either budgetary deconcentration or substantial devolution, the Ministry of Finance in is assessing the possibility of introducing deconcentrated district (or Zila) budgets as part of the national budget document (Bangladesh Ministry of Finance, 2011). Although a strong argument could be made that the need for budgetary transparency and deconcentration is greatest at the sub-district (or Upazila) level –since this is where all front-line services are delivered and advisory councils exist–, the Ministry of Finance implicitly recognized that national budget procedures and systems would be ill-suited to switch from a fully centralized national budget to preparing 489 Upazila level budgets. Instead, given the current state of decentralization (or lack thereof), the Ministry believes that budgetary deconcentration of key sectoral budgets to 64 Districts would be an important and feasible first step.

Our review of public sector structures and international practices reveals that (in contrast to devolution of functions and financial resources to the district level), budgetary deconcentration to a sub-regional district level is relatively rare, and that a territorial sequence exists to putting in place a deconcentrated district level: in the countries reviewed, budget deconcentration to the district level is only pursued in countries where the next-higher level also has budget authority (either in the form of deconcentrated provincial budget authority or in the form of provincial devolution). International experiences further suggest that establishing a deconcentrated district level is the work of decades, not years (see Box 3).

20 Politically, provincial administration and (advisory) provincial councils face a reduction in resources under their control. Technically, having budget plans reach down to the district level and building the capacity of district staff to process expenditures through the provincial treasury has proven difficult, especially since many districts do not have electricity or internet access. From a financial management viewpoint, a problem that has been encountered is that funding for district line departments is being co-mingled in a single district administration account.

21 << Em 2006, O Governo de Moçambique (GdM) introduziu o Orçamento de Investimento de Iniciativa Local (OII) 2, popularmente conhecido por “7. Milhões” >>

22 Whereas Bangladesh is organizationally deconcentrated on as sector-by-sector basis, the budget does not recognize subnational budget entities as separate budget units when national budget appropriations are made.
Box 3: The time horizon of intergovernmental institutional transformations

As emphasized in the 2011 World Development Report, institutional transformations require a time horizon of at least 20 years, underlining the long-term support needed for achieving and consolidating strengthened PFM systems. Post-conflict countries have to achieve institutional strengthening, progressive change, and consolidation frequently beginning at very low levels. A realistic time horizon for effective PFM strengthening is 10 to 20 years, and possibly more to complete interacting reforms such as establishing and consolidating intergovernmental systems. To achieve such institutional transformations, reform efforts must be sustained across potential changes in governments as well as across major macro-political changes such as gaining independence or phasing out external security support. Sustainability also requires that capacity bottlenecks be effectively addressed over time.


Whereas deconcentration to the district level –when done properly- will result in greater empowerment than deconcentration to the provincial level, it does not necessarily make sense to focus on district-level deconcentration in the short run, especially not when provincial-level departments are not even budgetary units yet themselves. In fact, prematurely inserting an under-developed level of district-level administration may worsen the coordination between the central state and front-line services and may result in greater corruption and less responsive (rather than more responsive) public service delivery.

Lesson 4. Deconcentrated countries tend to have a responsive village level at the bottom of the formal public sector

If many post-conflict countries rely on a deconcentrated state administration (as suggested by Lesson 2) and if deconcentrated systems grow from the top down (as Lesson 3 indicates), then how do you reduce the distance between the public sector and the people in order to allow the public sector to be responsive and obtain legitimacy by providing resources and services to the people? In some sense, this is the critical state-building question in the aftermath of a conflict.

Although the most comprehensive way to achieve a responsive local public sector is through devolved local government, looking across international practice, a pattern emerges showing how deconcentrated countries have sought to achieve a degree of responsiveness in their public sector structures. Almost universally, deconcentrated countries have sought to introduce a level of responsive local governance at the sub-district or village level, which typically falls below the lowest level of (effective) state administration. Under this scenario, small-scale local governments typically receive a formula-based local development grant or local community grant in order to address the most urgent infrastructure or service-delivery needs of the local community.23 Because the final use of these resources is decided at the local level, these projects tend to be visible to the local community and provide a signal that the central government is seeking to be responsive to the needs of the people.

23 Although a responsive community or village level is most likely an important ingredient for achieving better and more responsive local public sector, the village-level lack the administrative scale and capacity to effective provide key social services and to solve the scale of problems and investment needs that are needed below the central level.
With degrees of variation, there are a host of international examples that follow this model, ranging from Cambodia’s Commune-Sangkat Fund; Nepal’s Village Development Committee (VDC) block grant; to Bangladesh’s Union Parishad Block Grant. To some extent, Mozambique’s deconcentrated Fund for Local Investment Initiatives (FIIL), and Afghanistan’s National Solidarity Program (NSP) are examples of this same model as well. These local development grant schemes share a number of common features. The basic elements include the central government setting aside a pool of resources (typically around $1-$2 per capita, or 1-2 percent of national budgetary resources) which is provided to the lowest level of local government (or in some cases, quasi-local governments) on a formula-basis to be programmed by the local community in accordance with local community priorities. Even though the size of the grant is typically small, the formula-based allocation signals the desire of the government to be fair and to provide services to all people. Typically, eligible jurisdictions need to meet certain basic minimum conditions in order to qualify for the grant in order to ensure that the grant is used for the benefit of the community: for instance, the local government must develop an inclusive investment plan; a bank account must be opened and maintained in a transparent manner (or similar financial management processes must be established); and an oversight committee must be in place. Whenever possible, these grants tend to be provided through government treasury systems. Because these resources typically flow to very small jurisdictions as close to the grassroots as possible (typically with populations around 5,000-10,000), local capacity and central oversight are relatively weak. Instead, these programs tend to rely on social accountability to make sure that resources are spent in accordance with the priorities of each local community. The social cohesion and community cooperation required to prioritize and plan for these grants builds social capital and can re-establish community ties in a constructive way after a period of conflict, instability and insecurity.

In essence, then, what local (or community) development grants seek to do is to establish or mobilize local governance at the very lowest possible level of the public sector, typically below the level where the formal public sector is able to reach through its deconcentrated state structures. There are both advantages as well as disadvantages of this approach.

In most countries, in the immediate aftermath of a conflict, deconcentrated state structures are ineffective, and building them up to the point where they can deliver meaningful services across the national territory can take several years. One of the main advantages to the village/community development approach in a post-conflict environment is that reaching out to the local/community level through a local development grant (or a similar mechanism) allows the public sector to visibly reach across the national territory in order take support public service delivery without delay. In essence, the village or community level can perform a gap-filling function: until the public sector is able to empower people by devolving or deconcentrating key public sector functions relatively close to the people (e.g., to the district level), it is helpful (or

24 Similarly, Uganda’s Local Government Development Grant (LGDG) and Tanzania’s Local Government Capital Development Grant (LGCDG) were based on a similar model. Although at a less advanced stage, Egypt was experimenting with Decentralization in the Local Development Sector prior to the collapse of the Mubarak regime.

25 See Steffensen (2010) for a review of such performance-based grant systems.
almost a political necessity) to have a more-or-less formal, elected community or village-level
tier where some level of basic local services is provided. Whereas these village-level
interventions are seldom aimed at (or successful in) providing key sectoral services at the
subnational level (such as education or health services), these village-level interventions provide
an opportunity for central authorities to signal their intent to be participatory, inclusive and
responsive to the needs of local communities.

However, working through the lowest level of the public sector is seldom an effective long-term
public sector development strategy, as the subsidiarity principle suggests that functions should be
assigned to the lowest level of governance that can perform these functions efficiently. The long-
term challenge is that village- or community jurisdictions are typically too small to be viable in
terms of providing meaningful, efficient public services. Therefore, as the formal,
deconcentrated (or devolved) public sector matures from the top down and is increasingly
capable of providing public services in an efficient and responsive manner, many of the
functions that are initially assigned to the village level may be absorbed by higher-level
governments. However, judging by experiences in Cambodia, Nepal and elsewhere, it may take
years or even decades for such a transition to take place.

**Lesson 5. Intergovernmental fiscal reforms are inherently political and typically
incremental, as reforms require a careful alignment of champions in order to succeed**

Successful subnational governance reform—empowerment of the people over the public sector
by strengthening the local public sector—requires the central government to provide greater
financial resources, greater administrative discretion and—in devolved countries—greater local
political control to local officials. In many ways, therefore, decentralization is an illogical and
counter-intuitive reform, as central leaders and bureaucrats would have to act against their own
narrow political and institutional interest by reducing their own direct control over the public
sector downstream (Eaton and Schroeder, 2009). Indeed, over the past decades, numerous
decentralization efforts and subnational governance reforms have failed, either by design, or by
lack of political will. For instance, a common practice has been to formally decentralize a greater
share of public resources to the subnational level, while allowing central officials to retaining
central control over how these “local” resources are spent (Ebel and Yilmaz, 200?). As such,
subnational governance reforms only succeed when there is true commitment from the central
government itself.

Because “government” is not a single-minded monolith—but rather a compilation of ministries,
departments and agencies that are each subject to different functional, political and institutional
pressures—it takes time and effort to build a coalition of champions within the executive branch
in support of effective intergovernmental reforms. Successful subnational governance reforms
and putting in place the subnational fiscal architecture necessary to support subnational
governance involves more than just the Ministry responsible for local governance. Instead, the
implementation of wide-ranging subnational governance reforms not only requires the full
support of the Ministry responsible for Local Government and the Ministries of Finance and
Planning (which are the steward of planning and public finances, including subnational planning
and finances). In addition, successful subnational governance reforms further require the buy-in
of other central agencies (such as the Public Service Department) as well as line ministries.
Not only does subnational governance reform change relations within the executive branch, but it tends to shift the relationship between the executive branch and the legislative branch. For instance, would the executive branch be willing to allow parliament to make appropriations not only to each ministry, but to the main departments and provincial departments within each ministry? Ultimately, successful subnational governance reform has to be anchored in a solid legislative framework that requires a meeting of the minds (or at least, a compromise) between the executive branch on one hand and parliament on the other. This means that political parties and leading politicians need to see that long-term political gain can be achieved by compromising and accepting some reductions in their own powers in the short run. As a result of these intense political pressures, successful subnational governance reforms typically require persistent commitment and championing from the highest political level.

Such political economy pressures are not unique to Afghanistan. In fact, there are common to every country where decentralization or subnational government reform has taken place. Since so many stakeholders are involved in successful subnational governance reforms, most of such reforms are gradualist and incremental in nature.  

Although there is a “textbook sequence” that should be followed when pursuing decentralization and subnational governance reforms (Bahl and Martinez-Vazquez, 2006), policy makers and their supporters within the development community seldom have the luxury to follow such academic guidance. Instead, policy makers are frequently limited to taking advantage of the opportunity to push through a positive incremental subnational governance reform whenever the institutional and political window of opportunity opens.

4. The assignment of functions and expenditure responsibilities to the subnational public sector

Without determining which functional responsibilities will be assigned to the provincial level— and without determining the resources that will be made available for provincial departments to pursue these responsibilities—, no meaningful progress can be made with respect to the subnational governance agenda in Afghanistan. Before proceeding, it would be prudent to reflect for a moment on what motivates the proposed reform towards decentralization.

**Why decentralize functions, authority and resources within Afghanistan’s public sector?**

As far as the delegation (deconcentration) of functions to the provincial level, the Constitution is quite specific about its motivation: this is done “the purpose of expediting and promoting economic, social, and cultural affairs, and increasing the participation of people in the development of the nation”. In other words, deconcentration is pursued in order to (a) improve  

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26 Although much of the decentralization literature focuses on a few “successful” decentralization reforms such as Indonesia and South Africa, it is important to note that the “big bang” decentralization experience of Indonesia and the wholesale decentralization reforms in South Africa form exceptions, rather than being the rule. In fact, unique political circumstances presented themselves in Indonesia and South Africa that permitted large-scale decentralization reforms. Such conditions seldom present themselves in other countries.
the effectiveness of public service delivery, and (b) in order to enhance participation, presumably through Provincial Councils (among other mechanisms).

Although these are commonly cited and appropriate reasons for decentralization, it is worthwhile to take a moment to consider whether the implicit underlying hypothesis (that the fully centralized delivery of services is inefficient and unresponsive) is valid in Afghanistan, and whether deconcentration will offer a solution to the underlying problems. Although a comprehensive exploration of the weaknesses of public service delivery in Afghanistan is beyond the scope of the current study, there is certainly considerable evidence (both anecdotal and empirical) to suggest that the current (centralized) delivery of public services is resulting in poor public service outcomes.

### Box 4: Results of a Public Expenditure Tracking Surveys (PETS) in Afghanistan (2010)

A Public Expenditure Tracking Surveys (PETS) is a quantitative survey of the supply side of public services, which traces the flow of resources from origin to destination and tries to determine the location and scale of "outflows" of resources from the public sector. The unit of observation of a PETS is typically a service facility and/or local government (i.e., frontline providers like schools and clinics.)

A PETS was conducted in 2010 in the education sector in Afghanistan which analyzed the provision of primary education at schools in three districts: Balkh District (Balkh), Yakawlang district (Bamyan) and Qargaye District (Laghman). The analysis sought to trace the payment of salaries; presence of teachers; O&M spending; distribution of school books; presence of school buildings; and the construction of new schools.

Some of the conclusions of the survey included:

- Progress in the processing and timely payment of staff salaries has been remarkable
- The budget contains a high percentage of "ghost teachers" (but enrollment is also over-reported by the Education Management Information System (EMIS))
- The presence and use of school buildings is uneven across districts, resulting in different numbers of shifts in different locations
- The availability, accessibility, and use of O&M need to be developed and strengthened
- The distribution of textbooks has improved significantly over the past five years, but discrepancies remain in certain areas between numbers of books needed and numbers received
- A combination of technical, procedural, and political issues and bottlenecks has significantly delayed the construction of schools through the EQUIP program


Different factors may play a role in the unequal access to public services and the poor service delivery quality that is observed. First, the central allocation of public resources across provinces is largely done in an ad hoc manner and/or driven by input-based micro-norms that do not take into account the service delivery needs of the jurisdiction. Second, inadequate resources may be trickling down to the provincial level (especially in terms of O&M spending and development spending). Third, provincial staff have little or no discretion over service delivery mechanisms, making it difficult for them to respond to service delivery inadequacies – for instance, provincial officials have little or no control over the number of staff establishments in their province (which is decided centrally). Fourth, there appears to be an information asymmetry between central and
provincial officials (as well as between front-line service providers and provincial officials), with information about local needs only slowly and incompletely trickling up to decision-makers in Kabul, making the current system less responsive. Fifth, there are few accurate metrics of service delivery performance at all stages of the vertical sectoral systems, therefore making it hard to incentivize good performance (both at provincial level as well as at service delivery facilities) or hold local staff accountable for poor performance.

Some of the observed problems could be fixed with better top-down systems: for instance, one could improve the inter-provincial allocation of sector resources by introducing better (centrally determined) provincial allocation norms. However, other major obstacles simply cannot be addressed by top-down mechanisms. In particular, it is almost impossible to incentivize and motivate provincial staff or hold them accountable for good performance without giving them some degree of meaningful decision-making power. As such, when looking at the binding constraints on effective local service delivery from below, it could be argued that in order for public services to improve (and for inclusive development to be achieved), provincial and front-line public servants need to be given the necessary resources, discretion, and incentives to do their jobs well while being held accountable for their performance.

This supports the conclusion drawn by the constitution that the delegation of authority to the provincial level is needed in order to improve the quality of public services and for the purpose of expediting and promoting economic, social, and cultural affairs.

**Clarifying the functions, roles and responsibilities of the subnational level**

Although the Afghan Constitution mandates that the central government “shall delegate certain authorities to local administration units”, no specific legal indication has been made since the promulgation of the constitution which functions or authorities should be delegated to the provincial level. A recent commitment was made in the Tokyo Mutual Accountability Framework enact a legal framework to clarify the roles and responsibilities of government agencies at national, provincial and district levels, in line with the 2010 Sub-National Governance Policy. Normally, such issues are dealt with in the Local Administration Law, which does currently not exist in Afghanistan.

The Sub-National Governance Policy provides a specific vision for the future assignment of expenditure responsibilities, stating that “over time all implementation pertaining to Water and Sanitation, Health and Nutrition, Education, Provincial and Local Roads, Local Transportation, Rural and Urban Infrastructure, Agriculture and Irrigation, Natural Resource Management, Land Registration, Social Protection, Identity Card, Private Sector Development, Civic Services such as Solid Waste Management, Traffic Management, Street Lighting, Recreational Facilities, Libraries and such other services that people value most and that are locally produced will be delegated to the Provinces, Districts and Municipalities” [emphasis added].

How such an assignment of functional responsibilities will come about is left unclear in the Policy. Generically, the policy (SNGP, 2010: p. 15) states that “[e]ach ministry will develop an appropriate policy for delegation of authority and resources. Line departments will be reorganized and different powers, functions and resources will be divided between provincial and central offices to enhance efficiency. Each ministry will allocate the function to a level that
has a comparative advantage in the carrying out that function and is closest to the citizens. …. Having allocated function to the Provinces and Districts, the Ministry will allocate financial resources and authority to carry out this function to the Provinces and Districts. Procurement and contracting powers of provincial line departments, district offices, Provincial and District Governors will be substantially enhanced. The provincial line departments, their district offices, and Provincial and District Governors will have a distinct procurement and contracting authority.”

Given the current high degree of centralized control over all sectoral service delivery functions, provincial officials have limited or no experience making operational decisions with regard to delivering their sectoral services. While the current absence of decision-making authority should not be used as a pretext to argue that there is no capacity to make such decisions in the future, it is clear that provincial officials (let alone district officials) are not in a position to take over the management of the entire provincial service delivery process in each of the key sectors spanning from human resource management, operation and maintenance, procurement of goods and services, the design and procurement of the necessary capital infrastructure and monitoring, inspection and supervision. However, the SNGP reveals no specific strategy for phasing-in provincial (or district) responsibilities, nor does the policy framework indicate what specific functions and activities within each sector should be transferred to the provincial level versus functions that could be delegated on to the district sphere. Similarly, the SNGP failed to provide a clear approach on how the delegation of functions to the provincial level would be matched with the necessary financial resources.

Rather than the broader assignment of responsibilities contained in the SNGP, operationalizing the delegation of powers and responsibilities to the provincial level will require a clear and comprehensive indication exactly what decisions can be made by provincial officials. Should provincial officials have the authority to determine the number of staff establishments (tashkeel) in each province? Should provincial officials have the authority to hire, promote and fire? Who should assign teachers to individual schools? Should provincial officials have the authority to determine how many pencils versus stamps are needed within each provincial department? Who will procure these inputs? Should provincial officials have the authority to purchase school books or medicines or fertilizer used in the delivery of provincial services? Who should be responsible for ensuring basic maintenance and minor repairs? Who will conduct inspections? Who should designate where new schools are needed? Who should manage the procurement or construction of new schools? Until the exact mandate of provincial departments is clearly defined, we cannot expect these entities to play a meaningful role in improving public service delivery.

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27 Furthermore, provincial line departments do not have any legal or budgetary standing in the current institutional and fiscal structure. This issue is addressed in Section 5 below.

28 The SGNP called for a dual planning process which required that no less than 25% of the total provincial (presumably development) budget in a specific sector should be allocated through the line departments to “the People’s Plan” (prepared at the provincial level in a participatory manner), with the remainder allocated to the Ministry Plans. This approach had major conceptual and practical shortcomings. It appears that this proposed financing arrangement was primarily politically motivated, and its implementation was essentially abandoned subsequent to the adoption of the SNGP.
What are the lessons from international experience regarding functional assignment?

Considerable international experience exists with regard to the assignment of functions and expenditure responsibilities. In many countries, the determination of functional assignments is based on the principle of subsidiarity, which states that functions should be performed by the lowest organizational level that does so efficiently. Whereas this principle is most often applied in countries with devolved local governments, the same concept applies equally to deconcentrated countries. In fact the SNGP states that each ministry should assign different sectoral functions to the level “that has a comparative advantage in the carrying out that function and is closest to the citizens.” Following this principle, working sector by sector, it should be possible to come up with sectoral decentralization plans for each of the sectoral ministries that are involved in front-line service delivery.

However, functional assignments are seldom made based on their technical merits alone (Martinez-Vazquez, 1998; Eaton, Kaiser and Smoke, 2010). In fact, it is not unusual at all for line ministries to actively oppose having their functions deconcentrated or devolved to the subnational level. Failure to anticipate such institutional opposition can lead to substantial obstacles and obstruction in the implementation process.

For instance, when Mozambican line ministries were instructed to come up with functions that could be deconcentrated to the provincial and district levels, many ministries assigned only minor functions to the provincial level, while recommending that virtually all function should be retained at the central administration level, typically citing real or perceived capacity constraints at the local level. When central officials from sectoral line ministries are put in charge of developing devolution plans or deconcentration plans for their own ministries, such as practice has been likened to putting the fox in charge of the chickens.

Although the detailed assignment of functions and expenditure responsibilities varies from country to country, international experiences (see Table 1, next page) point fairly consistently towards a general assignment of functions between different territorial-administrative levels that would be quite applicable for Afghanistan.

Based on theoretical guidance provided by the literature on expenditure assignment and based on the review of international experiences captured in the table, a basic assignment of functional responsibilities in Afghanistan could be structured along the following precepts:

1. The responsibility for the provision of urban public services and basic urban infrastructure should be assigned to municipal local governments.
2. The responsibility for providing small-scale infrastructure and community services should be assigned to village or community level (at least, until the formal public sector can be pushed down closer to the people).
3. The operational (recurrent) responsibility for the delivery of main social sector functions should be assigned (“delegated”) to the provincial level. In principle, provincial

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29 As part of the fiscal decentralization literature, there is a considerable literature on expenditure assignments. For instance, see Martinez-Vazquez (2001). While taking on board the recommendations from this literature, this section does not seek to provide an overview of this literature on expenditure assignments.
departments should also be assigned the responsibility for capital infrastructure development in these sectors, although the actual transfer of responsibility for capital development is likely to require a transitional process.

4. Over time (possibly within the next 10-20 years), the delivery of public services could be gradually deconcentrated to the district level as appropriate.\(^{30}\)

<table>
<thead>
<tr>
<th>Functional Assignment</th>
<th>Urban Services are assigned to the Municipal Level</th>
<th>Community Services are assigned to the Village/Community Level</th>
<th>Social Sector Services are assigned to the Provincial Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>Yes: elected Pourashavas and City Corporations deliver urban services</td>
<td>Yes: elected Union Parishad deliver community services in rural areas</td>
<td>Yes: Social Sector Services delivered at Upazila Level (Organizational Deconcentration)</td>
</tr>
<tr>
<td>Cambodia</td>
<td>Yes: municipalities deliver urban services</td>
<td>Yes: elected Communes deliver community services in rural areas (CS Fund)</td>
<td>Yes: Social Sector Services delivered at Provincial Level (Budgetary Deconcentration)</td>
</tr>
<tr>
<td>Egypt</td>
<td>No: No elected municipalities exist. Urban planning is central function.</td>
<td>No: Experiment with Decentralization of Local Development Sector failed due to excessive centralization</td>
<td>Yes: Social Sector Services delivered at Governorate Level (Budgetary Deconcentration)</td>
</tr>
<tr>
<td>Mozambique</td>
<td>Yes: elected municipalities deliver urban services</td>
<td>No: Deconcentrated districts have some discretion over community services</td>
<td>Yes: Social Sector Services delivered at Provincial/District Levels</td>
</tr>
<tr>
<td>Nepal</td>
<td>Yes: Elected municipalities deliver urban services</td>
<td>Yes: Non-elected VDCs deliver community services in rural areas</td>
<td>Mixed: Some deconcentration to district level has taken place</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>Yes: Elected municipalities deliver urban services</td>
<td>Mixed: Both elected districts and traditional Authorities play a role in community services</td>
<td>Yes: Social Sector Services delivered at devolved District level</td>
</tr>
<tr>
<td>Uganda</td>
<td>Yes: Elected municipalities deliver urban services.</td>
<td>Mixed: Deconcentration below elected districts seeks to ensure inclusiveness</td>
<td>Yes: Social Sector Services delivered at devolved District level</td>
</tr>
</tbody>
</table>

The guidance from international practice on expenditure assignments is quite instructive but also quite general; the specific details for the exact functions (and subsequently, the level of sectoral resources that would have to be deconcentrated) would have to be worked out on a sector by sector basis. In this regard, it should be noted that subnational governance reform process in Afghanistan is taking a rather legalistic approach with regard to expenditure assignments, as the government has committed “to enact a legal framework to clarify roles, and responsibilities of government agencies at national, provincial and district levels, in line with the 2010 Sub-National Governance Policy”.

\(^{30}\) This point is more fully discussed in Section 6.
In fact, in order for subnational officials to be provided with a meaningful degree of discretion as well as a meaningful degree of accountability, the detailed functional responsibilities of provincial and municipal entities should eventually be incorporated into the Law on Local Administration (or in the Municipal Law, respectively). While it is appropriate for the functional responsibilities of provinces and other subnational entities to be codified in the legislative framework (as specified in the TMAF indicators), it is unlikely that the current political situation would allow for a consensus to emerge on this issue at Cabinet level, especially as line ministries would fear loss of control, power or prestige, even as the result of the most modest deconcentration reforms. Furthermore, it is not practical to have the lists of functional responsibilities for each sector to be determined as part of the legislative drafting process. The broad functional assignment that is enshrined in the law would have to reflect a clear political consensus. It is unlikely that the implementation of delegated functions will be successful or meaningful unless the overarching division of responsibilities is clearly spelled out in the legislative framework (typically, in the Local Administration Law).

Box 5: Examples of deconcentrated functional assignments: Egypt and Mozambique

There are different ways in which the legislative framework can assign functional responsibilities to provincial or local levels. While different countries may assign different functions to different levels, the legislated functional assignment should be as clear as possible, and should subsequently be clarified and operationalized through implementing regulations (see Box 6).

In Egypt, the Law on Local Administration (Law 43 of 1979, as amended) defines the organizational structure and functional responsibilities of provinces by indicating their organizational structure. The Law specifically lists the provincial directorates with deconcentrated functions and separate budgets, which include: (1) agriculture; (2) veterinary Medicine; (3) transportation and roads; (4) supply and internal trade; (5) housing and utilities; (6) health affairs; (7) manpower; (8) education; (9) youth and sport; (10) organization and administration; and (11) social affairs (IMF, 2009).

In Mozambique, the Law on the Local Organs of the State (Lei dos Orgaos Locais do Estado, Law 8/2003), specifies a list of 14 broads functions (or powers) of the Provincial Governor, which includes the power to “establish facilities providing primary health services and primary schools providing general education”. The same Law, however, establishes the principle that the district level in Mozambique is to become “…the principal territorial unit of the organization and functioning of the local administration of the State and the base of the planning of the economical social and cultural development of the Republic of Mozambique”. The law further assigns the responsibility to oversee and implement the activities of district services to the district administrator.

In addition to the broad assignments of provincial functions and responsibilities (which is typically done in the relevant law), there is a need to arrive at a more detailed list of specific functions or activities to be delegated within each sector. These more detailed assignments of functional responsibility are typically contained in a government regulation or in a cabinet decree. International experience suggests that the proposed SNGP approach to place each ministry in charge of developing their own policy for delegation of authority and resources is a
recipe for deadlock and for under-funding provincial responsibilities. Instead, arriving at a meaningful assignment of provincial (and potentially district and/or municipal) expenditure responsibilities requires a three-way decision-making process which is led by the champion for subnational governance reform (i.e., IDLG), but done together with the Ministry of Finance and each respective sector ministry.

Box 6: Examples of the delegation of specific functions and activities to the subnational level: Mozambique and Sierra Leone

It is important to define detailed functional responsibilities for provincial and other subnational bodies, and to ensure that the organizational structure of these bodies coincides with their functional mandate.

In Mozambique, the Law of the Local Organs of the State (LOLE, Law 8/2003) was operationalized by a set of implementing regulations (Decree 11/2005). It determined that the power of the Provincial Governor included—within the scope of the health and education— the power to decide on the creation of primary health facilities and the establishment of primary schools. At the district level, the District Administrator was assigned the responsibility “to oversee the good functioning of the service delivery units in health and education.”

In Sierra Leone, within the responsibilities assigned to districts in the Local Government Law (Schedule 3), a subsequent Cabinet Decree transferred responsibility for specific functions and activities to the local level. For instance, within the function of “District Education Schools”, the following activities were legally assigned to the districts: (1) Recruitment of teachers; (2) Payment of salaries of staff; (3) Provision of teaching and learning materials; (4) Payment of school fees subsidies; (5) Provision of furniture; (6) Rehabilitation and Reconstruction of schools; (7) Staff development (study leave matters).

While both Mozambique and Sierra Leone are good examples of countries were implementing regulations were introduced to provide greater clarity and details regarding expenditure assignments, it should be noted that neither of these countries have followed through strongly on the implementation of these assignments in practice.

How to move forward with the assignment of expenditure responsibilities in Afghanistan?
Subnational governance reforms are currently caught in a bit of a ‘Catch 22’: while moving forward with budgetary deconcentration to the provincial level (as discussed in Section 5 below) in principle requires a clear assignment of functional (expenditure) responsibilities, line ministries (both at a political level, as well as at a technical level) are hesitant to pursue the deconcentration of functions and finances until they can see provincial line departments as stronger advocates for their line ministries at the provincial level, free from capture by the Provincial Governor’s Office. So, how can subnational reforms be sequenced to overcome this political economy obstacle?

The first step is to adopt a nuanced reform strategy that recognizes that the delegation of functions and expenditure responsibilities is as much a process as it is an endpoint. Rather than

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31 The SNGP sought to ensure appropriate delegation of responsibilities and finances to the provincial level by instructing central line ministries to transfer the necessary budget along with the responsibility—this phrasing was explicitly included in the Policy to avoid or reduce under-funding. Furthermore, the proposed Cabinet Subnational Finance Committee was meant to act as an enforcement mechanism to prevent line ministries from choosing to delegate very little if anything.
treating central and provincial officials as isolated actors, it is important to emphasize that central line officials and their provincial departments are—and will remain—mutually dependent in a multi-level, collaborative public sector framework. In this context, the key policy question to be pursued with line ministries should not be whether to “deconcentrate or not”, but rather, to look at ways to improve capacity and coordination among public stakeholders at different levels of government to increase efficiency, equity and sustainability of public spending (Charbit, 2011).

Although it is unlikely that central line officials will at any point become strong champions of delegation (which typically comes at the expense of their own authority and resources), a process of constructive engagement can at least lower the obstacles typically posed by line ministry officials. Different techniques have been used in other countries to guide a more gradual decentralization/deconcentration process by which the objections from line ministries are overcome. For instance, rather than trying to force a high-level political agreement on the assignment of functional responsibilities, it is much more likely that agreement can be reached at a technical level about the specific functions and activities that provincial administrative officials should play with each sector, especially if these clarification would possibly (or likely) result in additional resources being allocated to the sector as a whole (albeit it the provincial level).

In terms of the provincial line departments that are currently operational at the provincial level in Afghanistan, one could imagine arriving at a definition of provincial responsibilities within each sector that covers both the current functions already taking place at the provincial level, along with a number of functions which should be delegated to the provincial level in order to strengthen the delivery of public services within each sector. For instance, one could imagine including a list of (de facto) functions and responsibilities as part of a Provincial Budget Guidelines document that provides central guidance to provincial line departments within a sector on how to plan and budget for their provincial activities. If successful and broadly accepted, such a de facto expenditure assignment can then be codified in a de jure manner at a later stage.

As an example of the specificity with which functions should be assigned to provincial departments, the province could possibly be assigned the following responsibilities in the realm of basic education:

1. Recruitment and management of teachers
2. Payment of salaries of teachers and staff
3. Operation and maintenance of school facilities
4. Provision of teaching and learning materials
5. Provision of school desks and other furniture
6. Rehabilitation, reconstruction and improvement of school buildings
7. Planning the location of new school buildings
8. Construction of new school buildings

32 For instance, decentralization of functions can be initiated by providing greater discretion to provinces that meet certain qualifying criteria. Alternatively, decentralization can be pursued sector by sector, or gradual within each sector. Yet another approach is to deconcentrate different elements of subnational service delivery and the subnational budget over time (e.g., start with the O&M budget, then wages, then development expenditures).
9. In-line teacher development (study leave matters)
10. Supervising the conduct of standardized examinations
11. School inspections
12. Oversight over private school facilities operating in the province

5. Subnational budget structure and intergovernmental fiscal arrangements: options for Afghanistan at the provincial level

Provincial planning and budgeting is not a new phenomenon in Afghanistan. In fact, anchored within the Ministry of Finance, provincial budgeting efforts have been ongoing with a varying degree of success for the past six years. Until recently, most of these efforts have focused on strengthening provincial budget planning. As part its stewardship over the subnational governance agenda, IDLG has exerted considerable effort over the past year to reach a consensus with MoF about which parts of financial reform should be prioritized and how they should be sequenced within the context of the NPP4LG. Most recently, IDLG implemented its first every provincial budgeting workshop in August 2012, allowing the finance directors of the Provincial Governors Offices to plan their 1392 budget.

However, the recommendations emerging from the current analysis are suggesting that the current provincial budgeting efforts are not going far enough. It is recommended that two important weaknesses need to be addressed beyond the efforts that already ongoing. First, there is a need to create real space within the budget structure for provincial departments within which provincial officials can exercise a degree of discretion or authority. Second, to a large extent, provincial budgeting has hitherto been treated as a voluntary reform whereby line ministries are encouraged to seek input from their provincial department heads. Instead, the delegation of sectoral functions and the concomitant deconcentration of financial resources to the provincial level should not be considered a voluntary reform for line ministries to consider or reject: fundamentally, these provincial budget reforms should be imposed upon sectoral line ministries by changing the public financial management framework of the country as it applies to provincial administration units.

Previous and ongoing efforts to empower the provincial level
Changing the role of provincial officials in national planning and budgeting processes has been an important element of the subnational governance reform trajectory since 2005 (Lister and Nixon 2006). In order to ensure increased inclusiveness and responsiveness in subnational planning, UNAMA and other development partners have promoted the preparation of Provincial Development Plans (PDP). However, PDPs were never properly integrated into the national planning process, and no attempt was made to incorporate the priorities identified by PDPs into the budget formulation process. Given these shortcomings, the first attempt at de facto subnational governance reform –by having provincial officials prepare PDPs- resulted in little more than each province preparing s strategic document which –rather than being a being a

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33 It could be argued that in the absence of a degree of formal provincial budget authority, current provincial budgeting efforts are focused on “bottom-up provincial planning” with “top-down provincial budgeting”.

34 For instance, see the wording of the Tokyo Mutual Accountability Framework (2012).
costed and actionable plan—merely gave some sense of priority to guide line ministry and donor decision-making in the provinces (World Bank, 2007).

A second line of effort to strengthen the role of the province has been through provincial budgeting. Provincial budgeting was first piloted in August 2006 (1385) along with the piloting of program budgeting (Ministry of Finance, 2008). During the initial phase of this effort, three ministries—Ministry of Education (MOE), Ministry of Agriculture, Irrigation and Livestock (MAIL); and Ministry of Rural Rehabilitation and Development (MRRD)—were selected for piloting based on their contribution to the country’s socio-economic development. Likewise, three provinces—Balkh, Panjshir, and Kandahar—were selected for the provincial budgeting pilot. The number of involved provinces and ministries was expanded in subsequent years. During this initial phase of provincial budgeting, the Ministry of Finance supported the selected ministries to disaggregate their ministerial budget ceiling by program and by provinces; encourage a more objective and equitable distribution of provincial resources; and encouraged line ministry officials to hold consultations with their provincial line departments in the budgetary process. Despite the increase in consultation at the provincial level, however, all provincial resources were folded into the ministerial budget appropriation and the ultimate allocation of provincial resources was determined by each respective the central ministry.

Until 1390 (FY 2011/12), provincial budget activities mostly focused on building basic PFM capacity in the provinces, largely building on the MoF efforts on provincial budgeting that preceded the SNGP. In recent years, however, the Ministry of Finance has been urged from different sides to provide a more meaningful role to provincial officials in the budget formulation process, and a convergence seems to have taken place between the efforts within the MoF and the broader subnational governance agenda pursued by IDLG. As part of a more ambitious provincial budget agenda for 1391, five key line ministries were selected for a more extensive provincial budgeting approach (Ministry of Finance, October 9, 2011). For each of these ministries, indicative provincial budget ceilings were set based on estimated additional funding for specific programs delivering services at the provincial level (US$ 0.5 million for NRAP, EQUIP, BPHS and HLP and US$ 1.0 million for PBGF). While the fixed provincial ceiling amounts were intended to allow for simplicity in the first year, it was envisioned that a formula-based approach would be adopted in future years. While this approach was supposed to be introduced in 1392 (with MoF organizing provincial budgeting workshops to plan activities in the sectors/programmes), the effort failed to take off due to disagreement between the MoF and donors on implementation details.

Box 7: Provincial and district-level efforts in Afghanistan that could inform provincial budget reforms

Efforts are ongoing across Afghanistan to build the PFM skills at the provincial level. For instance, the existing GIZ-managed Strengthening Local Governance in Uruzgan (SLGU) Project is aimed at ‘providing capacity building and coaching to key service delivery line directorates’. Similarly, AusAID is further providing targeted support to line directorates in Uruzgan to facilitate improved budget and financial management processes, and piloting line ministry PFM capacity at the provincial level. This support includes provision of training and mentoring for government directorates in Uruzgan, and linking the province to national budget processes.

In addition, efforts at the district-level budgeting could help to inform provincial budget processes and reforms.
Building on the previous steps and attempts at provincial budgeting reforms, a proposal is currently under development and consideration for an ARTF O&M facility which would seek to improve the operation and maintenance of public assets at the provincial level by providing additional donor funding for increased provincial O&M allocations in key areas such as education, health and transport (roads) and, thereby, make public investment more sustainable.

**Interplay between expenditure assignments and budget structure at the provincial level**

One element that has been consistently disregarded up to this point in the efforts to promote provincial budgeting is that provinces (or more accurately, provincial line departments) are vertically deconcentrated administrative entities of the central government. As such, the assignment of functional responsibilities to the provincial level is constrained by the current intergovernmental fiscal architecture: ongoing provincial budgeting efforts have focused on requiring central line ministry officials to consult with their own provincial line departments, rather than providing provincial officials with any degree of real budgetary discretion or authority. In fact, provincial officials currently have no legal basis for making any authoritative decisions (or for being held accountable) about service delivery or anything within their purview. In particular, in the current budgetary framework, provincial officials have no budgetary authority; they live or die by the allotments provided to them fully at the discretion of their respective ministers. Thus, *in order to make the delegation of real responsibility and authority to the provincial level possible, provincial entities need to become an organizational and budgetary (sub-) entity within the public sector that is recognized as being distinct from the central ministry to which it belongs*. The pursuit of vertical budget deconcentration - by creating provincial budget authority at the provincial level - is discussed in greater detail below.

Beyond the intrinsic political and technical challenges that will most likely be faced in establishing provincial line departments as budgetary sub-organizations that are recognized in the Chart of Accounts in accordance with the Public Finance and Expenditure Management Law, the functional assignment and deconcentration process in Afghanistan is further complicated by the fact that there are four separate streams of budgetary resources going to the front lines over which –in principle- provincial officials should have some degree of discretion in order to achieve (some of) the potential benefits of decentralization and subnational governance reforms.

**Public spending on salaries and wages.** Currently the bulk of “provincial expenditures” is made up of the salaries and wages that are paid out to provincial-level public servants, including the local administrators, teachers, agriculture extension workers, and other public servants posted in the province. Although the wage payments for provincial establishments are paid through the provincial treasury, all decisions about staffing levels within each province are made at the central government level by the Independent Administrative Reform and Civil Service Commission (IARCSC). Although these human resources form the main inputs into the
production of provincial services, provincial officials currently have little or no influence over their own staffing structures.

It is unlikely that provincial officials in Afghanistan will be accorded any real discretion over the creation of establishments within their provinces in the near future. While continued centralized management of provincial human resources is the norm in many countries, this does not mean that no reform are needed in this area. Without addressing the existing large disparities in staffing levels between provinces and districts, and without ensuring that provincial and district officials have the power to dismiss under-performing teachers and other public servants, little progress on responsive and effective public service delivery is likely in the near future.

**Public spending on Operation & Maintenance.** The area where provincial officials potentially have the greatest opportunity to improve public service delivery in the near future is through their (possible) control over O&M spending (generally, major object code 22: Goods and Services). In the past, provincial O&M expenditures in the budget of each line ministry were centrally earmarked using a set of myriad “micro-norms”. A consensus is emerging that the responsiveness of public service delivery could improve considerably if directors of provincial line departments would be given the discretion or budgetary authority to allocate O&M resources within a pre-determined provincial appropriation in order to meet local priorities. For instance, this would not only give provincial director the ability to budget provincial O&M resources in accordance with local needs, but would also allow him (or her) to re-allocate resources in the case of urgent priorities during the budget year (e.g., weather-related damage to schools or other buildings).

The advantages of (initially) focusing on O&M expenditures includes that some provincial involvement has already taken place in the planning and budgeting of O&M expenditures under provincial budget pilot. Furthermore, operation and maintenance is an area where provincial officials can have considerable control since most O&M spending can not only be planned but also executed at the provincial level through small procurements.

An important area for attention is the size of resources available for O&M. *De facto* discretion over operation and maintenance requires a certain degree of adequacy in funding for recurrent non-wage expenditures at the provincial level. Based on international experiences, it will be important to protect the size of provincial O&M spending in the budget, as central line ministries may be inclined to under-spend on this category of expenditures.

**Core development spending.** The core development budget accounts for only a small share of actual development spending. Instead, the development budget contains considerable spending for O&M (Searle and Res, 2011).

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35 Although the resources would continue to be part and parcel of the line ministry’s budget, it would be prudent to give the PDC and/or the PC an oversight role to ensure that the resources are appropriately prioritized.

36 A related issue is that central line ministries are likely to retain certain O&M functions. For instance, in many countries, the Ministry of Education retains the authority to procure school books (which are then provided to the provincial level in-kind), even though provincial officials are arguably in a better position than central officials to identify and prioritize the need for learning materials.
To the extent that budgetary resources are available for development expenditures within the functional areas that are (or will be) assigned to the provincial level, provincial officials might have two roles. First, to the extent that capital infrastructure projects are deemed too large for the provincial level to procure, provincial officials could be given a coordinating role in the process of prioritization and planning. Second, provincial officials can be given a leading role to the degree that smaller capital infrastructure projects can be prioritized and procured at the provincial level (e.g., the construction of a small market, latrines, or a perimeter wall).

**External development spending.** An ongoing reality in Afghanistan is that a considerable share of external support continues to circumvent the national budget processes, and/or that these resources are programmed in close coordination with external donors. To the extent that the operations for such external development projects are already committed to in their respective project documents, it becomes difficult (if not impossible) to re-program these resources in accordance within a sound provincial budgeting framework.

**Pursuing vertical budget deconcentration by creating provincial budget authority**

As noted above, functional delegation to the provincial level cannot be realized unless provincial departments and their lead officials are provided with the organizational and fiscal space to administer their responsibilities with some degree of separation from their respective line ministries. Within the context of a deconcentrated public sector structure, international experience suggests that provincial line departments need to be given, first, a budget line and, second, some degree of control over that budget line. Without this as a building block, subnational government reform at the provincial level would be meaningless.

It should be noted that pursuing *vertical* budget deconcentration (by which provincial line departments are given a degree of budget authority but remain within their respective line ministry) is in line with Afghanistan’s constitutional and legal framework and would continue to allow the central government to set overall budget priorities between (as well as within) sectors and programmatic priorities, while at the same time allowing provincial line officials greater flexibility and control over their service delivery responsibilities. In contrast, *horizontal* budget deconcentration (by which provinces and/or districts are established as primary budget entities in their own right) would be inconsistent with the current constitutional and legal framework.

**Establishing provincial departments as (secondary) budgetary sub-units of their respective ministries.** As a first step towards meaningful subnational governance reform, the fiscal “plumbing” will have to be put in place that will allow a degree of provincial budget discretion or budget authority. Technically, creating the space for provincial budget authority (within a vertically deconcentrated budget structure) is easy to do: provincial line departments could be established as ‘secondary’ budget units (sub-organizations of their respective line ministries) by the Minister of Finance by amending the organizational codes within the Chart of Accounts.

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37 For instance, there is no reason for central officials in Kabul to determine the location of new school buildings or the location of new health clinics at the provincial level, even though the construction of such infrastructure may be procured centrally.

38 As a consequence of the vertical budgetary structure, provincial officials do not have the ability to shift resources across different sectors.
It should be noted that under the current Financial Regulations (Gazette #893), Cabinet (upon the advice of line ministries) already has the prerogative to establish provincial line departments as secondary budget units.\(^{39}\) The Financial Regulations do not explicitly require secondary budgetary units to be recognized in the organizational codes within the Chart of Accounts upon their establishment, but it may be implicitly assumed that this is the case. Mandating the creation of fiscal space for provincial departments as secondary budget units can thus be achieved by a Cabinet decision.

The most important policy question associated with the deconcentration of provincial budget authority is whether provincial budgets should be prepared on the basis of *provincial appropriations* or whether *provincial allocations* should be made based on ministerial appropriations. According to the definitions established in the Public Finance and Expenditure Management Law, an “appropriation” is the authority granted to the Ministry of Finance (in accordance with the annual budget procedures) for issuance of an allotment form, while and “allotment form” means an official form issued by the Ministry of Finance authorizing state administrations to make expenditures of the amount approved in accordance with appropriations.

Under a system of *provincial appropriations*, the Ministry of Finance would prepare the annual budget plan by preparing two separate appropriations for each line ministry: one appropriation for the central ministry, and a separate appropriation (or a series of provincial appropriations) to the provincial line departments belonging to that ministry.\(^{40}\) This would be a far-reaching reform that would not be desirable in the current political climate, as this would most likely open the door for systematic political intervention in the allocation of provincial resources. This option is unlikely to find broad political or institutional support among stakeholders in Afghanistan, and is not further pursued here.

A less drastic reform would be to introduce provincial *allocations* in the budget (formulation and execution) process without making provincial *appropriations*. Based on the arguments made above, this would require –first- the establishment of provincial departments as secondary budget units within their respective ministry’s organizational structures (within the Chart of Accounts) and –second- for provincial departments to be assigned the powers of incurring commitments on behalf of the state and having allotment advice issued pursuant to their allocations (as per the current Financial Regulations for secondary budget units). In practical terms, this would mean that the annual budget plan for a relevant line ministry would not only reflect the budget

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\(^{39}\) Due to lack of clarity in some of the Financial Regulation’s clauses, it is unclear to which degree provincial departments are already considered to function as secondary budget units. As noted in the text, it stands to reason that a secondary budget unit would have to be recognized as an organizational unit in the Chart of Accounts. If this interpretation is correct, no central line ministries have accorded their provincial departments with the status of secondary budget units. However, if provincial line departments are already deemed ‘secondary budget units’ under the Financial Regulations, a sharpening of the Financial Regulations may be required.

\(^{40}\) This reform could be triggered by a legislative modification of Section 32 of the PFEM Law in order to state that in addition to appropriations for each central unit [headquarters] of administrations in the fiscal year, the annual budget (the revenue and expenditure plan) also ought to make appropriations for each local unit [provincial department] of administrations in the fiscal year. Currently, the law requires the annual budget to include “appropriations for each central unit [headquarters] of administrations in the fiscal year”, but suffices with an estimate of “Revenues and expenditure of local administrations”. 
appropriation for the ministry as a whole, but that the budget would also indicate the provincial allocations (against which *provincial allotments* would be issued) for the respective provincial line departments. In other words, each line ministry budget would be required to present its budget plan broken down by sub-organization.

**Box 8: An example of a vertically deconcentrated budget structure: Cambodia**

Similar to Afghanistan, Cambodia follows a vertical or sectoral approach to deconcentration. However, in Cambodia, provincial line departments are recognized as administrative sub-organizations of their respective line ministries.

Cambodia’s budget is presented in four tables. Of these four tables, Table B describes general expenditures. In this table, the budget is presented by line ministry, broken down by central administration level and provincial level (see excerpt).

It should be noted that the ‘provincial’ classification does not merely give a geographical indication of each expenditure or the location where a treasury disbursement is made (as it currently does in Afghanistan’s budget classifications).

Instead, provincial expenditures in Cambodia’s budget reflect the aggregated budgets for the provincial line departments of each ministry. The detailed budget for each line ministry further breaks down the aggregate provincial allocation to each individual provincial line department (i.e., province by province, by type of expenditure).


In parallel to these reforms, as part of the expenditure assignment question, decisions have to be made about the segments of the budget which will be delegated to the provincial departments, and the degree of control that provincial officials would have over the expenditures over which they are yielded budget authority. Will provincial line departments be primarily yielded control over the O&M segment (Major Object Code 22), effectively similar to the situation in Sierra Leone or in Uganda? Or will provincial line departments also be yielded any control over (part of) wages and salaries (Major Object Code 21)? To what degree will provincial departments be delegated authority over the planning and budgeting of core development expenditures within their respective realms of responsibility, if any?

Not much would change in practical terms during the annual budget formulation cycle at the provincial level compared to what is currently being done under the provincial budget pilot, except that provincial line department allotments would be charged against the allocation for the respective line department (rather than the against the central ministry). At the beginning of the budget formulation process, provincial line departments are provided with an indicative budget ceiling within which to plan their provincial departmental budgets. Rather than having the provincial budget requests subjected to central line ministry review and modification (as is
currently the case), these budgets would be incorporated into the line ministry budget under the respective sub-vote for each provincial line department. The introduction of provincial budget authority removes the ability of central line ministries to micro-manage individual provincial budget line items, effectively turning the provincial budgeting process from one of provincial consultation into one of provincial empowerment.

Box 9: Provincial budget authority – a matter of semantics or real reform?

Although the level of detail with which the national budget plan in Afghanistan is presented changes from year to year, the current budget process already recognizes subnational expenditures based on a geographic location code. In other words, recurrent expenditures for education in Balkh Province can already be identified in the budget, since education expenditures are broken out by location code. One could argue that there is therefore no need to require the introduction of a sub-organization code for the Provincial Education Department in that province. If this is the case, isn’t the introduction of secondary budget authority through the introduction of budgetary sub-organizations a matter of semantics?

In contrast to the proposed establishment of budgetary sub-organizations in the Chart of Accounts, the current geographic location code used in Afghanistan’s budget structure is not associated with specific budget authority. As such, the geographic code mixes ‘provincial’ expenditures executed through the provincial treasury with ‘central’ expenditures made within a province. Using the geographic location code alone, it is impossible to know which expenditures were made under the control of provincial officials, and which expenditures were made by central officials for the benefit of a province.

Based on international practices, a strong case can be made that introducing formal budget ceilings for provincial line departments (in terms of provincial allotments associated with each specific provincial department) considerably strengthens the degree of budget authority exercised by provincial officials. In addition, the introduction of secondary budget unit can considerably improve the degree of budget transparency and budget accountability, as provincial officials can now be held accountable for the use of resources allocations under their control. The degree to which transparency and accountability is improved depends to a large extent on the level of subnational detail with which the national budget is published.

Some might say that the administrative capacity is currently lacking at the provincial level for provincial line departments to play a meaningful role in the national budget process and to hold any degree of budget authority. This is an unsuccessful argument. First, capacity will only fully develop when authority and responsibility are assigned. Second, the provincial budget project has been engaged in training provincial officials for the past six years. Third, the budget authority assigned to the provincial level won’t be unfettered: the provincial budget authority will be secondary in nature, with the line ministry continuing to hold primary budget authority and responsibility over the entire ministry budget. The respective line ministries will set the ceilings for their respective provincial departments; provincial discretion will most likely only apply over certain segments of the budget (e.g., O&M); and central line ministries will provide planning guidance to their provincial departments.

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41 Practical issues that would have to be resolved include how to ensure the stability of provincial budget ceilings for each line ministry defined in Budget Circular 1. Changing these ceilings during the remainder of the budget formulation process would require every provincial department in the country to realign its provincial budget plan.
It should be noted that the main obstacle to this proposed reform is not technical or capacity-related: the main obstacle is largely institutional and political. Politically and institutionally, there are three likely sources of resistance. First, line ministries may resist such reform, as it would (arguably) reduce the minister’s ability to move resources across his or her ministry. Second, the Ministry of Finance might be concerned with the implications of the proposed reforms on sounds public financial management, as setting aside budgetary resources to be executed by provincial line departments might reduce budget execution rates and open the potential for slow or inconsistent budget implementation. Third, in the case of provincial appropriations, the executive branch as a whole (including the President, Cabinet and again, the Ministry of Finance) would be likely to resist such a reform, as it potentially extends greater control over the budgetary process to parliament. Development partners and international financial institutions that are supporting decentralized subnational governance should recognize the nature of the main obstacle to subnational governance reform and ought to condition their support to GIRoA accordingly.

It should also be recognized that deconcentration of budget authority goes against the prevailing direction of PFM support to Afghanistan over the past ten years. As the steward of the country’s public finances, the Ministry of Finance has sought to increase its control over budgetary processes for years in order to reduce inefficiency and corruption. Deconcentration will require budget processes to place greater trust in the planning and implementation capabilities of a wider circle of officials outside of Kabul who are harder to manage from the center. At the same time, deconcentration of some budget authority during budget preparation sets up a path towards greater provincial budget authority during budget implementation, which create potential fiduciary risks. As such, the introduction of provincial budget deconcentration should be done in a relatively gradual manner that minimizes these risks and ensures a more effective allocation of budget resources.

One possible first step in the budget deconcentration process is already being explored: increasingly place donor-support provincial-level project activities on-budget through the provincial level. For instance, the existing provincial budgeting program as well as the proposed O&M ARTF Facility fit well within this broader strategy. The main additional requirement that should be made in order for the proposed O&M ARTF facility to be fully aligned with the current proposal is that the financial resources intended for provincial-level operation and maintenance activities should be budgeted (and most likely executed) by the provincial line departments themselves (as sub-organizations within their respective ministries), rather than having provincial O&M expenditures being prioritized in a top-down manner by each respective central line ministry. Additional issues upon which common understanding should be achieved between GIRoA and its development partners are –first- that GIRoA should not claw back its own resources to the provincial level as the donor community increases the level of

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42 This concern should be less for recurrent expenditures versus capital expenditures.
43 This is not an abstract concern. Andrews (2010) provides evidence that PFM reforms are easier to manage when they concentrate on engagement with a small sets of actors. In this regard, deconcentration is not a quick-win strategy.
provincial O&M resources and—second—that GIRoA commits to using the same funding channel (the budgets of the provincial budget units) to channel its resources to provincial-level activities.

One way in which provincial deconcentration could be pursued (outside the realm of the proposed O&M fund) is for IDLG to lead the way by formally recognizing each Provincial Governor’s Office as a department in the ministerial organization of IDLG (as reflected in the Chart of Accounts), and mainstream the PBGF within the IDLG budget. In order to achieve agreement on such a move, MoF and IDLG may have to compromise on the downstream management, supervision and accountability of such funds. More generally, it should be noted that in a post-2014 environment, donor-funded parallel programs may be increasingly costly to operate outside government systems and therefore, folding these programs into the national budget may be the only way for GIRoA to retain the funding for these programs.

**Pursuing realistic and affordable provincial service delivery standards along with provincial sectoral allocation norms.**

The vertical and horizontal allocation of resources in Afghanistan—both the way in which resources are distributed between the central and provincial levels, as well as the distribution of provincial resources across the provinces—seem to be determined in a rather ad hoc manner. Whereas wages resources are generally disbursed in a more deconcentrated manner, resources for operations and maintenance are managed in a more centralized manner, while the management of capital (development) resources is almost always fully centralized.

In addition, considerable arbitrary variation exists between provinces (and districts) in the distribution of provincial-level staff (per 1000 residents), the distribution of O&M resources, and the allocation of funding for capital infrastructure (World Bank 2008; Altai Consulting, 2011). For instance, in 1386, Nimroz Province received a budget allocation for goods and services of almost Afs. 500 per student, whereas Herat received less than Afs. 40 per student for the same purpose (Boex and Nixon, 2010). Such a large disparity raises a concern that public financial resources are not distributed across provinces in a fair and efficient manner, especially if the provincial allocations are made in a discretionary way.

Within discussions between the Ministry of Finance, IDLG, the World Bank, and other stakeholders, a clear consensus has emerged that the current approach to allocating provincial expenditures—which are currently made either on a somewhat discretionary basis, or are based on a set of highly detailed input-based norms—should be replaced with an allocation process in which finances follow the assignment of functions as well as government priorities, in a way that relies on client-based, output-oriented norms (Boex and Nixon, 2010). The introduction of client-driven provincial allocation norm which (i) more closely ties the allocation of budget resources to the policy outcomes that the government is trying to achieve; (ii) provide a budgetary ceiling within which provincial officials can have meaningful discretion and flexibility, and (iii) reduces the excessive centralization that derives from the current highly fragmented input-based norms. The recommended approach is sometime tied to the establishment of affordable provincial

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44 It should be noted that shifting the implementation of the PBGF on-budget is an explicit commitment of the NPP. It unclear, however, whether IDLG’s current vision of the “direct implementation [of the PBGF by IDLG]” is consistent with the full delegation of budget authority over these resources to the provincial level.
service delivery standards and consistent with sound public finance management concepts as well as with international best practices.

**Box 10: Implications for resource availability at the provincial level**

What are the implications of the proposed provincial budget reforms on the budgetary needs or requirements of the Afghan public sector? There are two elements to the financial “need” of deconcentration to the provincial level. First, what size should provincial sectoral allocations be? Second, what are the implications of the proposed reforms on subnational administrative costs?

First, what size should provincial sectoral allocations be? Of course, this question cannot be meaningfully answered until the determination is made which functions will be assigned to the provincial level. However, if done right, the shifting of budget authority and functional responsibility to the provincial level would not have a direct impact on the overall resource requirements of the public sector, since deconcentration by itself would merely shift budget authority over existing budgetary resources to the provincial level.\(^{45}\)

Second, given the existing administrative capacity already in place at the provincial level and given the relatively limited number of provinces, the shift in administrative responsibility brought about by provincial budget deconcentration should not impose a major additional financial burden on the public sector in Afghanistan.\(^{46}\)

Across the board, there is a need to determine the actual needs of provincial departments, and then, to consider how the allocation of provincial resources can be made in a more or less objective in proportion to their needs. These issues are discussed in greater detail in Annex A.

**6. Subnational budget structure and intergovernmental fiscal arrangements:**

*Options for Afghanistan at the sub-provincial level*

Based on the current state of subnational governance in Afghanistan, at this moment in time, the province is the most viable unit for the delegation for key public sector functions, such as basic education, primary health services, agriculture extension, rural development and so on. This is not to say that there is no role to play for districts in the public sector structure of Afghanistan. It does mean, however, that to the extent that our current challenge is to focus on supporting a minimally effective subnational governance system, that in the near future, the strengthening of the district level should be de-emphasized. Thus for the foreseeable future, for instance, district entities should most likely remain organizationally deconcentrated entities of the province.

\(^{45}\) In practice, international experience suggests that decentralization becomes an opportunity for different sectors to draw attention to the inadequacy of resources available for front-line service delivery. As such, in the process of determining provincial service delivery norms (and in computing the associated size of necessary provincial allocations), it is important to start from the resources available to the public sector, rather than starting from some unaffordable level of “desirable service delivery needs” (for instance, as defined in the ANDS): after all, the first tenant of economics is that while resources are scarce, human wants and needs are limitless.

\(^{46}\) In contrast, a much more serious financial impact would be felt if the Government sought to deconcentrate major functional responsibilities to the district level, given the larger number of districts and their current administrative weakness.
In contrast to provincial and district bodies—which primarily function as deconcentrated entities to implement centrally-delegated functions—the role of municipalities and villages is not necessarily one based on strict top-down delegation from the center. Being closest to the people and furthest away from the center, these local bodies can be most responsive to the needs of their local community, while at the same time relying more on social or horizontal accountability mechanisms than on top-down oversight. The Afghan Constitution assigns municipalities a status as semi-autonomous local self-governance units in the country’s urban areas. Likewise, international experience suggests that it can be quite beneficial for highly centralized or deconcentrated countries to have an elected village government level as close to the grassroots as possible. As discussed below, however, the legal framework in Afghanistan is less facilitating for the establishment of elected village governments or for transforming Community Development Councils (CDC) into a formal devolved tier of the public sector.

Although a review of international practices and experiences suggests that—whenever possible—Afghanistan’s public sector could benefit from devolving certain functions that are exclusively local in nature to municipalities and villages, greater variety exists in the options available for the (institutional and fiscal) organization of the sub-provincial local public sector when compared to the recommendations at the provincial level.

**Interplay between expenditure assignments and the sub-provincial institutional and fiscal architecture**

Section 4 proposes an assignment of functions and expenditure responsibilities that assigns urban public services to municipal local governments, whereas small-scale infrastructure and community services should be assigned to village level. In order to implement this recommended assignment of functional responsibilities, the first step would be to clearly define the institutional and fiscal architecture at the subnational level: in other words, what is (or what should be) the legal and budgetary nature of municipalities and villages in Afghanistan? Despite the guidance contained in the constitution and in the SNGP, no national consensus has been reached on the institutional and fiscal framework at either the municipal or at the village level. Agreement on this issue would have to form the first step towards meaningful implementation of the sub-provincial subnational governance agenda.

So far in this document, little attention has been paid to the legal and budgetary status of municipalities. IDLG is currently in the process of preparing a new Municipal Law. Given the exclusive processes surrounding the formulation of the law, it is unclear whether the resulting legislation will provide an appropriate institutional and fiscal environment for municipalities to become effective devolved local government entities in line with their constitutional mandate. In order for municipalities to rise beyond the lowest deconcentrated tier of Afghanistan’s public sector (which is effectively their current status, despite their loftier constitutional status), municipal organizations would need to be bestowed the basic features of a devolved, semi-autonomous local government unit: (i) that has its own political leadership, consisting of an elected mayor and council (not Mayors appointed by Kabul), (ii) be assigned clear and meaningful functional responsibilities (without perpetual interference of central line ministries), (iii) that functions as a corporate body that can make its own decisions and determine its own staff establishments and organizations, without requiring central government approval; and (iv)
that prepares and approves its own budget. As devolved local government entities, municipalities should not be required to have their budget plans approved by IDLG and MoF, nor should they living under the threat that any budget surplus at the end of the year—generated from own revenue sources—should be returned to the national treasury. In fact, as discussed further below, there are strong arguments to be made that municipalities in Afghanistan should receive financial support from the center (and/or from external donors) through a regularized municipal grant (Boex, Buencamino and Kimble, 2011).

Similarly, there is a need to formalize a local governance tier that is close to the grassroots in rural areas. In order for such village-level entities to be legitimate and able to translate the needs of people into concrete action, these entities have to be downwardly accountable corporate bodies. In addition, it should be recognized that that many village-level entities are not in a strong position to collect substantial own-source revenues, meaning that these entities would need an ongoing grant to deliver small-scale public services and community infrastructure. Until now, the role of the lowest level of governance to the people has been played by CDCs (which are not considered part of the formal public sector) which have been funded by the NSP (which has largely operated in parallel to the formal intergovernmental fiscal system).

**Formalize a performance-based Municipal Development Fund / Grant System**

As far as subnational entities, the legal situation for municipalities is the clearest: they have a clear constitutional status as elected local government entities and are assigned a functional mandate that is distinct from the central government. The slow pace of reform in the creation of a devolved municipal sector has been a weak spot for Afghanistan’s ambition to create a more effective, responsive and accountable public sector.

A consistent focus within municipal reforms (including within RAMP-UP, other municipal projects, as well as NPP4LG) has been placed on increased own source revenue collections. Despite consistent calls for municipal revenues to increase, by international comparison, municipal revenue in Afghanistan in fact are already quite high. Furthermore, little or no attention has been placed on introducing the political and administrative mechanisms to make sure that these locally-collected resources are spent in accordance to local needs and priorities.

While the SNGP foresees a municipal grant system and IDLG is a proponent of a municipal grant system, not all stakeholders within and outside GIRoA are convinced about the need for a municipal grant system. Indeed, despite the fact that GIRoA receives a considerable share of its own funding from external sources, there is a virtually unquestioned attitude at the central government level that it is appropriate for municipalities in Afghanistan to be fully financially self-reliant.

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47 In particular, there appears to be opposition within the Ministry of Finance against *de facto* recognizing municipalities as semi-autonomous public sector entities, and the implications that flow from such recognition. For instance, some MoF officials believe that—similar to central government entities—municipalities should transfer any year-end financial balance to the national treasury at the end of the fiscal year. This approach is completely inconsistent with the notion of local self-government.
In contrast to the prevailing opinion at the central level that municipalities only produce local benefits, municipalities often serve as the face of the public sector at the local level and effective municipal governance could considerably enhance the legitimacy of the public sector as a whole. Municipal governments provide functions of national importance (including providing key economic infrastructure) as urban areas serve as the country’s engines of economic growth. Most countries recognize that effective urban local government provide positive spillover effects for their surrounding regions and the rest of the country and therefore encourage good local governance and effective urban service delivery by the provision of intergovernmental transfers. Indeed, virtually every country in the world gives (urban) local governments a certain degree of financial support in terms of recurrent or development grants.\(^{48}\)

Until now, financial support to municipalities has been limited to in-kind transfers of infrastructure under donor-supported municipal projects, such as the USAID-funded RAMP-UP projects.\(^{49}\) This approach is unsustainable, especially in light of the shifting security situation post-2014. It would be much more efficient, transparent and appropriate to funnel support to the municipal sector on-budget through the introduction of on-budget municipal grants. While the World Bank and other development partners have extensive world-wide experience with the introduction of formula-based (and even performance-based) municipal grants to strengthen urban infrastructure and urban service delivery, the MoF has been hesitant to move in this direction and is unlikely to pursue municipal grants full-throttle.

At the sub-provincial level, the introduction of formula-based, performance-based municipal grants would be an important step towards increasingly responsive governance and increasingly effective municipal service delivery. If well-designed, even relative small annual municipal grant scheme –for instance, $20 million per year- could have a substantial impact on urban governance and services. The design of such a municipal grant system could take into account the fact that certain municipal centers play a more important role in national and regional economic development than others (and therefore, that the pay-off for investments in urban infrastructure in these municipalities may be higher than in other municipalities).

Focusing on the introduction of a municipal grant may serve as an important political-will litmus test for subnational governance reform and creating stronger subnational fiscal linkages below the provincial level: if proponents of subnational governance reforms cannot convince MoF to provide a small level of municipal grants through the national budget to urban local bodies that have a constitutional mandate (which is already permitted under existing law and forms a central part of the SNGP), it will be unlikely that MoF will be willing to provide grants to other local government entities, quasi-governments or community entities such as Village Councils, CDCs (in their current legal status), School Committees, or other community organizations.

\(^{48}\) Mozambique is a helpful example in this regard, as it has a subnational architecture very similar to Afghanistan. Even though Mozambican municipalities are expected to contribute a considerable share of their financial resources through the collection of local taxes and other own source revenues, Mozambique’s central government provides municipalities with a formula-based recurrent grant as well as with a formula-based development grant.

\(^{49}\) Under the PEFM Law, the Ministry of Finance is authorized to provide municipalities with deficit-grants. As noted earlier, it is unclear whether the Ministry of Finance in fact provides such grants and –if so- on what basis.
Institutionally Formalize the Village (or Community) Level and Introduce Village/Community Development Grants

A second element of the subnational budget structure and intergovernmental fiscal arrangements at the sub-provincial level that is yet to be decided is the nature of the institutional and fiscal arrangements at the village or community level. Although the constitution conceives of villages as a consultative level of the state administration (and potentially, as a level that organizes activities in its own name), in reality, the state administration is not able to effectively reach the grassroots through its hierarchical, deconcentrated structures below the provincial level. Nonetheless, international experience suggests that there is a substantial potential for gains in legitimacy, social capital and effectiveness (in terms of the public benefit to the community) that can be achieved by steering funding as close as possible to the grassroots. In the short run and medium term –in the absence of a functioning district administration- this means creating an institutional and financial modality that can reach the grassroots level.

The National Solidarity Programme (NSP) has arguably been the most visible and successful development intervention in Afghanistan over the past decade. As such, a leading option at the village or community level would be to replace NSP -now in its third phase- with a mainstreamed Village Development Grant or Community Development Grant. The design of such a Village Development would be able to draw lessons not only from NSP, but also from similar grant schemes in Bangladesh, Cambodia, Mozambique, Nepal, and Uganda. A discussion of the main features of a possible Village/Community Development Grant in Afghanistan is presented in the Annex B.

Two important points of contention exist with regard to the establishment of a village-level funding modality. The first question is whether such a program would be desirable and affordable: does it make sense to have a village-level grant system when the district level is so poorly funded? Tentatively, international experience suggests that the answer to this question should be ‘yes’. Despite the obvious concerns about efficiency of scale, fragmentation, and lack of top-down accountability, there are things that can be done at the village level that simply cannot be done at the district level. Even a relatively small annual Community Grant or Village Grant can be a visible and regular signal that the national government intends to have an ongoing, direct, positive impact on people’s lives. As such, a village level grant –when designed properly- can be an important element in promoting state legitimacy by providing direct support to community priorities. At the same time, proximity to the grass roots allows for the emergence of downward accountability and the development of social capital at the village or community level that is unlikely to materialize at the district level, where the link between the individuals and the communal decision is much weaker.

At the same time, care should be taken in the design of the Village or Community Grant to clearly recognize the limits of the role that this level can play in delivering public services, even when funded through local development fund. In the presence of a weak state administration, there is often a desire to assign sectoral functions to the lowest level of governance, rather than assigning functions to the lowest governance level that can perform the function efficiently. For instance, the village level is unlikely to be able to effectively deliver key sectoral services, such as basic education or health services. In order to ensure that subnational governance reforms remain focused, it is important to recognize such limitations up from.
The next (but closely related) point of contention with regard to the establishment of a funding modality for village/community infrastructure and services in rural areas is to determine what or who the intended recipient would be. The size and scale of the recipient body needs to be sufficiently small to be close enough to the grassroots in order to ensure participation, responsiveness and accountability, while at the same time, the scale of villages or communities should be large enough that it represents a manageable number of recipient bodies for central or provincial authorities. Determining the optimal scale of village/community jurisdictions requires a balancing of interests without a single correct answer. This issue is further explored in Annex B.

A Village/Community Development Grant scheme (as further discussed in Annex B) ought to be an important modality for community development for at least the next ten years. But village-level institutions –as well as the funding structures for this level- should be positioned with a long term view – how will the functional role of the village level evolve in the future? As the formal public sector “grows up” over time in terms of increased efficiency, responsiveness and accountability, many of the functions that –in the near term would be performed by the village level could gradually be shifted to an emerging district level. At that stage, villages would transition to becoming a tier for social mobilization and communal action, while the formal state administration would reach to the district level.

**Gradually begin to put the PFM plumbing in place to establish districts as deconcentrated budget organizations**

Given the transition awaiting Afghanistan in 2014 (both in terms of the military transition, but also the presidential elections), the current focus of subnational governance reform –in fact, the focus of the entire international development agenda- in Afghanistan should be to pursue a realistic approach to achieving –in the shortest time possible- a minimally effective (subnational) system of governance, financing and service delivery. As formulated above, the quickest way to achieve this is through a two-pronged approach: first, pursue budget deconcentration to the provincial level for the most important state functions, and second, pursue devolution to municipalities and villages for local functions that are (essentially) exclusively local in nature.

This viewpoint seems to neglect the district level. Indeed, experiences from other countries (e.g., Cambodia, Mozambique, Uganda) suggest that the strengthening of the district level as a stand-alone governance level should be low on the priority list right now, both from a governance perspective as well as from a service delivery viewpoint. International experiences in this regard largely mirror the experience with prior (and largely unsuccessful) efforts to jump-start an effective and sustainable district level in Afghanistan using the “government in a box” approach (Brown, 2012). At this stage, there is no intergovernmental plumbing in place to reach the district level, which is even further removed from the center of decision-making in Kabul than the provincial level. Furthermore, an excessive focus on the district level would risk fragmenting scarce public sector management resources too thinly across too many jurisdictions.

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50 Unlike in Afghanistan, in fragile, post-conflict places where districts did play a meaningful role in the public sector, districts were the highest tier or level of subnational governance (e.g., Uganda, Sierra Leone and possibly Nepal).
As already noted in Section 3 (as part of Lesson 3), prematurely inserting an under-developed level of district administration may in fact worsen the coordination between the provincial level and front-line service delivery units, and may result in greater inefficiency and corruption. As such, over the next 5-10 year, arguably the most effective way to improve public service delivery would be to improve sectoral services from their current provincial base. As such, there is no compelling reason at this stage to transform the current set of district-level interlocutors (such as District Development Assemblies or ASOP Councils) into more full-fledged local governments or local administrative units. In fact, this shift away from the district level is already recognized, for instance, in the reformulation of the DDP into SPAD, which shifts the focus from the district level to the provincial level (although it –correctly- aims to retain the participatory element at the sub-provincial level).

In the longer run, experiences from Cambodia and Mozambique might give useful direction how to gradually build up a stronger and permanent district administration level as a deconcentrated level in its own right.

It is important to assess the current subnational governance implementation strategy (e.g., NPP4LG) in accordance with realistic priorities about subnational governance in Afghanistan in the near term. One has to wonder whether the considerable resources expected to be expended under Component 2 will provide value-for-money in terms of improved governance. Instead, at this time, would an investment of the same value in front-line and district-level service delivery systems (anchored within the relevant provincial line departments) produce a more immediate and greater service delivery impact?

This does not mean that the district is irrelevant in terms of attaining progress in subnational governance, finance, and service delivery. In fact, districts –as territorial jurisdictions, as well as spaces within which communities convene- play an incredibly important role in the process of strengthening service delivery within provinces. For instance, SPAD is piloting the constructive engagement of district-level stakeholders into provincial-level planning processes, to ensure that the bottom-up planning processes meet the top-down budget process. Likewise, one can imagine using the district level increasingly as the main territorial level for reporting on central and provincial services and for other statistics. For instance, being able to report statistics such as enrollment rates, student-teacher ratios, classroom availability and basic education spending by district –rather than just by province- will be tremendously informative for officials within the public sector as well as for civil society at large as Afghanistan pursues its national development strategy. Much of this transparency, however, can be achieved without putting in place a full-blown district administration level, but rather, by more extensive use of AFMIS data and other relevant sectoral management information systems.

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51 The reader should be reminded that provinces in Afghanistan are relatively small by international comparison when compared to provincial governments that function as intermediary-level governments.
7. Implications for the way forward

As noted at the outset of this document, the primary purpose of the current study is to stimulate and inform discussions and debate on the adequacy and effectiveness of intergovernmental (fiscal) systems in Afghanistan. It sought to do so in part by pointing out that—in its pursuit of a more effective and responsive local public sector—the situation faced by Afghanistan is not unique, and that lessons can be learnt from similarly situated countries.

In fact, if Afghanistan is willing to take on board the lessons that can be drawn from international experiences, then there is a relative clear path forward on the reform of the country’s subnational fiscal architecture, which will create stronger fiscal linkages between the center and the subnational level to underpin the country’s subnational governance policy. Elements of a stronger and coherent intergovernmental fiscal architecture include:

1. Pursuing vertical functional deconcentration in line with the Constitution by assigning clear functional responsibilities to the provincial departments of relevant line ministries.
2. Pursuing (vertical) budgetary deconcentration to the provincial level by establishing provincial line departments as budgetary sub-organizations of their respective ministries within the Chart of Accounts and the national budget.
3. Introducing realistic and affordable provincial service delivery standards along with provincial sectoral allocation norms.
4. Establishing municipalities as real devolved local government entities and formalizing a performance-based Municipal Development Grant System
5. Institutionally formalize local bodies at the village or community-level and introduce a Village/Community Development Fund.
6. Over time, introducing deconcentration to district-level administrations in order for district to play an increasing role in overseeing, coordinating and delivering public services within their jurisdictions.

These proposals are consistent with Afghanistan’s constitution, the country’s subnational governance policy, and the existing legal framework, and provides the fiscal foundation for the constitutional requirement to that the government “shall delegate certain authorities to local administration units for the purpose of expediting and promoting economic, social, and cultural affairs, and increasing the participation of people in the development of the nation”. At the same time, the details of each of these elements of a stronger and coherent intergovernmental fiscal architecture would still have to be worked out.

By and large, the ideas being floated here are also consistent with IDLG’s SNGP Implementation Strategy as well as by the National Priority Program for Local Governance (NPP4LG). Likewise, the proposals are in line with the commitments made by the government as part of the Tokyo Mutual Accountability Framework.

Despite the constitutional mandate to achieve the delegation of functions (and resources) to the provincial level, some of the key central government stakeholders (the Ministry of Finance and central line ministries, in particular) may be hesitant to embrace budgetary deconcentration. Subnational governance reform and provincial budgeting in Afghanistan, however, will remain a
paper exercise until a consensus or compromise emerges that provides provincial line officials with a meaningful degree of discretion for provincial operations and service delivery—including some degree of authority over their budgetary resources. The same is true for the institutional and intergovernmental fiscal arrangements in place to support municipalities and local bodies at the village level. It is important to emphasize that the purpose of provincial budget reforms and other subnational governance reforms is not to weaken central line ministries, but rather, to strengthen the effectiveness and responsiveness with which central line ministries pursue their policy objectives at the subnational level. Central line officials and their provincial departments are—and will remain—mutually dependent in a multi-level, collaborative public sector framework. Similarly, strengthening participatory inputs into the preparation of the budgets of provincial line departments should be seen to strengthen the national budget process, rather than detracting from it. In this context, the key policy question to be pursued with line ministries should not be whether to “deconcentrate or not”, but rather, to identify ways to improve capacity and coordination among public stakeholders at different levels of government which increase the efficiency, equity and sustainability of public spending.

Rather than pursuing a high-level political consensus on the overall implementation of the Sub-National Governance Policy (which is unlikely to be achieved in the near future), incremental reform can be achieved by improving the way in which the national budget process provides funding for front-line service delivery units which are factually managed at the provincial level. Informing the discussion about the role of the sub-central public sector in improving public service delivery—by identifying the binding constraints on the effective delivery of public services at the subnational level—could serve as a useful starting point to inform technical-level agreements for putting in place effective linkages between the center, provinces, districts and villages, many of which can be implemented within the context of existing laws and regulations.
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Annex A

Comments on the introduction of norm-based provincial resource allocations

Analysis of intergovernmental fiscal flows and provincial expenditures finds that there are substantial variations in per capita public expenditures between provinces in Afghanistan (World Bank, 2008). Little or no formal guidance is given to line ministries how to distribute budget resources across provinces, contributing to persistent substantial horizontal fiscal imbalances. There is increasing consensus among policy makers and the development community in Afghanistan that there is a need for a more systematic framework for determining provincial budget allocations which also achieves a closer link between public expenditure patterns and the policy objectives of the Afghanistan National Development Strategy through improvements in results-based program budgets and emerging notions of minimum service standards.

Box A.1: The current approach to horizontal allocation of provincial expenditures – the case of the Ministry of Education

In February 2010 a collaborative review with the Ministry of Education of budgetary practices for 1389 established that the distribution of general education resources across the 34 provincial education departments (plus the education department for Kabul City) occurred in a norm-based manner. However, it was also noted that norms are applied by the Ministry of Education in an input-based and fragmented way. This approach results in a number of problems.

First, different input-based norms were applied for each relevant object code within each Major Object Code, thus resulting a system based on many “micro-norms”. For instance, 12 different norms were used to distribute wage and salaries expenditures across provinces (for each object within Major object code 21). For the distribution of goods and services expenditures across provinces (Major object code 22), 16 different norms were used. Within this category, different types of budget norms were used for distributing travel allowances, fuel expenditures, furniture, postage, and so on. As a result, many of the norms were used to distribute small sums of money, using up valuable time and energy in the budget formulation process and isolating these sums from other aspects of the budget. For instance, resources for postage were distributed using a detailed norm, separate from other goods and services expenditures, resulting in each province receiving and earmarked amount for postage expenditures which -on average- amounts to less than $2000 per province.

Second, this fragmented approach results in an over-earmarking of budget resources. The current budget process presumes that the central line ministry is in a position to determine spending priorities across budget objects for each of the 34 provincial line departments, and indirectly, over 300 district line departments. In reality, as part of the current budget formulation process, the central line ministry is not in a position to determine whether a province or district has a greater need for travel allowance or postage. As such, the application of such detailed norms provides a false sense of accuracy of what provincial needs really are, and reduces the scope for increased provincial level input into resource allocation now or in the future.

The over-fragmentation of budget allocation could be alleviated by determining the provincial division of education resources in a simpler, more transparent manner based on client-based or output-based norms. For instance, rather than applying 16 separate norms for each individual component of recurrent non-wage spending, it might be possible to apply one single norm to all spending that falls under budget code 22.

Third, a major concern with the current norms is the fact that they are input-driven. Although provincial budget allocations are made in a seemingly objective manner (rather than in a discretionary or ad hoc manner), the base for these norms may be determined in a discretionary manner. For instance, if wage expenditures are determined in
The basic proposal for introducing norm-based provincial sectoral allocations in Afghanistan

How would norm-based provincial sectoral allocations differ from current provincial allocation practices? A detailed proposal for norm-based provincial allocations for General Education was developed by the World Bank in close consultation with the Ministry of Finance and the Ministry of Education (Boex and Nixon, 2010). The proposal for improved provincial resource allocation norms in Afghanistan closely follows the public sector’s current budget structure, is consistent with the budget process improvements pursued by the Ministry of Finance, and adheres to the notion of formula-based provincial resource allocations contained in the Subnational Governance Policy prepared by IDLG.

Within the confines of the expenditure responsibilities to be deconcentrated (or “delegated”) to the provincial level, each sectoral line ministry should develop one or more provincial service-delivery norms along which the available sectoral resources should be distributed across the provinces. In combination with the total amount of resources that would be made for provincial administration and service delivery within each sector, these norm-based resource ceilings would provide each provincial line department with the budget ceilings for their respective departmental budget, within which they can plan in accordance with the guidance contained in the national Budget Circulars and sectoral guidelines.

The basic proposal for improved provincial resource allocation norms for general education would establish norm-based allocations for a handful of budget components. Thus, instead of applying norms for every object code in the budget, a norm-based provincial allocation of resources would be done at for the major object codes (Code 21, 22 and 25). In addition, norms could be applied to the distribution of school books as well as to school-level (O&M and rehabilitation) grants provided under EQUIP. Norms would further be pursued for a number of (mostly non-discretionary) windows in the Development Budget, although the hope would be that some of these windows would eventually be merged into a unified budget process as budget integration proceeds.

For instance, the available resources for provincial expenditures on Goods and Services might be allocated based on a simple budget norm by which each province receives a certain (small) fixed amount of money for administrative overhead expenses, while the remainder of available provincial sectoral resources would be distributed among the provinces in accordance with the number of students or school-aged children in each province.

How are actual budget allocations determined within these norm-based provincial ceilings? Within the provincial resource ceilings set by these 5-6 sets of norms, a set of guidelines or secondary norms might be necessary within some of these budget windows to determine the

Source: Boex and Nixon (2010).
exact use of resources. In many cases, the secondary norm would allocate a share of the overall resource ceiling for a specific purpose (or object code) in an indicative manner.

For example, rather than using a separate norm for allocating resources for the maintenance of school desks and chairs across provinces in proportion to the number of school buildings or classrooms in each province (as is currently the case), the total provincial ceiling for spending on Goods and Services would be determined in aggregate based on a simple norm (as suggested above). As a secondary norm, a certain share or percentage of each provincial allocation could then be set aside for the repair and maintenance of desks and chairs. Additional sectoral budget guidance or instructions would then guide the planning and use of the available resources at the provincial level (for instance, by indicating that provincial education department should plan to spend roughly 100 Afs. on average for the maintenance or repair of each desk).

Of course, as the provincial budgeting pilot progresses, provincial officials can increasingly be relied upon to allocate the available resources within each of the major ceilings to specific activities and objects within each program. As such, while the secondary resource allocation norms may start out being compulsory, provincial officials may be given substantial discretion within each major code to reallocate resources among objects. Over time, the secondary norms and guidance would largely become indicative rather than compulsory. The greater the discretion provided to the provincial level, the more responsive provincial line departments can become to the service delivery needs of the communities they serve.

The proposed provincial resource allocation approach might appear slightly more complex than the current process, since a two-stage approach is followed: first, the main provincial allocation norm or formula allocates a program’s resources (within a certain budget component) across the country’s provinces; second, this resource ceiling is divided (either compulsory or indicatively) across budget objects using a secondary (percentage) norm. Yet, there are several advantages to this process:

- The allocation approach is not input driven, and therefore more equitable than the current budget norms. For instance, provinces that currently have fewer school buildings (relative to their school-aged population) are no longer penalized by getting a smaller share of operation and maintenance resources.
- The allocation approach links expenditure allocations more closely to the number of clients served by the public sector (and possibly, variations in the cost of serving those clients), and is therefore consistent with ANDS and sectoral policy goals.
- The approach is transparent: it is easy to explain to all stakeholders how resources are distributed across provinces.
- The approach is affordable: the norms are not absolute and therefore do not demand more resources than available in the budget. They also provide for hard budget constraint at the provincial level and provide realistic planning ceilings for each province.
- When adequate planning capacity is present at the provincial level, the proposed process allows a balance between central sectoral guidance and adequate provincial planning space.
**Provincial allocation norms apply differently to different parts of the budget**

Although norm-based provincial allocations can contribute to improvements in the horizontal allocation of public resources, the nature of the Afghan budget imposes certain constraints on the degree to which provincial budgetary resources can be allocated in a norm-based manner (Boex, 2009). In particular, a considerable share of development resources is allocated in a manner that is outside the immediate control of the Ministry of Finance. This includes development projects that are funded through the External Budget, as well as earmarked donor-funded programs that are funded through the Core Development Budget. To the extent that the allocation of these development resources is already largely pre-determined, norm-based sectoral expenditure allocations can effectively only be applied to ordinary budget spending at this stage.

Even within the ordinary (recurrent) budget, the application of provincial budget norms will vary between different types of expenditures. Whereas the allocation of O&M resources (Code 22: Goods and Services) can relatively easily be changed quite drastically from year to year due to the introduction of a norm-based allocation approach, it would be much more difficult (if not impossible) to make similar sweeping changes in the allocation of wage expenditures (Code 21), which would potentially require major movements of teachers and other government staff across provinces.\(^{52}\) This means that provincial budget norms will have a bigger potential impact on some sectors as compared to others, as some sectors have greater recurrent budgets vis-à-vis development budgets. In particular, the education sector largely consists of on-budget recurrent spending, and therefore could benefit significantly from an improved, norm-based approach.

**What obstacles are faced in the introduction of norm-based provincial allocations?**

The introduction of norm-based provincial allocations in itself is not a new suggestion, and is already accepted government policy as part of the ongoing Provincial Budget Process (Ministry of Finance, 2011). Support for this effort is contained in the NPP4LG and other initiatives. Indeed, as series of workshops and interactions were facilitated between the World Bank and key government stakeholders as early as 2009 and 2010 to lay the technical foundation for the development of such norm-based provincial allocations (Boex and Nixon, 2010).

So why haven’t provincial expenditure norms been fully embraced and adopted as part of the annual budget formulation process? A few explanations are possible.

First, coming up with objective norm-based provincial allocations is not necessarily an easy exercise, to the extent that the norms (and the resulting allocation of provincial resources) have to be both technically sound (resulting in an efficient and equitable allocation of resources to fund the delivery of provincial services) as well as politically acceptable. Greater technical support and more persistent institutional engagement may be required for some of the key sectors in order to arrive at a set of provincial allocation norms that can receive broad-based support.

Second, there is a need to overcome institutional inertia, both at the central level as well as at the provincial level. Current provincial allocations are generally made based on *ad hoc* decisions in

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\(^{52}\) This does not mean that provincial allocation norms cannot be applied to wage expenditures. It does mean, however, that the creation of establishments and the allocation of wage expenditures should be informed differently by a norm-based allocation process. For a more detailed discussion, see Boex and Nixon (2010).
combination with a number of input-based “micro-norms”. Since all stakeholders are used to this approach, it is likely that provincial ceilings will largely continue to be determined more or less equally (e.g., in accordance with the grade of the province) rather than in proportion to the true sectoral expenditure needs within the province (typically determined by the number of clients that are in need of public services). Likewise, it is likely that provincial officials are inclined to continue to follow the current approach of input-based budgeting (based on micro-norms), rather than prioritizing provincial expenditures for activities where they are needed the most.

Third, the slow adoption of norm-based provincial allocations may signal weak institutional support for the introduction of this reform. In particular, line ministries might be concerned about this reform, as it –especially when combined with greater provincial budget discretion- could greatly reduce the central line ministry’s control and discretion over the sector’s budget. However, the introduction of norm-based provincial allocations requires the active concurrence and cooperation from IDLG, Ministry of Finance, and the involved line ministries. Without broad support by all stakeholders, even the most narrow introduction of norm-based provincial allocations (e.g., for O&M expenditures) can easily delayed or obstructed.

Fourth, provincial budgeting may have been seen by some primarily as an exercise to attract greater donor resources to the provincial level. While provincial line departments are at the front-line of public service provision in Afghanistan, and while these departments could benefit from access to greater financial resources, the primary objective of provincial budgeting is to use provincial resources (including existing government resource that are used for provincial functions) more effectively.

Finally, it should be emphasized that the introduction of provincial budget norms is an almost irrelevant exercise without first creating budget authority for provincial departments: unless the “indicative budget ceilings” for provincial departments are transformed into a real budget ceilings for each provincial line department (reflected in the Chart of Accounts and in the national budget structure), the provincial budgeting process will remain one of provincial consultation rather than one of provincial empowerment, as central ministry officials will remain free to modify provincial budgets without the consent (or even without the knowledge) of their provincial departments. At the same time, establishing provincial budget authority is virtually useless without creating norm-based provincial budget ceilings. After all, unless provincial directors know how much they will receive in terms of resources, they will not be able to effectively plan the delivery of services for which they have been assigned the responsibility.
Annex B
Considerations for the design of a Village/Community Development Grants

There is an important role to be played by the village level in Afghanistan’s subnational governance architecture, particularly in terms of promoting social cohesion, supporting rural (community) development, and promoting the legitimacy of the state. However, because the village level is at the lowest rung of the public sector structure, the linkages between itself and the center are potentially the weakest.

In the context of the constraints imposed by the environment in Afghanistan, how does one go about designing a sustainable village/community grant scheme? To what extent can the design of such a Village/Community Development Grant build on existing experiences and practices, both internationally as well as in Afghanistan (such as NSP or DDP/SPAD).

Main features of a Local Development Grant
As already noted in Section 3, local development funds are a common feature in many countries, including in a large number of fragile, post-conflict countries (Steffensen, 2010). The features that most of these grant systems share in common provide an appropriate starting point for discussing the design of a village or community development grant in Afghanistan.

1. Whenever possible, Village/Community Development Grants are funded on-budget, and provided annually to the recipient entities as grants through regular treasury processes.
2. Recipients of the grant are often local government entities or local administrative bodies at the lowest level of the public sector. In the absence of formal, elected local government bodies at the grassroots level, quasi-local government entities (such as Community Committees) can be designated as grant recipients.53
3. The size of the funds provided as block grants are relatively small; the size of such block-grant pools typically generally range from $1-$3 per capita.
4. The available block grant pool is allocated in a fair and transparent manner among all eligible Villages/Communities. Typically, such grants are allocated based on a simple allocation formula, which is largely—if not exclusively—based on population (avoid reliance on a fixed amount per village in the allocation formula).
5. A set of guidelines and/or an operational manual is typically provided to Village Councils (or Community Councils) indicating the permitted uses of the grant resources; providing accounting and reporting instructions and requirements; and so on.
6. In order to receive the grant, villages or communities need to adhere to certain minimum conditions and/or performance standards, such as having an elected leadership; following basic inclusive, participatory planning processes; as well as having practices in place that ensure transparency and accountability in financial management, procurement and implementation.

53 Alternatively, grants can be provided to an intermediate level of government, on the condition that prioritization and implementation takes place by entities at the grassroots level. For instance, in the case of Tanzania, the Local Government Capital Development Grant is provided to the district level, although planning and prioritization takes place at the village and ward levels.
7. As appropriate for grants and subsidies (as per IMF guidance), the grants are transferred into the accounts of the Villages/Communities, and their final expenditure are be managed outside treasury system.

8. Management and monitoring of the Village/Community Development Grant is done by the responsible government agency (e.g., IDLG). A system of third-party audits may be put in place.

**The size and nature of recipient entities of a Village/Community Development Grant**

Determining the optimal scale of village/community jurisdictions –in terms of being recipients of a Village or Community Development Grant- requires us to balance two features. On one hand, the size and scale of the recipient body needs to be sufficiently small to be close enough to the grassroots in order to ensure participation, responsiveness and accountability, while one the other hand, the scale of villages or communities should be large enough that it is sustainable and represents a manageable number of recipient bodies for central or provincial authorities.

For instance, given a fixed and limited pool of resources (of say, one or two dollars per person, or about $25-50 million annually), if Villages or Communities had an average population of 1000 residents or less, than the average grant would likely be unsustainably low ($1000-$2000 per village or community) in terms of being able to fund meaningful community infrastructure or services. As such, one could imagine that a local recipient body with an average population of about 5000 people would be a more meaningful target for a Village Development Grant than spreading the same amount of resources over 35,000-42,000 villages or rural settlements with a population of around 500-800 residents.

Likewise, a village development grant scheme that has 4000-5000 recipient entities with an average population of 5000 each (with about 150 village/communities entities per province; 10-12 per district) would likely be possible to manage on an ongoing basis, whereas a scheme with more recipients would most likely not be (fiscally or organizationally) sustainable from an administrative viewpoint in a post-2014 environment.

Although village/community jurisdictions with an average population of around 5000 will not have the same degree of participation and inclusiveness as a smaller entities, it is likely that the scale is not prohibitive in terms of achieving a degree of social cohesion and bottom-up accountability. In contrast, if we would increase the scale of the recipient jurisdictions too much beyond this point (say, to 20,000 or 50,000 residents per jurisdiction), it is increasingly likely that a considerable loss of voice (participation, inclusiveness, and accountability) will occur, thereby increasing the chance that the grant becomes ‘captured’ by local elites, by the civil servants disbursing the grants, or by both.

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54 This amount is chosen as a starting point for the discussion here based on a number of factors. First, if the total grant per jurisdiction becomes too large, social accountability pressures may not be sufficient to ensure proper use of the funds (in the absence of a large and unsustainable facilitating structure). Second, allocative efficiency within the public sector requires a degree of proportionality between the funding availability and the functions assigned to the relevant governance level (for comparison: provincial O&M spending for education amounts to about $40 million per year). Finally, the total size of the grant pool should be sustainable in the long run (in terms of being able to secure domestic or external funding on an ongoing basis).
The legal nature of the local bodies which would become the recipients of the Village/Community Development Grants is probably not the most important determinant of the success of an effective village/community level. In practice, how the formal village level will be construed largely depends on how GIRoA wishes to resolve the legal status of CDCs and Villages. The preferred option might be to transform groups or clusters of current CDCs across the country into formalized Villages (with a target population of approximately 5000 residents), for which Village Councils would be elected under the supervision of the Independent Electoral Commission. In order to become the recipients of Village Grants, of course, such Village Councils would have to become corporate bodies legally capable of opening their own bank accounts and –to some extent- making and implementing their own decisions. It is beyond the scope of the current study to judge whether this is a legally or politically viable outcome.

If the establishment of devolved councils is not a (politically or legally) viable option, a secondary option would be to fund and deliver community-level development by consolidating clusters of CDCs into larger jurisdictions. Such Consolidated Community Development Councils would function as quasi-government entities: they would formally fall outside the public sector and legally be equivalent to NGOs, but otherwise they would follow the process outlined above to provide them with Community Development Grants through the national budget. The success of this option would depend on the degree of legitimacy that these entities would be able to harness. As long as these jurisdictions have an elected leadership and are able to receive annual grants from the national budget, as long as there is a mechanism in place to ensure that these entities operate in an inclusive, participatory and accountable manner, and as long as central and provincial authorities recognize them as being constructive part of the governance structure (although not formally part of the government structure), their formal legal designation is not likely to matter all that much in determining their effectiveness.

Managing the finances and operations of a Village/Community Development Grant Scheme

If possible, the Village/Community Development Grant scheme would be fully mainstreamed in government operations, and its funding fully integrated in the annual budget cycle. Recognizing that the strongest platform for subnational service delivery and administrative for the foreseeable future is the province, it would be prudent for the subnational administration and management of a Village/Community Development Grant scheme to be anchored at the provincial level.

In practical terms, this would mean that a small team within each province (most likely anchored and mainstreamed within the Provincial DRRD or OPG) would oversee and administer the program within the grant scheme’s national framework. One of the main activities of the

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55 Under this scenario, CDCs would cease to exist in their current form. In practice, the CDC areas would still likely play a role. For instance, the current CDC jurisdiction might become the equivalent of the ward-level for the resulting village.

56 An advantage of this approach is that the village level would have a more manageable number or jurisdictions. However, a formalized village entity of this scale would no longer necessarily coincide with the (apparently prevailing concept) of a village as the smallest cluster of human settlement in Afghanistan.

57 As quasi-public entities, their elections would not have to be supervised by the IEC. However, it would be appropriate to have some type of formal public supervision over these grassroots elections.

58 It should be noted that the provincial focus of the proposed Village/Community Development Grant bears similarities to the revised design of the DDP/SPAD.
provincial teams would be to conduct a basic assessment of the Village Councils or Consolidated Community Development Councils each year to verify that the local bodies are adhering to the rules of the grant scheme and that they meet the minimum conditions for access to the grant funds. Technical and logistical support in conducting the annual assessment could be provided by external evaluators and District Governors, respectively.

Grant allocations to the Village/Local Councils would be determined nationally (possibly by MRRD and/or IDLG, as a mainstreamed function) based on an objective allocation formula, conditional upon the findings of the annual performance assessment. The grant allocations would be included in the national budget, and provincial allotments would be made in accordance with the formula-based allocations. Disbursement of the grants to the respective Village/Local Council representatives would be made through the Provincial Treasury to representatives of each council. For transparency, the size of all grant allocations (along with results of the performance assessment for each council) could be published in national newspapers. Financial oversight would largely come in the form of ex post oversight and control: Village Councils that fail to abide by the grant scheme’s guidelines will be disqualified from receiving funding in future years.

**Potential institutional obstacles**

To the extent that Village Councils or Consolidated Community Development Councils are corporate bodies (and not deconcentrated units of the state), the expenditures made by these bodies should be made outside the treasury system, subject to financial legislation and regulations that apply to such local entities, rather than subject to the provisions of the Public Finance and Expenditure Management Act that apply to central government organs.¹⁵

One of the main likely obstacles faced by a proposal of this ilk is institutional opposition from the Ministry of Finance. In the past, the Ministry of Finance has insisted of strong treasury controls on public expenditures and resisted the disbursement of public funds where the accountability controls lie beyond the scope of the Finance Ministry itself.

Another institutional issue to be settled is whether such a village/community level grant ought to be provided under the auspices of IDLG or MRRD. It is likely that the institutional status of the recipient entity (i.e., Village Council versus Consolidated Community Development Council) will be a determining factor in this decision.

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¹⁵ Unlike other types of budgetary outlays or transactions (such as wage expenditures or spending on goods and services), there is no exchange involved in the provision of a transfer (grant or subsidy). As such, grants should be disbursed and recorded when all requirements and conditions for receiving them are satisfied and the receiving unit has an unconditional claim (IMF 2001, p.58).