Introduction

As the World Bank’s Development Policy Review points out, Pakistan has launched a far-reaching decentralization initiative, and has made remarkably rapid progress in implementing the initiative during a period of great internal and external stress. Local Government Plan 2000 was announced in March 2000 by the National Reconstruction Bureau (NRB). The legal transformation to a new jurisdictional structure was completed, on schedule, by August of 2001. Five rounds of elections were held for the newly defined three tiers of local government between December 2000 and September 2001. A new Local Government Ordinance promulgated by each of the provinces has defined the functions, sources of revenue, and accountability relationships for the newly created local government entities.

Despite this progress, many operational questions remain as to how the new structure will function in practice, and how well it will perform. NRB and the Government of Pakistan have identified two overriding objectives for devolution: greater accountability of local governments to citizens coupled with less bureaucratic centralization of decision-making, and higher-quality and more efficient delivery of basic services. This report takes stock of some of the key issues that remain to be resolved in the decentralization process, and the opportunities that exist for assisting Pakistan to achieve a practical decentralization that meets its objectives.

The Political, Governance, and Service-Delivery Dimensions of Decentralization

A decentralization initiative as wide-ranging as Pakistan’s has political, governance, and service-delivery dimensions. The three elements often interact.

The Uncertain Role of Provinces. One issue, possessing both a political and service-delivery element, is the role of provinces in the new, devolved structure. Pakistan is divided into four provinces. Punjab, the largest province, has dominated national governmental ranks as well as the military. Sindh, where Karachi is located, has been the primary focus of economic activity. Parts of the two remaining provinces, Baluchistan and the Northwest Frontier Province, border Afghanistan and are more traditional tribal areas.

The decentralization program launched by the Musharraf government has left the future role of the provinces uncertain and has invited conflicting interpretations of what that role will, or should, be. The Local Government Ordinance assigns some of the most important functions of the provinces—including education, health, and road construction—to local governments (districts in this case), without expressly taking away policy making authority in these areas from the provinces. As of this date, there are no parallel ordinances defining the responsibilities of the provinces, nor has NRB outlined such provisions, though there has been discussion of the value of having a separate, clearly defined list of provincial functions. The result is a great deal of ambiguity regarding the dividing line between provincial and local authority and potentially overlapping or conflicting service functions.
Provincial governments remain responsible, for example, at least through 2002-2003 for paying the establishment (personnel) costs of districts. This includes the costs of teachers and health-care workers, as well as general administration officials, all of whom have been re-assigned to report to district-level management rather than to provincial line departments, though they remain members of the provincial or Federal civil service. The case of schooling illustrates the potential confusion resulting from unclear provincial responsibilities. National curriculum standards are promulgated by the national government. District governments have responsibility for delivering school services. Between these two levels of responsibility, there typically is an intermediate level of government that monitors local school performance, administers testing, structures school financing (including some degree of equalization between local districts with different access to resources), and otherwise establishes school policy. It is unclear which level of government is to perform these functions under Pakistan’s decentralization program. Responsibility for education appears to have been assigned to districts. Yet provinces in general are continuing to perform these policy functions, at least for the time being, without explicit legal assignment of the role.

Ambiguity of this type has promoted confusion in other countries. Both local and provincial authorities may attempt to exercise authority, or, under budgetary pressure, both levels of government may walk away from service coverage. Similar issues to those in education arise in health care, road construction, and other functions where there is a need for common policies that extend beyond the boundaries of local jurisdictions.

If anything, the potential for mutual misunderstanding is greater on the revenue side of the budget. Administrative responsibility for collecting the various sub-national taxes has been assigned to one level of government or another. Often, however, provincial governments and local governments share in the tax revenues that are collected, or one level of sub-national government may collect a tax on behalf of another level of government. This arrangement creates potentially perverse incentives, where one level of sub-national government depends for its “own” resources on the fiscal motivation and capacity of another level of government to levy and collect the tax.1

The lack of clarity regarding the provincial role has raised the question in some quarters as to whether Pakistan’s devolution program is designed in part to weaken the provinces and to substitute a direct central government-local linkage for the former mediation of the provinces. Provinces do appear to have lost power relative to both local governments and central government. Citizen services are now seen as local government functions. The provinces no longer can override local actions, at least without the concurrence of the federally appointed provincial governor. NRB has proposed the

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1 The agriculture income tax illustrates this problem. Revenue collection for this tax in the Northwest Frontier Province (NWP) has been devolved to the district level. However, revenue from the tax continues to accrue to the province. NWP has experienced a massive shortfall in budgeted revenue from this source in 2001-2002. Whether the shortfall is due to lax local revenue collection or unjustifiably optimistic provincial budgeting (or most likely, both) is a matter of dispute. One provincial Revenue Board official is quoted as remarking plaintively, “Despite the fact that the Senior Member, Board of Revenue issued numerous instructions to the district revenue collectors, recoveries could not be improved.” Cited in “Decentralization Fails to Improve Revenues,” Dawn Business Section (Feb. 2, 2002).
creation of a Devolution Trust for Community Empowerment, with UNDP and international financial support, that would be chaired by the President of Pakistan. The Trust would make grants directly to local non-government organizations to support citizen involvement in meeting their own service and development needs. Those who see a deliberate lessening of the role of provinces in the devolution initiative tend to interpret it as a reaction to the fear that strong, ethnically oriented provinces could eventually splinter the Pakistani state.

For the immediate future, completion of the devolution program appears to require a clearer definition of the provincial role, and a closer matching of revenue sources with service delivery, so that a particular sub-national authority can in fact be held responsible for budgetary and service performance in a particular field.

**Governance and the Citizen Community Boards.** Pakistan’s devolution initiative properly devotes a good deal of attention to governance issues and citizen accountability. The need for greater governmental accountability is beyond challenge. Pakistan’s public sector has been known for bureaucratic indifference and corruption. Comparative citizen surveys in five South Asia countries (Pakistan, India, Sri Lanka, Bangladesh, and Nepal) have reported that, along most dimensions of governance, Pakistani citizens have rated conditions in their country worse than do citizens of other countries in the region. (See Table 1)

### Table 1
Citizen Views of Governance

<table>
<thead>
<tr>
<th>Question</th>
<th>Most Negative</th>
<th>Most Positive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are political leaders corrupt?</td>
<td>Pakistan</td>
<td>Sri Lanka</td>
</tr>
<tr>
<td>Have they become even more corrupt in the past 5 years?</td>
<td>Nepal</td>
<td>Bangladesh</td>
</tr>
<tr>
<td>Are police officers corrupt?</td>
<td>Pakistan</td>
<td>Nepal</td>
</tr>
<tr>
<td>Are public representatives responsive to citizen needs?</td>
<td>Pakistan (yes,15%)</td>
<td>India</td>
</tr>
<tr>
<td>Are you satisfied with the civil service?</td>
<td>Pakistan (yes,17%)</td>
<td>NA</td>
</tr>
<tr>
<td>Are NGOs an important tool to public empowerment?</td>
<td>Pakistan</td>
<td>NA</td>
</tr>
</tbody>
</table>

The Citizen Community Boards (CCBs) are an attempt to stimulate greater citizen involvement in local government and greater responsiveness of local governments to citizen priorities. The CCBs, however, have been assigned multiple, and potentially conflicting roles. They are, first of all, a source of proposals for local development (capital) expenditures. The NRB report on Local Finance cites examples of possible CCB initiatives: to improve the delivery of service from a public facility, to develop and manage new facilities, to establish farming or consumers’ cooperatives, to identify and mobilize resources for municipal development projects. In this capacity, the CCBs are promoters of local development activities. They are supposed to mobilize at least 20% of the cash costs of the activities they propose, to be matched with an 80% contribution from local government. Initially, it was proposed that half of the local development budget be set aside to finance CCB-identified project priorities, but that proposal is now being reconsidered.

The role of investment promoter and citizen lobbyist is potentially at odds with another responsibility assigned to the CCBs—that of helping local legislative bodies monitor the performance of the local government administration. The intertwining of the lobbying role, which expresses a demand for spending to benefit a particular community segment, with that of the monitoring role, which presumably requires citizens to evaluate more evenhandedly how government is responding to all citizen demands, is indicative of the only partially defined expectations regarding the role of citizen involvement. It also raises the question of who sits on the CCBs. The CCBs are voluntary organizations, formed by citizens of their own volition. They are non-profits, which can spend public funds as these are assigned to them, and whose members receive slight reimbursement for travel, but they cannot use public funds for salary, profit or bonus of the members. They must raise their 20% project matching contribution in cash. Whether these CCBs will, as the government hopes, reflect the interests of ordinary, poor citizens, or become vehicles for expressing development demands of the traditional local power structure remains to be seen. It is perhaps easier to visualize local elites seizing this initiative. As reported in Table 1, Pakistani citizens appear to be as skeptical about the good governance contributions of NGOs as they are about governmental institutions.

Helping the CCBs function effectively as an expression of ordinary citizen demand registered with decentralized government should be a priority in the devolution program. It is an area where international experience with the mechanisms of community empowerment and citizen accountability has much to offer Pakistan.

Service Delivery Assignments. The new structure of local governments in Pakistan has been detailed elsewhere and does not need to be repeated here. It is sufficient to note that there are three tiers of local government, moving from more localized to broader geographical scale, linked by indirect elections in which popularly elected officials at one level serve as a type of electoral college for selecting key officials at the next level. At the most “local” or village level are more than 6,000 Union councils. Corresponding to the “town” level are 307 Tehsil governments and 30 city towns (which are part of the four City districts). At the district level are 92 Districts and 4 City districts. The Districts are relatively populous jurisdictions, averaging 1.5 million in population. Some Districts,

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including the City districts, are much larger. All of these local bodies have held elections and are now functioning.  

The Tehsil governments—i.e., the Tehsil Municipal Administrations headed by the Tehsil Nazims—have direct responsibility for most “local” service provision. [In the City Districts, which correspond to metropolitan regions, the Districts retain more direct service functions.] Under the Local Government Ordinance, there is an appointed Tehsil Municipal Officer, who reports to the indirectly elected Tehsil Nazim, with oversight provided by the Tehsil Council. The Tehsil Municipal Officer administers three key sets of responsibilities: direct delivery of infrastructure and services, planning, and municipal regulations. Tehsil service provision includes Water Supply; Sewerage/Drainage; Sanitation and Solid Waste Management; Roads, Streets, and Street Lighting; Fire Fighting; and Parks and Open Spaces. Planning responsibilities cover Spatial Planning, Land-Use Planning, Development Facility Planning, and Housing Site Development, among others. Municipal regulations include Business Licensing and Property Development Approvals.

District governments—the broadest tier of local government—are in principle, expected to allocate resources among the Tehsil governments in their districts, thereby paying for the bulk of Tehsil expenditures (with resources that they in turn receive from the provinces and central government.) The Districts also have responsibility for the most costly human service functions, education and health care, as well as district-scale roads and other broad infrastructure or development projects.

Local capacity to deliver services effectively results from a combination of the skill level of public employees, the adequacy of local government resources, and willingness of public sector institutions and employees to adjust to the re-organization of local governments. Budget resources are scarce throughout Pakistan. As is true elsewhere in the world, budget pressures tend to postpone those actions that can most readily be postponed, even when there are large cost consequences. Local governments routinely have deferred maintenance and upkeep of capital facilities, badly eroding their service delivery capacity.

Devolution has caused a considerable re-structuring of local government workforces. Although the Tehsil governments primarily have inherited the workforces of the former Tehsil Municipal Corporations, they also have had to absorb workers from other local institutions, such as the Development Authorities. Workers at the District level have had to undergo a fundamental re-orientation of lines of responsibility. These workers are civil service employees, belonging either to the provincial or Federal civil service. Formerly, they reported to their line ministries and departments in provincial government, and to the

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3 Opinions differ as to the openness of the local elections. There is general agreement that the direct elections to Union Councils were fair and open. Subsequent rounds of indirect elections to select Nazims, or administrators, and deputy Nazims have been more controversial. There have been reports of military involvement in approving or rejecting candidates and of corruption in the electoral colleges. The Local Government Ordinance specifies that candidates shall have a “non-party character.” This provision has been used to deny election to some high-profile members of a political party. See Teresita C. Schaffer and Mandavi Mehta, “Political Institutions and the Army,” report from the Center for Strategic and International Studies project on Pakistan’s Future and U.S. Policy Options (April 17, 2002).
powerful District Deputy Commissioners who were the district representatives of national
government. Now they report to a District Nazim, indirectly elected by the Union Nazims
in the District.

Scattered reports indicate that the quality of some services may have suffered during
this re-organization. WHO reports, for example, that the number of employees not
reporting to work at health clinics has risen, in part because the lines of employee
accountability during transition are not clear. These are likely to be temporary impacts. It
is too early to assess the effects of local government re-organization on long-run service
delivery. It is hoped that the increased avenues for electoral accountability, accountability
to Council monitoring committees, and accountability to CCBs will improve service
quality. Civil service employees tend to be highly skilled workers. It is their orientation to
consumer satisfaction that is in question and is addressed by the accountability reforms
built into the devolution process. Moreover, there will need to be a change in mind-set of
many of the provincial level civil servants whose primary experience has been in capital
project development and expenditure without much consideration for the operational and
recurrent costs of investment decisions.

One matter that is clear is that, however skilled they may be in their professions, the
new set of local government officials lack the financial and budgetary skills that have
become critical as a result of devolution. In an UNDP survey of training needs in
Northwest Frontier Province, elected representatives and government functionaries agreed
on the training priorities they required to cope with their new circumstances. The first
priority was for training in Finance, while the second priority was for the closely related
topic of adjusting to the Local Government Ordinance in terms of budgeting and funds
management. Within Finance, priority topics were identified as budget formulation;
maintenance and reconciliation of accounts; drawing money from treasury; and resource
mobilization. Within the topic of adjusting to Local Government Ordinance 2001,
priorities identified by elected representatives and government functionaries included local
fund rules; management of local finances and property; community development; and
community empowerment. 4 This self-assessment of training needs seems to accord well
with the principal shifts of responsibility involved in the devolution program, the
Government’s emphasis on living within hard budget constraints, and the universal
problem that local governments have had with budgetary deficits.

Fiscal Decentralization

Political re-structuring of local government was tackled first in Pakistan’s
decentralization strategy. However, NRB has acknowledged that “Fiscal decentralization
is the heart of any devolution exercise. Without fiscal decentralization no authority is
devolved.”5

It is instructive to compare NRB’s assessment of the flaws of the previous
intergovernmental financial system, and its priorities for reform, with the priorities listed
by outside public finance economists. These priorities have yet to be captured in fiscal

4 See Government of Northwest Frontier Province, Training Needs Assessment of Elected Representatives and Government Functionaries (December 2001)
5 National Reconstruction Bureau, Local Finance (2002)
reforms. The year 2001-2002 was an admittedly transitional year, in which fiscal allocations primarily were held harmless, in order to permit concentration on political devolution. Originally, fiscal year 2002-2003 was intended to begin the process of fundamental fiscal reform. However, it now appears that most major changes in financing principles will be delayed at least another year.

**NRB’s Assessment of the Finance System.** NRB’s White Paper on Local Finance identifies four key areas of failure in the former finance system and proposes broad strategies for rectifying them.

First, it points to the poor linkage between Development (capital) and Non-Development (operating) budgets, both in provincial/local planning and in central government project financing. Development schemes were funded by central government according to central government priorities without any analysis of the continuing costs of operation and maintenance, without an understanding of how these costs would be financed, and without consultation with local governments as to their project priorities. The previous process of allocating development funds is described in the White Paper as “totally non-transparent and inequitable.” The result was a ‘Graveyard of Projects’ which were never completed or, if constructed, could not be sustained in operation. Meanwhile, the funding of unplanned development projects badly eroded budgetary support for basic services, such as education, health, and water supply.

This failure of the old financing system is to be dealt with by giving local governments power over their development budgets and project priorities, along with block grants for fiscal assistance. Local governments will become responsible for their own development planning and for ensuring that development expenditures today are consistent with tomorrow’s O&M requirements and projected operating budget revenues.

Second, NRB criticizes the basis of fiscal transfers from provinces to local governments under the old financing system. These are said also to have been calculated in a non-transparent, inequitable, and capricious manner. The Local Finance report states that a Provincial Finance Commission will be established in each province, and that each Provincial Finance Commission will adopt a fully transparent formula for allocating funds among local governments, taking into account such factors as fiscal effort and revenue generation capacity, in addition to population. For 2001-2002, historical support levels are to be maintained. Even this hold-harmless provision required that provinces for the first time would prepare their overall budgets District-wise (i.e., on a district by district basis, as opposed to a single aggregate amount, which would be allocated among local governments later, according to whatever criteria seemed fitting.)

Third, the Local Finance paper prescribes very modest changes in own-source revenues for local governments. Virtually no change is made in revenue sources. The major message is that all new taxes must be levied in a transparent manner, with previous publication of the tax proposal and after inviting public objections.

Fourth, the Local Finance report laments the complexity of local budget preparation. As of the date of paper preparation, Districts and Tehsils would have had to prepare separate Development and Non-Development budgets for each of the Provincial funds
from which they received monies and for each of the local funds from which they received monies. This morass of budgetary paperwork was bound to obscure overall budgetary priorities and budgetary choices. In practice, budgets for 2001-2002 were prepared District-wise by the provinces. In April of 2002, the Government prescribed that local budgeting would be performed on a combined account basis, joining provincial allocations and locally raised revenues in a combined budget.

External Perspectives on Pakistan’s Fiscal Decentralization. To outside observers, one of the most fundamental flaws in Pakistan’s intergovernmental fiscal system goes unaddressed, and even unmentioned, by NRB. This is the low level of own-source revenues generated by local governments, and the failure to tie together the quality and quantity of services delivered, on the one hand, with the cost of those services, on the other. The principles of fiscal federalism require that this nexus be spelled out clearly, and that citizens have the power to express their preference for different levels of service costs (borne by them) vs. service quality.

Pakistan’s approach to fiscal decentralization does not contemplate a change in the reliance of local governments and provinces on fiscal transfers, though the limitations of local government resources (as opposed to provinces’) does not seem as severe as often reported. In 2000-2001, central government transfers accounted for 87% of Provincial revenues. Most of the remaining “own-source” revenue of Provinces was derived from taxes and tax-rates established by the central government. The Federal share of Provincial budgeted revenues has been climbing steadily for the last 25 years and continued to do so in 2001-2002. Northwest Frontier Province, for example, budgeted own revenues at about 8.5% of total revenues for 2001-2002, with own source funds growing more slowly than Federal transfers (and much more slowly than budgeted expenditures). Even in Sindh, a more prosperous province, the own-source share of total revenues was budgeted at about 15%, with own-source revenues budgeted for no growth whatsoever in 2001-2002 over 2000-2001.6

Local urban governments are significantly less dependent upon external transfers than are the Provinces. Peshawar City District is a representative example. In 2001-2002 it will generate just over a third of its total revenues from own-source taxes, fees and charges.7 Tehsils until 1999 generated large amounts of revenue from the octroi (urban Tehsils) and from the Zila export taxes on agricultural goods (rural councils). These taxes were grossly inefficient in their impact on economic activity. They were abolished in 1999, and replaced by a Federal transfer allocation that, while holding recipients harmless in the first year, has not grown with time, as octroi receipts would have done.

At present, the nexus between local taxpayer cost and local service delivery clearly is lacking. There have been some suggestions that this mismatch is due to restrictions on the legal right of local governments to impose taxes or fees. If that were true, moving to a more efficient fiscal federalism would require basic reforms, expanding the types of taxes that local governments can impose and providing them with more latitude to set tax rates

7 Peshawar City District Alternative Financial Forecasting, report prepared for City Development Strategy (2002).
and fee levels. Closer inspection of urban government budgets, however, suggests that these governments actually have quite elastic revenue sources and have much more revenue generating capacity than they choose to implement.

The Urban Tax on Immovable Property (UTIP) is a potentially high-yielding revenue source for urban areas. It is now assigned to Tehsils. The tax is administered and collected by the provinces, with an 80% share remitted to Tehsils, while the remainder is kept by provincial governments. Local governments and provinces together have a good deal of flexibility in the way UTIP is administered and hence in the revenue it generates. When Peshawar carried out a fresh survey of properties subject to UTIP and changed the basis of assessment from rental value to uniform flat rates for residential properties and scaled classifications for commercial property, it was able to increase UTIP yields by 261% from 1997-98 to 2000-2001. Even without rate or assessment changes, yields are projected to continue to grow at a 25% annual rate for some time.

Service charges offer even more scope for revenue increases. Peshawar presently covers only 20% of the O&M costs of water supply in urban areas from service charges (recovery rates are far less in rural areas). Much of the gap is accounted for by illegal water connections, leakages in the system, as well as the failure to adjust water supply charges. Solid waste collection and sanitation fees recover a still smaller portion of O&M costs, roughly 10% in Peshawar City District. Service fees for both water supply and sanitation can be adjusted by the local government at its discretion if economically justified.

In sum, local urban governments appear to have available to them tax and revenue instruments that could go far toward generating additional own-source revenues. If they chose, they could establish a policy of full cost recovery for basic service delivery. Or, they could adjust fee schedules so that poor households do not pay the full costs of O&M, while middle income and more affluent households and commercial operators do, with targeted subsidies for poor households. This adjustment would both raise own-source revenues and establish a clear connection between service costs and service delivery.

No adjustments in local taxing authority appear to be necessary for this result—only a determination at the local level that such pricing and taxation policies are desirable, plus the capacity to implement fee or tax increases. Once the intergovernmental transfer picture stabilizes, and the hope for external transfers subsides, urban governments may well turn to their own-source budgets for additional revenue. Over the long run, such a nexus will help solidify the accountability connection that Pakistan seeks to achieve through devolution.

International Assistance for Pakistan’s Local Governments

International assistance programs in support of Pakistan’s devolution program tend to fall into the same programmatic categories that have been summarized in this report. External funds are being used to help design the national and provincial fiscal transfer systems, to assist Pakistan’s sub-national governments and citizen groups to carry out governance reforms, to promote democratic reforms at the local level including greater access of women and minorities to the political system, and to help fund investments in basic infrastructure facilities.
**Fiscal Decentralization Design.** The Asian Development Bank is financing a program in collaboration with NRB that seeks to strengthen fiscal decentralization. The program is being carried out by Development Alternatives of the US, together with the Pakistani firm AHZR. The program provides support to NRB in analyzing formula bases for fiscal transfers from the national government to the provinces, and from the provinces to district governments. It also is intended to encourage local revenue mobilization to reduce dependence on federal and provincial transfers, and to help develop new budgeting systems that can serve as a performance management tool to encourage efficient service delivery. Most recently intended to conclude in June 2002, the project has encountered delays and has been extended. DFID has augmented ADB’s original budget.

**Governance Programs.** UNDP has taken the lead in Governance programs. It operates a regional governance program for South Asia, which sponsors comparative citizen surveys regarding governance perceptions as well as transfer of successful governance practices. The Pakistan Action Research and Development of Governance and Management (PARADIGM) program is a national level program supporting transparency and accountability in government as well as decentralization and local empowerment. It and sister UNDP programs have drafted model “freedom of information” legislation to make government actions more transparent to the public, are supporting efforts at local resource mobilization in smaller Pakistani towns, and have advised the Government on the assignment of policing powers during devolution. Other UNDP efforts have targeted NGOs, seeking to make them informed participants in budgetary and resource allocation decisions, by training the NGOs in basic financial issues and in interacting with government offices. UNDP also is active at the Provincial level. The Essential Institutional Reforms Operationalisation Programme (EIROP) is a $4.4 million program in support of devolution within Northwest Frontier Province. EIROP has conducted training needs surveys of newly elected local government representatives and local government functionaries, then provided training in the areas identified as top priorities—finance, budgeting, and compliance with devolution legislation. A parallel Management Development Programme in Baluchistan has provided training for provincial and local government officials there. Finally, UNDP programs in support of women’s participation in governance and improvement of education and health services have intersected with devolution strategies.

USAID also has scheduled for 2002 democratic governance programs in support of Pakistan’s decentralization. These focus on non-governmental organizations, universities, think tanks and other civic organizations that can expand informed public participation in local government decision-making. A proposed project would work with political parties, in the hope of supporting a more open political process based on policy alternatives after the elections scheduled for October 2002.

**Local Infrastructure Investment and Capital Markets Reform.** ADB has announced that it will provide approximately $1 billion of soft loans to Pakistan in 2002 in support of decentralization and capital market reforms. Approximately $300 million of this total will support investments related to poverty reduction and human development at the local level. ADB also has targeted several development projects in the provinces of Punjab and Sindh, as well as capital markets reform aimed at strengthening the country’s stock
exchange and introducing credit rating agencies, among other policy objectives. ADB financing will be through long-term loans carrying interest rates that range from 1% to 1.5%.

**Opportunities for World Bank Involvement**

The ideal local government Services program for the World Bank would:

- Strengthen basic service delivery
- Strengthen the nexus between service delivery and service costs by moving to a tariff structure that recovers full O&M costs, at least for better-off customers
- Demonstrate the cost savings potential from careful analysis of local service cost structure and reforms aimed at reducing these costs
- Involve collaboration of urban local governments with the provincial government
- Build on the specific experience that the Bank and its partners have accumulated in similar situations of early decentralization reforms, and the support required to go through the transition period.

**Several areas of support are suggested for analytical work focusing on developing local government capacity:**

**Transitional Issues**

1. ‘Advising how to / helping to’ clear up the many ‘carry-over’ problems likely to be inherited by the new local governments from their predecessors, for example: extensive arrears (creditors) such as delayed payments for power; addressing the poor quality of assets being transferred, and financing any remedial works to ensure at least a minimum standard of functionality; debt service liabilities associated with these assets – confirming the loan balance, and even the original loan / grant terms can be a lengthy exercise in Pakistan, and is not always conclusive; planning how to reduce excessive numbers of staff transferred; etc.

**Capacity Development**

2 Developing mechanisms for training local staff. Per the UNDP survey, training in financial management is the top priority of staff. This is clearly essential if local bodies are to have the degree of autonomy intended. Further requirements will also arise as local governments become established – already staff have identified training on how to work better with communities (see 3 below) – and a continuing need for replacement / reinforcement training will exist. Given the likely initial capacity constraints, training in ‘working with / supervising work by’ private contractors may be essential, for example.

**Financial Management**

3 Others are working on formula-based fund distribution mechanisms. Accounting has yet to be finally agreed, but should involve the CGA. Provincial government and local government representatives, and should provide / work towards adequate autonomy for the new local bodies, alongside satisfactory arrangements for accountability for the use of public money. External audit is the responsibility of the Office of the Auditor General (OAG), but capacity constraints there may need to be eased. Possibilities include making greater use of private audit firms working under contract to OAG, and the conversion of
Local Fund Audit into an internal audit function for local bodies. This latter action would necessitate specific training, but could greatly reduce the burden of audit on the external auditor.

One option that meets all of these criteria is to focus on the financing and institutional options of specific services that have now been devolved to the District/and or Tehsil level. Clearly, the political boundaries that have been established for local governments, are not necessarily congruent with the requirements for specific services, and there are likely to be issues of economies of scale and scope. Water distribution networks, coupled with focused efforts at lowering the per-unit costs of [legal] water supply while re-adjusting tariff levels so as to fully recover O&M costs from commercial businesses and that portion of the residential population judged able to pay. The insights and information gained from the Peshawar CDS provide a sound analytical base for such a project. This work has identified the impact on per-unit water delivery costs of illegal connections, water leakage from under-maintained systems, as well as the revenue shortfalls resulting from failure to adjust tariffs. Under the new devolution structure, City Districts and Tehsils have more authority to allocate budget resources as they see fit. If it can be demonstrated that a program of leak repairs and catch-up maintenance can reduce service costs significantly over a realistic time frame, the demonstration impact on other local governments could be large. The ability to introduce full O&M pricing for one high profile service sector could go even farther toward persuading local governments to take advantage of the greater freedom of decision-making they now have before them.

Of course, a local government loan program to finance water distribution is not possible. For one thing, local governments are now prohibited from borrowing. For another, tariff adjustments that recover the costs of capital, even if subsidized, are unrealistically ambitious, at a time when tariffs are only recovering 20% of O&M costs. A World Bank project then would have to be structured internally as an intergovernmental grant program. It should be possible to frame such a project so that several local governments and more than one province were potential participants, with grant funds being steered to the combination of cities and province that made the most progress in cutting the real costs of per-unit water delivery and achieving full cost recovery for O&M costs. Such an arrangement has several of the design features of a performance grant, without attempting to take away resources that local governments regard as their entitlement, and while using a very simple—but fiscally crucial—measure of local performance.

More than anything, local governments would seem to benefit at this juncture from a clearly defined program target that demonstrates how they can utilize the powers afforded them through devolution to produce cost savings for taxpayers. Even the effort to persuade CCBs and NGOs of the benefits of fuller cost pricing, in terms of reduced pressure on the general local budget, though challenging, would represent the type of informed policy dialog between local government and citizens that devolution is intended to support.