I. Introduction and Context

A. Country Context

Ghana has experienced two decades of strong and sustained economic growth. The average GDP growth rate from 2001 to 2008 was a robust 5.6 percent and has translated into substantial poverty reduction—the national poverty rate fell from 52 percent in 1992 to 29 percent in 2006. Ghana is expected to become the first Sub-Saharan African country to achieve the first Millennium Development Goal of halving poverty and hunger by 2015. With the recent discovery of oil, prospects for sustained growth are positive.

With the passing of the Local Government Act in 1993, the Government of Ghana (GoG) sought to implement comprehensive local government and decentralization reforms. Some successes have been achieved through the creation of 170 local authorities (metropolitan, municipal and district assemblies, or MMDAs), the transfer of some authority, resources and responsibilities from the center to the local level (including through the creation of the District Assemblies Common Fund or DACF), and awareness raising among citizens. However,
progress has been slow and hampered by contradictory regulations, lack of clarity regarding roles of the center versus the local, and capacity constraints.

**Ghana is urbanizing rapidly.** 2010 marks the year when Ghana’s urban population surpassed the rural population. 51% of the population currently lives in urban centers, and the urban population growth rate is high at 3.2%. Ghana’s cities and towns face vast challenges in managing urbanization and have so far been unable to meet the growing demands for infrastructure and services. This is evidenced by the increasing incidence of urban poverty, the development of slums, and low levels of access to water, sanitation, and other services in urban areas.1

**GoG has recently undertaken a series of important steps to reinvigorate its planned decentralization of functions to local governments.** A new Decentralization Policy Framework has been finalized in 2010, clearly recognizing the need to accelerate the decentralization process by directly addressing bottlenecks and gaps, and to do so in a coordinated and holistic manner rather than the incremental changes attempted in the past. The accompanying National Decentralization Action Plan (NDAP 2010-2014) lays out priority areas for action. Other significant activities include the initiation of constitutional and legislative reviews related to the decentralization process, the introduction of Legislative Instrument 1961 transferring local level civil servants to a Local Government Service, the creation of the Interministerial Coordination Committee (IMCC) on Decentralization chaired by the Vice President, and the establishment of the District Development Fund (DDF) offering performance based grants to eligible local governments. Collectively, these activities have established a renewed commitment to far-reaching decentralization as an instrument to improve the accountability and effectiveness of basic service delivery.

**Parallel to these decentralization initiatives, GoG has also prepared a draft national urban policy.** This reflects the growing consensus that Ghanaian cities are facing significant and growing challenges resulting from high rates of urban growth and recognition of the increasingly urban nature of both poverty and economic development. Although still under development, this policy recognizes the centrality of effective institutions of city management in positioning cities as future engines of growth and poverty reduction.

**B. Sectoral and Institutional Context**

**The intergovernmental fiscal framework is not yet responsive to the specific and significant needs of Ghana’s cities.** A strong basis exists for fiscal decentralization in Ghana through the DACF and the DDF referred to above. However, fiscal transfers adopt a uniform approach to local governments that discounts the pressures faced by growing urban centers. Ghana’s cities not only face large scale, lumpy investment needs associated with capital intensive basic infrastructure networks (such as sanitation, water supply, local roads and public transport), but must also provide regional scale infrastructure that serve non-resident populations while coping with the pressures of rapid population growth. These needs are currently not being met through the existing fiscal transfer systems which spread funding across the 170 local governments. Additionally, most large scale infrastructure investments have thus far been financed through

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1 National Urban Policy (draft), 2010, Ministry of Local Government and Rural Development
projectized approaches. The generation of local revenues from property taxation and user fees has received inadequate policy and administrative attention, as evidenced through the low proportion of financing generated from local sources (in 2007, local revenues amounted to only 16% of total revenues in five secondary cities in Ghana). These are key constraints to sustainable and sufficient urban infrastructure investment, and also reduce the prospects for future municipal borrowing.

As more powers and resources are being decentralized, ensuring that local governments are being held accountable to central government as well as to their citizens becomes increasingly important. Current accountability systems, both upward and downward, are weak. The unpredictability of resources makes it difficult for local governments to respond to the needs of citizens and undermines citizen participation opportunities that exist in the planning and budgeting process. Financial accounting and reporting systems need to be strengthened. Audits in large part either do not exist or are of insufficient quality, and there is limited sharing of information about finances and programs. Linkages between citizens and their assemblies similarly are very weak.

Decentralization in Ghana must thus increasingly meet the dual objectives of strengthening an accountable system of local governance while specifically enabling cities to meet the challenges of urban growth. Key to addressing these objectives will be measures to re-orient and enhance the capacity of both national and local government agencies to play the new roles demanded of them in a decentralized framework for governance and service delivery. For national government, enhanced ability to set priorities and support and monitor their implementation become critical, while at the local government level the capacity to design and manage local development interventions will be of key importance.

C. Relationship to CAS
Ghana’s current Poverty Reduction Strategy (GPRS II) presents its strategies according to three thematic pillars: (i) private sector competitiveness; (ii) human resource development; and (iii) governance and civic responsibility. The last pillar notes the importance of upgrading public expenditure and financial systems, strengthening social accountability mechanisms and implementing effective decentralization to local governments.

In 2007, development partners, including the World Bank, formulated a Ghana – Joint Assistance Strategy (G-JAS) to support GPRS II. The Bank’s specific program of support under the G-JAS (the CAS) provides an explicit commitment to make available analytical and financial resources to strengthen governance through “activities in decentralization, including urban policy, public sector reform, economic governance and promoting evidence- and results-based public policy choice”. This project will specifically contribute to this commitment.

II. Proposed Development Objective(s)

A. Proposed PDO
The proposed development objective of the project is to build the capacity of local governments to deliver local services by (i) enhancing the intergovernmental fiscal framework, (ii) improving municipal management capabilities, and (iii) strengthening local accountability.
B. Key Results
The key results areas for the project are: (i) a predictable and transparent intergovernmental fiscal framework; (ii) improved municipal management capabilities in key reform areas; and (iii) increased citizen knowledge and engagement with local government in key reform areas. Specific indicators to measure these results areas are currently being developed.

III. Preliminary Description

A. Concept
The project will provide an integrated package of support to build the capacity of Metropolitan, Municipal and District Assemblies (MMDAs), with a specific focus on urban assemblies. A systematic and dynamic approach to capacity building is proposed, aimed at ensuring that an appropriate enabling policy, regulatory and fiscal environment at the national level supports efforts to strengthen local government capabilities. It would also ensure that the capacity of urban assemblies is built in relation to functions that they actually perform (“learning by doing”), and that they are held to account (by citizens and national government) and appropriately rewarded for the performance of these functions.

This project will build on the incentive driven approach to enhancing MMDA performance that has been initiated through the DDF performance grant that has been operating over the last two years, and which is showing positive outcomes. It will focus on the specific needs of urban assemblies through encouraging the emergence of a differentiated fiscal framework and providing incentives and support in key reform areas already identified in the NDAP and related policies of government. The broad focus area of these reforms will be on local government public financial management systems, as these are recognized as the critical foundation of accountable and effective local governance and service delivery. The specific reform areas considered critical are: (i) budget reform; (ii) reporting, monitoring and auditing systems; (iii) asset management; (iv) revenue management; and (v) social accountability.

The project will complement and harmonize with existing and planned support from other development partners (DPs) to the overall decentralization framework. Specific support to administrative decentralization is already being provided by the Danish (DANIDA), French (AFD) and German government (GTZ), with further support planned by the European Union (EU). The growing focus of the EU support is on the work of the Local Government Service Secretariat (LGSS) related to personnel decentralization and civil service reforms. In this context, Bank support under this project will focus on fiscal decentralization and financial management reforms, given their importance in supporting administrative decentralization as well as enhancing local service delivery and governance outcomes. The project is also being designed in strategic partnership with other DPs engaged in decentralization to ensure a mutually reinforcing reform agenda in support of the government’s decentralization policy (using common frameworks, performance criteria, indicators, triggers, etc).

B. Description
Four project components are proposed:
a) **Strengthening the fiscal framework for decentralization ($8m):** This component will support the establishment of a predictable and transparent intergovernmental fiscal framework. It will assist the Ministry of Finance and Economic Planning (MoFEP) to develop its management capacity in this regard and enable it to develop specific aspects of an enabling fiscal framework that creates appropriate incentives for effective and accountable local governance and service delivery. Focus areas include regulation and management of municipal resources (including own source revenues and borrowing); the regulation and management of the DACF; the rules governing public financial management by MMDAs; and the monitoring and management of fiscal risks associated with the transfer of functions, assets and staff to local governments. As more resources are transferred to local governments, it will be important to ensure that national policies and frameworks around public financial management foster citizen engagement and enhance transparency—support will therefore be provided to ensure that social accountability perspectives are embedded in reforms to the fiscal framework.

b) **Enhancing decentralized urban service delivery ($70m for performance-based grants and $17m for capacity building activities):** This component will support urban local governments to improve their management capabilities in the identified key reform areas. The core of the component is an annual performance-based grant to urban assemblies. While all 46 urban assemblies (6 metropolitan and 40 municipal assemblies as per the formal classification of MMDAs) are eligible, 12 assemblies that will receive substantial support through other initiatives will be excluded. In order to access the grant each year, the remaining 34 assemblies will need to already be eligible to receive the District Development Fund (DDF) and also achieve an above average score on the DDF annual assessment (the Functional and Organizational Assessment Tool or FOAT). Funds will be provided in addition to existing DDF allocations, weighted according to the results of an assessment focused on the key public financial management (PFM) reform areas targeted by this project. Assuming a gradual entry of the 34 eligible urban assemblies over the project period, an assembly participating in every year of the grant would receive $2 million in total (or $15 per capita) over 5 years. Assessment, operational and fund disbursement procedures will be closely aligned with the existing DDF mechanism.

The component will also finance a targeted capacity building program to urban assemblies to enhance their performance in the key reform areas. This will include training to provide the assemblies with a basic skills set. In addition, a targeted demand driven capacity building program will be provided to enhance their performance in the key reform areas through the provision of hands-on technical assistance and incentives to use innovative service delivery instruments (such as revenue management contracts). It will also support urban assemblies in increasing the transparency of local government finances and citizen participation in PFM through activities such as the preparation and

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2 These are 4 assemblies being supported through a new AFD project and 8 assemblies in Greater Accra, which are targeted for IDA support in 2012.

3 Assuming 5 assemblies enter in year 1, increasing to 10, 15, 20 and 34 by year 5, this amounts to an estimated average of $600,000 per assembly (or $4.50 per capita) in the first year, rising to $900,000 (or $7 per capita) by the end of the project.
dissemination of user-friendly formats that will make financial information (budgets, audits, etc) more accessible to citizens.

c) **Stimulating demand for accountable governance and service delivery ($2.5m):** This component will aim to foster more effective engagement of civil society (citizens, assembly members CBO/NGOs, traditional authorities) with assemblies on PFM issues. Activities will include training activities to inform civil society of their rights and responsibilities associated with PFM and build their capacity to engage with MMDAs; dissemination activities encompassing local media and others to help bridge the information gap on MMDA finances, expenditures, etc; engagement of parliamentarians; and support for structured accountability instruments that strengthen civil society oversight of local government (e.g. resident satisfaction surveys). The activities supported under this component will directly complement the “supply-led” accountability initiatives introduced under Component 2.

d) **Project management and evaluation ($2.5m):** This component will provide project management support to the Ministry of Local Government and Rural Development (MLGRD) in project implementation, as well as support regular project evaluations, including procurement and safeguards reviews, financial reporting and auditing.

C. Safeguard Policies that might apply

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D. Tentative financing

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*By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*
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