

A CHECKLIST FOR SOUND FISCAL DECENTRALISATION

1.0	The Assignment of Functions and Expenditure Responsibilities	
1.1	Local governments are assigned meaningful expenditure functions and service delivery responsibilities	
1.2	The assignment of expenditure responsibilities is clear and recognizes the multi-dimensional nature of functions	
1.3	Expenditure assignments follow the subsidiarity principle	
1.4	Central line ministries support and monitor local public services	
1.5	Local budget formulation and execution processes are participatory, transparent, and accountable	
2.0	The Assignment of Revenue Sources	
2.1	Local governments are assigned one or more meaningful revenue sources and have control (at the margin) over the tax rate	
2.2	The 'correspondence principle' is generally observed in financing local public services	
2.3	Whenever appropriate, user fees and charges are used on a cost-recovery basis to finance local public services	
2.4	Local revenues are administered efficiently, fairly and transparently, with central oversight	
3.0	The Provision of Intergovernmental Fiscal Transfers	
3.1	The transfer system achieves vertical fiscal balance ("finance follows function")	
3.2	The transfer system is equitable: horizontal fiscal balance	
3.3	The transfer system balances national priorities with local discretion	
3.4	The transfer system is well-designed (e.g., cannot be manipulated by officials and does not create incentive problems)	
3.5	Transfers are provided in a timely, complete and transparent manner	
4.0	Subnational borrowing	
4.1	Local governments have access to infrastructure funding	

4.2	The regulatory framework for local borrowing resolves the 'inter-temporal mismatch and adheres to the 'golden rule'	
4.3	The approach to local borrowing is transparent, promotes accountability, prevents political moral hazard, and provides a hard budget constraint	

Assessing fiscal decentralisation: The Kingdom of Rasunia

Background: Decentralisation in Rasunia

- Located in South Asia; population 237 million
- Underwent major decentralisation reform in 1999: 241 deconcentrated districts became elected local governments, which were provided key functional responsibilities as well as financial resources
- The decentralisation law states that all functions –except National Defence, Foreign Policy, and Macroeconomic Policy- are assigned to the local government level. The centre maintains a coordination and oversight role over the remaining functions.
- Districts now receive a combination of shared revenues, own revenues, a formula-based Recurrent Allocation Grant (RAG) and a formula-based Capital Allocation Grant (CAG)
- The size of local government resources is fixed by law as 25% of total national budgetary resources.
- Civil service reform never took place, so that district officials are unable to hire or fire local (district) government staff

Intergovernmental fiscal picture

Planned and Realized District Revenues and Expenditures (billions of dinars)

	Planned	Realized	Difference
<i>Revenues</i>			
Own-Source	8,294	9,322	-1,028
Shared	20,436	25,488	-5,052
RAG	71,358	71,422	-64
CAG	5,758	5,817	-59
Borrowing	6979	7,493	-515
Total	112,825	119,542	-6,716
<i>Expenditures</i>			
Current	88,572	79,532	9,039
Capital	34,323	26,170	8,153
Total	122,894	105,702	17,192
Surplus/Deficit	-10,069	13,840	-23,909

Current reforms in Rasunia

- Because districts cannot hire and fire, the RAG was adjusted to approved salary levels (as centrally approved) plus a formula-based amount
- Local election law was changed to create local primary election and elected local executive, in order to free local politicians from central party control and to prevent local political stalemates.
- Local governments were given the right to collect any local revenue source approved by the local council.
- Central government is seeking ways to link district plans and budgets to national poverty reduction strategy.
- Efforts are ongoing to harmonise the Decentralisation Law and the Law on Decentralized Finances, which would harmonize the Recurrent Allocation Grant with the minimum service delivery standards for each local functional responsibility.
- Concern over size and distribution of district Capital Allocation Grant.
- Because the level of CAG may be inadequate, ADB has provided funding for an unconditional lending mechanism for the local government level through MOF. The total amount of local borrowing is determined by the volume on loan applications.