PROGRAM-FOR-RESULTS INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC0071584

Program Name	*Intergovernmental Fiscal Transfers Program for Results*
Region	*Africa*
Country	*Republic of Uganda*
Sector	*Sub-national government*
Lending Instrument	*Program-for-Results Financing*
Program ID	*P160250*
Parent Program ID	*N/A*
Borrower(s)	*Republic of Uganda*
Implementing Agency	*Ministry of Finance, Planning, and Economic Development*
Date PID Prepared	*June 6, 2016*
Estimated Date of Appraisal Completion	*April 30, 2017*
Estimated Date of Board Approval	*June 20, 2017*
Concept Review Decision	Following the review of the concept, the decision was taken to proceed with the preparation of the operation.

I. Introduction and Context

A. Country Context

1. **Uganda has been among top regional performers in terms of economic growth and poverty reduction over the last decades, despite a recent slowdown.** Uganda is a low-income country with GDP per capita of USD 550 in 2013. Since 1987, Uganda has experienced a sustained period of high growth, averaging over six percent a year, largely explained by the combination of macroeconomic stability, post-conflict rebound and pro-market reforms. Among others, this growth benefitted the poorest households: over the last ten years, Uganda managed to reduce the proportion of households living under $1.25 a day PPP faster than any other country in sub-Saharan Africa. However, more recently the rate of economic expansion decelerated from an average of 7.6 percent a year during FY2006-10 to 5.5 percent from FY2011-15 because of external factors, inconsistent fiscal and monetary policies, and a slowdown in the efforts by the government to implement further reforms. Combined with low domestic revenue collection, this has tightened the overall fiscal constraints of the government. These constraints might be relaxed when Uganda begins to start exporting oil, but the timing of this is highly uncertain, especially because being a land-locked country Uganda will depend on its neighbors for transferring its oil to the ports.

2. **Uganda has been among the pioneers of decentralization in Sub-Saharan Africa, but the quality of its decentralized public services still leaves much to be desired and its decentralization frameworks needs to be rebalanced.** Ugandan decentralization efforts of the 1990s represented an unusually authentic and powerful local government reform, compared to similar efforts pursued in many other low-income countries. However, over time the changing

interests of the central agencies and the overall dynamics of the country's governance resulted in the adoption of a number of re-centralizing policies. Dissatisfaction with service outcomes might have contributed to this too. While Uganda has made significant progress in child school enrollment and child survival rate, findings from a recent Service Delivery Indicators initiative launched by the World Bank show that Uganda still needs to focus on significantly raising quality and efficiency in health and education, the two sectors accounting for over 70 percent of local government spending. For example, the portion of teachers with minimum requisite knowledge is twice as large in Kenya as in Uganda; Kenyan health providers are 20 percent more likely to diagnose accurately and are twice as likely to correctly manage maternal and neonatal complications.

3. **Uganda has a structural difficulty with finding a balance between spending on infrastructure and on social services.** The country has very high fertility (with a total fertility rate of more than six children per woman) and a very young population (with a median age of about 15 years). Given the scarcity of its fiscal resources, the government finds it difficult to invest in both infrastructure and social services in amounts that would be sufficient to allow the majority of its young people to find jobs when they enter the labor market. An increase in one of these categories of investment leads to gaps in the other. In the 1990s and early 2000s, the government focused its efforts on social services until it became apparent that the country's infrastructure required urgent attention. Sooner or later this recent shift in priorities might be reversed, following the same logic that led to its occurrence. However, judging by past experience, it may take a decade or more for this reversal to occur. In this context, central government transfers to local governments decreased as a share of GDP from about 5 to about 3.4 percent, with a bulk of decline in those intended to finance education and health expenditures.

4. **The Government of Uganda has a renewed commitment to accelerate implementation of the FDS aiming at enhancement of decentralized service delivery.** The reform momentum in this policy area is much stronger than in many others. The Government finds it increasingly important to improve value-for-money in service delivery by local governments, particularly in the social sectors. This opened a window of opportunity for streamlining of fiscal transfer modalities to local governments in order to increase the efficiency and effectiveness of local governments.

B. Sectoral and Institutional Context of the Program

5. **Uganda was one of the first countries in Africa to embark on a major decentralization.** Significant administrative, political, and fiscal powers were devolved to local governments. The government announced the policy in 1992 and subsequently set out to develop a system that was defined in the Constitution (1995) and further elaborated in the Local Government Act (1997). The bulk of service delivery responsibilities were devolved to local governments, with the exception of urban water and sewerage and electricity, which are provided by national corporations. Line ministries were left primarily with the responsibility of setting national policies and standards, assuming inspection, supervision and monitoring roles, providing technical advice and support, and training local governments. The legal framework also provided for intergovernmental fiscal transfers (unconditional, conditional, and

equalization) and several types of local own-source revenues. The elected local councils were empowered to develop and execute plans and budgets and to hire and fire staff. In short, decentralization in Uganda created several levels of local government with a fairly broad set of autonomous powers and functions typical of a devolved system.

6. **Districts cover mostly rural areas and are responsible for delivery of a broad range of services.** These include education, healthcare, infrastructure (roads, water supply), natural resources, and agricultural extension. Grants from the central government finance services in all these sectors as well as local public administration and community services. Figure 2 presents the structure of aggregated local government expenditures and the number of grants from the central government they received for various sectors in 2014.

7. **FDS covers intergovernmental fiscal transfers totaling about 3.4 percent of GDP and serves as an umbrella for the efforts to streamline their modalities.** FDS was adopted in 2002 with the following objective: "To strengthen the process of decentralization in Uganda through increasing local governments' autonomy, widening local participation in decision making and streamlining of fiscal transfer modalities to local governments in order to increase the efficiency and effectiveness of local governments". The adoption of the FDS was to respond to concerns about the likely impact that local governments' funding mechanisms would have on the key objectives for local autonomy and accountability in decisions making under its decentralization policy. Local governments were experiencing a build-up of administrative costs arising from a large number of transfers, multiple procedures, bank accounts and lines of reporting due to increasing conditional grants. Amounts of such transfers to individual districts were based on complex mixture of historical practices, need-based formulae, and ad hoc considerations. The central government was also affected as sector ministries had to dedicate more time and resources to accountability procedures associated with the grants including having to deal with increasing loads of quarterly reporting from local governments. The Government sought to use the FDS to address these concerns and, in particular, to streamline transfer modalities in a way which would enhance local autonomy in line with broader decentralization policy,

8. **Until 2015, FDS was implemented to a very limited extent.** This made it more difficult for the local governments to discharge their mandates. Although overall the decentralization framework of Uganda is strong in constitutional, legal and policy terms, central government decisions and actions have not always followed the strategic orientation set out in the above-noted legal instruments and policy documents. On the fiscal side, over 80 percent of the local governments' funding comes from conditional transfers from the central government, while own-sourced revenues account for less than 10 percent of their budgets. Uganda had some 58 conditional transfers to the local governments. On the institutional side, the system remained more decentralized, with local councils being elected and exercising a certain degree of authority over the local civil services. However, the districts' chief administrative officers are now appointed by the central government.

9. **Uganda is still marked by inequality across districts in terms of public spending per capita as well as in terms of outcomes.** For example, in 2015 public spending on health differed by a factor of 7.2 between 10 best funded and 10 worst funded districts, and public spending on

education differed by a factor of 7.0. About one third of positions in local governments are currently vacant, and the share of vacancies varies a lot across districts, also affecting equality of outcomes. There is also variation in the level of services provided in various sectors. For example, in the education sector, the number of students per primary school teacher varied from as low as 32 to as much as 100 across districts, and the share of deliveries in government health facilities varied from 4 percent to 94 percent across districts.

10. While efficiency of the transfers system has improved over the last decade, major problems remain. Quality of guidelines for application of and reporting on grant allocations has improved; processes of disbursements are becoming more transparent and in a number of districts, quarterly transfers are placed on notice boards; most service delivery units have good records of application and reporting on funding. Efficiency of the fiscal transfers system has been further improved with introduction of Straight Through Process (STP) that ensures direct transfer of funds to service units in health and education sectors. However, some major problems remain, especially with the grants financing development spending. For example, transferring of funds for road maintenance by local governments may take up to six weeks.

11. Since 2015, the Government of Uganda made substantial progress in implementation of FDS through reform of intergovernmental fiscal transfers. Design of the new system of transfers is based on the following objectives:

- Restore adequacy and equity in allocation of funds for service delivery.
- Shift the focus away from fragmented input-based conditions toward accountability for allocation decisions, expenditures, and results.
- Increase discretion to enable local governments to deliver services in line with local needs while ensuring that national policies are implemented.
- Allow new national policies to be funded via the transfer system, at the same time avoiding future fragmentation of transfers and reduction in discretion.
- Use the transfer system to provide incentives to improve institutional and service delivery performance.

The reform follows a sequenced approach, starting from consolidation of the transfers (reducing their number).

12. Consolidation of the transfers in 2015 was a critical first stage of the reform, for several reasons. It reduced by to 20 the number of transfers to local governments. Consolidation was a necessary first step because will help to increase recipients' flexibility in the use of their fiscal resources, and opened the way to developing rational formulae for the grants. It helped to reduce transactions costs associated with the grants planning and monitoring. It also made the reform process more transparent and understandable for the local governments, and is helping them to achieve greater economies of scale in use of their resources.

13. The second stage of the reform launched in 2016 focuses on reducing horizontal inequities and enhancing efficiency of the transfers system. Its design involves three key steps:

- Development of the new formulae for consolidated grants. The formulae will seek to strike a balance between reducing horizontal inequity (e.g., seeking to make per capita funding in the health and education sectors more equitable) and enhancing incentives to perform and accountability for the use of resources (e.g. rewarding the local governments which receive clean audits from the Auditor General, provide timely and accurate reporting on use of resources, etc.). The formulae for the grants covering general government sector will be closely linked to rationalization of the district civil services.

- Design of transitional arrangements for the phase-in of the new formulae. In order to facilitate adjustment by the local governments to the new rules for financing, the new formulae will be phased in gradually, in a course of several years.
- Enhancement of the transfers' system efficiency. This will include revision of the guidelines and reporting arrangements for the new grants, development of institutional arrangements helping to ensure that the new formulae, guidelines and reporting arrangements are followed in practice, that release of funds by the central government to the local governments and by the local governments to the service unit.

C. Relationship to Country Partnership Framework (CPF)

14. **The Program will support two CPF objectives.** These are "Enhancing Economic Governance and Fiscal Management" and "Improving Social Service Delivery". Reduction in horizontal inequities in per beneficiary spending on social services across districts will directly contribute to achieving one of the CPF objective indicators. The Program's focus on improving financing of service delivery, enhancing value for money, and reducing inequities in public spending on social services will help to achieve the twin goals of ending extreme poverty and promoting shared prosperity in a sustainable manner.

D. Rationale for Bank Engagement and Choice of Financing Instrument

15. **The Bank has been closely involved in a fiscal decentralization policy dialogue with the Government of Uganda, and assisted the Government in its efforts to build the momentum for reforms.** The FY13 Public Expenditure Review "Service Delivery with More Districts in Uganda: Fiscal Challenges and Opportunities for Reforms" developed a set of institutional and fiscal policy recommendations for the reforms of fiscal decentralization framework. The Government has formed an inter-ministerial task force charged with implementation of these recommendations which helped to prepare proposals for reforms of intergovernmental fiscal transfers and district civil services. The former proposal has been presented by MoFPED in December 2014 at the Budget Workshop on Decentralized Service Delivery attended by Prime-Minister, Minister of Finance, and a large number of senior officials from both central and local governments, and received broad support from that audience.

16. **The Bank has also supported design and adoption of the first stage of the reform with technical assistance and development policy financing.** In March 2015 – June 2016, the Bank provided technical assistance to the Government in development of the new consolidated framework for the grants, development of formulae, grant conditions, budgeting and reporting guidelines for the new framework. The First Fiscal Decentralization, Governance, and Service Delivery Development Policy Operation (DPO) supporting implementation of the first stage of the fiscal transfers' reform has been appraised and all its prior actions have been completed.

17. This puts the Bank in a strong position for helping to strengthen the government's capacity and incentives for improving implementation of the reform. This will involve helping to achieve in a course of several years (i) more equitable allocation of resources through transfers from central to local governments, particularly in the social sectors; and (ii) more efficient functioning of the transfers system.

18. Adoption of the Program for Results instrument will help to achieve lasting results by leveraging finance to strengthen institutions and to build capacity. Implementation of effective fiscal decentralization reforms will result in fiscal savings and improvements in value-for-money that could be quite substantial. FY13 PER demonstrated that increasing value-for-money in education and health expenditures in the districts that are lagging behind would help to achieve better outcomes without raising overall costs. Some districts are able to achieve better outcomes while operating under tighter budget constraints. Bringing every district up to the outcome-to-spending ratio of the districts that perform very highly in both health and education sectors could save about 0.8 percent of GDP per annum. While such potential financial gains certainly justify financial involvement of the Bank, in an institutional environment of a low-income country implementation support to predictable, gradual yet steady change in path-dependent budget allocations to local governments in order to reduce horizontal inequities, and lasting strengthening of incentives and capacities of the implementing agency to improve value for money are critical for maximizing the actual gains. Program for Results instrument is better positioned for such purposes than either DPF or IPF, and is therefore more appropriate for this operation.

II. Program Development Objective(s)

19. The Program's Development Objective is to enhance equity and efficiency of financing of decentralized social services.

III. Program Description

20. The Program is a "time-slice" of Fiscal Decentralization Strategy (FDS) with a focus on reduction in horizontal inequities in several fiscal transfers financing services delivered by the local governments (to be identified). As a part of FDS implementation, the Government of Uganda is planning to undertake a reform of intergovernmental fiscal transfers to the districts. The Bank will support this reform through a combination of Program for Results financing and technical assistance provided jointly with other development partners. While technical assistance will support the reform as a whole, the Program will focus on the thorough reform of 2-4 transfers financing decentralized social services. The intention is to make the selected transfers a "reform model", and to generate demonstration effect leading to spillovers of good practices to services financed through other grants.

21. The Disbursement-Linked Indicators of the operation will represent a mix of outputs and intermediary outcomes. Their specific formulations could be derived from the following general ones:

- Policy outputs adopted for the second stage the intergovernmental fiscal transfers reform

- Actual allocations to local governments at each pre-defined step are based on a pre-agreed plan of the phase-in of the new formulae for the grants, helping to reduce inequities in social spending across local governments and efficiency of the transfers system;
- The comprehensive assessments of local governments' performance are completed every year.

IV. Initial Environmental and Social Screening

22. **Environmental and social risks are likely to be low.** The overall social impact of the program is expected to be strongly positive, as it will help to achieve greater value for money in social services and hence better social outcomes, among other things by means of reducing horizontal inequities in per capita funding for health services. Environmental impacts are not expected to be large.

23. Tentative financing

Source:		($m.)
Borrower/Recipient		50
IBRD		0
IDA		200
Others (specify)		
	Total	250

24. Contact point

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