

ETHIOPIA

ISSUES IN STATE TRANSFORMATION: DECENTRALIZATION, DELIVERY, AND DEMOCRACY

A Draft Institutional Governance Review (IGR) Concept Note

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A. COUNTRY BACKGROUND

1. Since the early 1990s, Ethiopia has been in the process of transforming its basic institutions responsible for economic development and poverty reduction. Integral to state transformation has the Government's multi-phased strategy for deepening democratic decentralization. The first phase of this strategy involved the creation of a federal state structure based on ethnic regional states responsible for a broad range of the country's political, economic, and social objectives. Through a policy of "balanced regional progress" *inter alia* through the use of formula-driven block transfers and the redeployment of the majority of civil service staff, the Government sought to ensure the viability of regional states, and their executives.¹ Notwithstanding the success of *regionalization*, public sector governance within Ethiopia's regions continued to rely on inherited systems of administrative and fiscal hierarchy that afforded local communities little by way of decision-making or accountability.² Enduring challenges of improving frontline service delivery in priority sectors loomed large.

2. In recognition of these constraints to delivery and democracy, the Government launched a second phase of decentralization designed to shift decision-making closer to the people at the "grass roots level" and to improve the responsiveness of service delivery.³ A series of far-reaching legal, fiscal and administrative measures were rapidly introduced in 2001 in the four most populous regions (Amhara, Oromia, SNNP, and Tigray) to empower the local government sphere—comprising *woredas* and municipalities—to deliver the bulk of basic services in a responsive manner, as well as promote democratization and local economic development. The primary fiscal instrument that regions used to ensure rapid decentralization of delivery responsibilities to *woredas* was a formula-driven, equity-oriented "block" grant. Implemented for the first time in the 2001-2002 fiscal year, this "unearmarked" transfer was expected to empower local authorities and their *kebeles* to make critical allocative decisions and in the process, enhance the responsiveness of service delivery as well as downward accountability. In addition, regions streamlined, and in some cases, eliminated intermediate administrative layers [between bureaus and *woredas*], that is, zonal sections. Regional and zonal staff were rapidly redeployed into administrative pools, accountable to local executives.

3. An important complementary element of this current phase of democratic decentralization is the reform of municipalities or urban centers. Until recently, municipalities were governed by outdated imperial era legislation that was neither conducive to the evolution of financially viable local entities, nor consistent with the constitutional framework for *woredas*. In parallel to *woreda* decentralization, the Government launched efforts to modernize the legal, fiscal, and administrative systems of municipalities that govern urban centers and their rural hinterlands. The ongoing restructuring efforts seek to empower municipalities to undertake service delivery and economic development activities necessary for sustainable and complementary development of urban centers.⁴

4. The institutional, technical, and logistical challenges associated with this rapid transformation process are myriad. In addition to ensuring the short run stability of intergovernmental design, Ethiopia's *Sustainable Development and Poverty Reduction Program* (SDPRP) sets forth a forward-looking agenda for supporting democratic decentralization within regions. This institutional transformation agenda includes clarifying and harmonizing the legal

¹ World Bank. *Regionalization Study*. 2000.

² World Bank. *Woreda Studies*. 2001.

³ Federal Democratic Republic of Ethiopia (FDRE). *Sustainable Development and Poverty Reduction Program (SDPRP)*. August 2002. Ethiopia's SDPRP is the country's poverty reduction strategy.

⁴ World Bank. *Municipal Decentralization in Ethiopia: A Rapid Assessment*. AFTU1. July 2001.

framework for woredas and municipalities (including assignment of expenditure and revenue responsibilities); the continued innovation of sub-regional fiscal instruments such as transfers and other revenue sharing arrangements; the role and functional restructuring of regional bureau as well as woredas and municipalities; the sequenced implementation of civil service (expenditure and personnel management) reforms across spheres of government, and the establishment of sectoral monitoring arrangements as part of the multi-sectoral fiscal system with regions. The democratic aspect of decentralization is considered a priority and specifically, the ability of local communities and civil society to take advantage of new decision-making authority afford to them and hold local executives accountable.

5. In pursuing its objectives of institutional and political transformation, the SDPRP envisages a far-reaching program of capacity building at the federal, regional, and local levels. In 2001, the Government unveiled the comprehensive *National Capacity Building Program* (NCBP), which is designed strengthen working systems, improve organizational effectiveness and rapid develop human resources in the public, private, civil society, and higher education sectors. A super-ministry, the Ministry of Capacity Building, was established to provide policy direction, coordination, implementation support, as well as monitoring and oversight of capacity building subprograms. Counterpart Capacity Building Bureaus were also created in regions in order to support holistic capacity building efforts at the sub-national levels.

6. Of the NCBP's fourteen subprograms, five (Civil Service Reform, District-Level Decentralization, Tax Systems Reform, Justice Systems Reform Subprograms) are directly concerned with promoting the durability, efficiency, and accountability of Ethiopia's ongoing public sector transformation process. These five subprograms are currently being consolidated and organized in form of the flagship *Public Service Delivery Capacity Building Program* (PSCAP), which seeks to enable Ethiopia's federal, regional, and local institutions to deliver public services efficiently and effectively, empower citizens through public participation, and foster a governance environment conducive to value creation.⁵ The design of PSCAP (including the sequencing of various elements of the above-mentioned subprograms) is a work-in-progress. In parallel, the Government is considering fiscal measures to help absorbing the transitional costs of decentralization within regions, and also to support the capital or investment service delivery needs of newly empowered woredas and municipalities.

7. The Government has established a Public Institutions Working Group in order to monitor progress in achieving the institutional transformation and public sector capacity building objectives of the SDPRP. Specifically the Thematic Group would review key elements of state transformation such as woreda and municipal decentralization as well as civil service reforms; support benchmarking public sector institutional performance at the federal, regional, and local levels; and develop strategies for sequencing public sector reforms and capacity building efforts over the medium-run. In addition to key federal institutions such as the Ministries of Capacity Building, Finance and Economic Development, and the Federal Affairs, Ethiopia's regional leadership is keen engage the SDPRP monitoring process and identifying lessons learned from the current phase of state transformation, and its prospects for improving delivery and democratization. It is envisaged that technical assistance and international expertise would be leveraged through IDA and other strategic partners to support the SDPRP monitoring framework.

⁵ FDRE. *Public Service Delivery Capacity Building Program (PSCAP)*. Concept Paper, August 2002. **Annex 1** provides a more detailed description of each of the subprograms within PSCAP.

B. PROPOSED INSTITUTIONAL GOVERNANCE REVIEW (IGR)

8. *Objectives.* A multi-year World Bank and multi-donor financed Institutional Governance Review (IGR) is proposed to support the Public Institutions Working Group of the SDPRP in reviewing the ongoing experience with decentralization within regional states, and assessing its progressive impact on service delivery and democratic empowerment.⁶ The objectives of this IGR will be achieved by (i) reviewing the progress of woreda and municipal *decentralization*, (ii) assessing its impact on the structure and output of *delivery* in priority sectors for woredas and municipalities, and (iii) analyzing prospects for democratic empowerment within the framework woreda and municipal governance.

9. *Organization of the concept note.* The remainder of this section provides an elaboration on the basic IGR concept, the expected outcomes of this study, and linkages to other in-country processes and assistance programs. The concept note will then provide an explanation of the analytical framework proposed for the study (including a commentary on methodology); a discussion of critical issues related to decentralization, service delivery, and democratization along with specific analytical and advisory activities (AAA) proposed as inputs to the IGR; and a description of task teams, deliverable dates, task budget, and quality assurance arrangements.

10. *IGR concept.* The IGR concept draws directly from the Government's strategic vision—delineated in the SDPRP—for improving service delivery and deepening democratization through decentralization. The IGR is therefore to be organized into three parts. Part I of the study, “Decentralization,” will consist of a review of intergovernmental reforms (including legal, administrative, fiscal, and accountability aspects) undertaken over FY2002-2003 including lessons learned about strategic sequencing and other aspects of transformation. Part II, “Delivery,” will examine how the ongoing process of decentralization has affected the governance of service delivery and frontline performance in two priority sectors—primary healthcare and land use management—which represent state and municipal functions respectively. In Part III or “Democracy,” the IGR will attempt to examine how decentralization is affecting prospects for empowering the poor by expanding capabilities and opportunities for exercising democratic choice and accountability.

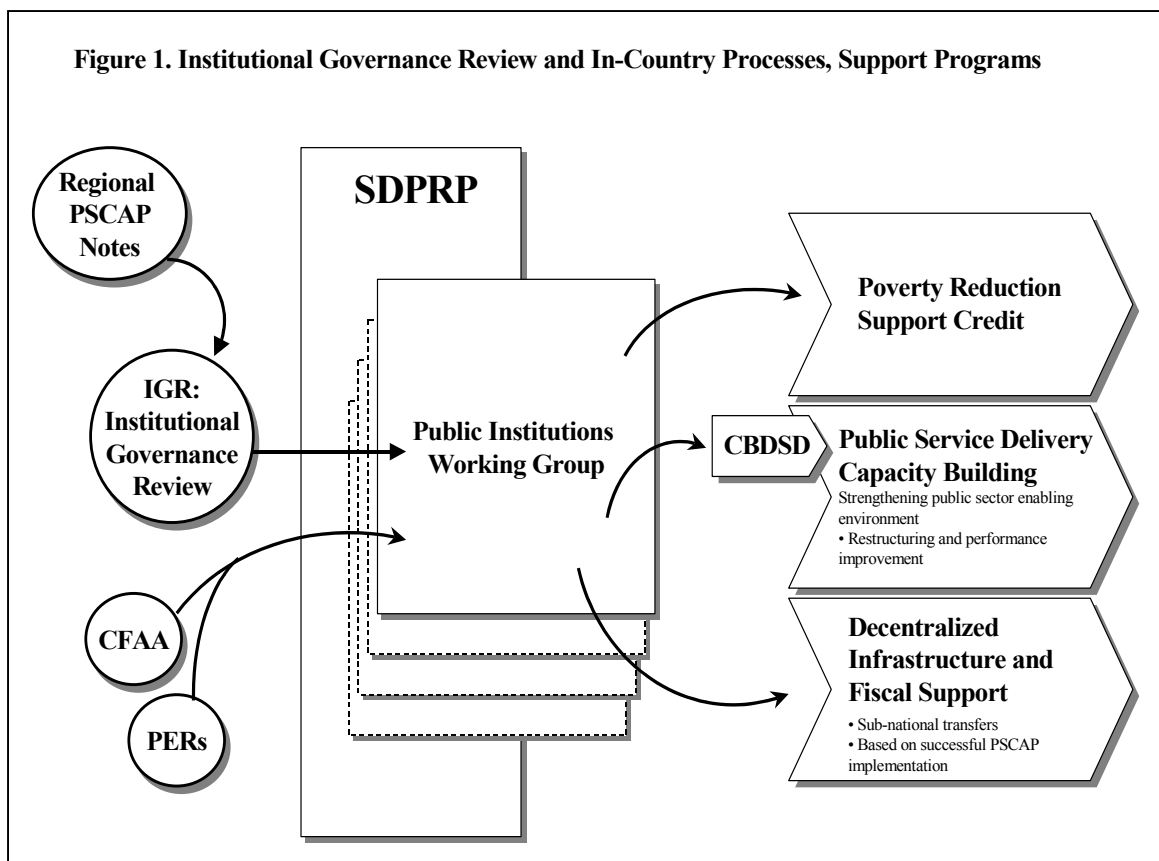
11. The concept was developed in a highly participatory manner through a series of regional and federal consultations undertaken since June 2002. The concept has been reviewed and endorsed by the Minister of Capacity Building, as well as relevant State Ministers and senior officials in the Ministry of Capacity Building (MCB), the Ministry of Federal Affairs (MFA), and the Ministry of Finance and Economic Development (MOFED), as well as the leadership in various regions. It is envisaged that the State Minister of Finance and Economic Development would serve as the key interlocutor for this work. Further details about the management of the IGR are provided in Section G.

12. *Expected outcomes.* This study will be client-led and undertaken jointly by Government and World Bank-led multi-donor teams. Active regional participation in the team is anticipated. Building on its close links with the Government's priorities, as described in the SDPRP and the

⁶ *Institutional and Governance Reviews* or IGRs are a family of analytic instruments designed to bring a greater focus on and understanding of governance arrangements in the public sector and their link to public sector performance. IGRs were first piloted in FY99-00, and have been conducted in Argentina, Armenia, Bangladesh, Benin, Bolivia, Burkina Faso, the Organization of Eastern Caribbean States, Indonesia, Nigeria and Peru. Some common characteristics of IGRs is a focus on institutional performance and its governance underpinnings; the use of empirical methods to benchmarks and understand institutional realities in the country concerned; and the application of these findings to help shape feasible and effective programs of institution-building for client countries.

PSCAP concept documents, this approach will help leverage knowledge generation and knowledge sharing activities to support the implementation of stable, durable, efficient, and accountable local government spheres in Ethiopia. Specifically, this client-oriented IGR is expected to contribute to the following outcomes—(i) establishment of quantitative and qualitative benchmarks for the progress of decentralization and related public sector reforms, as well as the quality of public institutional performance; (ii) identification of effective approaches to sequencing of various institutional reforms supported under PSCAP; (iii) agreement and monitoring of reform commitments identified under the SDPRP; and (iv) more responsive design of capacity building and fiscal support programs.

13. *Linkages to IDA and donor support for SDPRP.* Pursuant to these results, the IGR will be linked to various in-country processes and support programs in the context of Ethiopia's *Sustainable Development and Poverty Reduction Program (Figure 1)*. First, the IGR will build on analytical and advisory activities that have been completed or are currently underway. Several fiduciary and fiscal management reviews undertaken with the support of donors are relevant in this regard including the 2000-2002 *Public Expenditure Reviews* and the 2002 *Country Financial Accountability Assessment*. Findings of previous IDA-financed studies on decentralization such as the 2000 *Regionalization Study*, 2001 *Municipal Rapid Assessment*, 2002 *Woreda Studies*, and pilot surveys of decentralized school governance in Oromia also serve as a starting point for the IGR. Finally, a series of Regional Notes—describing the fast-moving public sector transformation process within regions—have been prepared by multi-donor teams as inputs to the *Public Service Delivery Capacity Building Program (PSCAP)* design process. These IGR will deepen these analyses as well as other ongoing work undertaken by other donors such as DfID, EU, GTZ, the Irish Embassy, and UNDP.



14. Second, the IGR will serve as a key input to the preparation, appraisal, and supervision of the various donor-financed direct and programmatic budget support initiatives proposed in response to the SDPRP. Of particular importance is the proposed IDA and multi-donor financed *Poverty Reduction Support Credit* (PRSC), which will provide direct budget support for reform commitments and output benchmarks—*inter alia* on issues related to decentralization and public sector reform—identified under the SDPRP. In addition, the findings and recommendations of the IGR should inform, in “real time,” the design and implementation of programmatic technical assistance and investment operations including the recently approved IDA-financed *Capacity Building for Decentralized Service Delivery (CBDS) Project*, the multi-donor *Public Service Delivery Capacity Building Program (PSCAP)*, and the proposed *Decentralized Infrastructure Fiscal Support Program*. For instance, benchmarks established under the IGR as well as recommendations for strategic sequencing of cross-cutting reforms (for example, planning and budgeting) and restructuring would be incorporated into the proposed PSCAP Strategy Paper.

C. ANALYTICAL FRAMEWORK AND METHODOLOGY

15. *Elements of intergovernmental design.* Given the focus of the Government’s SDPRP, the appropriate point of departure for framing the analysis in the proposed IGR is current thinking on decentralization, and more generally, intergovernmental design. There is already a considerable practitioner and academic literature on various elements of intergovernmental design. This body of work has helped identify “good practice” approaches to developing enabling legislation; managing the macro-fiscal risks associated with fiscal decentralization; designing incentives into various types of grant instruments to encourage revenue mobilization and service delivery performance; improving geographic and income targeting of fiscal grants; improving expenditure tracking and multi-sectoral performance monitoring; and establishing arrangements to promote participatory budgeting and downward accountability of local governments, along with feedback to sectoral ministries and agencies. Rather than attempting to summarize this vast body of work, the concept note simply highlights four critical elements of intergovernmental design, along with critical success factors, that have been tried and tested in numerous country settings. These are described below and in detail in **Table 1**:

- * Constitutional and legal framework: A robust constitutional and legal framework is necessary to clearly delineate the roles of various tiers of governments; their delivery responsibilities (in line with the principle of subsidiarity); and the fiscal sources that local governments can utilize to carry out their mandates.
- * Intergovernmental fiscal relations: The intergovernmental fiscal system should seek to match the delivery responsibilities with adequate, optimized own revenue sources including sufficiently buoyant direct and indirect taxes (most notably, urban property, automotive, incomes and sales taxes as well as user and development fees). Even if own revenues were optimized, local governments in most developing countries would face a gap between their available resources and the actual fiscal costs of meeting their delivery responsibilities. To fill this “fiscal gap,” governments typically seek to provide a range of predictable and transparent subnational transfers (for example, block, equalization, and conditional grants) that enable local authorities to meet their recurrent and investment needs. In principle, the design of intergovernmental transfers should address both equity and efficiency concerns.⁷

⁷ Bahl, Roy and J. Linn. *Urban Public Finance in Developing Countries*. New York: Oxford University Press, 1992.

Table 1: Elements of Intergovernmental Design—Critical Success Factors

Elements of Design	Critical Success Factors
Enabling legal framework	<p><i>Establishing the local government sphere</i></p> <ul style="list-style-type: none"> * Legal and constitutional framework delineating spheres of government and their mandates * Assignment of delivery responsibilities and fiscal sources (or expenditure and revenue assignments)
Intergovernmental fiscal relations	<p><i>Seeking a match between delivery responsibilities and adequate, optimized own revenues plus transfers</i></p> <ul style="list-style-type: none"> * Autonomy over direct and indirect taxes (including rates) * Buoyancy of revenue bases assigned to sub-national authorities * Incentives for optimizing revenues (including collection methods and compliance measures) * Improvement in revenue collection (including through favorable revenue sharing and compliance measures) <p><i>Seeking transparent, predictable, and fair sub-national transfer system, based on efficiency and equity concerns</i></p> <ul style="list-style-type: none"> * Revenue-sharing arrangements between spheres of government including transfers (including appropriately designed transfer mechanisms for recurrent and investment service delivery needs)
Core systems and administrative structures	<p><i>Embedding expenditure and personnel management systems</i></p> <ul style="list-style-type: none"> * Implications of fiscal design for expenditure management systems including budgeting, planning and prioritization, cash management, accounting, and auditing * Local government civil service systems (for example, unified versus devolved systems) * Wage and grading policy (including special incentive measures) * Merit-based performance management systems in local government (including a clearer demarcation between political appointees and civil or public service posts) <p><i>Streamlining structures</i></p> <ul style="list-style-type: none"> * Role review and restructuring of line ministries, agencies * Developing institutional structures for local governments
Accountability mechanisms	<p><i>Fostering transparency, upward and downward accountability</i></p> <ul style="list-style-type: none"> * Fiscal and output monitoring of transfers (for example, quality of fiscal data, reporting relationships, feedback mechanisms) * Clarification of sectoral role in multi-sectoral fiscal system * Local electoral process and practices * Legislative oversight * Participatory performance tracking, budget process * Administrative recourse and redress mechanisms * Institutional service charters

The experience of several developed and developing countries suggests that a broad array of equity- and performance-oriented revenue raising and sharing instruments can be progressively employed to realize service delivery and local empowerment objectives of decentralization. The use of other complementary instruments including access to debt for creditworthy local governments will depend on the legal and regulatory framework as well as the development of the financial sector.

- * Core systems and administrative structures: The administrative systems underpinning fiscal and personnel management are crucial to ensure that local governments are able to leverage their newly acquired autonomy to improve the efficiency and effectiveness of public resources. Even as flows of discretionary financial resources are increased to local government, expenditure management systems will need to be embedded to improve planning, budgeting, cash or liquidity management, accounting, and auditing. Another priority is the development of merit-based personnel systems that are also able ensure some degree of spatial or geographic balance in the deployment of key staff.

Similarly, administrative structures should also be developed (and in most cases, redesigned) in line with the mandates of various levels of government, as defined in the enabling legislation. In most countries, this requires the review role and function, followed by the restructuring of line agencies that were previously involved in program implementation (or in the case of Ethiopia, regional bureaus). In parallel, the structures of local government will need to be defined and appropriate strengthened consistent with the transfer of core competencies and staff from restructured line agencies.

- * Accountability and feedback mechanisms: Accountability and feedback—whether downward to citizens or upward to federal or regional agencies—involves *inter alia* the timely and reliable use of data to support regular feedback into local and national decision-making processes. *Downward accountability* therefore involves the use of regular reporting on financial and operational performance to local executives and inter-jurisdictional benchmarking (for example, benchmarking of fiscal and operational performance) in order to inform legislative oversight and electoral processes. They could also involve administrative recourse and redress mechanisms, complaints handling systems, and institutional charters. Similarly, *upward accountability* mechanisms include well-established monitoring of sectoral performance from facilities and local governments to higher level authorities. Upward accountability of local governments to sectoral standards and targets tends to be strained in intergovernmental fiscal systems such as that are primarily dependent on spatial grants.

16. The above-mentioned elements provide a robust framework for a “steady-state” analysis of intergovernmental reforms and their impact on *institutional quality* or the institutional endowment in the public sector. In recent years, a growing body of work in formal institutional analysis has identified four “institutional quality” variables that are typically impacted by reform efforts. *At any given level of government* (for instance, federal, regional, or woreda), institutional quality variables are (i) the inclusiveness of planning and prioritization process; (ii) the adequacy and predictability of financial and human resource management; (iii) the flexibility of delivery arrangements; and (iv) the enforceability of various regulations and standards on inputs and outputs. Benchmarking of performance along these four dimensions should help assess the state’s institutional endowment at a particular point in time, and more important, help determine the impact of intergovernmental reforms (including various sequencing strategies) on public sector institutional quality over the medium term.

17. *Issues in the analysis of rapid change in Ethiopia—balancing autonomy with predictability*. Notwithstanding the analytical issues discussed above, IGRs undertaken in settings undergoing transformation in relatively short period of time (for example, Ethiopia, Uganda, South Africa, transition countries in the ECA) face an additional burden—that is, to go beyond a “steady state” analysis and identify the underlying drivers and dynamics of change. Identifying institutional performance problems in the public sector or diagnosing the structural weaknesses and capacity gaps that undermine performance is necessary but not sufficient. It is also important to inquire into the historical and political economy underpinnings of

transformation, and the trade-offs inherent in the change process. Of particular interest is how regions—in deciding on and implementing policy and institutional reforms—balance the political objective of deepening fiscal and administrative autonomy with the overriding need to ensure institutional predictability and durability?

18. A key cross-cutting concern for the IGR is whether and how the *interdependencies and associated sequencing strategies* between various aspects of the intergovernmental system in Ethiopia (for example, the design of fiscal transfers and their implications for financial management roll-out, or the interrelationship between restructuring processes and downward accountability) can increase the likelihood that autonomy is deepened within an acceptable level of uncertainty. Such an approach will help reforming governments develop a strategic stance towards the management of change (for example, sequencing of fiscal and administrative reform).

19. *Implications for frontline delivery outcomes, democratic empowerment.* Countries such as Ethiopia that embark on public sector reforms—such as decentralization or civil service reforms—are ultimately interested in their impact “on the ground,” that is, the extent to which reforms work their way through the governance system in order to promote tangible improvements in frontline delivery and empowerment of the poor. Therefore, IGRs should also measure the impact of institutional change on the access, output efficiency and quality of service provision, as well as the empowerment of the poor *inter alia* through great access to information, participation in decision-making, accountability, and capacity building.

20. *Methodology.* A variety of analytical and advisory activities—described in the following sections—will provide key inputs to the proposed IGR. These will include targeted technical assistance on critical issues (for example, the design of intergovernmental transfers) that draw on “good practice” around the world in addressing key reform issues in Ethiopia. Case-based comparative reviews of regional or sector reform processes will be employed to better understand the dynamics of change as well as the interdependencies between various elements of intergovernmental design. In addition, structured interviews and focus group discussions will be used to gather the views of citizens, civil society leaders, beneficiaries, and public officials on the unfolding process of state transformation.

21. In order to complement the above-mentioned techniques, the IGR will also rely on survey-based techniques—applied in appropriately sampled local jurisdictions—to generate systematic quantitative and perception data on public sector institutional performance, frontline delivery in key sectors, and citizen empowerment. In recent years, the development of such empirical techniques—largely triangulated survey methodology (for example, surveys of public officials, private enterprises, and households)—have enabled reforming governments to benchmark institutional quality using both quantitative and perception data.⁸ In countries with considerable institutional diversity across sub-national jurisdictions (for example, Ethiopia, Argentina, South Africa), survey-based tools are necessary to ensure that findings are based on more than anecdotal evidence.

22. The IGR will draw on the existing body of donor-financed and academic work on public sector institutions and institutional reform in Ethiopia. Linkages with federal and regional level research institutions will be leveraged in the design and implementation of surveys and comparative reviews.

⁸ Manning, Nick et al. *Public Officials and Their Institutional Environment: An Analytical Model for Assessing the Impact of Institutional Change*. World Bank Policy Research Working Paper No. 2427, August 1, 2000.

D. PART I—DECENTRALIZATION

23. Part I of the IGR will review the legal, fiscal, administrative, and accountability aspects of decentralization in Ethiopia’s reforming regions. The accent on Part I will be on the interdependencies between these key elements of intergovernmental design (for example, the legal framework and fiscal design, transfers and expenditure management roll-out) and whether they allow reforming regions to deepen the *autonomy of local jurisdictions within an acceptable level of resource and institutional uncertainty*. This section of the concept note will highlight key issues in the decentralization process in the reforming regions of Ethiopia. In addition, it will identify specific analytical and advisory activities (AAA) envisaged as inputs.

Constitutional and legal framework—empowering woredas and municipalities

24. In launching the “second wave” of democratic decentralization in mid-2001, each of Ethiopia’s four most populous regions undertook far-reaching constitutional and legal reforms designed to clarify the separation of powers (between the executive, legislative, and judicial branches of government), to transfer authority to the *woreda* sphere, and to empower municipalities. Enabling legislation was passed to define the delivery responsibilities of different levels of government as well as the fiscal sources (for example, transfers or own revenues) available to meet recurrent and investment needs. Recent regional consultations suggest that these functional and revenue assignments were delineated and codified in a very short period of time to meet the overriding political objective of woreda block grant implementation. In other words, the development of enabling legislation should be seen as a work-in-progress. Two issues related to this emerging legal framework will likely affect prospects for the development of an accountable local government sphere in both rural and urban areas.

25. *Clarity and consistency of functional assignments across woredas and municipalities.* According to the new legislation, responsibilities of regional states or *state functions* such as primary education and healthcare have been reassigned to woredas and financed largely through the block grant and to a lesser extent, user fees.⁹ Few if any direct taxes are retained by woredas to finance the capital and recurrent needs of delegated state functions. The legal framework for municipalities assigns various *municipal* or *own-source* functions to these urban centers such as management of urban land use, central markets, and abattoirs, as well as waste removal, and street lighting. Urban centers are empowered to retain virtually all their own revenues to finance these types of municipal functions. It is not yet clear whether sub-regional transfers such as the woreda block grant would also be made available to urban centers (or their woredas) to finance the capital or recurrent needs of their state functions (for example, primary healthcare or education). Nor is it evident that regions have adequately provided—through the appropriate assignment of own fiscal sources—for the growth of municipal functions in woredas, particularly those in rural hinterlands of urban areas.

26. *Legal issues in equity- and performance-based access to intergovernmental transfers.* Historically, intergovernmental relations in Ethiopia (originally, federal-regional and more recently, intra-regional relations) have been characterized by a heavy equity-orientation as a means of ensuring “balanced progress.” Underlying the issue of equalization as well as the design of intergovernmental transfers in Ethiopia (for example, the regional subsidies, woreda block grants, and the National Capacity Building Program) is the legal bases for various forms of conditionality in relations between autonomous spheres of government.

⁹ The concept note refers to regional responsibilities reassigned or delegated to woredas and municipalities as *state functions*.

27. Proposed AAA Inputs (1). Local consultancy services will be procured to assess the clarity and the consistency of the legal framework for *state* and *own-source* functions in both woredas and municipalities in reforming regions. The consultancy will also assess the legal basis for conditionality (process, input, and output-based) in intergovernmental transfers between federal, regional, and local levels of government (including federal programs such as the NCBP).

Intergovernmental fiscal design—supporting fiscal transition in woredas and municipalities

28. The legal framework for decentralization provides the basis for the selection and design of fiscal instruments such as intergovernmental grants, revenue-sharing arrangements, as well as the establishment of sub-national borrowing rights. Like other African countries that have undergone rapid state transformation (for example, South Africa and Uganda), Ethiopia has relied primarily on intergovernmental transfers as the primary fiscal instrument for promoting empowerment and responsive service delivery in its largely poor rural jurisdictions.¹⁰ At the same time, there is growing recognition that the success of decentralization depends in part on establishing effective revenue mobilization and revenue sharing in woredas and municipalities.

29. *Framework for financing woreda functions*. In pursuing a strategy of rapid fiscal decentralization, reforming regions have opted to use a single instrument—namely, an “unearmarked,” formula-driven, equity-oriented block grant to woredas—to achieve these SDPRP objectives. The block grant—introduced in FY2002-2003—amounts to approximately sixty to eighty percent of the annual budget of each of the reforming regions, and is intended to help woredas meet the recurrent and investment needs of state functions such as education, healthcare, and agricultural extension. Modeled after the federal subsidy to regions, the woreda block grant was allocated on the basis of a weighted formula comprising three variables—population, the development or infrastructure gap, and revenue performance. Given the overriding importance of equity considerations, regions heavily weighted the population variable in the formula, however, did not provide for existing operations or commitments as a variable. As a result, some woredas received under- or over-allocations vis-à-vis the previous year’s budgets. Despite these design issues, the early experience suggests that regions have adopted a balanced, pragmatic approach.

30. Specifically, reforming regions pursued the block grant as a consolidated, multi-sector funding option for woredas, while simultaneously retaining some degree of control over woreda spending consistent with fiscal transition and regional priorities (for example, education, health, or adequate staffing of remote jurisdictions). When instituting the block grants, regional officials limited the discretion of individual woredas in expenditure assignments through providing budget guidelines on the functional and economic split of expenditures.¹¹ Second, transitional measures were employed to smooth out grant implementation including a rural hardship allowance for officials deployed to remote woredas; a contingency fund that provided additional financing to woredas that were unable to meet existing recurrent commitments; and a health revenue sharing arrangement whereby woredas retained a portion of revenue obtained from cost recovery on basic medical services. In parallel, regions continued to draw on federal programs such as sector capital grants (for primary education and healthcare) that fund specific capital projects that were planned or underway, as well as food security transfers received in both cash and kind. In this manner, fiscal transition in regions was handled in an equitable and “risk aware” manner.

¹⁰ FDRE. *Sustainable Development and Poverty Reduction Program*. August 27, 2002.

¹¹ Based on regional consultations undertaken during PSCAP preparation, October 28-November 7, 2002.

31. Notwithstanding the commendable efforts of regions in implementing the block grant, five critical risk factors remain to be addressed in the context of fiscal decentralization to woredas. First, preliminary evidence from reforming regions suggests that costs of woreda decentralization—including permanent increases in recurrent requirements of new woreda structures—were significantly underestimated, and have contributed to unprecedented, fiscal shock in certain regions such as Oromia. Second, the block grant may become overloaded with a range of sectoral and regional objectives, even through it offers little scope for the conditionalized pursuit of regional priorities. Third, the grant formula has a heavy (although justifiable) bias towards equity that may result in rewarding failure over the longer run. Fourth, the existing capital funding mechanisms available for basic services and infrastructure, particularly the sector specific mechanisms funded by a variety of donors, require immediate reviewed in light of the basic thrust of Ethiopia’s fiscal decentralization objectives. Fifth, there is urgent need to review the incentives for woredas(particularly those in the rural hinterland of urban centers)—through greater tax autonomy—to “grow” their municipal functions over time. Revenues raised by woredas (for example, land use and fertilizer fees, community contributions) are off-set in the existing grant system. Initial survey data also suggests that revenues within woredas are sub-optimal because they are collected in an uncoordinated and arbitrary manner.

32. *Fiscal strategy for municipalities.* Unlike “rural” woredas, municipalities in Ethiopia enjoy full retention of own-revenues from direct and indirect tax sources ostensibly to finance municipal functions. However, municipal level autonomy in setting tariff and tax rates is limited. Information and institutional constraints such as incomplete cadastral surveys and weak administrative capacities limit the ability municipalities to fully exploit existing tax autonomy. More broadly, municipalities are not eligible to receive regional transfers such as the woreda block grant. There is growing acknowledgement across regions that municipalities require a more predictable, transparent, and equitable system—consistent with fiscal arrangements for woredas—to finance state and municipal functions.

33. Proposed AAA Inputs(2): Three analytical activities are envisaged to help reforming regions develop a more *formal transition* to an adequate, predictable, equitable, and sustainable fiscal framework for both woredas and municipalities. These are described below

- (a) A costing exercise is envisaged to assess fiscal implications of woreda decentralization across reforming regions, based on existing functional assignments and prescribed institutional structures (see “Restructuring” section of Part I). The fiscal costs of carrying out both state and municipal functions in urban centers will also be assessed.
- (b) Based on the initial analysis of woreda block grant implementation (undertaken as part of PSCAP preparation), the IGR will finance advisory services to identify the underlying factors affecting fiscal design in Ethiopia (including the Government’s political considerations, path dependencies in public spending, administrative or institutional factors, and citizen preferences), and then to suggest workable options for progressively a comprehensive and predictable fiscal stance towards woredas. Prospects for financing municipal functions through transfers, in addition to own-revenues will be considered. The work will draw on instructive examples from decentralizing states in Africa, Latin America, and South Asia.
- (c) Consultancy services will be procured to assess the impact of various revenue mobilization and revenue sharing arrangements in woredas and municipalities, and identify options for deepening tax autonomy in a predictable manner, and in step with the evolving grant system.

Public financial management—adapting systems, sequencing reforms

34. The current wave of decentralization was launched in the context of an ongoing comprehensive, homegrown Civil Service Reform Programme (CSRP), which has been under implementation since the mid-1990s. The Expenditure Management and Control Program (EMCP)—a key pillar of the CSRP—has taken on added importance in light of the Government’s fiscal decentralization program. EMCP seeks to modernize planning, budgeting, accounting, cash management, and auditing systems, and also develop the accounting and auditing professions. Notable progress has been made in prototyping legislative reforms, policies, procedures, and systems related to financial management, primarily at the federal level, over the 1996-2000 period. Key milestones include the adoption of a new chart of accounts; the introduction of a double-entry, modified cash accounting system; reduction in the backlog of federal and regional accounts; the development of a macroeconomic and fiscal framework (MEFF) to guide a medium-term public investment program (PIP). In the past year, the Government has sought to facilitate the transition from a dual to an integrated budget system (notably through the integration of ministries of finance and planning); build political commitment to transition from an incremental budget to three-year rolling budgets; and deepen the implementation of expenditure management reforms in some regions (such as SNNP).

35. Since the introduction of woreda block grants over FY2002-2003, reforming regions have quickly recognized that sustainable and successful fiscal decentralization depends on rapid adaptation and roll-out of expenditure management reforms at regional and sub-regional levels.¹² Given the limited absorptive capacity of expenditure management systems, a key strategic issue for reforming regions is to clarify priority institutional reforms (for example, financial regulations, adoption of a new chart of accounts), procedures and systems (for example, planning, budgeting, and accounting), and human resources that should be sequenced at various levels of government. Moreover, the overriding short term priorities of block grant implementation—namely, in-year and multi-year resource predictability as well as timely and accurate monitoring of grant utilization—also imply a certain road map for the roll out of financial management reforms (**Annex 2**). As a broader range of priorities emerge in the implementation of the woreda grants (such as output efficiency and service quality), more sophisticated demands will be placed on expenditure management systems, thereby clarifying further the likely medium-term requirements of sequencing.

36. In most countries that utilize sub-national fiscal grants, benchmarking of local government performance—and specifically grant utilization—is an important tool for managing the fiduciary risks of rapidly enhancing expenditure autonomy. A key element of the public financial architecture in decentralized settings, benchmarking can also help monitor compliance with process and capacity requirements for access to various fiscal sources such as capital grants. Issues related to fiscal monitoring of transfers and expenditure management more broadly is discussed in the section on “Monitoring performance.”

37. Proposed AAA Inputs (3): To better understand the public financial management reform requirements of fiscal decentralization, joint comparative work on the implementation of expenditure management reforms at the regional and local levels will be carried with the support for AFRITAC, DfID, as well as local consultants. Of particular interest is the proximate impact of various approaches to sequencing expenditure management reforms under the Expenditure Management and Control Program (for example, planning, budgeting, accounting, cash management, and auditing) on the resource predictability and utilization, and their likely impact

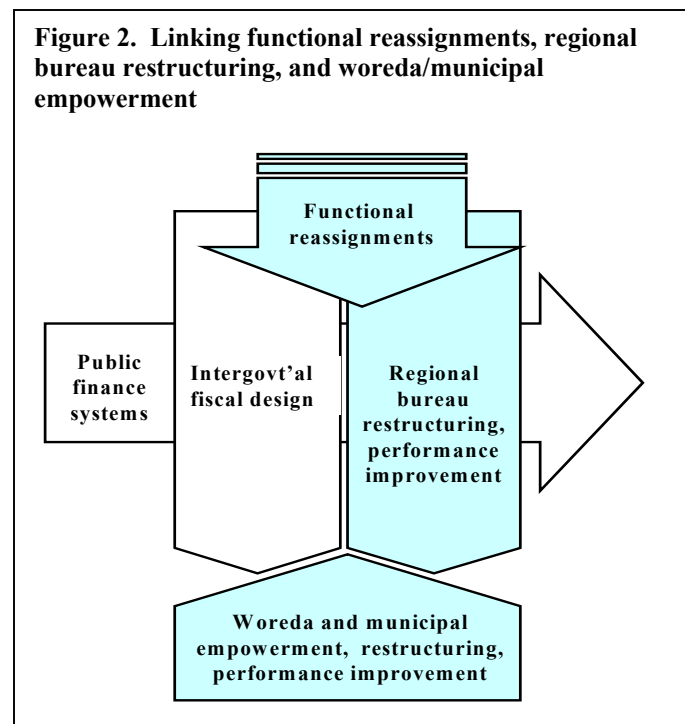
¹² Joint Communiqués on PSCAP preparation from Tigray and Oromia. November 2002.

on the efficacy of grant monitoring (by regional bureaus).¹³ Based on its findings, the review will propose “better practice” approaches to sequencing of financial management reforms in the context of fiscal decentralization, as well as indicators for monitoring fiscal and financial performance at regional and sub-regional levels.

Restructuring—administrative structures, strategic staffing, and performance improvement

38. With the launch of fiscal decentralization, reforming regions embarked on an initial phase of restructuring for regional bureaus and woredas. Similar efforts are underway in the municipal governments of urban centers. The experience of other developed and developing countries suggests that these types of critical restructuring and strategic staffing efforts tend to lag intergovernmental fiscal reforms (for example, the introduction of block or other types of grants). Moreover, the introduction of performance or results-orientation with restructured sub-national institutions is not automatic and therefore will require more deliberate efforts. In so, doing they may forestall progress in deepening decentralized democracy and service delivery.¹⁴ From this vantage, three factors in Ethiopia are likely to be pivotal in ensuring that restructuring results in improved efficiency and accountability. These factors are the viability of institutional structures at the regional and sub-regional level; the affordability of staffing arrangements; and the credibility of CSRP’s performance improvement system as a mechanism for enhancing the output- and results-orientation of civil service institutions.

39. *Viability of institutional structures.* As an integral part of the current wave of decentralization in FY2002-2003, Ethiopia’s reforming regions began establishing basic administrative or institutional structures for woreda and municipal governments based on general prescriptions by the Ministries of Capacity Building, and Federal Affairs. At the same time, functional reassignments by reforming regions implied a set of requirements in terms of administrative restructuring of regional bureaus, and the transfer of core competencies to the local level. There are already indications that functional reassignments in priority sectors (for example, health and education) and prescribed structures for woredas and municipalities are in all cases not consistent or sustainable. Furthermore, the fiscal costs of the new woreda structures were considerably higher than expected, in some cases, are contributing to fiscal “shocks.” Finally, as reforming regions continue their restructuring efforts, there will be need to develop *process change* modalities—such as the CSRP’s Performance and Service Delivery Improvement Program—that systematically link reassignment of functions to role restructuring of bureaus and woreda or municipal empowerment (**Figure 2**).



¹³ Data for the comparative review of financial management reforms will be generated through the woreda and municipal benchmarking exercise (see the “Monitoring performance” section).

¹⁴ Burki, Shahid Javed, et al. *Beyond the Center: Decentralizing the State*. Washington, DC: World Bank, 1999.

40. *Performance improvement.* Even as it seeks to deepen fiscal and administrative autonomy through decentralization, the Government has sought to introduce and institutionalize a comprehensive system of performance improvement—namely, the Performance and Service Delivery Improvement Program (PSIP)—across civil service institutions as part of the second phase of the CSRP.¹⁵ The initial steps required of ministries, authorities, and regional bureaus (MABs) include the development of civil service action plans and realization of “quick wins,” which are rigorously monitored by the CSRP Coordinating Office. Progress in preparing these plans and realizing quick wins enables an MAB to move further along the performance improvement chain through *inter alia* the development of multi-year strategic plans, identification of output targets, as well as the preparation and implementation of a service improvement and restructuring plans (for example, consideration of outsourcing, contracting out, joint management, autonomization and other options). As a flagship initiative, this performance improvement system is intended to promote demonstrable improvements in the operations of MABs as well as woreda and municipal institutions, and thereby generate frontline results. Efforts to implement the performance improvement system are underway in the Addis Ababa City Administration as well as select federal institutions such as the Ministry of Inland Revenue and Ethiopian Investment Authority. Within reforming regions, the credibility of the PSIP will depend on several factors—its linkages to woreda, municipal, and bureau restructuring; the degree to which it provides predictability and stability in the context of a rapidly evolving intergovernmental system; and ultimately, the ability of citizens to engage the PSIP process as a means of demanding accountability from public institutions.

41. *Strategic staffing.* A priority across levels of government in Ethiopia is to relieve endemic and severe staff shortages in generalist and specialist posts, as well as ensuring strategic deployment of staff to fully meet functional assignments at the regional and local levels. In the context of decentralization, newly prescribed woreda and municipal structures imply staffing arrangements that, in all cases, may not be realistic or appropriate. The resulting upward pressures on vacancy rates across local jurisdictions is particularly acute in remote, rural areas. In response, reforming regions have implemented a variety of “risk aware” measure to ensure that basic functions are carried out during the transition period. These include a rural hardship allowance designed to attract qualified financial management staff to remote areas, as well as staff pooling arrangements to ensure that various offices or sections in woredas are provided appropriate support services. The efficiency and effectiveness of such measures—especially the pooling arrangements—in meeting the new functional requirements of devolved woreda and municipal government should be reviewed in the near future.

42. More broadly, problems in attracting and retaining staff in Ethiopia have been related to low wage levels as well as overly opaque job and grading systems at the federal, regional, and local levels of the Ethiopian civil service. Efforts are underway in the context of the CSRP to implement a comprehensive remuneration or salaries policy within the three-year Macroeconomic Fiscal Framework based on a simplification of the job and grading system.¹⁶ To be useful as a prototype for reforming regions, this job evaluation will also need to consider the bulk of woreda and municipal posts such as those of finance and sector program officers, and also frontline workers such as primary school teachers, nursing assistants, and extension workers. It would also need to consider outsourcing options, particularly for locally provided services. Only then would the remuneration and job grading policy provide a realistic, affordable framework within which regional and local restructuring can take place.

¹⁵ FDRE. Draft Operational Manual for Performance and Service Delivery Improvement Program (PSIP). *Capacity Building for Decentralized Service Delivery Project*. 2002. See Annex 3 for description of the PSIP.

¹⁶ World Bank. *Ethiopia Structural Adjustment Credit*. Memorandum of the President. 2001.

43. Proposed AAA Inputs (4): As a key input, a comparative review of restructuring in reforming regions will be financed using international and local experts. This restructuring review will assess the formal and informal processes and methodologies used for implementing functional reassignments, establishing institutional structures for local governments, redeploying staff, and establishing new accountability relationships for personnel within sub-regional institutions. It will also incorporate specific case studies of the implementation of the performance improvement system at the federal and regional level as well as in municipalities such as Addis Ababa. Of critical concern in these restructuring reviews are the interdependencies between strategic staffing and intergovernmental fiscal design; the utility of the PSIP modality in ensuring that restructuring processes are predictable, transparent, and credible; the institutional path dependencies (for example, bureaucratic interests, capacity constraints) that shape the restructuring process; and the role of key stakeholders such as bureaucrats in key control and sector bureaus as well as citizens.

Monitoring performance, strengthening feedback

44. Ethiopia’s approach to decentralization—and in particular, its use of “unearmarked,” equity-based entitlements or block grants—poses new challenges for monitoring sectoral as well as local government performance. Specifically, reforming regions face the two-fold challenge of promoting the accountability of woredas and municipalities to the SDPRP’s service delivery objectives as well as its decentralization objectives.

45. *Monitoring implementation of sectoral objectives in a decentralized setting.* From the perspective of the SDPRP’s service delivery objectives, woreda block grants (like regions subsidies) provide for only weak-to-moderate input criteria (for example, indicative guidelines for recurrent and capital allocations) and no explicit output criteria (for example, sectoral output indicators). The monitoring challenge for sector management within regions (for example, bureaus, zones, woredas, and municipalities) is to preserve and improve vertical monitoring, on a sectoral basis, of financial and other inputs as well as outputs. Carrying out effective sectoral monitoring in a system based on primarily spatial grants is ultimately a problem of coordination. Other countries that are currently developing approaches to sectoral monitoring of multisectoral grants including South Africa and Uganda. In such cases, key milestones include the development of robust interagency arrangements to support monitoring, consensus on a common monitoring framework with “capacity light” requirements from local governments, and the establishment of clear sanctions for non-compliance with reporting requirements.

46. *Benchmarking local government empowerment and performance.* An equally important strategic concern for reforming regions (as articulated in the SDPRP) is how efficiently newly empowerment local executives are managing their fiscal independence. There is currently no formal system of woreda and municipal benchmarking that rates basic elements of local government performance such as revenue performance, expenditure and human resource management, and responsiveness to local needs. In addition to vouching for the fiduciary concerns associated with rapid fiscal decentralization, such a benchmarking system would enable reforming regions to monitor in “real time” the development and sustainability of the local government sphere. As the fiscal system within regions evolves, an additional concern is the actual degree of fiscal autonomy that local entities enjoy over the medium run.¹⁷

¹⁷ The experience in African countries undergoing rapid transformation suggests that the level of tax and expenditure autonomy afforded to local government can vary considerably over time. The use of primarily unearmarked, multi-sectoral grants to meet the recurrent and capital needs of local government has in some cases given way to a proliferation of sector-specific conditional grants.

47. Proposed AAA Inputs (5): Two inputs are envisaged to assess prospects for monitoring of sectoral performance and progressive development of a democratic local government sphere.

- (a) A consultancy will be procured to help assess how sectoral and fiscal monitoring systems within reforming regions are evolving in response to fiscal decentralization. Of particular interest are the emerging coordination arrangements between sectors (at the bureau, zonal, or woreda levels) that are needed to support monitoring of input and output performance of woreda block grants. In addition, data quality, vertical and horizontal reporting arrangements, and feedback mechanisms will be reviewed. Building on the CFAA and various sectoral reviews of M&E systems, consultancy will seek options for improving the quality and timeliness of information flows as well as the “policy levers” available within the emerging intergovernmental system to ensure sectoral accountability.
- (b) Also the IGR will support a survey-based woreda and municipal benchmarking exercise—covering a stratified sample of local jurisdictions. It will survey processes and outputs related to core public management functions (such as financial management, human resource management, and responsiveness) as well as fiscal autonomy (such as tax and expenditure autonomy). Where it is appropriate, the survey will build on existing instruments and benchmarks already employed in Ethiopia, for example, in the context of HIPC tracking as well as the *Woreda Studies* and the *Municipal Rapid Assessment*.

E. PART II—DELIVERY

48. Part II of the IGR attempts to understand the legal, fiscal, and structural implications of decentralization for service delivery in specific sectors. As noted in the discussion in decentralization, an emerging strategic issue for reforming regions is the degree to which they are able to clearly delineate and finance *state* functions as well as *municipal* or *own-source* functions in all jurisdictions. This section of the concept note proposes more in-depth analysis of prospects for efficient and effective provision of primary healthcare services (a state function) and land management services (a classic own-source or municipal function). Specific AAA are proposed as key inputs to Part II of the IGR. Reviews of decentralized delivery for other state and municipal functions will be undertaken separately including through the UPAS exercise, the proposed Poverty Assessment, and other sectoral AAA interventions.

Decentralized delivery of primary healthcare

49. Ethiopia ranks as one of the poorest countries in terms of health status. Poor access, low levels of utilization, and inadequate service quality constitute significant constraints on health outcomes in Ethiopia. While approximately 90% of facilities in the health system are public, Ethiopians continue seek care outside the public sector about 38% of the time in part due to distance to clinics and low quality. In seeking to address these constraints, Ethiopia’s Health Sector Development Programme’s (HSDP)—which is entering its second phase—has sought to increase access and coverage of health services and to improve service quality through training and an improved supply of necessary inputs at regional and woreda levels. The Government is pursuing these objectives *inter alia* by strengthening the decentralized management of health services at the federal, regional, and local levels, and encouraging private sector and NGO participation in the provision of primary healthcare. Notably, HSDP II is intended to be

implemented in the context of Ethiopia's ongoing public sector transformation program including efforts to deepen democratic decentralization and civil service reform at all levels.¹⁸

50. During the first phase of HSDP implementation, the Federal Ministry of Health established a management system with clearly defined fiduciary, inspection, and monitoring responsibilities at the federal and regional levels of the health pyramid. This degree of clarity, coherence, and capacity is yet to materialize at the sub-regional levels—that is, between regional health bureaus, zonal and woreda health teams, or woredas health teams and councils. Therefore, the key challenge for the sector, especially within regions, is to strike a balance in its efforts to empower woredas (and their health teams) in undertaking planning, financing, and implementation functions while maintaining mechanisms for technical support and monitoring. In addressing this challenge, regional and sub-regional stakeholders in the health sector will need to contend with four issues which should provide the focus for the Part II of the IGR.

51. First, the approaches that reforming regions have taken in reassigning key functions related to primary healthcare provision across the regional, zonal, and woreda levels (for example, planning and budgeting, procurement of drugs, and hiring and firing of frontline workers) has far-reaching implications for access, utilization, and efficiency. A related issue is the way in which regions have assigned responsibility for primary healthcare provision in municipalities. In some cases, regions have assigned responsibilities for health provision in certain urban centers to neighboring woredas, which are financed through the block grants.

52. Second, the consistency between costed functions and assigned fiscal sources will be critical in determining the affordability of the emerging decentralized system of primary healthcare in reforming regions. In other words, policymakers in the health sector have a view on whether the block grant instrument in combination with other measures such as retention of medical fees can meet the adequacy, predictability, and sustainability criteria of primary healthcare financing in Ethiopia's reforming regions.

53. Third, the size and spatial allocation of the frontline workforce is currently a key constraint on improve access, utilization, and efficiency in primary healthcare provision. The health worker/population ratios for Ethiopia are three to four times lower than those in neighboring African countries. Endemic staff shortages across all categories of healthcare providers are exacerbated by the maldistribution of health workers between urban and rural areas, and high attrition due to migration to the private sector and brain-drain. The prospects for achieving the national objective of rapidly expanding workforce size (including the proposed development of a kebele extension service) in a decentralized setting.

54. Fourth and finally, the delivery of primary healthcare services will ultimately depend on how facilities are managed within the constraints and capabilities of woreda and municipal governance. The implications for broader changes in the fiscal and administrative system will ultimately depend on how accountability relationships within local jurisdictions between health facilities, local government officials, and clients evolve. The local pressures on facilities to perform is a critical success factor which depends in part on the role of local executives (and local health officials), the openness of local governments to alternative arrangements for healthcare provision, and the power of clients and consumers to demand accountability (either through local political accountability or choice).

¹⁸ FDRE. *Health Sector Development Program II*. Draft. 2002.

55. Proposed AAA Inputs (6): Two inputs are proposed to review the structure and output of primary healthcare provision in the context of decentralization within reforming regions.

- (a) A comparative review of the system of primary healthcare provision within woreda and municipal government will be undertaken by international and local experts. The review will be based on in-depth interviews with public officials and providers in the health system and should investigate the functional reassignments undertaken for the essential package of primary health services in reforming regions; the degree to which block grant financing meets woreda and municipal level capital and recurrent needs; the organizational and institutional arrangements for administering public facilities (and interfacing with local officials); and the nature of the monitoring and standards-setting challenge for the sector in reforming regions.
- (b) Equally important is a view of facility level performance. It is proposed the facility level survey under implementation as part of the *2003 Public Expenditure Review* be augmented to include all the reforming regions. The augmented survey would capture a broader range of institutional and fiscal issues to assess how facilities are responding—operationally—to the legal, fiscal, and administrative reforms associated with woreda decentralization. Data from this augmented facility survey as well as other planned surveys (woreda benchmarking and the Government’s planned household survey) would be used for more formal analysis of the structural and institutional determinants of efficiency and effectiveness in healthcare provision across Ethiopia’s reforming regions.

Land use administration

56. The SDPRP views land provision and efficient land use administration as essential urban services, critical to poverty reduction processes in Ethiopia’s urban centers and their rural hinterlands.¹⁹ A basic municipal or own-source function, local land use planning and administration should aim to minimize bureaucratic impediments to securing land, promote high yield investments, and promote the optimal generation of rental revenue for investment in other public services (for example, infrastructure) necessary for local economic development. Ethiopia’s municipalities—to varying degrees across regions—are charged with the following responsibilities related to land management: preparing and enforcing land use plans for plots within their jurisdictions; reviewing and recommending for approval by regional authorities applications for land use and investments; and collecting land use rents, which constitute a potentially significant source of own-source revenues. Ongoing municipal reforms and restructuring efforts can have potentially far-reaching impact on the ability of urban centers to carry out these above-mentioned functions.

57. Three issues are critical to the evolving role of municipalities in land use management. First, there is a lack of clarity in the legal framework governing urban land use including the powers and functions assigned to various levels government. While successive regimes since the imperial era have sought to revise the legal framework for urban land use and management (including the 2002 lease law), new laws have been typically superimposed on existing legislation, bye-laws, and regulations without due consideration to consistency and clarity. The resulting uncertainties in the legal framework appear to have adversely affected the investment climate within urban centers. Second, absent clear criteria and enforcement mechanisms for expropriation of (and compensation for) privately occupied land have also prevented municipalities from effectively planning for land development within their jurisdictions. Third, institutional weaknesses in land management such as land survey and cadastral systems prevent

¹⁹ FDRE. *Sustainable Development and Poverty Reduction Program*. August 27, 2002.

municipalities from optimally extracting land and property rates and taxes. Ongoing efforts at municipal restructuring should ideally address the above-mentioned gaps in order contribute to improve own-source revenue mobilization and ultimately, adequate financing of a broader range of municipal functions in urban centers.

58. Proposed AAA Inputs (7): Two AAA are proposed to assess the impact of the ongoing decentralization process on prospects for effective land use management in municipalities across Ethiopia's reforming regions. These are described below:

- (a) Building on work undertaken with GTZ support in the City of Addis Abeba, an international consultant will be recruited to help revise federal urban land legislation and develop regional prototype regional legislation (based on the Addis model). This work on the legal and policy framework will include clarification of functional reassignments undertaken for the various (legal and non-legal) methods of land acquisition, definition of the government's to regulate the use and development of the land as well as expropriate privately occupied land.
- (b) Local consultancy services will be employed to conduct a rapid assessment of land survey and cadastral systems will be undertaken to assess the institutional capabilities of municipalities to extract land and property rates and taxes, as well as the potential revenue impact of appropriate capacity building efforts in the land use departments of select urban centers across reforming regions.

F. PART III—DEMOCRACY

59. In addition to improving the responsiveness and efficiency of service delivery, woreda and municipal decentralization is expected to promote the democratic empowerment of Ethiopia's citizens at the grassroots level, particularly the poor. According to the SDPRP, decentralized democracy is central to Ethiopia's ongoing "political transformation" and should contribute to the evolution of accountable, transparent, and modern state institutions. Two aspects of the political transformation in particular warrant further analysis in the context of decentralization and will form the basis for Part III of the IGR. These are (i) the emergence of sub-national executives and legislatures, and (ii) the empowerment of local communities within the framework of woreda and municipal governance.

Exercising executive and legislative authority

60. As part of the current wave of democratic decentralization, reforming regions embarked on a series of constitutional and legal reforms that sought to empower woredas and municipalities as executives unto themselves, while simultaneously establishing appropriate checks and balances on executives by clearly delineating the separate branches of government (executive, legislative, and judicial) at all levels. A key issue for SDPRP monitoring is how legal and institutional reforms introduced in FY2002-2003 are affecting the exercise of executive and legislative authority in Ethiopia's regions, woredas, and municipalities. At the regional level, the emerging role of legislators during the prioritization and appropriations processes is a critical indicator of open, contestable policymaking. Also significant is the ability of regional assemblies to carry out oversight responsibilities *inter alia* through budget monitoring, policy review, and engagement with civil society and the media. At the local level, the early experience of elections in municipalities as well as the attempts to empower woreda executives should provide insights into the factors motivating political candidates as well as those holding elective office, their ability to

effectively represent local preferences, and ultimately, their accountability to local constituencies for the delivery of services.

Empowering local communities

61. An overriding priority of the SDPRP is to ensure that local communities—particularly the poor—take full advantage of the opportunities that decentralization provides *inter alia* by participating in, negotiating with, influencing, controlling, and holding to account the institutions of woreda and municipal government.²⁰ The challenges that local communities, as well as historically disenfranchised groups, face in the context of woreda and municipal governance are myriad. These include (but are not limited to) influencing local government planning and budgeting processes, gaining access to critical information related to service delivery and local economic development (for example, employment opportunities, pricing of various urban services, administrative procedures for procuring licenses, recourse and redress mechanisms); building coalitions around specific issues and concerns (for example, access to water or other municipal services); and holding government officials accountable (for example, through electoral processes, resource and redress mechanisms, and investigative media).

62. In meeting these challenges, several recent studies suggest that the residents of woredas and municipalities have to contend with a variety of formal and informal constraints such as basic nutritional deficiencies, exclusionary customs and practices, unequal gender relations, and lack of education.²¹ Historical patterns of governance within kebeles can also affect the ability of citizens to build coalitions, federate community organizations, and ultimately, give expressions to new preferences and priorities, particularly of the poor. The democratic character of decentralization will likely depend on sub-woreda, sub-municipal, and kebele level efforts to undertake collective actions that demonstrably enhance the asset base and capabilities of Ethiopia's rural and urban poor.

63. Proposed AAA Inputs (8): The following expert and survey-based assessments of democratic governance are proposed as inputs to Part III.

- (a) An international consultant will be hired to conduct a comparative analysis of political governance trends at the regional as well as the municipal and woreda levels. The review will assess the impact of recent legal and institutional reforms on the ways in which executives and assemblies (or legislatures) function within reforming regions. Critical issues will include the ability of legislatures to carry out both prioritization and oversight functions at the regional level, the extent to which woreda and municipal officials exercise autonomy on key issues related to public management (particularly in priority sectors such as health and education), the robustness of formal checks and balances (for example, the judiciary) on executive authority, and finally, the role of civil society and local communities in holding public officials accountable.
- (b) A household survey in woredas and municipalities is proposed to benchmark the empowerment of communities by (i) taking stock of the organizations that Ethiopian citizens at the local level associate with, have access to, participate in and use at different times and for different purposes; (ii) categorizing the mechanisms (formal and informal) that mediate citizens access and use of these organizations for purposes of public decision-making; (iii) analyzing the relationships/level of interaction between these organizations and local

²⁰ World Bank. *Empowerment Sourcebook*. 2002.

²¹ World Bank. *Woreda Studies*.

government (kebeles, woredas, municipalities, and regional councils); and (iv) identifying the empowerment/capacity building needs of these organizations. It is envisaged that the survey will be undertaken in a sub-sample of jurisdictions covered by the municipal and woreda benchmarking survey in order to allow for analysis of the governance underpinnings of local level empowerment.²²

G. IGR MANAGEMENT AND PREPARATION

64. The management and quality assurance arrangements, as well as time-bound deliverables and estimated budget for the preparation of the IGR are described below.

Task Teams

65. In keeping with a client-oriented approach, the study will be supported jointly by FDRE and World Bank multi-donor teams. It is envisaged that the Government's SDPRP Working Group on Public Institutions would serve as key technical level counterpart for the preparation of the IGR. The Working Group includes *inter alia* key technical experts from the Ministries of Capacity Building, Federal Affairs, Finance and Economic Development (including the Department of Regional Affairs), as well as the Federal Civil Service Commission. The participation of Bureaus of Capacity Building, Civil Service, and Finance and Economic Development from the four reforming regions is also anticipated.

66. The World Bank's multi-donor team for this IGR will be led by Navin Girishankar, AFTPR (Task Team Leader) and will include the following three sub-groups. The sub-group for **Part I** will include Elsa Araya, AFTPR; Kevin Brown, Consultant (strategic staffing, performance improvement, bureau restructuring); Nazmul Chaudhury, DECWD (woreda and municipal benchmarking); David DeGroot, AFTU1 (local government development); Duncan Last, AFRITAC (cash management and treasury operations, and strategic sequencing of expenditure management); David Savage, Consultant (intergovernmental fiscal design); and Vivek Srivastava, EWDSA (local government structures). For **Part II**, sub-team members will include Anwar Bach-Baouab, AFTH3 (decentralized management of primary healthcare); Luc Christiaensen, AFTP2 (augmented facility survey); and David DeGroot, AFTU1 (land use management). For **Part III**, the sub-team will be comprised of Joel Barkan, Consultant (political governance, democratic empowerment); Maria Correia, AFTES; Ruth Alsop, PRMPR; and Jalal Abdel-Latif (WBIRC). In addition, local and international consultants will be hired by the Bank and other donors to contribute to the work of the sub-groups.

67. In addition, close collaboration with colleagues of the Country Team will be an important feature of the IGR's preparation process. Regular consultations and informal peer review will be from key country team colleagues. Strategic advisory support will also be leverage from the Africa Region's CDD Secretariat (empowerment issues), PREM (public officials survey methodology, intergovernmental design, empowerment), WBIRC (decentralization), and FPSI (urban management issues). Finally, opportunities for collaboration with other interested partners including AFRITAC, Dfid, European Commission, GTZ, and USAID will be pursued.

²² It is expected that these AAA activities will serve as diagnostic work upstream of the proposed Civil Society Capacity Building Program.

Formal Peer Review and Quality Assurance

68. The peer reviewers for the IGR are Anand Rajaram (Senior Economist, PRMPS), James Hicks (Consultant, AFTU1), April Harding (Senior Economist, HDNHE), Yasuhiko Matsuda (Senior Public Sector Specialist, LCSPS), and Michael Stevens (Lead Public Sector Development Specialist, AFTPR). Additional internal peer review comments will be sought from key sectors within the Bank and from donor partners including DfID, EU, GTZ, and the Irish Embassy.

Deliverables and Dates

69. The proposed IGR is intended to be a multi-year exercise that produces analytical and advisory inputs—in “real time”—for the purposes of SDPRP monitoring as well as PRSC1-2 and PSCAP preparation. Specific AAA inputs (such as survey findings, comparative reviews, case studies) will be jointly prepared by the FDRE and World Bank teams and should provide content for the FDRE-World Bank dialogue on decentralization, service delivery, and empowerment over the FY03-05 period. **Annex 3** provides a tentative timetable for the various AAA deliverables proposed under Parts I-III of the IGR. It should be noted that certain advisory activities are already under way in the context of PSCAP Preparation. Table 2 provides detailed comments on activities that have been scoped or initiated under PSCAP or the PRSC. The additional time requirements are also indicated.

70. Parts I-III will be compiled in draft form as the relevant AAA inputs are completed over FY04-05. A final volume, combining inputs from Parts I-III, will be produced by the World Bank team by August 30, 2004 for review by the Government. It is envisaged that the final synthesis report would serve as a record of the issues and empirical evidence on public sector transformation in Ethiopia and possibly, as a foundation for a third generation of AAA on public sector decentralization in the FY06-08 CAS.

Budget and Disbursement Profile

71. The total estimated costs for the IGR are \$189,680, *excluding Bank staff costs and survey costs*, over the FY03-05 period. A detailed breakdown is provided in **Annex 4**. It is important to note the financing requirements are for activities proposed *in addition* to existing work underway in the context of PSCAP and the PRSC. Based on the timetable and projected budget, the following disbursement schedule is expected over the FY03-05 period.

Table 2: Expected Disbursement Profile

FY	Qtr	Expected
FY03	3rd	5%
	4th	5%
FY04	1st	25%
	2nd	25%
	3rd	20%
	4th	15%
FY05	1st	5%

72. Financing for the three proposed surveys, costed at approximately \$140,000, and the various international consultancies will be sought from a variety of sources including existing PHRD Grant Facilities, relevant trust funds, and interested donors.

ANNEX 1. OVERVIEW OF KEY ELEMENTS OF THE PUBLIC SERVICE DELIVERY CAPACITY BUILDING PROGRAM (PSCAP)

Civil Service Reform Program

In the mid-1990s, the Government recognized the urgent need to address the wide array of capacity constraints that hindered the performance of public institutions in Ethiopia. Core public management systems at the federal and regional levels were hampered by outdated civil service legislation and working systems; the absence of a medium-term planning and budgeting framework; ineffective financial and personnel management controls; inadequate civil service wages and inappropriate grading systems; poor capacity for strategic and cabinet-level decision-making; and insufficient focus on modern managerial approaches to service delivery. In recognition of these constraints, the Government embarked on a comprehensive *Civil Service Reform Program* (CSRP) in 1996. Indicative of Ethiopia's "first generation" capacity building efforts, the CSRP sought to build a fair, transparent, efficient, effective, and ethical civil service primarily by creating enabling legislation, developing operating systems, and training staff under each of the five pillars: (i) Expenditure Control and Management, (ii) Human Resource Management, (iii) Service Delivery and Quality of Service, (iv) Top Management Systems, and (v) Ethics. Successful efforts (for example, budgeting, planning, and accounting reforms) at the federal level were intended to provide *prototypes* for regional authorities.

The CSRP was implemented over the 1996-2000 period, albeit with intermittent lags due to poor coordination, particularly during the border conflict. The results of these effort were mixed. Notable achievements included the development of new legislation (for example, a financial management proclamation, a civil service law, a code of ethics, complaints-handling procedures, and a service delivery policy) as well as operating systems for budgeting, procurement, and some aspects of personnel management such as salary surveys and records management. Training in budgeting, planning, accounting, and procurement. Diagnostic work in these areas also progressed. While commendable, these initiatives have had only modest impact in relieving the institutional and capacity constraints within the Ethiopian civil service. There is little evidence of sustained improvement in output performance at the federal or regional levels. Core functions such as medium-term planning, accounting and auditing, personnel management remain weak. Attempts to develop an affordable, medium-term public sector pay policy were also delayed, and civil servants—despite an across-the-board salary increase in 2001—continue to receive low salaries. Role restructuring and performance improvement across federal ministries and regional bureaus was not undertaken in part because of the projectized design of the CSRP. Furthermore, lags in the prototyping phase meant that the implementation of CSRP at the regional level would be delayed. The opportunity costs in terms of foregone improvements in institutional and service delivery performance at the regional level were considerable.

Since September 2001, a reorganization of Government and the launch of its National Capacity Building Program (NCBP) has given new impetus to the CSRP. The Government have moved quickly to prepare the CSRP for its "full implementation" across regions and levels of government. Noteworthy initial steps include the establishment of focal points responsible for implementation of reforms in federal, regional, and local institutions, and a series of workshops undertaken to sensitize the political leadership and civil servants across the country about the objectives, design, and expected results of the CSRP. Supported by the IDA-financed CBDS Project, the MCB intends to further strengthen coordination and change management (from line ministries, regional bureaus, woredas and municipalities); complete all prototypes (particularly in human resource management and accountability); consolidate the original five pillars to three

core sets of activities (Resource Control and Management, Accountability and Transparency, Performance and Service Delivery Improvement); and rigorously monitor program implementation. It is envisaged that this approach would promote civil service performance in terms of financial and human resource management, responsiveness to citizens' needs, strategic prioritization of public resources, efficiency of program implementation, and enhanced accountability. These are described below:

- * *High-level Coordination and Change Management.* Following the reorganization of Government in 2001, the State Minister in the newly established Ministry of Capacity Building (MCB) has been given the responsibility for coordination, change management, and oversight of the CSRP. In addition, the Government has established clear accountabilities for CSRP implementation among heads of ministries and agencies across the civil service along with implementation units or focal points in civil service institutions at the federal and regional levels.
- * *Resource Management and Control.* Resource Management and Control activities would include the consolidation and roll-out of both expenditure management (originally supported under the EMCP pillar) as well as human resource management and control systems (originally under the HRM pillar) supported under the prototyping phase of CSRP. While aspects of Resource Management and Control have reached an advanced stage of prototyping (for example, accounting, budgeting, and planning reforms with the support of USAID, EU, and UNDP), other areas such as human resource management require additional assistance.
- * *Performance and Service Delivery Improvement.* The experience of other reforming governments suggests that line agencies respond when they are given an incentive (such as access to capacity building resources) to carry out restructuring and performance improvement programs. The CSRP Coordinating Office (CO) is moving quickly to develop the PSIP as a way of not only demanding accountability from ministries, agencies, and bureaus (MABs), but also empowering them to deepen implementation of performance improvement measures. Specifically, PSIP would require that MABs take certain *prior* actions such as reviews of legislative mandates, roles, functions, and accountability relationships; an analysis of organizational performance; and the development of a performance and service delivery improvement plan for restructuring, capacity building, and achievement of performance targets within an agreed upon timetable. Once its PSIP is approved, an MAB would be able to leverage financing from MCB to support implementation. It is envisaged that such an approach would better integrate the goals of the original five pillars of CSRP—EMCP, HRM, TMS, Ethics, and Service Delivery.
- * *Accountability and Transparency.* These activities would involve strengthening mechanisms for fiduciary accountability such as external audit, parliamentary oversight, anti-corruption, and the development of the accounting and auditing profession. Also critical to this set of activities is the strengthening of systems and development of innovative techniques for monitoring fiscal and output performance at various levels of government by public, private, and civil society institutions. These include expenditure or input tracking surveys, cost efficiency studies, service delivery report cards, anti-corruption and governance surveys, as well as other instruments for measuring the fiduciary and operational performance of public institutions at the federal, regional, and local levels.

District-Level Decentralization Program

During the 1990s, the Ethiopian state underwent a period of unprecedented institutional change and restructuring, with potentially far-reaching implications for the ways in which the Government can help promote poverty reduction and growth. Most notably, the adoption of the 1995 Constitution resulted in the creation of a federal state, centered around ethnically-based *regions*, within which the *woreda* constitutes the basic unit of decentralized, democratic government. Regional authorities have significant autonomy in fiscal and personnel management, and also shoulder significant new responsibilities in terms of service delivery and governance. Even as Ethiopia sought to establish a radically new brand of ethnically-based federalism across a diverse society, severe capacity and fiscal constraints hampered nascent regional and *woreda* institutions in fulfilling their new mandates, which include the bulk of service provision.

Regional governments inherited administrative systems that were hierarchical and capacity-constrained. Higher levels of government such as zones and regional bureaus are heavily involved in functions that were ostensibly the responsibility of *woreda* executives. For instance, planning and prioritization processes at the local level—while consultative—were short-circuited by zonal officials, who would vet *woreda* level plans in line with regional priorities. Project and program implementation were also burdened by overly centralized structures for procurement of goods and services and management of frontline personnel. The inefficiencies that resulted from highly centralized arrangements were further exacerbated by endemic staff and skills shortages, weak decision-making systems, and inadequate organizational structures. As a result, *woredas* remained deconcentrated units of regional bureaus rather than genuine, democratically elected executives in their own right. In addition to generating operational inefficiencies, this form of deconcentration has hindered the development of democratic and accountable local governments, capable of delivering services in a demand-responsive and sustainable manner. In addition, opportunities for involving communities, particularly women, more systematically in all aspects of service delivery (for example, parental management of schools) have been under-exploited.

Within the past year, the Government has moved quickly to remedy these constraints at the *woreda* level. A radical program of fiscal and administrative decentralization—based on far-reaching constitutional reforms in four regions—has been implemented as of the FY02 fiscal year. The program involves the transfer of a significant portion of the regional subsidies (in some cases, between 60 and 75 percent) to *woredas* in the form of formula-driven block grants. By implication, the decentralization of fiscal management responsibilities requires a massive redeployment of skills staff, typically from regional bureaus and zonal sections, to *woredas* to effectively carry out basic public management functions such as budgeting, planning, accounting, and service delivery implementation. Some regions have already taken bold steps towards rationalizing and restructuring what were top-heavy administrative structures. These far-reaching efforts to rapidly implement one of the most radical district-level decentralization programs in Africa (if not the world) have given rise to enormous capacity building challenges at the regional and *woreda* levels. These include systematic assignment of revenue and expenditure responsibilities within regions, role restructuring of regional bureaus, transfer of sector-specific functions to *woredas*, roll-out of basic financial and personnel management systems at the regional and *woreda* levels, development of fiscal transfer mechanisms and monitoring systems within regions, demarcation and harmonization of *woreda* and municipal structures, implementation of institutional structures for *woredas*, and bulk training of local officials, electorates, public servants, and other stakeholders, all of whom are critical to the success of this “second wave of democratic decentralization.” The Government’s *District-Level Decentralization Program* (DLDP) is seeking to meet these vast capacity building needs in ways that are beneficiary-driven, holistic, and properly sequenced. Under the IDA-financed CBDS Project, initial support has

been provided for regions and woredas through financing windows for technical assistance in refining enabling legislation for local authorities, assignment of expenditure and revenue responsibilities, restructuring of regional bureaus, and empowerment of woreda administration. It is envisaged that such modalities of support will be rapidly scaled up under PSCAP.

Urban Management Program

Critical to public service delivery and poverty reduction in urban areas (and their surrounding rural hinterlands) is the role of municipalities. In recent years, Government has become increasingly concerned with the economic and social needs of Ethiopia's rapidly growing urban population. Historically, municipal governments were not adequately integrated into the larger legal and accountability framework of regional governance, and therefore, have been limited—in providing essential services to their residents—by their ability to raise own-source revenues. Personnel shortages have also hampered municipal performance. Furthermore, the majority of Ethiopia's woredas share jurisdictions with municipalities, and therefore require a more systematic approach to coordination and harmonization between these two forms of local government. In addressing the needs of municipal government, the Government has prepared an *Urban Management Program* in the context of the NCBP to establish an appropriate framework for urban government through the development of enabling legislation for municipalities within regions, restructuring and staffing of municipalities, strengthening of planning and management capacity, mobilization of fiscal support from own and other sources to meet investment and recurrent needs, and improvements in land management and basic service delivery. Support for these and other capacity building activities in municipalities will be leveraged under the IDA-financed CBDS Project, according to the same beneficiary-driven modality described above for the DLDP.

Tax System Reform Program

Improving revenue performance at all levels of government is critical to meeting the growing expenditure requirements of Ethiopia's poverty reduction strategy. The Government has identified variety of policy, legal, institutional, and personnel factors that constrain revenue performance, and has embarked on short- and long-term initiatives to deepen policy reforms and strengthen administration within the tax system. Following the Government reorganization in mid-2001, a separate Ministry of Revenues was created and the Tax Reform Taskforce strengthened. An inter-ministerial steering committee, chaired by the Minister of Capacity Building, was established to refine and support the *Tax System Reform Program* of the NCBP. The Tax Reform Program aims to encourage capital investment and development, increase tax revenues (through improved compliance and efficiency of collection), and ensure equity and fairness in the tax system through a comprehensive overhaul of the current legislation and tax administration system. It is envisaged that the program would help increase tax effort to approximately 18-20% of GDP over the three-year life of the NCBP.

These objectives are to be achieved *inter alia* through the strengthening of tax policy capacity of the Ministry of Finance and Economic Development (MOFED), overhaul and codification of the income tax law; introduction of presumptive and value-added taxes; adoption of a tax payers identification system; reorganization of the Federal Inland Revenue Authority (FIRA) and its various branches; development and implementation of operational manuals for tax officials and training manuals for taxpayers; and computerization of tax administration at the federal, regional, and local levels. In addition, the program is seeking to deepen the restructuring and strengthening of customs administration.

Justice System Reform Program

The Government views a capable and efficient justice system as a indispensable to the development of Ethiopia's democratic federal system. A range of legislative, judicial, law enforcement, educational, and civil society institutions make up the justice sector in Ethiopia. Acute personnel shortages, institutional weaknesses, and inappropriate laws continue to hinder the functioning of these institutions. As a result, the dispensation of justice is delayed, democratic rights are not adequately protected, the legal framework for the smooth operation of a market economy remains weak, and law enforcement is inefficient.

The Government is currently developing its *Justice System Reform Program*. It envisages a holistic capacity building program designed to strengthen those institutions in the executive, legislative, and judicial branches of government that are directly involved in the dispensation of justice. For instance, the Program seeks to support *inter alia* the strengthening of the Ministry of Justice; introduction of managerial and operational improvements in the courts; bulk in-service training of legal professionals and administrative personnel in all three branches of government; sensitization of stakeholders at all levels of government; expansion of professional legal education; revision of commercial, civil, and penal codes; and strengthening of enforcement mechanisms. Through these and other initiatives, the Program seeks to deepen implementation of democratic and human rights, and promote public participation at all levels of the justice system.

ANNEX 2. ETHIOPIA’S EVOLVING FIDUCIARY FRAMEWORK—SEQUENCING EXPENDITURE MANAGEMENT REFORMS

Leveraging strengths

Since its democratic transition in the early to mid-1990s, the Federal Democratic Republic of Ethiopia has adopted a fiscal and financial reform strategy that sought to leverage its strengths—a well-disciplined civil service that complies with formal financial management rules and regulations—to address its historical weakness—a tradition of excessive fiscal and administrative hierarchy that offered local communities little, if any, decision-making authority. Specifically, the Government has undertaken bold, far-reaching initiatives in fiscal decentralization, while simultaneously seeking to modernize its historically disciplined (albeit rudimentary) public financial and administrative systems.

Fiscal decentralization. Fiscal decentralization in Ethiopia spans two phases. In the first phase, the Government created a federal state structure based on ethnically based regional states with a broad range of responsibilities for achieving political, economic, and social objectives. Along with the transfer of vast service delivery responsibilities, the federal government instituted a system of formula-driven, equity-based “subsidies” to regions, and redeployed over 300,000 personnel to regional executives. This transformation process was implemented decisively, and has proven durable for nearly a decade. The second and current phase of fiscal decentralization in the four largest regions involves the transfer of significant proportions of regional subsidies (in some cases, between 60 to 80 percent) to *woredas* or district governments in the form of formula-driven “block” grants. The decentralization of fiscal management responsibilities has required a massive redeployment of staff, typically from regional bureaus and zonal sections, to *woredas* to effectively carry out basic public management functions.

Financial management reforms. In parallel to democratic decentralization, the Government sought to build on the bureaucracy’s reputation for discipline and compliance through a Civil Service Reform Programme (CSRP) designed to improve the efficiency, effectiveness, and transparency of public institutions. At the federal level, these led to *inter alia* to the adoption of a new chart of accounts; the introduction of a double-entry, modified cash accounting system; reduction in the backlog of federal and regional accounts; the development of a macroeconomic and fiscal framework (MEFF) to guide a medium-term public investment program (PIP). In the past two years, the Government has sought to facilitate the transition from a dual to an integrated budget system (notably through the integration of ministries of finance and planning); build political commitment to transition from an incremental budget to three-year rolling budgets; and deepen the implementation of expenditure management reforms in some regions (such as SNNP).

Managing risks

As noted above, the “second wave” democratic decentralization has come with its share of risks to Ethiopia’s widely acknowledged tradition of administrative discipline in public financial management (for example, absence of systems to prioritize untied expenditures at the *woreda* level, increased reporting burdens, limited capacity at all levels, especially in remote areas; and increased liquidity management problems in local governments). The experience-to-date, described below, suggests that a pragmatic approach to block grant implementation has helped stabilize fiscal transition within regions during this first year of *woreda* decentralization.

- *Pragmatic, equitable implementation of block grants.* When introducing the block grants, regions limited the discretion of individual *woredas* in expenditure assignments through

providing budget guidelines on the functional and economic split of expenditures. Also, a number of additional transfers occurred in regions alongside the block grant mechanism including a *rural hardship allowance* for officials deployed to remote woredas; a *contingency fund* that provided additional financing to woredas that were unable to meet existing recurrent commitments; *sector capital grants* (for education, health, etc) that fund specific capital projects that were planned or underway; a *health revenue sharing arrangement* whereby woredas retained a portion of revenue obtained from cost recovery on basic medical services; and *food security transfers* received in both cash and kind. These additional transfers were introduced or retained in order to reduce the risk of disruptions to actual service delivery and to account for specific local financing needs that were not met by the formula mechanism.

This approach to fiscal decentralization reflect a balance between a conscious policy decision to pursue a consolidated, multi-sector, decentralized funding option for local authorities in parallel with functional re-assignments, and the need to retain a degree of control of woreda spending to ensure a disruption free transition and to pursuer specific regional priorities (such a food security and adequate staffing of remote woredas). The transition appears to have been handled in a transparent, equitable, “risk aware” and practical manner.

- *Administrative measures to address capacity constraints.* Regions employed various administrative innovations to cope with the staff shortages—in the aggregate—of key financial management and accounting personnel in the woredas of the four major regions. In addition to the rural hardship allowances mentioned above, administrative pools of skilled financial management personnel (some of which were formerly regional staff) were deployed to serve multiple sector offices within woredas. While such pool arrangements require further development, they are another indication of regions’ “risk aware” approach.
- *Comprehensive public sector capacity building program.* Prior to the initiation of the current wave of fiscal decentralization, the Government launched a National Capacity Building Program, which comprises an umbrella public sector capacity building program—the *Public Service Delivery Capacity Building Program (PSCAP)*—that aims to provide the technical assistance, training, and logistic support for the roll-out of civil service and expenditure management reforms, woreda decentralization, municipal development, and revenue enhancement. PSCAP therefore represents a key pillar of the Government’s risk management strategy for supporting institutional transformation at the federal, regional, and local levels.

Notwithstanding the “risk aware” approach of regions to fiscal decentralization, myriad challenges need to be addressed to ensure the development of financially accountable spheres of government. These include maintaining momentum on federal reforms related to medium term planning (including the proper integration of planning and finance functions in the newly merged MOFED), budgeting and accounting; renewing efforts to strengthen internal and external audit systems; and strengthening consolidated budget monitoring and fiscal reporting. In regions, the challenges include clarifying and costing the detailed assignment of powers and functions between regional and local authorities; ensuring that adequate revenue sources are available to meet the associated expenditure requirements; better defining the role of the block grant relative to other fiscal support measures provided to local authorities; as well as strengthening woreda structures and administrative pooling arrangements.

Seizing opportunities

On the one hand, the capacity building and institutional strengthening needs of decentralization in Ethiopia are infinite. On the other hand, states have limited capacity to absorb radical institutional transformation in a sustainable manner. Fiscal decentralization therefore offers opportunities for the Government to prioritize financial and administrative reforms—that is, to sequence elements of an ambitious institutional reform agenda in ways that first ensures *stability*, and over time, promotes the *efficiency* and *accountability* of the emerging intergovernmental system.

- *Strengthening budget execution in woredas.* An immediate priority for woredas in this first year of block grant implementation is to ensure that basic budget execution functions (such as cash management, book-keeping and financial reporting, closing of accounts) are carried out. Over the next year, the development of very basic planning prototypes will be necessary to promote a medium-term perspective in local governments.
- *Focusing on budget monitoring in regions.* A critical concern of regions in the current fiscal environment is to embed the new chart of accounts, and focus on timely budgeting monitoring and reporting. Equally important will be for regions to estimate the transitional fiscal costs of decentralization, as a basis for enabling the Government to ensure that the capital and recurrent requirements of decentralization are adequately financed.
- *Ensuring federal commitment to budget calendar, medium-term projections.* The overriding priority for sub-national authorities in the Ethiopian fiscal system is predictability. Currently, the federal government imposes the costs of unpredictable and therefore non-transparent transfers onto regions and their woredas. There is a clear need for expenditure management policy at the federal level to focus on timely cabinet-level approval of medium-term macro-fiscal projections, and early communication of indicative three-year budget ceilings to regions to allow for credible and inclusive medium-term planning at the regional and woreda levels.

In conclusion, Ethiopia has embarked on a program of rapid decentralization that few countries would have the political commitment and institutional capacity to manage. Despite its severe poverty and capacity constraints, the FDRE has demonstrated a willingness to take calculated risks and an ability to manage those risks [to its public sector fiduciary framework] in pursuit of historic agenda of democratic decentralization.

ANNEX 3. PROPOSED TIMETABLE FOR AAA INPUTS UNDER IGR

Item	Initiation	Completion	Comment
Activity 1: Review of legal and constitutional framework	3/15/2003	4/15/2003	Scoping of work undertaken during PSCAP preparation
Activity 2 (a): Costing of functional assignments and structures	7/15/2003	11/15/2003	Work initiated under PSCAP prep; 6 additional weeks required
Activity 2 (b): Intergovernmental fiscal review	7/15/2003	1/15/2004	Work initiated under PSCAP prep; 6 additional weeks required
Activity 2 (c): Stocktaking of revenue mobilization and revenue sharing arrangements	9/15/2003	2/15/2004	No comment
Activity 3: Assessment of expenditure management reforms in reforming regions	5/15/2003	12/15/2003	Scoping of work undertaken during PSCAP preparation with DfID support; To be undertaken with support of AFRITAC
Activity 4: Regional restructuring and performance improvement review	7/15/2003	2/15/2004	Scoping of work undertaken during PSCAP preparation with DfID support
Activity 5 (a): Sectoral monitoring systems review	4/15/2003	7/15/2003	Scoping of work undertaken during PSCAP preparation with DfID support, key input to PRSC appraisal
Activity 5 (b): Woreda and municipal benchmarking	7/15/2003	1/15/2004	No comment
Draft Part I--Decentralization		4/15/2004	
Activity 6 (a): Comparative institutional review of decentralized healthcare delivery	8/1/2003	4/15/2004	No comment
Activity 6 (b): Augmented survey of health facilities	9/15/2003	1/15/2004	No comment
Draft Part II-Decentralized health delivery		5/14/2004	
Activity 7 (a): Urban land management stocktaking	2/17/2003	11/15/2003	Work initiated under PRSC and PSCAP preparation, 4 more weeks required inter alia to supervise 7(b)
Activity 7 (b): Rapid assessment of land survey and cadastral systems	7/15/2003	10/15/2003	No comment
Draft Part II-Land use management		1/30/2004	
Activity 8 (a): Comparative analysis of political governance trends in reforming regions	4/20/2003	12/15/2003	No comment
Activity 8 (b): Household level empowerment survey	7/15/2003	11/15/2003	To be coordinated with AFTES and Civil Society Cap Bldg Program preparation
Draft Part III--Democracy		2/15/2004	
FINAL SYNTHESIS REPORT		8/30/2004	Dissemination activities planned to follow

