

AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON, D C 20523

June 26, 1987

MEMORANDUM

TO: Rural Development Sector Council Members  
FROM: S&T/HR, Christopher Russell  
SUBJECT: Decentralization: Finance and Management

Attached is a copy of the approved project paper for the new S&T/RD project, Decentralization: Finance and Management (DFM). The main features of the project were unchanged from the PID version reviewed by a joint meeting of the RD and Education Sector Councils on 2/11/87. In addition to technical improvements, the review produced decisions to: a) reduce LOP central funding from \$6 million to \$4.6 million, and b) focus the work of the new project on rural infrastructure and exclude education decentralization.

M/SER/OP is currently proceeding with competitive selection of the principal contractor for the project. An award is expected by September 30.

The Sector Council review was very helpful in shaping the final PP. In addition, unusually strong contributions from regional bureau and PPC people on the project subcommittee, and repeated interaction with a dozen interested missions, shaped the project to meet high priority field needs. Because of strong interest by ANE missions, ANE plans to contribute to core funding which supports ANE field programs.

Members of the project subcommittee were:

AFR/PD/CCWA, Howard Helman  
AFR/TR/ARD/PA, Curt Reintsma  
ANE/TR/ARD/APNE, Jim Lowenthal  
LAC/DP, Juan Belt  
PPC/PDPR/RP, Don McClelland  
S&T/RD/IDM, Ken Kornher

Attachment: Project Paper for DFM

AGENCY FOR INTERNATIONAL DEVELOPMENT  
PROJECT PAPER FACESHEET

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FY 95

9. ESTIMATED DATE OF OBLIGATION  
A. INITIAL FY 87  
B. QUARTER 4  
C. FINAL FY 94 (Enter 1, 2, 3, or 4)

10. ESTIMATED COSTS (\$000 OR EQUIVALENT \$) -

A. FUNDING SOURCE	FIRST FY			LIFE OF PROJECT		
	B. FX	C. L/C	D. TOTAL	E. FX	F. L/C	G. TOTAL
AID APPROPRIATED TOTAL	370		370	4,600		
IGRANT <sup>1</sup>	370		370	4,600		
ILOAN <sup>1</sup>						
OTHER U.S. <sup>2</sup>						
HOST COUNTRY						
OTHER DONOR(S)						
TOTALS	370		370	4,600		

11. PROPOSED BUDGET APPROPRIATED FUNDS (\$000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE		C. 1ST FY 87		H. 2ND FY 88		K. 3RD FY 89	
		C. GRANT	D. LOAN	F. GRANT	G. LOAN	I. GRANT	J. LOAN	L. GRANT	M. LOAN
103 (1) 3,000	289	040		320		450		300	
105 (2) 1,600	669	060						150	
(3)		030							
(4)		720							
TOTALS				320		450		450	

12. IN-DEPTH EVALUATION SCHEDULED

A. APPROPRIATION	N. 4TH FY 90		O. 5TH FY 91		LIFE OF PROJECT	
	D. GRANT	P. LOAN	H. GRANT	S. LOAN	T. GRANT	U. LOAN
(1) Sec. 103	350		350		3,000	
(2) Sec. 105	300		300		1,600	
(3)						
(4)						
TOTALS	650		650		4,600	

MM YY  
01 91

13. DATA CHANGE INDICATOR. WERE CHANGES MADE IN THE PID FACESHEET DATA, BLOCKS 12, 13, 14, OR 15 OR IN PRP FACESHEET DATA, BLOCK 12? IF YES, ATTACH CHANGED PID FACESHEET.

2 1 = NO  
2 = YES

14. ORIGINATING OFFICE CLEARANCE

SIGNATURE: *Eusebio...*

TITLE: Acting Director, S&T/RD

DATE SIGNED: MM DD YY 05 04 87

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PROJECT PAPER

DECENTRALIZATION: FINANCE AND MANAGEMENT

936-5446

S&T/RD/IDM

April 1987

# DECENTRALIZATION: FINANCE AND MANAGEMENT

## PROJECT PAPER

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1

DECENTRALIZATION: FINANCE AND MANAGEMENT

PROJECT PAPER

I. EXECUTIVE SUMMARY

Decentralization: Finance and Management (DFM) is a seven-year project expected to utilize \$12.01 million of USAID funds and \$4.6 million of S&T/RD funds. It will seek answers to the question, "How can developing countries find means to deliver and pay for essential public services in rural settings--especially maintenance of roads and irrigation facilities--on a sustainable basis?" The project will work at all levels from local through provincial to national. It will be concerned with service users, with distribution of benefits and costs, with how services are provided (authorized, funded), and how they are (or might be) produced.

DFM will treat "decentralization" not as an end in itself, but as a means to improve rural service delivery. It will recognize that institutional and funding arrangements are, or ought to be, different for different kinds of services--road maintenance is different from natural resources management. It will acknowledge that the countries A.I.D. is working with are poor, that the latent demand for services far outstrips available resources, that current fiscal arrangements in LDCs are predominantly centralized, and that competition for scarce resources is unavoidable.

The project will ask whether particular services have to be provided by government, or whether they might be more suitable for private provision (or a combination of private and public provision). It will assume that different levels in the hierarchy of developing country administration or government--along with private sector resources--often have complementary roles to play.

The project will introduce new social science tools, including those drawn from "political economy" and public finance economics, to support rigorous analysis of alternatives which host countries can use to strengthen institutional arrangements and incentives and find sustainable ways to pay for public goods and services in rural areas. The initial state-of-the-art paper will review these new tools, along with better-known approaches; the final state-of-the-art paper will report on their usefulness over the life of the project.

Finally, in three "demonstration" countries, DFM will take on the challenge of helping host country people try out new institutional and financial arrangements to improve and sustain rural infrastructure maintenance.

DFM can achieve its aims only through an unusually strong partnership with USAID missions and projects. Initially it will concentrate on rural road maintenance, with secondary attention to (a) irrigation maintenance, and (b) LDC policies and fiscal arrangements for decentralization. It will work most closely with three missions which plan buy-ins in a range of \$1-3 million, an amount which will support long term, in-depth work. In five additional countries it will provide long-term recurrent TI' and training support. To date, USAIDs with buy-in estimates in the range of \$750,000 to \$1 million include Zaire and Bangladesh. Substantial buy-ins for support services and specials studies are also planned by USAIDs Pakistan and Nepal; Indonesia plans a buy-in, and several other missions are interested.

The DFM project will provide three kinds of services, predominantly funded by USAID buy-ins:

(A) Applied Research and Long-term Field Teams.

A key activity during the first two years will be to establish applied research efforts evolving into closely monitored demonstrations of improved host country institutional and financial arrangements for road maintenance or other rural services supported by USAID projects. These long-term efforts, which assume placement of field teams in three countries, will become the heart of the DFM project. During the project's first three years they are expected to absorb the major share of resources and effort.

(B) Recurrent Technical Support and Training.

Short-term technical support and training teams will provide TDY services for (1) applied research, design or evaluation services, including support to policy dialogue on decentralization issues; (2) consulting and "team building" services to LDC organizations; (3) development of analytic skills, e.g., to improve understanding of institutional incentives, finance and benefit/cost factors in service delivery; and (4) building operational skills and capabilities to implement rural service delivery or cost recovery functions. These short-term support services are expected to be used extensively by the five "support" countries as well as the three "demonstration" countries.

USAID/Pakistan and other missions have emphasized involvement of host country research and training institutions and experts so that future work can be increasingly handled by host country people. DFM will address this important set of tasks.

(C) Dissemination, Networking and Coordination

As important lessons are learned from field experience and research, the project will insure the widespread sharing of findings through conferences, workshops, reports and publications.

Over its seven-year life the DFM project will complete in-depth tests of better ways to finance and deliver rural services (including road and irrigation maintenance) in three countries. It will provide recurrent services to strengthen the impact of USAID rural service delivery or decentralization policy projects in five additional countries. Finally, it will advance the "state-of-the-art of decentralized service delivery by using and promoting use of rigorous analysis as a complement to practical capacity-building through technical cooperation and training.

II. PROJECT RATIONALE AND DESCRIPTION

A. Project Rationale

There are four elements in the rationale for the Decentralization: Finance and Management Project:

1. Over-centralization of many aid recipient countries has contributed to poor economic and political performance. "Over-centralization" refers to both a tendency for governments to intervene in matters better left to private markets, and a tendency to conceive of "government" as having a single, dominant center with exclusive responsibility and authority for all matters "public."
2. A.I.D. and other donors have a great deal of experience with attempts to support decentralization in less-developed countries (LDCs). To date, results have been mixed. Respectable outcomes have been achieved in particular projects, and a number of countries--especially in Asia--have recorded solid progress in rural delivery of public services over the past 30 years. But in many countries, advances have eroded as centrist regimes neglected decentralized development or encountered economic difficulties. Predominant reliance on central budgets persists in almost all LDCs. Further, A.I.D.'s understanding of the institutional underpinnings of sustainable arrangements for local provision of services remains weak, and we have much to learn about the different arrangements that are needed for provision of different kinds of services.

3. Recent advances in the social sciences, not heretofore applied to decentralized service provision in LDCs, provide useful new tools to improve our ability to understand and support more effective, efficient, and sustainable efforts. Working through USAID projects, the applied research and technical assistance provided in this project will test these new tools, as well as support capacity-building with more familiar assistance tools and techniques.

4. A very serious problem is presented for most LDC governments by the financial and managerial difficulties inherent in operating and maintaining large, scattered rural infrastructure systems. Poor maintenance and failure to recover recurrent costs are the norm. International donors, lending organizations, and LDC governments, having invested heavily in creating infrastructure, are now investing in early, costly rehabilitation. Several USAIDs are making serious commitments to solving the evident problems of operation and maintenance in order to forestall the need for future iterations of the cycle.

These points are briefly elaborated in the sections which follow.

#### 1. Over Centralization

Many LDCs, especially those of Africa and Asia, are relatively recent evolutionary "products" of various colonial empires. Many, too, have evolved from monarchical or tribal regimes, sometimes with theocratic overtones. Whether colonial or traditional in origin, there are strong and deeply ingrained tendencies in these countries toward centralization of all activities of the "modern" sector under a dominant, monocentric government.

Colonies were primarily organized to be efficient extractive mechanisms, designed to control the productive activities of native subjects and to channel the available, or achievable, economic surplus to the colonial powers. Traditional regimes frequently performed similar functions for local elites.

These centrist root tendencies were only reinforced by the perceived need for rapid economic development and nation-building of the immediate post-colonial era. In an effort to "short circuit" the protracted, evolutionary process of several hundred years which had preceded Western economic and political development, LDC central governments, often encouraged and assisted by well-intentioned international donors, assumed powers and responsibilities beyond their actual capabilities and, in most cases, unjustified by subsequent performance. One dominant view

of LDCs is that they are characterized by "urban bias," inappropriate military and/or bureaucratic influence in national affairs, corruption, and a general tendency by peasants and elites alike toward "rent seeking behavior." Without subscribing to the notion that this characterization can be applied to all LDCs, or to all groups in any LDC, the DFM project does take the position that where the above malaise is present it is frequently a symptom of overly centralized political, administrative and economic institutions. At the same time, determination of optimum ways to handle decentralized provision and production of any given public service is a matter for systematic analysis, not for a priori determination. The general presumption against further centralization may or may not fit a particular case.

### 2. Experience with Decentralization of LDC Governments

In considering donor experience with decentralization of LDC government and administration, we have reference to great variety in objectives and strategies. Most projects intending to support decentralization have sought to do so by strengthening the administrative and/or planning capacities of one or more sub-national "levels" of government. Levels targeted for strengthening have varied widely, from province to village and many in between. Strategies frequently emphasize enticements to improved planning and/or implementation of development activities. Enticements are provided as "free" technical assistance, or as funding for sub-projects whose planning documents and/or process conform to pre-established criteria. Training in various aspects of "rational" planning or management is frequently offered as an inducement to participation and as the technical basis for improved administrative practices.

Results of these attempts have been mixed. There have been successes in strengthening the administrative capacities of sub-national governments, particularly in some of the Southeast Asian countries. The provincial development programs of USAIDs/ Manila and Jakarta come to mind. Donor investments in improvement of the Thai civil service also seem to have produced a competent and effective cadre whose impact reaches to all corners of the nation with largely salutary effect. Interventions elsewhere have, with some exceptions, produced rather disappointing outcomes. The salient outcomes are best summarized in the following points:

(A) In those instances where administrative capacities of sub-national governments are improved, effective decentralization of decision-making is not a necessary result. Strengthened administrative capacities can just as easily become an instrument of central domination. The Marcos regime's use of local governments is an example.

(B) A frequently reported cause of failure has been the unwillingness of central authorities to grant an appropriate degree of financial autonomy to lower levels of government. "Enlightened" central governments have tended to grant some autonomy with respect to local revenue sources and levels, but retain tight control over expenditures, thereby seeking to enlist the localities in the funding of centrally defined priorities and objectives.

(C) A second frequently reported cause of failure has been the paucity of skilled human resources at the lower levels of newly decentralized governments. Performance demands have greatly exceeded capacities.

### 3. Recent Advances in the Social Sciences

The DFM project represents a new approach to the subject of "decentralization." It plans the first application in LDCs of some of the most rapidly evolving sectors of current social science. These "sectors" include political economy (particularly "public" or "rational" choice theory), public finance economics and "the new institutional economics" (NIE). Samuel Popkin, Norman Nicholson, Robert Bates and others have applied choice-theoretic analytic frameworks to international development problems. S&T/RD's Local Revenue Generation and Administration Project (LRAP) greatly advanced the systematic application of public finance economics to local government finance in LDCs. Certain aspects of the NIE have been applied by James Roumasset, David Feeney and others to the analysis of LDC institutions. The DFM project is, however, the first systematic attempt to incorporate these frequently complementary approaches into a unified analytic program and the first attempt to examine LDC decentralization using these powerful tools.

It will be useful to emphasize some of the major differences between the logic of the DFM project and the logic that supported previous decentralization efforts. These differences may be summarized as follows:

(A) Individuals are boundedly rational; organizations may not be.

DFM assumes that individuals are rational and self-interested. Furthermore, they are the primary social phenomenon. If one wishes to analyze social reality, it is best to do so from the viewpoint of individuals. Previous decentralization efforts have tended to view public sector organizations as the phenomenon most worthy of analysis and to assume that they "behave" rationally. This assumption carries with it the notion that organizational actors pursue organizational, not personal, goals.

(B) Individual incentives vs. organizational skills and resources.

DFM places great emphasis on analyzing the many and varied incentives which can and do impact individuals in efforts to decentralize LDCs. Behavior (for example, decisions of organizational actors) is seen as self-interested. It follows that attempts to change behavior might best be based on a clear understanding of the incentives perceived by individuals and on efforts to modify those incentives. Previous efforts to deal with decentralization have paid only passing attention to incentives. Post-project incentives have been particularly neglected, and their neglect explains much of the failure to institutionalize and sustain many decentralization projects which achieved visible outputs during implementation. Previous decentralization efforts have tended to assume that failures in organizational performance were adequately explained as a lack of skills and resources. It was further assumed, often only implicitly, that organization members would use skills and resources for organizational purposes if they had them.

(C) Institutional arrangements for the delivery of specific goods or services vs. generic administrative structures.

DFM assumes that institutional arrangements are potentially infinitely variable and that they greatly influence the incentives presented to individuals in decision-making situations. When confronted with problematic outcomes (e.g., widespread, continuing, sub-standard road maintenance), the DFM analyst will seek to examine the various institutional arrangements (incentive structures) which impinge upon the situation and lead rational individuals to socially problematic outcomes.

Though the potential variety of institutional arrangements is infinite, the variety of effective, efficient, equitable, etc. arrangements in any particular situation is sharply constrained by the economic, social and technical characteristics of the good or service in question. Theoretically speaking, this means that "private" goods are best provided through markets, "public" goods require government intervention, and that "toll" and "common pool" goods are intermediate cases of considerable complexity, but clearly amenable to analysis. In reality, many goods and services have some mixture of the above characteristics and require government intervention in

some aspects of the institutional arrangements for their provision, and market arrangements for other aspects. The core of the DFM project's analytical work is the ability to comparatively analyze actual and potential institutional arrangements in order to determine their likely effects on delivery of a particular good or service.

By contrast, previous attempts to support decentralization have frequently confined analytic attention to a single organizational hierarchy. Within this hierarchy an attempt was made to move the locus of decision-making to lower levels, strengthen administrative and/or planning capacities, and, sometimes, incorporate provisions for user/beneficiary participation. Little analytic attention was given to the economic, social and/or technical nature of the good or service being produced. Alternatives to public sector bureaucratic production were often afforded insufficient attention. "Contracting out" was employed for certain functions, but its proper role was not well articulated. In the absence of comparative institutional analysis, decisions often led to strengthening of administrative hierarchies, even when the professed goal was "decentralization."

#### 4. Rural Infrastructure Operation and Maintenance

Among the valuable suggestions that DFM received from the Technical Sub-committee of the Rural Development Sector Council that advised on project development, was the suggestion that the project concentrate its applied research and long-term technical assistance on the decentralized provision of just one service, or a related small group of services, in its early years in order to maximize its chances for learning and eventual impact. Infrastructure operation and maintenance is a relatively well defined public sector service delivery "system." It is relatively easy to understand what the task is, or ought to be. The engineering requirements of the task are reasonably well defined. Current systems seem to malfunction because of a lack of knowledge regarding the appropriate institutional, managerial and financial dimensions of operation and maintenance. Thus, the expertise of DFM is apparently relevant to the problem.

The decision to sharply focus the project was further solidified during the course of TDY visits by project designers to several USAIDs. Among the many missions interested in decentralization and DFM, were several with planned or recently initiated projects supporting rehabilitation and maintenance of rural roads. Each of these mission projects proposed substantial attention to sustainable maintenance, but lacked a complete and convincing strategy for achieving it. Applied research and long-term technical assistance from DFM seems particularly appropriate.

DFM will concentrate on decentralized operation and maintenance of rural infrastructure (principally rural roads) during the early years, but the project does recognize that not all mission needs are confined to rural infrastructure situations. Some LDC governments, e.g., Bangladesh, Nepal, Sri Lanka, Sudan and others, face broad policy decisions with respect to decentralization that transcend the limits of any particular service. DFM will also respond to missions requests for technical assistance to support strategy formulation and policy dialogue of this type.

B. Conformance with A.I.D. Policy

DFM will strongly serve current A.I.D. policies by helping LDCs meet these needs (cited in the respective policy papers): (1) recurrent costs- a) ability to raise adequate revenue, b) allocation of public resources between capital and recurrent budgets; (2) private enterprise development- a) private sector participation in traditional government services, b) long-term financing of infrastructure; (3) institutional development- a) enhance a country's ability to marshal its own human and financial resources for development, b) provide individuals with opportunities to acquire the skills, resources, and services needed to increase their productivity, income, and well-being, and c) increase the likelihood that A.I.D. and host country resources will foster development that can be sustained after external assistance is withdrawn.

The Agency's Strategic Plan cites decentralization and local involvement in the development process as important means to improve the economic impact of both private and public sector programs (Blueprint for Development, p. 18). The project will address decentralization, local private initiative and decentralized finance needs stated at p. 45 of the S&T Bureau's CPSS and at p. 22 of its Action Plan. The U.S. Assistance Strategy for Africa highlights the need for continuing attention to rural infrastructure, as do a number of mission strategies in all regions. The view that government is the unique and necessary provider of infrastructure is consistent with the "Mellor model" recently put forth by John Mellor in "Agriculture on the Road to Industrialization." The project will be explicitly designed to

enhance the prospects for host country sustainability of infrastructure linked to very large resource transfers for infrastructure development by selected USAID programs including ESF (e.g., Pakistan) and Food for Peace (e.g., Bangladesh).

### C. Project Description

#### Concept

The DFM project attempts to respond to the problems and opportunities identified in the Project Rationale. The opportunities are fundamentally those of advancing the state-of-the-art in donor supported decentralization attempts through coordinated applied research and long-term or recurrent technical assistance. The project is based on three fundamental assumptions which are logically related to both the theoretical and practical constraints put forth in the Rationale. The assumptions can be stated as follows:

1. The sine qua non of local governments is (or ought to be) the delivery, in accordance with local preferences, of public goods and services to citizens.
2. Optimal institutional arrangements for delivering services will vary from one service to another and may include various combinations of public, private-for-profit, and private-not-for-profit agencies, as well as various hierarchical, contractual and market relationships among those agencies.
3. Any serious attempt to devolve powers of government must include careful attention to creating adequate locally controlled sources of recurrent revenues and appropriate local autonomy in expenditure decisions.

The implications of these assumptions are many and varied. Their significance is heightened when one juxtaposes them against the experience of previous attempts to support decentralization in LDCs and the current realities of LDC governments. The explicit focus on delivery of goods and services is a conceptual departure from previous donor-funded decentralization attempts and will necessitate fundamental changes in the point of view of many LDC civil servants. The emphasis on appropriate institutional arrangements suggests a more "messy" governmental apparatus than proponents of "improved" LDC public management have been willing to embrace in the past. "Contractual" and "market" relationships, although thoroughly consistent with the ways in which "hierarchies" actually operate, imply degrees of freedom which many analysts and practitioners of LDC public administration have previously rejected on both conceptual and normative grounds.

It should be noted that the DFM project does not propose to resolve (at least not single handedly) one problem earlier identified as a common source of failure in previous attempts to support LDC decentralization--the problem of insufficient skilled human resources in newly decentralized systems. DFM does propose a significant training effort, but the potential impact of these sessions will be limited to certain functions in selected locations. It is expected that, as a partial solution, USAID projects will make provision for necessary human resources development and that the DFM approach is its own partial solution to the problems noted in previous attempts in that it does not have administrative (bureaucratic) strengthening as a primary goal. DFM solutions to decentralization problems should be less reliant on skilled public managers and more reliant on appropriately motivated public managers and private citizens.

#### Approach

DFM will function as a center for the Agency's attention to resolution of the institutional and financial constraints on decentralized operation and maintenance of rural infrastructure systems. This project will conduct a centrally coordinated program of applied research on the institutional and financial difficulties of decentralized operation and maintenance of rural roads systems as the major activity of the first three years. Such research will provide specific suggestions to major buy-in missions as to the most appropriate courses of action to resolve rural roads maintenance problems. Research will also test specific hypotheses developed from the DFM theoretical framework. The project thus has a specific commitment to achievement of USAID project goals and to advancing the Agency's understanding of decentralized operation and maintenance of rural infrastructure systems.

The evolution of the project may see the extension of the lessons learned with respect to rural roads operation and maintenance to irrigation systems and to other problems such as natural resources management. DFM analytic methods are easily as applicable to irrigation systems as to feeder road systems, although the specific issues of irrigation systems will be somewhat different than those of road maintenance.

The project will have two principal modes of applied research and technical assistance. Those LDC governments and USAID missions making a multi-year commitment involving long-term, resident technical assistance staff provided by a DFM contract will be designated as Demonstration Countries (DCs). Under such multi-year buy-in arrangements, the DFM contractor will make a specific, negotiated commitment to the success of the buy-in mission project. The intent is to hold the DFM contractor responsible for specific aspects of the success of the buy-in project. These responsibilities will be negotiated at the time of

the multi-year buy-in and will normally be concerned with insuring the sustainability of decentralized modes of operation and maintenance. In Demonstration Countries the DFM contractor will attempt to maximize the transfer of analytic and operational methods to host country institutions through formal training and involvement of host country persons and institutions in DFM project work.

Recurrent technical assistance, or special studies, design, or evaluation efforts will be provided by USAID buy-ins in DFM Support Countries. The commitments made by DFM in Support Countries will generally be limited to specific high-quality products, consultations, or training sessions, with responsibility for project outcomes left to USAIDs, "roads" contractors and host governments. However, recurrent support, quality control of TDY teams, and DFM's strong analytic tools and cross-country learning should greatly benefit host countries through USAID programs.

The project activities and outputs mentioned so far are all country specific, or at least derived in the context of a country-specific activity. DFM will also work with analytic frameworks, tools, and syntheses of experience that transcend the limits of country-specific work. It will be in these more general documents that advances in the state-of-the-art of decentralization will be evaluated and recorded. Documents of this kind will include an initial state-of-the-art paper with a life-of-project applied research prospectus and annexes treating road maintenance (year one) and irrigation maintenance (year two). An interim guidance paper for LDCs and donors, plus end-of-project guidance and a state-of-the-art summary will be produced. Research and development reports, four academic journal articles and a book are also planned.

Finally, it is intended that DFM serve as a catalyst and coordination point for LDC, A.I.D. and other donor efforts dealing with decentralization. The concerted program of DFM action and research is intended to help stimulate related and coordinated efforts from other sources. DFM will seek to establish networks of interested persons and institutions in order to maximize discussion, learning, and dissemination of the approaches which emerge as useful.

#### D. Objectives

##### Goal

The goal of the DFM project is "Economic growth, increased income and wide access to goods and services." The DFM project shares this goal with many other projects, both host country and A.I.D. financed, and will complement them. Measures of progress in attaining the project's goal will be explicitly linked to goal attainment for the specific USAID projects that DFM is working with.

Achievement of the project's goal will depend on economic conditions and the quality of government and donor economic, education, health, and other programs. Factors that are outside the project's control, but which influence its achievement of objectives, are called "assumptions" in A.I.D.'s logical framework system for designing projects.

#### Sub-goal

The DFM project's sub-goal is "Sustained usefulness and use of rural infrastructure." Sustained usefulness of rural infrastructure requires satisfaction of both technical criteria and user preferences. From a technical standpoint, it means slowed deterioration, reduced frequency of facility breakdown and increased life for capital investment. From the users' viewpoint, sustained usefulness means that user preferences regarding access to services are increasingly fulfilled, and per unit costs and time spent acquiring services are less than perceived benefits. Sustained use of rural infrastructure is measured by frequency, function and socioeconomic class (which addresses equity issues). Measurement of project progress in meeting both usefulness and use indicators for the goal would include both absolute levels and trends over time.

Illustrations of sustained infrastructure usefulness would be a stable or growing number of kilometers of passable roads by season and vehicle type over time, and reliable access to irrigation water at a price users are willing and able to pay. Examples of sustained use would be stable or increasing numbers of people using roads for market, education and health purposes, and stable or growing quantities of irrigated land or numbers of farmers irrigating their land.

Achievement of the sub-goal depends on the existence of economic and social activities that utilize rural infrastructure; user access to the equipment, facilities and income necessary to make use of infrastructure; and the technical maintainability of rural infrastructure.

#### Purpose

The DFM project purpose is "Increased decentralized capacity to finance, manage and maintain rural infrastructure. It is achieved when the following occur:

- i. maintenance and repair functions are carried out regularly over time;
- ii. recurrent costs are covered by a combination of fees, local taxes and, when appropriate, transfers from central governments; and,

- iii. multilevel institutional arrangements exist that allow expression of user preferences, their translation into infrastructure maintenance and recurrent cost coverage.

Achievement of the project's purpose depends on the political and administrative feasibility of decentralization, including willingness of the host country government to decentralize, sufficient potential incentives from decentralization, local willingness to take on the responsibilities and costs of infrastructure maintenance, and the desire of USAID missions to support decentralization. In logical framework terms, these factors are "partial assumptions" since they are not totally beyond the control of DFM project personnel. The project will attempt to influence purpose level feasibility factors through policy dialogue with host country governments and successful demonstrations.

#### E. Outputs and Expected Achievements

Expected outputs and achievements during the DFM project will include the following:

- tested methods for the design and operation of sustainable decentralized finance and management systems;
- demonstrations of sustainable decentralized rural infrastructure maintenance systems;
- decentralization policy guidelines;
- a trained cadre of host country individuals who are capable of designing and operating decentralized finance and management systems; and,
- a network of international development practitioners and scholars interested in sustainable decentralized finance and management systems.

These expected accomplishments are discussed in more detail in the following subsections.

#### Tested Methodologies for the Design and Operation of Sustainable Decentralized Finance and Management Systems

These will be developed within a context of rural infrastructure maintenance, but will also be adaptable for resolving recurrent cost and local management problems in a broad range of situations. Two primary tools will be used in these methodologies.

First, diagnostic procedures will be used to assess the feasibility and appropriateness of decentralized finance and management of specific functions in developing countries. The diagnosis will address decentralization in developing country contexts from both institutional and public finance standpoints. Issues addressed by these diagnostic tools will include:

- the tasks and management arrangements required by different types of rural infrastructure;
- whether the infrastructure maintenance problem warrants decentralization;
- inducements and obstacles to decentralization from different perspectives; and,
- the public finance implications of decentralization.

Second, techniques for designing decentralized institutions to finance and manage the maintenance of rural infrastructure will be developed. Design tools will state the conditions under which different decentralization arrangements are appropriate. Problems addressed by the design tools will include:

- matching of infrastructure problems with jurisdictional units and organizational structures;
- assignment of finance and management tasks and responsibilities;
- design of local finance and management systems;
- design of contracts with maintenance and repair organizations; and,
- development of tools to monitor and evaluate the cost-effectiveness and responsiveness of decentralized finance and management institutions.

#### Demonstrations of Sustainable Decentralized Rural Infrastructure Maintenance Systems

In cooperation with local people and specific USAID projects, the DFM project will analyze, design, set up and support rural infrastructure maintenance demonstrations that can be replicated. As its primary purpose, the project will seek to produce sustainable infrastructure maintenance and cost-coverage processes wherever it makes an intervention.

## Decentralization Policy Guidelines

In addition to design and management tools, the DFM project will produce policy recommendations on generic decentralization, public finance and recurrent cost problems and issues. Although the project will focus on specific rural infrastructure maintenance problems, it will generate guidelines on decentralization for both the countries in which it works and for general use in LDCs.

## Trained Cadre of Host Country People

The DFM project intends not only to influence policies and procedures in the participating countries, but also to provide a basis for improving performance throughout A.I.D. and the developing world. Thus, training based on the tools and methodologies just discussed is an important project contribution. The project will promote human resource development through the following activities:

- training or assisting host country people to analyze and reach decisions on decentralization demonstrations (through short-term, in-country training programs);
- educating and training host country people to analyze and design multilevel, decentralized finance and management systems (through long-term training at the graduate level either in-country or abroad, and through supplemental short-term training.);
- training or assisting host-country people to perform the operational functions needed in demonstrations of sustainable rural roads maintenance finance and management (or other service delivery);
- preparing training materials for in-country demonstration or replication programs; and,
- preparing materials for training programs emphasizing the design and operation of decentralized finance and management systems that can be used generally in graduate and professional institutions in developing countries.

## Network of International Development Practitioners and Scholars

Methodologies, conclusions and policy guidelines regarding decentralization in the developing world will be communicated to research and development communities by means of publications,

workshops and conferences. Particular target populations will include:

- LDC policy-makers, program managers, experts, and trainers;
- other development practitioners (including donors); and,
- LDC and international researchers and analysts.

### III. COST ESTIMATE AND FINANCIAL PLAN

#### A. Cost Estimate

Total cost of the project is estimated at \$16.61 million, distributed as follows:

- S&T Bureau - \$4.6 million (including \$130,000 contingency unallocated in the financial plan);
- ANE - expected to contribute \$.05 million to the S&T total above through an FY 87 PIO/T or OYB transfer; and,
- USAID Missions - \$12.01 million.

S&T Bureau core funding will provide for overall administration of the applied research and field work, for elements of R&D which cut across individual mission projects and programs, for comparative state-of-the art work, for donor and LDC coordination and exchange, for publications and dissemination, and for part of training design and support costs. S&T (or other A.I.D./W) funding for the principal contract is expected to support 220 person-months of U.S. professional and 84 person-months of U.S. administrative personnel over seven years. Other S&T procurement is expected to support about 30 person-months of U.S. professional and 15 person-months of U.S. administrative services and about 37 person-months of LDC professional and 19 person-months of LDC administrative services.

ANE intends to support the core activities of the project for comparative regional research or support work.

Field work affecting a particular country, or participation of host country people in research, TA, training, R&D workshops, or related activities, will ordinarily be mission-funded. S&T funds may be used to support field work of any type, but funds for field work will nearly always come from USAIDs. Mission buy-ins are expected to come mainly from project funds. However, the project will also support analysis for strategy, program analysis, and project development, so PD&S funds may be used. Mission buy-ins are projected for distribution approximately as follows:

- principal contract, \$12.01 million over seven years. USAIDs are projected to support long-term field teams for four years in two countries and for three years in one. Each of these teams is budgeted to include two U.S. professional and one U.S. administrative person, and local-hire support aggregating about 13 person-years of professional and 13 years of administrative work. In addition, short-term services to the three "demonstration" and five "support" country missions is projected to require 180 person-months of U.S. professional services, 30 person-months of U.S. administrative services, and 89 months each of local-hire professional and administrative services.
  
- through FY 89 S&T/RD will obtain "start-up" support for DFM from the Decentralization Advisor of the National Association of Schools of Public Affairs and Administration (NASPAA). He will support both A.I.D. and the principal contractor in documenting a knowledge base and research prospectus for the project, and work with the contractor and USAIDs on country baseline study and planning tasks, especially in "demonstration" countries. Missions may also utilize the grant or contract mechanisms of NASPAA within authorized levels of the S&T/RD Performance Management Project. Such use of mission funds is especially appropriate to mobilize university people for tasks that emphasize R&D on management of developing country programs and are intended to strengthen NASPAA and U.S. university resources for international work.
  
- Other Procurement. For S&T, other regional and central bureaus, and field missions, there will be circumstances (e.g., evaluations) when an independent perspective is required, or when the requisite work is within the scope of the DFM project, but not available from the continuing mechanisms of the principal contract. Hence, procurement from other sources is authorized. USAIDs may utilize this authority along with S&T or regional and central bureaus. S&T procurement of \$285,000 is provided; missions may buy in as a contingency in lieu of using the principal contract.

Within the overall ceiling authorized for S&T and for buy-ins, procurement may be shifted from one contract or grant mechanism to another as required over the seven year life of the project. Authorized ceiling provided in the principal contract, and not yet used, may be reallocated to other A.I.D. missions, bureaus and offices as required by changing circumstances. All such reallocations will be accomplished within then-current procurement regulations, and documented in annual workplans.

## B. Financial Plan

Table 1 shows the distribution of estimated A.I.D./W and Mission obligations for LOP.

Table 2 shows indicative LOP obligation, pipeline, and expenditure estimates for S&T and for USAIDs by different implementing mechanisms.

Table 2 of Annex 5 contains FY 89-94 estimates of USAID buy-ins to the principal contract by type of activity. The estimates assume an annual inflation rate of 4 percent on the cost estimates for each year after FY 88.

Table 1 of Annex 5 contains an indicative LOP estimate of S&T obligations and expenditures under the principal contract, along with line-item cost estimates for S&T core funding. USAIDs are also expected to pay a portion of core staff costs incurred for field work. The S&T core accounts for \$484,000 of FY 88 principal contract expenditure estimates.

## IV. IMPLEMENTATION PLAN

Project preparation, initial obligation of \$320,000, and signing of the principal contract are scheduled for FY 87. S&T/RD's Institutional Development and Management Division and the NASPAA Decentralization Advisor will continue with identification of USAID requirements during FY 87. In addition, S&T/RD/IDM and NASPAA will continue to gather and critique technical materials and field project descriptions and analyses. These will be shared with the principal contractor when the contract is signed. USAIDs Bangladesh, Zaire, Nepal, and Indonesia have all indicated their interest in early buy-ins. Plans for these start-ups will also be laid during FY 87. The implementation plan in Table 3 lays out key events and activities for fiscal years 88 through 94. Because the kind, number and scheduling of USAID-funded activities and some S&T/RD and other A.I.D./W activities cannot be precisely predicted, the plan is intended to be flexible. More precise definition of activities will be documented in a workplan prepared annually by the principal contractor. The workplan will cover activities for the next FY in considerable detail, and will project planned activities for a second year. The detailed portion of the work plan covering the next FY will be subject to approval by S&T/RD, and may contain country annexes for USAID approval of plans and funding for the next FY.

## V. MONITORING PLAN

S&T/RD's designated project officer will be responsible for overall monitoring, and for involving regional bureau and other A.I.D./W people involved in backstopping. To facilitate A.I.D./W coordination, a continuing project committee will meet as needed.

Table 1.  
Estimated AID/W and Mission  
Obligations, Life of Project  
(\$000)

	<u>S&amp;T</u>	<u>Other AID/W</u>	<u>USAIDs</u>	<u>Total</u>
FY 87	320	50 ANE	-	320
FY 88	450	non	600	1,050
FY 89	450	add	1,000	1,450
FY 90	650	to	2,510	3,160
FY 91	650	S&T	2,450	3,100
FY 92	650		2,650	3,300
FY 93	650		1,800	2,450
	650	-	1,000	1,650
	<u>4,470</u>	<u>          </u>	<u>12,010</u>	<u>16,480</u>
Contingency	<u>130</u>	<u>          </u>	-----	-- 130
Totals	4,600		12,010	16,610

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Table 2  
Decentralization: Finance and Management  
Funding Plan, S&T (\$000)

FY	<u>Contract</u>			<u>R&amp;D Tech. Guidance and Field Liaison</u>				Obl.	<u>Other Procurement</u>	<u>Total LOP</u>	
	Obl.	Avail.	Exp.	Pipeline		Pipeline					
				9/30	Obl.	Avail.	Exp.	9/30			
87	320	320	0	320	[Perf. Mgt. Proj.]			10]			
88	350	670	484	186	100	110	60	50			
89	400	586	511	75	-	50	50	0	50	LDC Grants	
90	650	725	580	145	-	-	-	-	-		
91	580	725	590	135	-	-	-	-	70	Evaluation	
92	625	760	620	140	-	-	-	-	25	LDC Grants	
93	600	740	640	100	-	-	-	-	50	LDC Grants	
94	560	660	660	0					90	Final Eval.	
95											
<hr/>											
Totals	4,085		4,085		100				285		
										Contingency	130
										LOP PAF	4,600

Regional and Central Bureaus, Contract

ANE will provide 50 for contract in FY 87 by OYB transfer (included in S&T 320 shown above).

Funding Plan, USAIDs (\$000)

FY	<u>Contract</u>				<u>Program Management and Training</u>				Obl.	<u>Other Procurement</u>	<u>Total LOP</u>
	Obl.	Avail.	Exp.	Pipeline 9/30	Obl.	Avail.	Exp.	Pipeline 9/30			
87	-	-	-	-	<u>b/</u>						
88	600	600	350	250	<u>b/</u>						
89	1,000	1,250	562	688	<u>b/</u>						
90	2,510	3,198	1,274	1,924							
91	2,450	4,374	2,369	2,005							
92	2,650	4,655	2,749	1,906 <sup>a/</sup>							
93	1,800	3,706	2,976	730							
94	1,000	1,730	1,730	0							
<hr/>											
Totals	12,010		12,010								

( 9,210 basic contract, 2,800 extension)

Note: Contract will provide for a two-year extension at the option of the U.S. Government for FYs 93 and 94.

<sup>a/</sup> Assumes extension option exercised.

<sup>b/</sup> USAID buy-ins authorized under Performance Management Project FYs 87-89.

Table 3: Implementation Plan

GLOSSARY: AR = Applied Research  
 DC = Demonstration Country  
 EAT = Executive or Analytic Training  
 LOP = Life of Project  
 R&D = Research and Development  
 SC = Support Country  
 SOAP = State of the Art Paper  
 TCAR = Tech Cooperation or Applied Research Outputs  
 (Predominant USAID Funding)

Year 1 (FY 88)	2 (FY 89)	3 (FY 90)	4 (FY 91)	5 (FY 92)	Optional Contractual Extension Period	
					6 (FY 93)	7 (FY 94)
Contract begins: 2-yr. workplan w one-year approval Baseline papers w LOP AR prospectus and roads annex DC #1 selected Country baseline/ plan prepared.	2-yr. workplan; FY 90 approved Irriga. Annex to Baseline R&D Workshop (Donors, 3 LDCs) DCs 2, 3 selected and baseline/plans prepared.	2-yr. workplan; FY 91 approved DC #1 R&D Workshop Long-term advisors arrive DCs #1 and #2 mid-yr.	2-yr. workplan; FY 92 approved R&D Conference (Donors, 5 LDCs) Guidance paper Long-term advisors Arrive DC #3 mid-yr.	2-yr. workplan; FY 93 approved Optional SOAP (See YR 7) DC #s 2, 3 R&D Workshop.	1-yr. workplan; FY 94 approved R&D Grant to host country.	Final SOAP Final R&D Conference (Donors, 5 LDCs) 3 teams LT advisors return mid-yr. 1 set final guidance papers Select library donated to university.
3 DC TCARs	3 DC TCARs	3 DC TCARs	2 DC TCARs	2 DC TCARs	2 DC TCARs	2 DC TCARs
SC #1 selected	SC #2 selected	SCs #3, #4 selected	SC #5 selected			
1 SC TCAR	1 SC TCARs	2 SC TCARs	3 SC TCARs	4 SC TCARs	4 SC TCARs	3 SC TCARs
	2 EAT training sessions (either DC or SC) Select library estab. 50 documents disseminated	2 EAT 2 operational training sessions 100 documents disseminated	3 EAT 3 operational training sessions 150 documents disseminated	2 EAT 4 operational training sessions 200 documents disseminated	2 EAT 5 operational training sessions 200 documents disseminated	2 operational training sessions 300 documents disseminated
		1 article published	1 article published	1 article published	1 article published 1 book published	
		Management Review	Proj. Evaluation  Feb. '91 decision on optional extens. of contr. (Yrs 6, 7)		Management Review	Final Evaluation

The structure of the project also demands collegial monitoring by people from host country, USAID, other donors, and implementation organizations. Host country people responsible for demonstration efforts, and designated USAID managers in "demonstration countries" will play an especially important role.

Because of the scale of the effort and strictures on direct-hire staffing and travel funds, a special externalized technical monitoring role has been designed into the project for R&D and mission liaison functions. A Decentralization Advisor of the National Association of Schools of Public Affairs and Administration (NASPAA) will work both to strengthen NASPAA's capabilities and knowledge-base for decentralized program management, and to serve from FYs 87 through 89 as an R&D specialist, monitor and coordinator on behalf of host countries, missions, S&T/RD/IDM, and resource organizations or individual experts. The NASPAA Advisor will help the principal contractor acquire and use analytic frameworks, accumulated materials, and knowledge of host country and USAID needs and interests. The advisor will also assist the contractor in initial field work, including research planning, and continue a technical monitoring and R&D support role through FY 89.

The principal contractor will provide primary documentation of progress and plans through a) annual R&D and progress reports, and b) annual two-year workplans. USAIDs are expected to contribute to this monitoring and planning work by funding of country-specific annexes to the annual reports and plans.

## VI. SUMMARIES OF ANALYSES

This section contains very brief summaries of the analyses (Annexes 4-8) performed in the project development process. The analyses were intended in part to provide a strong basis for the project's applied research. This is particularly true of Annex 4, which is composed of discrete, but related, appendices dealing with the proposed conceptual frameworks of the DFM project.

Annexes 5 through 8 are more traditional in their subject matter (economic, financial, social, administrative and environmental analyses), but not so traditional in their conclusions. In general, the annexes support the conclusion that LDC impact will depend greatly on the success of field work linked to USAID buy-in projects.

### A. Annex 4 - Technical Analyses

Though the subject matters of the nine appendices that comprise this annex are quite disparate, they provide a prima facie case for the usefulness of the conceptual framework which underlies the applied research and technical assistance that will be the core of the DFM project. Collectively, these appendices

answer the question, "Why should we presume that this research is worth doing and will lead to valid and useful conclusions?" They are:

Appendix A - Case Evidence Supporting DFM Working Hypotheses.

Appendix B - Summary of A.I.D. and World Bank Experience with Rural Roads Projects.

Appendix C - Summary of A.I.D. and World Bank Experience with Decentralization.

Appendix D - Decentralized Finance and Management for Development. (Not attached. Incorporated by reference)

Appendix E - Institutional Analysis: Procedures and Results.

Appendix F - Public Finance Analysis: Procedures and Results.

Appendix G - Infrastructure Maintenance as a Local Public Good.

Appendix H - Problems and Strategies.

Appendix I - Demonstration Activities.

The appendices have been grouped so as to emphasize commonality of subject matter among adjacent appendices. Appendices A through C report the experience which suggests the need for and feasibility of a project dealing with the operation and maintenance of rural infrastructure. Appendices D through H deal with various aspects of the conceptual basis of the proposed project. Appendix I forecasts in some detail the "demonstration country" mode of operation of the project.

1. Experience.

Appendices A, B and C review the three kinds of experience relevant to the design of this project. Appendix A reviews the "case" or "anecdotal" evidence regarding five issues thought to be central to the eventual success of the DFM project:

(A) local infrastructure maintenance;

(B) local revenue generation and resource mobilization;

(C) local self-regulation;

(D) separation of the provision and production of infrastructure maintenance services; and

(E) multilevel, overlapping jurisdictions as efficient systems for the provision of maintenance services.

The first three deal with the capacity of local groups to perform the functions identified. That is, do we have at least prima facie evidence that local groups can and/or will successfully maintain local infrastructure, mobilize resources, and regulate themselves in the use of infrastructure or other economic resource systems? The Appendix identifies many instances in which these functions have been successfully performed with respect to roads, bridges, irrigation systems, water supplies and schools. Local groups have performed these functions, sometimes for very extended time periods, with varying degrees of involvement and supervision from central authorities and external donors.

Factors four and five deal with structural arrangements for decentralized service delivery thought to be preferable by DFM project designers. The Appendix concludes that aspects of these types of structures are commonly found in existing LDC public service delivery systems, particularly road maintenance systems.

The Appendix considers the feasibility of road maintenance in technical, economic and social terms. Local routine maintenance, which can be a relatively labor-intensive activity, is well within the range of local technical feasibility, subject only to a minimum population density requirement. From the economic point of view, the aggregate payoffs to maintenance activities appear to provide strong incentives and to be capturable by local groups. The conclusion is worth quoting:

Local finance of rural road maintenance appears to be economically feasible in the aggregate, drawing upon user-based finance mechanisms. The amount of revenue generated for a given road from user charges, however, depends on the rate of use in vehicles per day. At the same time, maintenance needs are only partially dependent on rate of use. This implies some variability in the feasibility of local user-based finance from one road to another.

This conclusion points to the need for careful attention to understanding individual local realities and to constructing the institutional arrangements necessary for "capture" and distribution of costs and benefits with local realities in mind, rather than mythical "averages."

Appendix B identifies various institutional arrangements which have been, and are being, used to provide local maintenance services. Among the arrangements cited are use of local, commercial agricultural companies and parastatals to maintain roads essential to business; agreements between central road

authorities and local road-maintenance associations; and, increasingly, the use of private road maintenance contractors. The Appendix notes that:

"The institutional development efforts of both A.I.D. and the World Bank have been largely focused on strengthening national institutions to maintain primary and secondary, usually paved, roads. These efforts have been directed mainly toward the development of professional capabilities in central highway bureaus and toward appropriate financing and budgeting techniques. Community participation in rural roads projects have been undertaken largely as an adjunct to national rural development efforts that are primarily oriented toward planning and construction. Local institutions have been taken as given. Yet sustained community maintenance of rural roads has been rare (World Bank, 1985, p. 8). This indicates a need to try out fundamentally different approaches. One approach is to concentrate on the creation of new local institutions, specifically designed and tailored to provide rural road maintenance in particular communities.

The Appendix concludes with a section dealing with specific country experiences of A.I.D.

Appendix C begins the task of reviewing donor organization's experience with decentralization. The Appendix is presented in three sections:

- (A) Global review by development organizations of experience with decentralization;
- (B) Case studies of specific attempts to implement decentralization; and,
- (C) Reviews of decentralization literature and theoretical discussion.

The Appendix notes that decentralization has taken a number of forms: a) deconcentration of functions within the central bureaucracy; b) delegation to semi-autonomous or quasi-public corporations; c) devolution to local government; and d) transfer of functions to non-governmental organizations. The Appendix lists factors which may affect success of decentralization efforts, including fragmentation of local governments, limitation of sources of local revenue, levels of local capacity, and conflicts between capacity-building and production objectives.

Samples of A.I.D. and World Bank experience are based on available documents, not a systematic review. The material suggests that decentralization efforts in some countries (e.g., Indonesia, Morocco, Thailand, Pakistan and Tunisia) may be

associated with improvements in resource distribution, local participation, extension of public services into rural areas, project identification and implementation, and employment generation.

The review identifies a pervasive lack of conceptual clarity in the "decentralization" literature as a problem, noting that:

Much implementation and research work has been done by development organizations in the area of decentralized administration. Sometimes the work has been done explicitly in the name of decentralization. Just as often it has been undertaken with other objectives and using other terminology.

The Appendix goes on to identify a number of potentially relevant documents for future analysis ranging from single-case studies of efforts to strengthen a particular aspect of local government to global summarizations of knowledge about decentralization. Although the heterogeneity of this experience will make it difficult, the early stages of the DFM project will include a review and critique of this material to derive reliable generalizations and identify fruitful hypotheses to guide applied research and field work.

## 2. Conceptual Basis of the DFM Project

Appendices D through H deal with aspects of the DFM conceptual framework. The tone of these appendices is explanatory and advocative. Appendix D (incorporated by reference) was written in May, 1986 as the concept paper for this project; it provides by far the broadest overview of the conceptual framework. Appendices E through H supplement Appendix D and the conceptual sections of the Project Paper. Appendices E through H provide "discrete" treatment. Appendices E and F may be especially worthy of further attention during project implementation, because they describe the two major analytic procedures anticipated for DFM--institutional analysis and public finance analysis.

### B. Annex 5 - Economic and Financial Analysis

Benefits of the DFM project are difficult to quantify. This is particularly true of the benefits to be derived from the core funding to be contributed by S&T. The benefits which are expected to result from this funding include the following:

- the capability to learn about and improve the practical ability of decentralized decision-making units in developing countries to maintain infrastructure investments;

- the ability to provide technical support to USAID missions, through the DFM project, for policy dialogue with developing countries decision-makers on the crucial issue of finance and management of decentralization; and,
- a means to systematically disseminate DFM project findings to interested policy makers, analysts and researchers in the developing world and elsewhere, thereby improving overall understanding of the issues involved in decentralized finance and management systems. While these benefits are significant, they are also largely intangible and, for that reason, probably impossible to quantify.

Benefits to be derived from USAID mission buy-ins to DFM are somewhat easier to identify and will be relatively easy to quantify in the context of USAID projects. Among the benefits which will result from improved and sustained maintenance of rural roads are the following:

- lower transportation costs;
- higher farm-gate prices for commodities;
- increased agricultural production;
- improved access to agricultural credit;
- generally higher land values for land located near maintained roads;
- increases in small scale commercial and industrial enterprise activity; and,
- improved access to and, in some instances, greater usage of social services, such as health clinics and primary education.

A number of alternative ways to achieve effective and efficient use of S&T/RD funds in the project were considered during PP design, and are briefly discussed in Annex 5. The main benefit/cost issues revolved around means to achieve a) enough concentration to increase the probability of reliable learning and of impact in cooperating countries, along with b) economy of scale in both comparative applied research and provision of field support. The option of providing a broad menu of services in response to a broad set of USAID needs was rejected early in the design process in favor of both sub-sector and country concentration. This led to the decision to concentrate on rural infrastructure as a sub-sector and on about three "demonstration" and five "support" countries. It was the consensus of the Subcommittee of the RD Sector Council which played a key role in

design decisions that these parameters would assure reasonable concentration, while achieving good economies of scale in field work.

During the PID review the issue of LOP mortgage was raised in the light of possible straight-line funding for the S&T/RD Office over the next few years. At the same time, the Subcommittee, especially AFR and ANE representatives, were urging an S&T input commensurate with the large Mission buy-ins anticipated (\$12 to \$15 million LOP). This issue led to unusually detailed PP budget analysis, and an agreement endorsed by S&T/HR that S&T/RD inputs should be authorized at a \$4.6 million LOP level. Hence, there is good reason to believe that S&T funding is provided at the minimum level required for overall DFM management, R&D, and dissemination requirements, with USAID funding to cover nearly all tasks which will have specific country benefits.

### C. ANNEX 6. Social Soundness Analysis

#### Introduction

The major impacts of DFM in LDCs will be achieved through its buy-in USAID mission projects, each of which will operate under its own social soundness analysis. The eventual impacts of DFM will be accounted for in the social soundness analyses of the USAID projects.

The DFM project is likely to have very positive social impacts because the primary purpose of the project is to conduct a program of applied social research in order to improve and sustain the impacts of USAID mission projects. Improving the social soundness of buy-in projects and improving the Agency's social science knowledge base in this area is the primary justification for DFM.

Social impacts of DFM will benefit from the strict analytic focus on individuals and the incentives that they perceive. To the extent that views of a wide range of participants can be captured and reflected in project interventions, project impacts are likely to be increased and more sustainable. The focus on individual incentives will include gender differences.

In each USAID "demonstration" project, relationships between existing state organizations and local socio-political cultures will have to be analyzed in detail. The latter will strongly influence feasibility of institutional innovations designed to decentralize finance and management functions to local levels.

#### Beneficiaries

Benefits of the S&T/RD funded portion of the project will be spread among host country government officials (both central

and local) local researchers and trainers, USAID staff, other international development practitioners and scholars. The primary benefit of the S&T funding is increased knowledge of sustainable, decentralized finance and management of rural infrastructure operation and maintenance. The initial benefits of this knowledge will redound to LDC government officials, local experts in research and training institutions and international assistance officials.

Primary beneficiaries in buy-in projects will be rural people who use the target resources. Ultimate benefits will be increased incomes. Individuals who send farm produce to market on feeder roads, or depend on irrigation as a basic production input, will constitute the primary beneficiaries. Farm inputs and produce will be transported at lower cost due to decreased vehicle operating costs and extended transport seasons.

Irrigators will benefit from more reliable and, in some cases, increased water supplies. Indirectly, other rural and urban people will benefit through enhanced performance of local and regional economies. Performance will be improved by lowering costs per unit of road or irrigation system outputs (transportation and water) and by more efficient allocation of resources between road or irrigation system construction/rehabilitation and road or irrigation system operation and maintenance.

Decentralized rural infrastructure maintenance is relatively labor intensive. Local laborers will benefit from DFM activities, through increased demand for their services. An especially appealing example of the way this might work is current work by CARE, with financial support from the Canadian International Development Agency, in Bangladesh in which groups of destitute women have contracted for maintenance of rural roads.

Finally, central governments of participating countries will benefit because the project's approaches to decentralized finance and management will to some extent reduce the central government's burden of financing and managing development activities by mobilizing more revenues within local communities. This should increase central government flexibility by reducing its dependence on outside financing. Within a context of level or shrinking aid budgets and the pressures of debt repayment, this will be an extremely desirable consequence of the project.

#### Participation

When authority is devolved from central or intermediate government jurisdictions to local-level regimes, and offices are multiplied, chances for effective participation increase. When political and financial power are transferred in tandem from central to local jurisdictions, local people can exert more

influence on funding levels and expenditure goals than they can when central government officials must approve all activities and appropriations.

Participation in infrastructure management will take many forms. Decisions to promote popular participation must be fitted to the problem and the circumstances, and sometimes subordinated to the criterion of allocative and productive efficiency. In some instances, combinations of public jurisdiction, voluntary association and private firm production of O&M may be indicated. In others, sole reliance on private sector producers of road maintenance services may be the most rational approach. Most resource management projects will rely increasingly on devolution of management authority to local levels and to individuals.

All affected parties (or their representatives) should ideally participate in project design and evaluation stages, though not necessarily in implementation. The extent to which all parties participate will be determined in part by the nature of the project. However, effective representation must be facilitated at all decision making stages for voluntary associations, local jurisdictions, and private firms, when and as these different organizations play a role in management or maintenance activities.

#### Socio-Cultural Feasibility

Several major issues of socio-cultural feasibility have been identified and will be the subject of considerable attention during DFM implementation. These issues include:

1. Willingness of the host country government to decentralize or devolve significant decision-making authority over program activities and financing to local regimes;
2. Capacity of local jurisdictions and voluntary associations to provide certain services, in terms of financing, planning and either controlling implementation or actually implementing activities effectively;
3. Local jurisdiction capability, if public production is envisaged, and private sector viability and capability, where private production of some or all required services is indicated;
4. The danger of "capture" of infrastructure maintenance activities by local elites, with subsequent diversion of benefits; and,
5. The danger of collusion, or various "barriers to entry," undermining competitive processes for the allocation of public resources.

The existence of these dangers is the ultimate argument in favor of a DFM-type project, which concerns itself with the socio-cultural feasibility of decentralized rural infrastructure maintenance. It is not only DFM which is potentially undermined by these dangers, it is the very feasibility and sustainability of rural infrastructure maintenance.

Secondly, DFM's analytic approach, emphasizing the study of incentives as perceived by individuals and comparative institutional analysis, offers reasonable hope of being able to cope with these dangers.

### Impact

DFM and USAID buy-in projects will contribute to the goal of helping people in developing countries increase their incomes and meet their basic human needs. Only through enhanced economic growth can some or all of the revenues required for infrastructure maintenance and management be generated at the local level.

If proper incentives are provided, private and individual interests will lead those affected to sustainable patterns of interaction involving both collaboration and competition for shares of the stream of benefits arising from the increased efficiency and productivity. To the extent that collective action is a necessary part of the institutional framework for sustaining benefit flows beyond an initial investment period, the costs of such action can be at least partially financed from benefits generated.

The macro-impacts of DFM will be felt in two ways. First, more efficient resource allocation will have lasting and multiplicative impact. Both public and private sector productivity will be enhanced by having appropriate combinations of markets and hierarchies. Second, the motivating effect of providing local public services in accordance with local preferences and within the bounds of local willingness to pay should not be underestimated.

Sustainable arrangements, valued by a majority of local citizens, are possible if one starts from a position that attempts to understand the situation from the points of view of individual participants. Arrangements sustained through time by the acceptance of large numbers of participants, are the only arrangements which can have major impacts.

### D. Annex 7 - Administrative Analysis

This annex describes suggested administrative arrangements and implementation requirements for the DFM project in A.I.D./Washington and buy-in USAIDs. Administratively, the project is fairly typical of S&T projects in that the overall

coordination and management of the project is provided (and funded) by S&T, but participating regional bureaus and major buy-in missions can influence the course of the project through an on-going project committee. This type of shared management has proven to be an effective working arrangement in numerous S&T projects, although not without its costs in terms of additional communications and negotiations among the various parties involved

The administrative arrangements of the project will include a project manager and a backstop from S&T/RD, oversight by a project committee, a negotiated plan as the basis for each major buy-in (demonstration countries) to the project and preparation of two-year workplans by the DFM contractor with one-year approvals from S&T/RD. USAIDs may approve USAID-funded activities in annexes to the two years workplans with annual approved contractor plans, or through PIO/Ts providing for work under the contract.

Two potential issues of project administration were identified during the course of project development. Both issues concern ways to integrate the goals and objectives of the DFM project with the goals and objectives of USAID project activities. The issues are:

1. How can DFM project administration insure close cooperation between USAID road rehabilitation contractors and the DFM contractor?
2. Will USAIDs be willing and able to negotiate changes sometimes necessary to secure institutional and financial policy changes through policy dialogue with host governments?

Both issues are difficult, and no one can be one hundred percent sure in advance of project execution that they will be resolved satisfactorily. However, these issues have been anticipated in project design and certain aspects of project administration are designed to deal with them. Specifically, it is anticipated that strong project management from S&T will enhance the DFM contractor's willingness to cooperate with missions' contractors and that strong USAID project officers will have to insure the corresponding cooperation from USAID contractors. In anticipation of the need for strong project management, S&T has provided a project manager, a backstop and a grant-funded decentralization expert from the National Association of Schools of Public Affairs and Administration. Issue number 2 will be the subject of negotiations during preparation of the country baseline study and plan for each demonstration country.

#### E. Annex 8. Environmental Analysis

On the grounds that DFM project interventions in LDCs will be conducted through existing missions projects which are subject

to environmental reviews and approvals and that the impacts of the applied research and technical assistance to be provided by DFM are likely to be environmentally positive or neutral, the Initial Environmental Examination reached a negative threshold determination.

#### VII. Evaluation Arrangements

As shown in Table 3, an internal management review is planned for FY 89, (year two of implementation), an evaluation for FY 91 (year four), another management review in FY 93 (year six), and a final evaluation in FY 94 (year 7). For the FY 91 evaluation about \$70,000 of contract services are planned, along with participation of A.I.D. and host country representatives. This evaluation will include an on-site review of progress in at least two demonstration countries. The evaluation will support decisions on (a) whether the U.S. Government should exercise its option to extend the principal contract for two years beyond the five-year initial contract; (b) if so, what design changes would be needed for the final two years of the project; and (c) if not, whether the project should be redesigned for a phase II follow-on with new procurement.

The fifth year management review (FY 93, assuming exercise of the extensions option) will support decisions on the final phase of the project and desirability of a follow-on project. The final evaluation (FY 94) at an estimated cost of \$90,000 will provide a strategic appraisal of LOP accomplishments, major research findings, progress in advancing the state-of-the-art for both applied research and country assistance, and future needs.

The underlying philosophy of design for this project is one of combining (a) flexibility and "rolling design" to take account of learning and new opportunities during implementation, with (b) structure and discipline imposed by iterative planning and annual approval of two year workplans. Given this design approach, both evaluations and management decisions taken during implementation will be very influential in molding project activities from years 3-7.

PROJECT DESIGN SUMMARY  
LOGICAL FRAMEWORK

Life of Project  
From FY 87 to FY 95  
Total US Funding \$16.6M (\$8.1 \$4.0M)  
Date Prepared 7/13/87

Project Title &amp; Number: Decentralization: Finance and Management

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Program or Sector Goal: The broader objective to which this project contributes: GOAL: People benefit from econ. growth, increased income, and wide access to goods and services. SUBGOAL: Sustained usefulness and use of rural infrastructure.</p>	<p>Measures of Goal Achievement: Economic growth, changes in income attributable to infrastructure use. Increased use of schools, health facilities due to road access. Condition of infrastructure over time. Accessibility to users, equity in access. Recurrent costs covered. Increased productivity of irrigation or natural resources.</p>	<p>Time series data of local jurisdiction. Interviews or surveys of local government and non-governmental people affected. Applied research/studies, USAID evaluations and project monitoring.</p>	<p>Host Country (HC), provides sufficient money authority to local jurisdictions. National government policies satisfactory. Public order and market links satisfactory. Infrastructure design and construction satisfactory. Local institutions, elite, permit wide access.</p>
<p>Project Purpose: Increased decentralized capacity to finance, manage and maintain rural infrastructure.</p>	<p>Conditions that will indicate purpose has been achieved: End of project status. Expanded authority/influence of local jurisdictions/people. Improved match between tasks and jurisdiction assigned them. Improved incentives for maintenance, accountability. Effectiveness of maintenance operations over time. Efficient/effective collection/accounting for revenues/fees.</p>	<p>As above, plus feedback from TA and training personnel.</p>	<p>Assumptions for achieving purpose: Local incentive systems permit change. Local people/interest groups accept need to pay recurrent costs. USAID buy-ins of sufficient magnitude. Adequate numbers of educated trained people for demonstrations to succeed.</p>
<p>Outputs: (A) Baseline state-of-art, country planning studies; (B) country demonstra. of infrastruc. maint., finance, mgt. changes; (C) country asstc. products (analyses, plans, evals., reports, trained people, operating systems changed); (D) R&amp;D network establishing, meetings materials disseminated; (E) R&amp;D reports, publications; (F) guidance papers.</p>	<p>Magnitude of Outputs: (A) 1 set, 3 country studies; (B) three countries; (C) five countries, recurrent support; products as specified by USAIDs. 600 people trained in 24 sessions, 8 countries; (D) AID, IBRD, 1 other donor, LDCs; 3 workshops, 2 conferences; (E) 1 book, 4 articles, 10 reports. 1 EOP state-of-art paper.; (F) 1 interim; 1 final.</p>	<p>Technical reviews, publications, USAID and S&amp;T evaluations, formal/informal host country reports/feedback. Dissemination events, LDC/donor organization/expert reports/feedback.</p>	<p>Assumptions for achieving outputs: Procurement achieves right mix of skills. USAID buy-ins permit intensive demonstrations. HC operational and support institutions cooperate. USAID engineering prime contractors cooperate. Local organization, skill levels sufficient to take on new functions.</p>
<p>Inputs: Applied res., analysis, TA, consulting org. devel. and training. Dissemination, communication. Core, AID/W 24 person-yrs. of prof. svcs. (incl. consultants), 10 person-yrs. admin. svcs. USAIDs 37 person-yrs. U.S. prof. 14 person-yrs. U.S. admin. 13 person-yrs. LDC prof. 13 person-yrs. LDC admin.</p>	<p>Implementation Target (Type and Quantity) Type Quantity "State-of-art" 1st yr., 7th yr. Demo. countries, 3 by 2nd yr. Support countries, 5 by 4th yr. Training Sessions, 28 USAID-funded country asstc. or applied res. products, 20 Documents disseminated, 1000 Evaluation/mgt. reviews, 4</p>	<p>Monitoring, tech review, S&amp;T management review, evaluations.</p>	<p>Assumptions for providing inputs: S&amp;T funding level of \$12.01 USAID funding level of Negotiations for multi-party cooperation and inputs successful.</p>