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DECENTRALIZATION SECTOR REVIEW/ANALYSIS

SECTOR II PID

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PREFACE

It is difficult to know what to call this document. Initially, the task was to do a Sector Assessment of the Egyptian decentralization program supported by AID over the last four to five years. This assessment would be based on a review and synthesis of existing evaluations and would, presumably, lay the conceptual groundwork for any further AID support to the sector. There would be no new field investigation; rather, the assessment would be based on existing documentation. It was not intended to be an independent evaluation of the program.

About half way through the task we were informed that the Near East Bureau would consider the Sector Assessment as a program identification document ("PID") for Phase II of Decentralization Sector Support. The issue of whether the next phase was to be a "project" or a program was left open, but early indications were that the Near East Bureau favored a project, whereas the Mission (Cairo) favored a program.

At that point, we made a decision that influenced the form and content of this document. We decided to use the format of the PID, and integrate our synthesis and judgments about Phase I into the PID. Thus, what we have prepared is a "PID-like" document, strengthened by five years of previous AID experience in this sector.

We have attempted to develop a working document which, if successful, will serve as the conceptual and strategic basis for further AID support to the decentralization process. We hope that it incorporates the best elements of both an assessment of past experience and a proposal for future work.

The team was led by Richard Blue, Director, Office of Egypt Affairs, Bureau for the Near East. Team members were Robert Firestine and Gary Hansen, both from AID Bureau for Science and Technology, and John Roberts, Director, DSRPS/LAD, USAID/Egypt. We gratefully acknowledge the excellent editing and secretarial support provided by Mary Megalli. Errors of fact and judgment are, of course, the responsibility of the team.

DECENTRALIZATION SECTOR REVIEW/ANALYSIS

SECTOR II PID

I. PROGRAM FEATURES

A. Conformity with Egyptian Strategy/Program

Since 1960, the Egyptian Government has recognized the need for substantially increasing overall decentralized decision-making at all local governmental levels as a prerequisite for a more broad based development posture throughout the country. Beginning in 1960 and continuing through 1971, 1975, 1979 and 1981, a series of enabling laws were enacted in the Peoples' Assembly to provide the stimulation, authorities and developmental incentives for local development at all of Egypt's 26 Governorates (21 "rural" and 5 "urban") and administrative/economic divisions below governorate level: markaz (rural district [pl. marakaz]); qism (urban district); qarya (village); and hay (urban ward).

Since 1981, all governors have held the administrative rank of "Minister." Developmental budget authority and responsibilities devolved to the Governorates effective July 1982, and central budgetary subsidies for development have increased by a multiple of six since that date. The annual total GOE local development budet allocations to local governments now exceed the equivalent of $173 million (at the official exchange rate), all for application to local economic and social infrastructure and services.

The evolution of attitude is very significant in a nation with 5,000 years of highly centralized authority and decisionmaking. Egypt, with assistance over the past four years from the AID Decentralization Program, is steadily pursuing the course of economic and administrative decentralization and local development which will promote and enhance the building of a national development foundation for the present and for the future.

The President of the Repubic, Mohamed Hosni Mubarak, has repeatedly urged Governorates to assume their rightful role of administering local government and to shoulder full responsibility so as not to refer to central government without a crucial need to do so. The Prime Minister Dr. Fouad Mohieddin has called for major changes in financial enabling laws and authorities to promote more local level self-reliance in revenue generation, retention and utilization.

In a legal sense, it would appear that the basic underlying legislation is in place to support the sort of local financial contributions referred to in the 1983 Decentralization Sector Assessment. However, the extent to which enabling laws must also be passed before such reforms can be implemented -- even on a pilot basis -- remains unclear. Moreover, the GOE's essential political willingness to permit local resource mobilization (as envisioned herein) could likely benefit substantially from:

the convincing demonstration of local institutional capacity for self-reliant resource mobilization and utilization, and

the effective encouragement of diverse innovative approaches to resource mobilization, planning, budgeting, financial management, contracting, procurement, etc., at the local level.

B. RELATIONSHIP TO CDSS AND OTHER MISSION STRATEGIES

Decentralization projects have been in a position of importance within the Mission since 1982, when, at the urging of both the GOE and AID/W, several decentralized development project activities were subsumed by the Mission into the Decentralization Sector Program. Through FY 1985, a total of $525.2 million in AID/ESF grant funds will have been obligated and expended in a myriad of decentralization activities in almost every village and district of Egypt, benefiting a vast majority of Egypt's 48 million citizens. The developmental significance of these activities, clearly demonstrating a growing and effective capacity of local governments and people to play a major determining role in their own governance and developmental status, is viewed by the GOE and the Mission as establishment of firm foundations for the future.

The recent FY 1986 CDSS views Decentralization II (Local Development Sector) as the primary thrust of AID assistance to economic and social capacity-building and infrastructure at all levels. Concurrently, the Mission views the Decentralization Program as the most visible, far-reaching component of the entire USAID/Egypt portfolio and the principal developmental vehicle for directly addressing US/GOE policy and equity objectives.

By focusing on continued and expanded capacity-building objectives, the Mission and the GOE agree on the need for mobilizing local (rural and urban) resources; creating,

operating and maintaining local infrastructure and services appropriately placed at local levels, and enhancing and sustaining policy reform and the growth of democratic institutions and capacities at all levels. Decentralized local development is viewed as the appropriate and principal strategic focus and methodology for all USG assistance below major national-level projects.

II. PROJECT DESCRIPTION

A. The Problem

1. Centralizing Tendencies and the Dynamics of Change

a. The Historic Tradition of Centralism

In Egypt, two historical traditions and two more recent trends contribute to the very major role government plays in the economy and the society. Many Egyptians maintain that Egyptian political history demonstrates a tendency toward a strong centrist government. References are made to the interdependence between irrigated agriculture and the need for centralized control and coordination. This is known locally as the "pharaonic tradition." In fact, more recent Egyptian history prior to the Nasser revolution is better described as an arrangement between the local landed elite and a succession of foreign rulers. This "centrist tradition" has been complemented by a remarkable degree of passivity on the part of the Egyptian masses.

More recently, the rise of modern nationalism and its supporting ideologies of economic development and social justice became manifest in the 1952 Revolution. This revolution advanced the idea that the state was the principal engine of economic growth (socialism) and was responsible for providing benefits (the products of that growth) to the Egyptian people. An impediment to social justice was the landed elite, whose power and wealth were sharply curtailed by land reform. After the 1952 revolution, the state expanded in size, function and responsibility. The Egyptian people came to rely on the state for the provision of subsidized food, education, housing, energy, health services and most other basic human needs. The state also became the principal source of employment. State control over the economy was justified in terms of the need to generate wealth for redistribution to the people. The principal mechanisms of distribution were land reform and the subsidy system.

Thus, both history--or the mythology of historical experience--and contemporary trends converged to reinforce a centralized state and economic system. The masses remained passive, but now the state was something which did "<u>for</u> the individual." The traditional view remained that the state also did "<u>to</u> the individual".

Left out of this equation was the principle of popular participation and popular sovereignty. The corollary idea of private ownership of the factors of production was discouraged, if not eliminated. Socialist ideology combined with centralized bureaucratic elitism to foster an attitude of paternalism. In its benign face, paternalism meant taking care of the people who were not capable of taking care of themselves. In its malevolent face, paternalism also meant that people could not be trusted, individual accumulations of wealth were suspect and in some fundamental way considered corrupt.

b. Dynamics of Change in the Modern Era

Nevertheless, modern Egypt contained forces that worked to undermine the centrist, command economy concept of the polity. The reforms of the Nasser revolution contributed to the potential for a more participatory society. A rapidly expanding population constrained by a very limited habitable land area meant that the sheer volume of interactions and communications between people grew exponentially. Egyptians became better educated, large numbers worked abroad accumulating both wealth and knowledge. Expectations about the "good life" changed dramatically. The state as the producer of wealth and the distributor of benefits became increasingly hard pressed to meet these demands.

The growing imbalance between social and economic demands and supply was not the only problem to be solved. The growing complexity and increased integration of Egyptian economic and social life meant that centralized decision-making and administratively-determined resource allocations had become manifestly inefficient. The system suffered from information and decision making overload. Bureaucracies had become overstaffed, inefficient, and inadequately funded. Inefficiency, combined with unresponsiveness, wasted scarce resources. Moreover, the system was unable to tap the expanding energy and skills of a better educated, more mobile and articulate population. Human capital was being siphoned off by the demand for skilled and unskilled labor in other countries.

These countervailing trends led to the "corrective revolution of 1974" under President Sadat. Without abandoning the purposes of social justice and state control of the economy, President Sadat introduced fundamental

changes in the means by which these purposes were to be achieved. The legitimacy of the regime no longer would depend on the evolution of powerful symbols of Arab nationalism and permanent hostility towards Israel. Rather, legitimacy would depend on the maintenance of peace and broadly based economic growth and development. The economy would be permitted to be more pluralistic, trade and investment relationships with the West were expanded, and a program of gradual structural adjustment and rationalization of the economy was begun.

President Mubarak has continued these economic reforms and added new emphasis to a concomitant liberalization and democratization of the polity. Press freedom has expanded, civil liberties are better protected, and this year--for the first time--a free national multiparty parliamentary election will take place.

c. The Onset of Decentralization

A less dramatic but, in the long run, equally profound change is occurring. This is the process of decentralization. Decentralization entails the dispersion and sharing of power throughout society among both national and local government and non-governmental institutions. Its normative premise derives from an interest in building a pluralistic and democratic social order. The benefits of decentralization are equated with higher levels of efficiency and effectiveness in the generation and allocation of scarce resources for local investment. Similarly, sources of political stability and support are multiplied when authority and power is widely dispersed and local communities can solve their own problems without relying on the commands of a central bureaucracy. Finally, decentralization allows for greater innovation and entrepreneurship by individual and local communities in accelerating the process of social and economic change.

In the third world context, decentralization involves a focus on achieving a more proper balance between national and local constituencies, with particular emphasis on empowering local communities to undertake their own self governance. In many countries like Egypt, a long legacy of strong central government continues to constrain the growth of local self reliance and self government. Pre-modern patterns of central control designed to produce local dependence are perpetuated by topheavy national bureaucracies which remain unresponsive to local needs. As

a consequence, a set of popular expectations has developed which assumes that an already over-extended central government will serve as the chief producer of income and employment. An excessive reliance on central government can only be reversed by shifting the balance of power toward local constituencies where untapped sources of capital, entrepreneurship and initiative can be mobilized in generating a more self reliance development process.

Fueled by increased purchasing power, better communications and a more sophisticated population, the locus of political and economic activity has begun to expand beyond the central ministries located in Cairo. Possibilities and resources now exist for development action at the local level, in the rural areas and in the small and medium towns outside of Cairo and Alexandria, as well as in the districts which make up those great urban conglomerates.

d. Decentralization to Encourage Local Control and Accountability

In Egypt, a local government framework is already in place. In recent years, the legal basis has been established for decentralization. Until 1980, however, the process of decentralization had been relatively limited. Nevertheless, the Egyptian government is still intent upon bringing local areas into the mainstream of development. This process can produce one of two results. It may be appropriated by central line ministries and extend their control over local jurisdictions, thereby making local areas become appendages of central government and reducing their self-development capacities. Alternatively, it may be directed by the emergence and support of local centers of power which establish local control and accountability in the generation of economic growth. The AID decentralization portfolio is designed to support the latter possibility.

Rapid change in intergovernmental relationships: There are several dimensions of this change which create both problems and opportunities for the GOE and for AID as we try to improve the effectiveness of our assistance program. First, it is a fact that the relationship between governorates and central government is changing and being redefined. Governors enjoy increased responsibility and status in the overall system. GOE grants in aid have increased dramatically and at a rate far greater than to central ministry budgets. Governorate authority over central line personnel has increased as well. Finally,

governorates are increasingly responsible for much of the implementation and management of public infrastructure and services, such as basic education, health, agriculture, water and sewerage and roads.

Decentralization versus devolution: If the process amounted to no more than increased revenue and capacity for local implementation and management of centrally planned and financed activities, it would be difficult to describe it as decentralization. While there may be gains in efficiency and effectiveness through such a process, it would remain primarily a devolution and extension of the central government. Indeed, some observers would argue that this, in fact, is what is happening.

Political articulation of local preferences: Decentralization of administrative and technical authority to local units in Egypt has not been matched by similar decentralization of political authority. There are some positive trends, however. On the political side, a parallel structure of representative bodies exists which, though long dormant, is becoming more active in its representational role. Second, the national parliamentary election has energized the political process at the local level as well. Third, economic activity, some public but much of it private, has increased considerably, much of it small scale, agriculturally based and labor intensive. Thus, what is emerging is an expanding demand for better infrastructure and services, increasingly articulated through the political process. This in turn has begun to transform the role of governors from that of representing central authority to that of being responsive to and advocating the interests of the citizens of the governorate.

This process continues to evolve as the people and the GOE struggle to cope with the dynamics of change. There is and will be resistance from the central ministries that perceive that their role is being diminished. Bureaucrats and technicians will no doubt resist what they will perceive to be political interference in technically based "scientific" planning and decision making. Other "threats" to the decentralization process also exist. If, for example, local participatory institutions become vehicles for extreme expressions of dissent by religious minorities or other dissatisfied groups in the society, it is unlikely that the process will survive. Nevertheless, the dynamics that support further decentralization and economic and institutional pluralism do exist and cannot be ignored.

AID's Role and Accomplishments

Through the combined effort of projects making up the Decentralization Sector Program, AID has helped to give form and substance to this process. This will be further described and assessed in Section III. It is necessary to summarize briefly what has been accomplished in order to define clearly the issues and problems that must be addressed if there is to be a "Phase II" funded by AID. Future AID support for this process must be fashioned with great care and sensitivity to political risks involved.

a. Tangible Accomplishments to Date

AID and its counterpart organizations have followed a simple but effective strategy. The basic premise has been that while local government structures were in place, they lacked resources and capacity to be active participants in the development process. AID's role has been to provide resources: grants under BVS, NUS and PCD to local units; equipment to governorates under DSF, and capitalization for a local development loan fund through DDI. Training and technical assistance has been provided to develop capacity at various levels of local government in order to translate AID and GOE resources into effectively managed development projects. The products of the combination of financial resources, technical assistance and local initiative have been (i) increased capacity of local units to set priorities, assess problems and propose solutions, secure external resources, and plan and implement projects; (ii) locally planned and managed development projects in every local jurisdiction in Egypt.

It is relatively easy to measure the accomplishments of the program in terms of number of projects completed, people trained, and equipment purchased and loans made (see Annex E and respective evaluations). The physical outputs of the project are impressive. Egyptians at the local level are very much aware of AID's involvement. Independent observers who have visited rural areas in Egypt have come away with highly favorable views of the energy and enthusiasm of the people and with the accomplishments of the program.

From the perspective of AID's traditional concerns for absorptive capacity and rapid disbursement and implementation, the program is also a success. The project is well monitored with respect to expenditure and subproject implementation tracking. Financial review and accounting procedures have been established which, while not without controversy, appear to have satisfied both GOE and AID requirements. The projects have been evaluated and assessed by both internal and external evaluation teams. The LAD office assigned to manage the projects is well informed, highly motivated and professionally competent.

b. Significant, though Less Tangible, Accomplishments to Date

In proclaiming these clear achievements, however, the Mission has inadvertantly understated the more important sector project demonstrations of local institutional capabilities. In general, institution-building is the real purpose of these sector projects. Perhaps surprisingly, though, the recent documentations of widespread project success in meeting infrastructure planning/implementation targets may be seen as clear evidence that many of these local government institutions can very rapidly achieve significant levels of institutional accomplishment. In a real sense, this shows that local institution-building in Egypt can proceed--and perhaps is proceeding--at a much faster pace than was originally anticipated.

Unfortunately, this vital aspect of sector progress to date has been masked by the more usual measures of project accomplishment. As a result, considerable confusion has been generated between the Mission and AID/W regarding the proper future approach to the Decentralization Sector. Importantly, this emerging evidence of impressive local capabilities in the utilization of locally-available resources confirms the timeliness of moving the Decentralization Sector strategy toward:

various models and pilots to demonstrate effective, diverse, and innovative approaches to local resource mobilization; and

policy reforms (and attendant enabling legislation) to institutionalize a more permissive environment for effective, responsive, and self-reliant local government.

Demonstrations of local institutional capacity should be seen as serving two rather separate purposes:

Convincing higher-level decisionmakers of emerging local institutional capabilities as a means of encouraging the GOE to consider reform of permissible local government resource mobilization and operational activities. (This has been the strategy thus far, and it should be continued in Sector II as part of the policy dialogue/reform effort.)

Building popular confidence in local-level institutions, especially regarding their abilities to reflect popular preferences for various local needs and to plan/implement and to self-reliantly finance local development activities with minimal recourse to higher government authority.

Transition from Sector I to Sector II

Sector I successfully initiated and demonstrated, beyond all expectations, local level capabilities for identification, selection, design and implementation of priority developmental activities in services, infrastructure, equipment, etc. It has also helped to identify critical constraints and opportunities for redirected AID assistance within the overall goal and purpose.

Sector II must now move forward with additional foci, namely the sustaining, operating and maintaining of the local development process and the mobilization and utilization of local resources (funding, manpower, etc.) at both the private and public levels. This intensified focus on local capacity building will enhance the developmental autonomy of local government and reduce the burden of local development on the national budget.

Assumptions

The following strategic assumptions comprise the initial policy agenda for Phase II of the Decentralization Sector in Egypt.

- The Mission, Bureau and GOE will agree on the local resource mobilization and institutional capacity building focus and objectives of the program.

- Sufficient flexibility in the allocation and control of funds by governorate and local authorities will be permitted by AID and the GOE.

- The GOE and participating local authorities understand that AID Sector II funds will terminate at the end of the five year program. (Sector III funding would be considered only if significant progress is made in achieving Sector II objectives.)

- AID and the GOE agree to a decentralization policy agenda and general implementation planning and review process. The policy agenda will include:

  - Enabling legislation for assigning revenue raising and budget authority to governorates and local units;

  - Provision of GOE budget support on a matching grant basis to local authorities;

  - The GOE, through the Saqqara Institute will move rapidly to develop a responsive program of technical and administrative training for local units;

  - Local units will move vigorously to take such actions as needed to increase financial resources and improve organization and management practices and capacity;

  - Popular participation, local agenda setting, and local authority will continue to be supported by GOE law and practice as basic premises of AID support to decentralization.

  - USAID and technical consultants will gradually withdraw from subproject monitoring and implementing roles and move toward increasing emphasis on achieving policy dialogue objective and increasing local resource mobilization and institutional capacity-building.

B. PROJECT GOAL AND PURPOSE

GOAL: To assist the GOE to establish a fiscally responsible and economically sustainable system of decentralized decision making, budget planning and revenue generation for local development.

PURPOSE: To further accelerate the GOE decentralization process begun in Sector I by supporting:

1. At the governorate and local levels,

   a) Improved systems of resource mobilization and revenue generation;

   b) Improved systems necessary for operation and maintenance of local infrastructure;

   c) Improved systems for planning, coordinating and integrating continuing investments in local infrastructure and human resource development;

2. At the national level:

   a) Accelerate development of enabling legislation and procedures for governorate planning, budgetary and resource mobilization;

   b) Further delineation, expansion and clarification of governorate and local level authority and functional responsibilities for infrastructure and human resource development;

   c) Establishment of more predictable patterns of, and criteria for, GOE revenue sharing with governorate and local levels, with such criteria based on both needs (equity) and progress toward local resource mobilization;

   d) Acceleration of the establishment of administrative and management training, information sharing, evaluation and technical advisory services responsive to goverorate and local unit needs; these training and support services will be the primary responsibility of, but not limited to, the Saqqara Institute.

C. EXPECTED ACHIEVEMENTS AND ACCOMPLISHMENTS

It is intended that project activities in Sector II (1985-1990) will generate the following accomplishments:

- Policy measures will have been adopted which more clearly delineate and expand the decision-making role of local jurisdictions in planning, financing, and implementing <u>all</u> levels of local development.

- Enabling procedures will have been enacted on a national policy level that expand the authority of local jurisdictions to generate retain and utilize revenue.

- Local models and demonstrations will have been completed in developing revenue sharing formulae that can be replicated on a wider-scale national basis.

- Systems will be in place for more effective operations and maintenance of local infrastructure/services projects.

- The Saqqara Institute will be functioning as a self-sustaining unit and responding to demands for analytical and training services from governorate and local authorities, and as a primary resource information center for national planning.

Sector II accomplishments will be measured by progress in developing a stronger legal and policy framework to support local autonomy and capacity. It is desirable that this framework will emerge more effectively and visibly at the governorate level than at the national level where the environment may be less responsive to innovation. Translation and replication of Sector II into larger scale implementation may still be undergoing institutionalization, perhaps requiring a Phase III. This would involve a focus on refining institutional procedures in order to consolidate on a broader scale what has been enunciated in policy during Sector II. As this implementation process proceedes, Phase III would feature a rather precipitous phase-out of AID and central GOE involvement in the decentralization sector support.

D. Project Outline and How it Will Work

A major shift in focus will occur in Sector II of the decentralization effort and this will require a fundamentally new and different approach to how the proposed assistance effort will be organized and implemented. In Sector I (1980-1984), major attention was devoted to reviewing and monitoring subprojects and building design and implementation systems within the Egyptian government to undertake this effort. Sufficient progress is being made in this task to allow a reformulation in the priority action agenda for Sector II. In particular, Sector II will involve addressing the following four activities:

1. Policy Dialogue

   Generating a policy dialogue at the governorate and national levels concerning issues which must be addressed in advancing and sustaining the process of decentralization;

2. Saqqara Institute

   Institutionalization of the Saqqara Institute for Local Development into a major action and support base for policy and institutional change;

3. Resource Mobilization Models

   Testing on a national, governorate and local level new approaches to mobilizing national and local resources in support of decentralized local development;

4. Base Program

   continuing grant-in-aid resource assistance, financial support and management involvement for BVS, NUS, PCD and DSF type project activities to local units of government, on a declining scale of AID involvement based on growing local resource mobilization efforts.

All four of the above activities are interrelated. Therefore, the project will need to be organized in such a way as to achieve a high level of mutual interaction and integration between the component parts.

The policy dialogue function will involve establishing close working relationships between the Saqqara Institute, Governorate authorities, and key national Ministries (Economy, Planning, Finance, and Local Government). In turn, policy dialogue would be directly linked with the design of experimental policy and institutional innovations for local development. In this regard, it is intended that several of the more responsive and innovative governorates will serve as field sites for advancing and testing new approaches to local resource mobilization and development. The Saqqara Institute would provide the backup design and technical support in monitoring and assessing this effort.

The Saqqara Institute should constitute the primary outreach center and a horizontal integrating mechanism, with its staff engaged in generating policy issues, promoting policy dialogue, and designing and implementing experimental national and governorate approaches to local development. Likewise, the Saqqara Institute would serve as a principal catalyst and forum where information exchange and training would be undertaken in support of decentralized development.

The current Sector Steering Committee will need to be reorganized to make it a more vital element in the policy dialogue process. In this regard, the feasibility of moving the Committee Secretariat to the Prime Minister's Office will need to be explored. In order to further strengthen the policy components of the project, an overview Sector Committee within the already existing Supreme Council for Local Government can play a crucial policy-determining role. The advantages of more direct access to the governors has been demonstrated by the active leadership of the urban governorates' Project Steering Committee for the NUS project. Creating a second tier policy forum at the Governorate level will reduce the dependence on the national arena where proposed policy initiatives can frequently be impeded by bureaucratic inertia.

A range of measures will be undertaken to consolidate and further strengthen the decentralization components demonstrated by the BVS, DSF and PCD activities. Review and budget approval authority for BVS subprojects will be transferred to the Governorates, thereby allowing ORDEV to work more closely with the Saqqara Institute in supporting more basic changes in the roles of village and district units. The DSF type activity will be continued on a reduced scale and all new equipment purchases through project funding will be phased out. Rather, DSF funding will be made available for spare part purchases to those governorates who demonstrate significant progress in operating effective maintenance systems. The PCD activities will be focused on intermediate-sized cities and will support small-scale infrastructure projects that serve to enhance the capacity of provincial authorities to plan and finance their own development activities. The scale of activities undertaken will vary depending on the capacities of the local units involved. It is expected that larger-scale projects will be proposed for consideration by AID under other sectoral programs such as water and waste water.

A cadre of full-time consultants, financed by the Sector, will be assigned to roles which serve to induce and facilitate the above mentioned processes of policy and institutional change. Consultant backgrounds will need to include a primary emphasis

on advanced social science skills in the analysis of political and economic variables, along with a firm grounding in the application of methodologies for undertaking institutional change. Special emphasis will be placed on those skills which are related to applied institutional technology transfer in the fields of revenue generation, financial management, project planning and budgeting, etc.

The consultants will be positioned at strategic locations where policy and institutional change can be most effectively generated and sustained. It is anticipated that several of the consultants will spend a significant share of their time in the two or three governorates which will serve as the primary learning laboratories in testing new policy and institutional innovations. The other consultants will serve at Saqqara. Their role would be to establish close linkages between Saqqara, the governorate field sites, and key national ministries. In brief, the consultants would be responsible for assisting Saqqara in building a dynamic set of interactions between itself, the governorates and the national ministries in order to stimulate and sustain an iterative process where lessons learned from policy-inspired field tests are synthesized and articulated at national policy level for wider scale replication.

III. FACTORS AFFECTING PROJECT SELECTION AND FURTHER DEVELOPMENT

A. SOCIAL AND INSTITUTIONAL CONSIDERATIONS

The proposed program is designed to improve the capacities of rural village units, urban districts and provincial cities to undertake and finance their own local development efforts. The direct beneficiaries of the project will be village and district jurisdictions, with the indirect beneficiaries being the local constituents who will assume a larger role in identifying and investing in the expansion of public goods and services.

Village and district jurisdictions, by most developing country standards, are small in area but extraordinarily large in population size. Many villages range from 20-40,000 in population, whereas urban districts in Cairo and Alexandria may have a population of a million or more inhabitants. Similar conditions are encountered in provincial cities. Consequently, most urban and village constituents live under highly congested conditions where social and economic infrastructure is either woefully inadequate or non-existent.

Local jurisdictions usually lack the authority, incentive structures and resources necessary to adequately address local needs. The central government exercises authority over most resource and expenditure decisions and this has served to create conditions of local passivity and dependency on central level handouts. The program is designed to alleviate these constraints through institutional reforms (at all levels of government), that will increase discretionary authority and incentives for local jurisdictions to mobilize resources in addressing their own development needs. These expanded capacities and opportunities for local retention and control over revenues will provide a stronger set of social and economic incentives for local constituents to participate in selecting and financing projects which yield immediate and direct benefits.

The BVS and NUS projects have already shown that, with proper inducements local jurisdictions can mobilize resources for local investments. These demonstrations serve the dual purpose of (a) supporting overall policy reform by convincing higher-level decision-makers of the existence of significant institutional capability at the local government level, and (b) building popular confidence in the local units' abilities to efficiently pursue development in accordance with community preferences.

The great population size within these jurisdictions dictates that the project will also need to strengthen complementary organizational channels to broaden participation and resource mobilization at the local level. Thus, efforts will be made to explore how local orgnizational resources in the non-governmental sector can exercise a greater role in facilitating more broad scale participation in agenda setting for local action and revenue enhancement measures.

Equity considerations as they pertain to participation and benefit distribution must also be addressed in Sector II once the resource mobilization possibilities have become better understood.

Finally, it is intended that the policy and incentive meaures introduced by the project to enhance central and local contributions to local development will serve to sustain local capacity beyond the termination of the project.

B. ECONOMIC CONSIDERATIONS

This section summarizes the important economic aspects of the decentralization sector to date and outlines essential economic elements of the proposed Sector II strategy.

1. Fiscal Decentralization: a Recognized Need

In the 1983 Decentralization Sector Assessment, important economic accomplishments were cited for Sector work as of that date:

> "Basic mechanisms of popular participation [are] in place, [and] ... the popularly elected councils are now responsible for setting development priorities and approving local unit budgets. ... [While centrally-controlled resources to implement these responsibilities] are being disbursed to local units, [this] considerable expenditure decentralization [is not matched by the essential] revenue decentralization. ... The GOE commitment to decentralization has been clearly demonstrated in all areas except revenue decentralization. ... The major constraints in the sector are policy development, local revenue generation, and management skills. ... There is a large gap between local development needs and financial resources. [Emphasis added]
>
> "The USAID strategy ... is based upon USAID's expertise in policy dialogue and institution-building. The strategy

recognizes that AID's primary concerns in the sector are to: strengthen community participation and self-reliance; reduce local dependence on central government, and increase local revenue generation so that localities can assume recurrent and replacement costs. AID has made a long-term commitment 'in order that sufficient opportunity is allowed for developing sustainable self-help capacity.'" (STATE 199220, 7/17/82).

2. Diverse Approaches are needed to Local Institution-Building and Resource Mobilization

Emphasis should be placed in this project upon local institution-building and resource mobilization in local units of government. This builds upon the accumulated experience of sector projects to date, especially BVS and the urban-district portion of NUS.

Because of (a) the contrasting conditions which exist in rural and urban parts of Egypt, and (b) the need for relatively innovative (and thus initially experimental) schemes to increase local capability and self-reliance, a diversity of approaches is required for implementation of local institution-building and resource mobilization approaches in this project.

In rural villages, the stronger sense of local community would indicate that possibilities for local participation/involvement are relatively greater than is the case in more urban areas. In such such rural communities, even small projects can enjoy relatively high visibility. This increases local enthusiasm for individual subprojects (thereby encouraging local willingness to participate in the local decisionmaking process while stimulating local resource contributions) while enhancing local recognition of AID's role in Egypt's development. Stronger sense of community in rural villages also increases the likelihood there of important in-kind labor contributions, local resident philanthropy, and financial contributions from repatriated earnings. Accordingly, these sources of local revenues are likely to be more important in rural villages than in urban districts. In the latter, active political participation is often more visible than in rural areas, although the local sense of community is much less significant.

In general, local taxes and similar broad-based revenue devices built around a taxpayer's ability-to-pay (ie., his

identifiable income stream from various sources or the value of his accumulated assets) are among the least promising sources of local resource mobilization. The opportunities for tax avoidance are simply too great.

Resource mobilization based on individually-perceived benefits, however, offers much more promising possibilities. Particular opportunities often exist for generating benefit-based revenues from local commercial activities whose earnings would inprove as result of implementation of a local development project. In NUS, there is the example of local merchants seeking to "buy into" a neighborhood street-paving project so as to extend the planned new pavement to cover the block in which their establishments are located. In this case, a betterment levy might well have been applied to all the commercial properties on the newly-paved blocks to defray the cost of the improvement, and--had the value of that levy been properly established--each of the affected merchants might well have gladly paid his assessed portion.

This appeal of benefit-related resource mobilization applies to rural villages as well as to urban districts. Nonetheless, the desirable character and mix of any revenue-raising arrangement would likely differ between rural and urban areas in accordance with the contrasting natures of the local communities.

3. Encouragement of Innovation in Policy Dialogue and Policy Reform

Policy dialogue leading to significant policy reform is the ultimate element of this project. Stimulation of innovative new approaches to local institution-building and resource mobilization can take place through careful policy analysis and well-designed experimentation in the field. However, actual policy change can occur only after the policy implications of this work have been actively considered by all important policy actors in Egypt (both inside the outside the GOE).

This sort of active policy dialogue may be facilitated by a visible and dynamic Egyptian institution such as the Saqqara Institute promises to be. Stimulated and assisted by an appropriate mix of expatriate specialists, Egyptian "teacher/activist" experts functioning out of Saqqara would actively build bridges between local subprojects successes and the policy design/implementation at the national (and

perhaps governorate) levels. (In a more traditional approach, as well, expatriate specialists in local institution-building and resource mobilization could offer--ideally in collaboration with counterpart Egyptian experts--carefully-defined technical instruction on these topics to regular Saqqara cadre. These Saqqara resident staff members might then offer appropriately tailored training sessions to local, governorate, and even central government officials.

In part, then, this "vertical" policy discussion would inform higher-level decisionmakers of the results of varied innovative approaches being implemented, ultimately, at lower governmental levels. It may be contrasted to an equally-important "horizontal" policy discussion to be conducted simultaneously (under Sakkara auspices) among local government leaders and governorate officials at the subnational level. This "horizontal" policy dialogue could involve Saqqara-sponsored experience-sharing traveling workshops, disseminating successful "hands-on" experiences (by the local leaders who had implemented them) to their local counterparts in other villages (or urban districts, etc.) within one or more governorates.

4. Revenue Mobilization

There are several elements of local revenue generation, each of which can play an important role in the functioning and ultimate success or failure of any local revenue initiative. These are:

- Reliability of revenue flows accruing to local government;
- Sustainability and growth of revenue flows;
- Administrative and compliance costs of revenue-raising arrangements;
- Economic effects of revenue instruments on the level and compositin of economic activity;
- Equity considerations for those local areas which are unable to raise sufficient revenues to meet their local needs;
- Policy tradeoffs that emerge among the above elements in a fiscal system.

Each of these concerns is discussed below.

a) Reliability of Local Revenue Flows

In order for self-reliant local government to succeed over the long term, its future financial resources must be assured. Ideally, this would mean that its revenue resources would be totally under its autonomous control and that they would be fully adequate to current and projected needs. In practice, of course, this is rarely possible. As a second-best alternative, therefore, reliability and sustainability are sought through diversity of funding sources and instruments, each of which should be designed to be as predictable and as independent (from external interference) as possible. In Egypt, such a scheme of local revenue generation might then include the following components:

(1) Autonomy is Essential to Local Revenue Reliability

- An autonomous local revenue base is essential for the success of the proposed decentralization program. It should consist of a variety of fiscal devices reflecting the diverse strengths of the local economy. Importantly, in contrast to the currently existing centrally-designed taxes and shared revenues ("sovereignty revenues"), autonomous tax bases and tax rates would be established individually by and for each separate local revenue authority. This would thus permit considerable local flexibility and variation in the fiscal effort expended by individual communities in the raising of local revenues. Such locally-designed revenue instruments could include:

- Benefit and user charges which are directly related to easily identifiable benefits accruing to local residents as a result of locally designed and implemented sub-projects;

- Local taxes:

  levied on those having the greatest ability-to-pay for the common local good, such as higher-valued local property or local commercial/industrial activities; or

earmarked for a popular specific purpose which would distribute benefits broadly across the local community, levied among many taxpayers, preferably with very low individual tax burden;

- earnings from public enterprises (as in DDI), although a careful accounting always should be made of the real economic returns to such activities in a country like Egypt where the true costs of some public subsidies are not always easily apparent.

(2) Possible Additional Revenue Instruments

- An intergovernmental grants system (central-to-local government grants-in-aid) which, ideally, would incorporate significant incentives to increased revenue effort by local governments through their autonomous local revenue authority.

- A local government credit mechanism, probably defined separately by each individual governorate in which it might operate, wherein localities (villages, marakaz) could seek credit for locally-designed capital development activities. Local governments might conceivably "buy into" such credit financing in a manner similar to that of a matching grant, thereby stimulating greater local generation of revenues while producing increased expenditures for local development purposes. Individual governorate specification of lending conditions should encourage innovation in the use of such schemes through the substantial local variability in resulting credit arrangements.

(3) The existing "Sovereignty Revenues"

- Centrally-administered taxes which are dedicated to local governments such as the present taxes on:

  land (on annual rental value of arable land with the first three feddans exempt, distributed between the governorate and the village in which the land is located);

buildings (on annual rental value of commercial and industrial buildings located in urban areas, distributed to the village in which the building is located);

entertainment (excise tax distributed to the town [village?] where the activity occured);

motor vehicles (registration fees distributed to the governorate in which a vehicle is registered).

(Such centrally-administered taxes now comprise approximately one-fourth of local government revenues in Egypt.)

- Shared revenues from centrally-defined surtaxes on central government taxes which now account for approximately three-fourths of local government revenues, largely through consumption-based taxes on imports and exports (plus a surtax on the Suez Canal Authority profits tax, divided among the three Canal cities).

b) Sustainability and Growth of Revenue Flows

Local revenue flows must be sustainable as well as reliable over the long term. Otherwise the desired regularity of the decentralized fiscal process at the local level will be forever endangered. Ideally, also, local revenues should be designed to expand over time (to meet increasing public service needs) in response to economic growth of the local private sector).

Thus local revenue instruments should be designed so as to be responsive to economic growth: as the economy expands (through the growth of local income), local revenues should be able to keep pace in proportion to the emerging need. This is the concept of income elasticity. At present, the bulk of local revenues (through shared taxes largely on consumption-based imports and exports) are probably quite income-inelastic. They are not likely to grow at a sufficient rate to meet anticipated future requirements. As in the recent past, local revenues may grow substantially only as tax rates themselves are

regularly raised -- a process which has clear limits in practice. Therefore, in designing a future autonomous local revenue system, sustainability should be sought through the use of elastic revenue sources which may yield revenue growth in keeping with anticipated local needs.

c) Administrative and Compliance Costs

The desired low cost of collection, administration, and compliance of any revenue-raising instrument relates both to the government and to the taxpayer. From the government's perspective, the greater efficiency of low collection and administration costs mean that a higher percentage of revenues raised may actually be used for provision of public services. From the taxpayer's perspective, lower compliance costs should reduce taxpayer resistance (and tax avoidance) while building popular support for efficiently-run local government. In some cases, this desired administrative efficiency would suggest the central collection of tax revenues for subsequent redistribution to local governments (as is now done with sovereignty revenues. In other cases, as when concerns for taxpayer compliance override anticipated costs of collection and administration on the government side, local collection and administration might well engender more extensive taxpayer confidence and thereby greater overall net revenue generation.

d) Economic Effects of a Revenue Instrument

Revenue devices can have important effects on the allocation of private resources toward various economic activities. Excessive taxation may tend to divert resources into other activities upon which the effective tax burden is less. This rather complicated subject is particularly important with regard to tax compliance: poorly designed revenue instruments (taxes, user charges, or whatever) can surely discourage honest compliance with the law, resulting in lost revenues and diminished public respect for government. However, a properly designed tax or user charge, as suggested above with regard to benefit linkages or popular public services, can assuredly enhance local revenue generation and public respect for local authority.

e) Fiscal Equity among Local Jurisdictions

Much of the foregoing has emphasized an incentive-based stimulation of local revenue generation for locally-perceived development purposes. Local initiative for a community's efficient use of its own resources is a cornerstone of this approach.

This is not to suggest, however, that equity considerations among localities are not to be taken into account. Such equity remains important, but it should be introduced only once it has become apparent that a local community's best efforts--given its own local economic base--are insufficient to raise revenues adequate to minimal local needs. Indeed, it is in the entire nation's best interests to ensure that such minumal public services are made available to each citizen. This is why public health expenditures and basic teachers' salaries are usually provided by the central government, regardless of a community's ability to raise funds for such public sector activities. Under the scheme outlined above, however, any community may still raise substantial local revenues for public health or education activities beyond this elemental support level for such public functions.

f) Policy Tradeoffs in an Intergovernmental Fiscal System

Finally, it should be noted that important tradeoffs exist among the various elements of local revenue listed above. As Dr. Roy Bahl, Director of ST/RD's Local Revenue Administration Project at Syracuse University has pointed out in a recent communication with the Mission, there may well be a tradeoff between general-purpose and conditional grants grants "wherein the former may give more discretion to local governments but the latter are the more effective way of stimulating local resource mobilization. By the same token, equalization may run counter to a program of using grants as 'carrots' to generate more local resource mobilization. This is an important reason why the whole [fiscal] system must be considered [in the design of proper local revenue generation arrangements]. For example, how much sense does it make to strengthen local administration to more effectively collect taxes while at the same time providing a grant system which induces local government[s] to substitute central grants for what they otherwise would have raised locally?"

6. Analysis of Local Resource Mobilization Possibilities and Pursuit of Local Government Finance Reform

Local resource mobilization possibilities (in the context of Egypt's overall government finance system) need to be carefully examined at the very beginning of Sector II. This should be a detailed analysis of Egypt's intergovernmental (central to governorate to local levels) fiscal arrangements with an eye toward life-of-project monitoring and eventual appropriate policy reform.

This should be carried out by a recognized institution in this field which is capable of both:

conducting detailed fiscal studies of the full range of local revenue possibilities in the context of Egypt's current overall government finance arrangements, and

pursuing the practical aspects necessary to achieve ultimate acceptance/implementation of the policy reform recommendations emerging from this endeavor.

Such an effort would likely involve conduct of some analytic work in the U.S. by experts who could visit Egypt regularly, plus maintenance of a resident advisor in Egypt to work in close collaboration with officials and specialists in USAID, the Saqqara institute, the GOE (at central and governorate levels), local government officials, and other contractor institutions. These analytic and policy reform efforts should encompass the entire life of this project, from initial analysis through monitoring of fiscal implications of emerging results, through formulation of policy recommendations and their ultimate implementation.

C. RELEVANT EXPERIENCE WITH SIMILAR PROJECTS

1. BVS and NUS

The BVS and NUS projects were designed to directly activate local development capacities at the village and district levels. The following experience can be formulated based on nearly five years of project activity for BVS and two years of activity for NUS.

Most village and district units quickly demonstrated their capacity to effectively manage and translate BVS/NUS funds into technically sound subjects for local infrastructure development.

Initial subproject proposals, particularly in the BVS effort, tended to be relatively conventional. In many instances, submissions reflected what the village unit assumed that higher authorities desired. This pattern is changing as subproject submissions assume a more diverse character and reflect what village councils consider important to their interests.

The concept of decentralization as embodied in the BVS and NUS projects has generated considerable support and legitimacy at the local and governorate levels. However, many of the central line ministries remain either indifferent or potentially hostile to the concept because of a perceived loss of authority and resources to local areas.

The central government and governorate authorities involved in the implementation of BVS-NUS are supporting project guidelines that restrict their role to exercising a passive technical and procedural review rather than substantive evaluation of village and district subproject selections.

Most of the major administrative functions and procedures for BVS and NUS are being rapidly internalized by Egyptian counterpart institutions at the central, governorate and local levels without any major additions of manpower or other administrative resources. As a consquence, BVS and NUS are rapidly achieving a position of self maintenance in their administrative operation by Egyptian authorities. This suggests that BVS and NUS have served to activate a considerable level of underutilized organizational capacity, particularly at the village and district levels.

A significant and increasing portion of subproject funding includes contributions in cash and kind from village and district units themselves. These contributions appear to derive from multiple funding sources and indicate considerable potential for local resource mobilization.

2. <u>The DDI/LDF Project</u>

The DDI/LDF project provided small scale loans to village councils for productive enterprises. It is the oldest, and in many ways the most successful project in Sector I. From

the Egyptian point of view, it is also considered the cornerstone of the portfolio since "it taught villages how to fish; it didn't give them a fish". The lack of emphasis on or proposed continuation of a rural credit component within Sector II as envisioned by this document should not detract from the critical and pioneer role played by DDI/LDF in the Decentralization I portfolio. In fact, it is believed that a rural development productive credit project aimed at stimulating private enterprise at local levels should be considered seriously by the GOE and the Mission. Implementatiojn of such a program could also occur under the decentralized strategy. Nevertheless, it has been argued that Sector II should be focused only on capacity building and resource mobilization, and locally based infrastructure and services. Productive enterprises in the public sphere should be dealt with by the GOE, and in the private sphere could and should be the subject of another project.

3. The PCD Project

The PCD project, another capacity building pilot component in Sector I at the secondary city level, has moved through project-funded master plans to a more substantial, major infrastructural activity focused on rehabilitation and construction of water and sewerage activities in the three target cities. Sector II funds, as conceptually proposed and presented in this document, should not be considered for application on major infrastructural needs at any local level. While primary and secondary urban areas will be included within the Sector II scope, subprojects of the contemplated magnitude of the Minia, Beni Suef, and Fayoum PCD proposals are outside the scope and intention of Sector II. Additional funding which conceivably may be needed for the water/wastewater subprojects in those thee cities under PCD should not come from the Decentralization Sector II program.

4. Long-range Problems

While the BVS and NUS projects have generated a solid base of accomplishment, a number of long-range problems still remain to be addressed that are related to making local capacity building a self sustaining feature of the Egyptian development process. They include the following:

a. Maintenance

It was originally envisaged that a set-aside

maintenance account (10% of BVS subproject costs and a variable rate for NUS subprojects) would adequately address maintenance needs, but many village and district units have been reluctant to use these accounts for their intended purpose. As a consequence, new incentives have to be devised and tested for appropriate maintenance performance at the local level.

b. Policy Dialogue

A sustained process of national policy dialogue has not been generated by the BVS and NUS projects in support of decentralization. Until recently, primary attention has been devoted to organizing and routinizing the design, review, implementation and monitoring systems for BVS/NUS subprojects at the village and district levels. This was a formidable task, involving the training of thousands of officials and the monitorng of performance as different levels of government learned to exercise new roles and skills in implementing BVS/NUS activities. The BVS system is well in place and the NUS will soon graduate to this stage as well. Some attention will need to be focused on system maintenance and improvement, but the central agenda should now include the generation of a national policy dialogue on issues relating to the wider expansion of local development capacities.

c. Resource Mobilization

Building the capacity of local authorities to generate their own resources is one major cornerstone of the decentralization process. BVS and NUS have demonstrated local capacities to mobilize resources on an ad hoc basis but no major effort has been made to systematically address what local and national authorities can do to expand local revenues. Particular attention needs to be focused on design of resource allocation arrangements from central level sources and expanding revenue generating authority available to local jurisdictions.

d. Constituency Mobilization

Strong institutional sources at the national level have yet to be mobilized for the defense and promotion of decentralization objectives. Building this base of support should constitute a major component of Sector II of the decentralization effort. This task needs to

be viewed as a long term evolutionary process that can only be undertaken with considerable care and caution. Given the ongoing progress in building the necessary support system for effective subproject implementation in BVS and NUS, Mission staff should now devote an increasing share of their time to designing and implementing strategies for inducing and nurturing institutional support at the national level.

e. Institutional Learning

Institutional learning will need to become a major component of the Sector II decentralization effort. Links to institutions with advanced analytical capacities in the social sciences should be developed in order to begin monitoring and assessng innovative local development efforts generated by high performing villages, districts and governorates which can then be documented and shared through information exchange and training with other jurisdictions. Likewise, more systematic analysis will need to be used in the design and monitoring of policy innovations undertaken at the national level. The Saqqara Institute is an obvious choice for beginning to undertake these analytical functions, but other resource institutions should also be included in this effort.

D. PROPOSED GRANTEE AND/OR IMPLEMENTING AGENCY

While the grantee will obviously be the Arab Republic of Egypt, there will be several units and levels of implementation focus:

1. National Policy-level Coordination

National policy-level coordination and guidelines (together with the AID Mission) will rest with the Supreme Council of Local Government, comprising the Prime Minister's Office, the Ministry of Local Government, and the Governors and Chairmen of the Popular Councils from each of Egypt's 26 Governorates. An active Steering Committee Program/Policy Secretariat is to be established within the Office of the Prime Minister.

2. Saqqara Institute

General technical assistance, training and information and subproject monitoring will be focused at (and out of) the

new Saqqara Institute for Local Development, to be initially administered through the Ministry of Local Government.

3. Fiscal Administration

AID-financed "grants-in-aid" will be provided to and administered at 26 separate governorate levels, both rural and urban. These grants-in-aid, to be directed at and utilized for capacity building and resulting local level economic and social infrastructure and services, will be provided over a five-year phase-down basis, innovatively and creatively applied to local-level resource mobilization, subproject local performance and completion rates, population and area of governorate, etc. The GOE and USAID will determine annually the matching fund grant-in-aid formuale for each governorate based upon project performance indicators and estimated resource mobilization potential.

Initial AID contributions vs. local contribution percentages will not be greater than 80:20, and will be reviewed and adjusted each year in each participating governorate. It is expected that initial AID contribution potential, depending on population density and assessed capability/need of each governorate will be between $1.5 million (rural) and $5.0 million (urban).

Over the life of the program, AID's share of grant-in-aid contributions will phase down as local revenue generation and retention contributions to local development projects increase. Annual reviews and policy decisions will be made with USAID and the Steering Committee Secretariat and will be discussed within the Supreme Council of Local Government.

E. AID Support Requirements and Capability

USAID support for DSSII will require certain changes in the way DRPS/LAD is organized and in the types of skills needed to support the program.

At the present time, the AID professional staff is organized along project lines, reflecting the five major projects included under the decentralization PAAD. This project manager form is familiar to AID and permits establishemnt of appropriate position titles and rank. Moreover, FSN staff have been assigned to each project for engineering and procurement support.

LAD has proposed a reorganization plan for Sector II which uses geographical areas as the basis for delineating line responsibilities, e.g., Urban, Riverine, and Desert, as well as several staff responsibilities such as training and local finance (see staffing and reorganization draft plan, Annex E).

Part of the motivation for this plan is to insure that the office hierarchy is structured to guarantee that high quality, senior (FS-1) people can be placed in positions with titles and responsibilities commensurate with their experience and skills. This is an extremely important consideration which has implications for whether DSSII is treated as a "project" or a program.

An alternative way of organizing LAD would be according to major subproject objectives. These would include:

- Policy Analysis and Dialogue
- Training Support (Saqqara Program)
- Revenue Decentralization Experimental Program
- Base Program in Geographic Areas

It may be possible to combine features of both the LAD draft plan and the alternative proposed above. At some point we would envision that the commodity support branch would be phased out as the DSF portion of the present program winds down.

In terms of types of skills needed, a shift away from emphasis on engineering and subpoject management skills and toward expertise in applied institutional technology skills should occur. More expertise in revenue generation, financial management, economic analysis, experience-based training and related capacity building skills will be required.

Developing organizational support for DSSII goes beyond reorganization of LAD. As the decentralization process continues, there will be new opportunities for AID funding for projects generated by local units which would be suitable for other AID sectoral areas of emphasis. For example, USAID could support "large scale" water and wastewater infrastructure projects in provincial cities, rural health clinic rehabilitation and family planning activities, by providing funding and technical assistance directly to governorates and local units. The Mission will need to develop some form of coordinating and integrating mechanism for insuring that such activities are considered with the overall decentralization strategy, even though fundng and project management responsibilities for such projects may be located outside of LAD.

F. ESTIMATED COSTS AND METHODS OF FINANCING

The project will consist of four basic elements:

Policy Dialogue: Continuous examination of important issues, discussion of emerging findings, and promotion of desirable policy reforms. Funding will be modest and will increase only slightly over the life of the project.

Saqqara Institute: Combines aspects of policy dialogue and promotion of innovative approaches with rapidly growing training and experience dissemination seminars at local community level. Funding expands significantly to level out in the fourth year of the project.

Resource Mobilization Models: Operational centerpiece of the project, supporting innovative experiments designed at local level and reviewed at governorate level. Significantly growing funding to fourth year; supplants phase-out support of base program.

Base program: Support of selected innovative aspects of BVS, NUS, and PCD projects.

Over the five years of the project, approximate budgetary breakdowns for each of these elements are as follows:

Tentative Decentralization Budget
(in $$ Million)

	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Policy Dialogue	1	1	2	2	2
Saqqara Institute	4	5	5	3	3
Resource Mobilization Models	20	64	83	90	95
Base Program	50	80	60	30	[illegible]
	75	150	150	125	100

All indicated funds are USAID grants. No contributions are planned from other sources, aside from annual increasing local contributions/resource mobilization funds.

A clarification should be offered concerning the nature of the disbursements to individual subproject activities. These are to be direct local-level disbursements for which USAID documentation is prepared for disbursement of funds subject to acceptable expenditure/project implementation performance as reported by each governorate. Accordingly, these fiscal actions should not be viewed as advances prior to implementation, but rather as disbursements subject to specified implementation performance.

G. Design Strategy

The AID MIssion will need to develop the Sector II program in close collaboration with the GOE counterpart planners and decision-makers. A wide range of GOE institutions will be involved in negotiating the various design components, including the Ministries of Economy, Finance, Planning, Local government and various governorate authorities. The Mission will arrive at a strategic assessment on which agencies are to be most involved in these dicussions. It is likely, for example, that several of those governorates who have assumed a major leadership role in projects under Sector I will be called on to exercise a similar role in preparing the project design, particularly for those componets which relate to the testing of new revenue generating measures and in specifying the services to be provided by he Saqqara Instutite.

The LAD office will take the lead in organizing initial discussions with the GOE. Given the magnitude of the design tasks and the specialist skills required, and additional 3 or 4 person AID/W team will be sent to assist in the PAAD preparation. The LAD office will intiate preliminary discussions with the GOE in July and August, followed by the formulation of the design team in September to prepare and submit the PAAD in December.

Mission/GOE PAAD design may be supplemented with a 3-4 person specialist team consisting of a public finance specialist, an institutional design/rural development specialist, and institutional design/urban development specialist, and a management/training specialist. Given the major policy emphasis for Sector II it is anticipated that the 3-4 person team will need to be on assignment in Cairo for a two/three month period in order to firmly establish AID/GOE roles and expectations for the proposed sector program objectives. One method of legitimizing the design process and expanding the

policy discussion could be to conduct a seminar drawing upon other third world experience and linking the various components, needs and strategies.

During the design phase, one of the issues to be addressed will be the extent to which this Program has and can contribute to increasing productive investment at local levels, and its relationship to the National 5-Year Plan. This information will be reflected in the Economic Analysis section of the PAAD.

H. AID POLICY ISSUES

General Policy Concerns with Local Government Assistance Programs (Note: All policy issues are derived from AID Policy Guidelines in AIDAC, Administrator McPherson, STATE 019922, 17 July 1982.)

1. Promoting broadly-based, self-sustaining development at local level is a key element of AID policy

   Decentralization Sector Support I has promoted broadly-based development at the local level. Sector II will focus attention on various elements of sustainability as described in the PID. Several factors in the host country environment are conducive to this shift in emphasis, including a new framework for decentralized decision-making, increased resource flows to governorates and local units, and demonstrated capacity to design and implement small-scale projects. The willingness of local units to participate financially in revenue generation and to maintain physical infrastructure should be greater since the benefits from development are directly felt and are immediately visible to people.

2. Our assistance should positively encourage greater community participation in development by energizing local elected councils with resources, improving their self confidence and management capabilities with training, and improving their quality of life with local infrastructure initiated and developed by the local communities.

   Small-scale successes provide experience and confidence to proceed with other activities, a proposition which has been tested in many developing countries with generally positive

results.. Moreover, infrastructure development and the capacity to sustain it is a key factor creating the conditions for orderly development of the "the market" upon which private enterpreneurial activity can flourish. There is considerable qualititative and some quantitative eivdence to support the proposition that private economic activity has increased in Egyptian rural and "rurban" areas. Finally, Sector I has directly supported nongovernmental activities through the Neighborhood Urban Services Project. This concept will be integrated into Sector II and applied to provincial cities and smaller rural communities, thus building on the strong social responsibility ethos found in Egyptian communities.

3. <u>AID assistance to local government should encourage the growth of local private enterprises</u>.

In addition to improving conditions for the private sector to develop, the DDI project helped to capitalize a loan fund (Local Development Fund) which was used by local communities to finance income generating projects. This has been a controversial program and the issues it has raised should be squarely faced. It should be noted that DSS I does not envision further support to this fund or for projects which finance publically owned enterprises.

The USAID has advanced two defenses of the LDF. First, the public enterprises were generally sucessful in financial terms, and provided a new revenue source controlled by the local unit which could be reinvested for local public goods development. Second, by establishing new productive enterprises, local governments were establishing "model" businesses which were then emulated by private entrepreneurs. In essence local governments assumed the "risks" of new enterprise development normally assumed by private entrepreneurs in capitalist societies. Once the profitability of the enterprise was demonstrated, private entrepreneurs have come forward to build new units and expand production and generate new sources of wealth and employment.

Critics of this approach have responded by pointing out several negative consequences of this approach. First, incomes from local public entreprises are often not used for public goods, rather they are more likely reinvested in further expansion of the enterprises or in new ventures. Moreover, it is unlikely that local units will divest themselves of successful businesses in order to take up "new" production challenges. Second, public enterprises at

the local level enjoy privileges not available to private capital, such as lower interests rates, subsidized inputs, and the ability to sell products at below market prices. If both public and private entrepreneurs were allowed to play by market rules, it is unlikely that public enterprises would be as efficient or market responsive and would eventually fail.

Both the advocates and critics of this program have a point. Private capital exists in Egypt but entreprenuers have been cautious in investing in new producition enterprises. Investments in land and construction services have been safer and equally profitable. Wherever the demonstration affect has worked there appears to be a growing willingness to take risks based in part on a gradually increasing confidence in an environment of support for private entrepreneurship, and in part on the demonstration effect of LDF type programs.

The review team explored several ways to include a restructured loan fund facility which would more directly stimulate private activity while avoiding negative aspects of the current LDF program. It was concluded that there may be merit in developing a program of assistance to stimulate and support private productive enterprise development in towns and rural communities in the governates. However, such a program should be independent of and complementary with the DSS II. Our understanding of the dynamics of local private enterprise development is extremely limited and further empirical work will have to be done.

4. <u>If AID grants or loans intended to strengthen local government are to administered through a central government hierarchy</u> (or local government linked to central government) <u>there should be clear and convincing evidence that this support will not serve to increase local government dependency on central government initiative, but rather strengthen government capacity to promote development at the local level.</u>

Part II A of this document assesses both centralizing and decentralizing forces in the Egyptian context. DSS I has successfully blended AID funds to support the latter. The assessment/PID team brought to its task considerable indepth experience with other programs in decentralization AID has supported in Indonesia, Philippines and Thailand. The judgement of the team is that considerable progress has been made in increasing local initiative and institutional

capacity, but that the process is by no means complete or so well entrenched that it could not fail. Continuing grants in aid to local commnunities while strengthening central and governate technical and policy authority would not meet the test of true decentralization. The danger of backlash must be faced and the possible risks explicitely recognized.

This argues for a program of what may be called strategic incrementalism. A strategic incrementalism approach avoids ad hoc pragmatism by clearly stating the desired objectives of a program while maintaining flexibility of tactics for achieving those objectives. The test of any specific investment or activity in this approch is whether or not it moves the system in the right direction. The DSS II PID has deliberately incorporasted this strategic outlook. A further test which the USAID must consider is whether other programs, such as family planning, agricultural development or basic education can be consistent with the goals and objectives of, in this case, the decentralization program. Without this overall program consistency, the USAID may inadvertently undermine with one program the objectives it is pursuing in others.

In the decentralization effort, therefore, the Mission should review its activities in other sectors to insure that it is not encouraging expansion of central government heirarchies and concommitant dependency relationships. Indeed, through cross covenants and other forms of USAID coordination, greater policy influence may be achieved.

5. AID assistance to local governments under highly centralized systems should be proceeded by negotiations that carefully delineate those functions, authorities and responsibilities which need to be transferred to strengthen local government autonomy.

The 1983 Sector Assessment and this Review/PID establish the need for a policy dialogue and proposes both an agenda as well as a broadening and restructureing of the focal points in the GOE for advancing that dialogue. The Ministry of Local Development has indicated a willingness to engage in a discussion and purports to have the full backing of the President and the Prime Minister in this effort. The Mission and the Project/Program design team will have to explore with the GOE the extent to which the government is prepared to move in the direction of sustainable decentralization. It must also devise the best

strategy for demonstrating that decentraliztion is in the interests of the GOE's overall development goals. However, it is unrealistic to expect the GOE to introduce radical transformation of their system prior to agreements with AID.

6. Effective assumption of (revenue raising, operating, maintenance and replacement) responsibilities is a significant test of the value and success of local government assistance.

   It is the intent of this project to address and find acceptable and workable solutions to this issue.

7. Support should be viewed as a long term institution building effort.

   DSS II is the second phase of a three-phase process extending over a maximum of fourteen years. The second phase (Sector II) will broaden and deepen project development, management and implementation capacity, expand local resource mobilization and test a variety of mechanisms for increasing institutional sustainabiliy. If successful, a third phase will be considered to support replication and spread of tested systems to all governorates.

ANNEXES

A. THE DECENTRALIZATION OF LOCAL GOVERNMENT IN EGYPT, A SPECIAL ASSESSMENT FOR USAID, Jan. 1983

B. ROBERTS TO DISTRIBUTION MEMO, SUBJECT: CURRENT SUB-PROJECTS SELECTION DISBURSEMENT PROCEDURES IN PLACE FOR BVS AND NUS PROJECTS WITHIN THE DECENTRALIZATION SECTOR SUPPORT PROGRAM (with attachment)

C. CAIRO 4911, DATED FEBRUARY 13, 1984, SUBJECT: DECENTRALIZATION SECTOR ACTIVITIES

D. CDSS - RURAL AND URBAN LOCAL DEVELOPMENT: DECENTRALIZATION SECTOR SUPPORT II, April 1984

E. THE GOVERNMENT OF EGYPT'S AND USAID'S DECENTRALIZATON SECTOR SUPPORT: ITS ACCOMPLISHMENTS AND EXPENDITURES, April 1984

F. ROBERTS TO ZARR MEMO, DATED APRIL 16, 1984, SUBJECT: WORK FORCE AND ORGANIZATION PLANNING

G. THE GOVERNMENT OF EGYPT'S AND USAID'S LOCAL DEVELOPMENT PROGRAM (DECENTRALIZATON SECTOR SUPPORT), April 1984

H. PRELIMINARY EVALUATION PLAN

ANNEX H PRELIMINARY EVALUATION PLAN

Evaluation of progress on Sector II activities should involve increasingly intensive participation of the Saqqara Institute and any other collaborating Egyptian institutions. This should be a natural outgrowth of continuing program implementation since Saqqara is to be the focal point for on-going monitoring of each of the other elements of Sector II: policy dialogue, resource mobilization models, and the base program. With such continuous information collection and activity monitoring by Saqqara, it should therefore be possible to conduct rather information-intensive program evaluations in a very economical fashion.

The key aspect of Saqqara's contribution to the emerging program makes it the natural of any evaluation effort. Its cadre of Egyptian specialists -- working closely with the expatriate contractor institutions -- provide the essential interconnection between the Saqqara Institute and the policy dialogue, resource mobilization models, and base program activities. Indeed, Saqqara's monitoring efforts of the base program and the resource mobilization modes will assure the essential link between these two elements. The formulation and pursuit of many policy dialogue initiatives must also be coordinated through Saqqara, since -- in the long run -- Egyptians themselves must ultimately promote and secure that objective if it is to be successfully attained.

Benchmark information, collected on a continuing basis, should be assembled (with increasingly central involvement of Saqqara cadre) for annual program reviews. This information will track tangible outputs of the various activities, of course, but its primary purpose should be the increasingly Egyptian involvement in monitoring and analysis of local resource mobilization models and institutional capacity building.

A formal interim evaluation should be held during the third year of implementation. Decisions to be taken at that time include:

Confirmation of termination date(s) for the base program,

Necessary re-design of any resource mobilization model approaches,

Greater specification of the timing and nature of national policy implementation of successful local resource mobilization models,

Appropriate modification or confirmation of the longer-term operational role(s) of the Saqqara Institute both in its training-and-outreach functions at the local level and in its policy dialogue and analysis functions at the national level, and

Preliminary decisionmaking on the preferred arrangements for Sector III, as appropriate.

A final evaluation of Sector II should be conducted during the fifth year of the program. This would continue the work of the interim evaluation and finalize any plans for a Sector III.