



Fiscal Decentralisation Strategy for Local Service Delivery in Puntland State of Somalia

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Key messages

- The strategy is intended to give a sense of direction rather than a blueprint
- It prioritises improving the systems through which LGs access, manage and account for resources to finance the implementation of the core municipal services they are currently responsible for
- It emphasises the need to facilitate dialogue to decide whether sectoral services should be devolved to LGs, and if so how they should be financed and managed.
- It underscores the importance of strong State Agencies that can manage and coordinate the financing and management of local services
- It highlights the need to support the State and LGs to manage and implement the service delivery financing reforms in flexible manner responsive to the context



UN Joint Programme on Local Governance and Decentralised Service Delivery



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Abbreviations

Abbreviation	Description
AG	Accountant General
AIMS	Accounting Information Management System
ALGPL	Association of Local Governments in Puntland
BIMS	Billing Information Management System
CG	Central Government
CoA	Chart of Accounts
DANIDA	Danish International Development Agency
DDG	Discretionary Development Grant
DFID	Department for International Development
EU	European Union
FDS	Fiscal Decentralisation Strategy
ILO	International Labour Organization
IPF	Indicative Planning Figure
JPLG	Joint Programme on Local Governance and Decentralized Service Delivery
LDF	Local Development Fund
LG	Local Government
MCs	Minimum Conditions
MoF	Ministry of Finance
MoH	Ministry of Health
Moi	Ministry of Interior, Local Government and Rural Development
MTEF	Medium Term Expenditure Framework
NGOs	Non-Government Organisation
OAG	Office of the Auditor General
ODA	Official Development Assistance
ODI	Overseas Development Institute
PFM	Public Finance Management
PHC	Primary Health Care
PMS	Performance Measures
PSAWEN	Puntland State Agency for Water, Energy and Natural Resources
ROC	Reform Oversight Committee
SADs	Social Affairs Departments
SDM	Service Delivery Model
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNICEF	United Nations Children’s Fund
USAID	United States Agency for International Development
WB	World Bank

Executive summary

The **Fiscal Decentralisation Strategy** provides a framework for strengthening the systems and capacities for financing local governments to deliver basic services in Puntland State of Somalia. While federal-state relations are still being developed, the State Government already has an established system of local government with Regions divided into Districts and Villages. Though capacity is uneven, most Grade A and B districts are able to provide core municipal functions, while services in the health, education and water sectors are provided by the State Government through regional and district departments and by donor-funded organisations.

The State Government has outlined its ambition to decentralise more of these services in the Decentralisation Policy (2013-2020). This requires the right mix of political, administrative and fiscal capacity at the local government level, and a strong State that can ensure that local governments adhere to the set guidelines. However, there is no one right way to do this, so the strategy sets out a process for building on the existing foundations in a way that fits the political, social and economic context of Puntland. It considers the practical steps needed to make improvements and resolve key policy decisions in three areas:

1. Making the existing systems work better.
2. Strengthening sectoral service delivery.
3. Management of fiscal decentralisation.

The Fiscal Decentralisation Strategy is informed by the detailed **LG financing assessment** and accompanied by an **Action Plan** that outlines short term priorities as well as the roles and implications of the Strategy to the different stakeholders.

Making the existing systems work better

Many of the basics of fiscal decentralisation are already in place, particularly in Grade A and B districts. Local governments collect a variety of revenues. In addition there is a state transfer provided to Garowe, ad hoc grants received by other districts and the Local Development Fund (LDF) which is a discretionary capital grant provided under the JPLG/UNCDF to seven LGs. Basic PFM systems are also being established especially in districts supported by the JPLG. The Grade A and B districts provide core municipal functions notably public works and solid waste management.

However, a number of key challenges remain to be addressed. Revenues (and by extension expenditures) are inequitable. Transfers maintain the inequities because they do not go to all districts. They are also unreliable and not transparent, which makes planning for services difficult. Many districts – especially outside the JPLG-supported areas – have yet to put in place the basic systems needed for budget preparation, execution and reporting. Those that have do not apply the same guidelines in the same way, which makes State oversight challenging.

This strategy outlines options for addressing these issues:

- Improving revenue collection and administration by improving and extending support offered to JPLG districts to other local governments, resolving disagreements in

revenue responsibilities between districts and the State, and harmonising revenue rates between local governments.

- Introducing unconditional grant to districts to support local services and improve the equity of resource allocations between districts. At first the State would improve the reliability of transfers to Garowe, and formalise transfers to Bosaso, Galkacyo and Laascaanood, which no longer retain customs revenues. Based on the experiences from this, additional resources could be transferred to other districts.
- Establishing a Discretionary Development Grant (DDG) to finance local government development expenditures. This would broaden the existing capital window of the Local Development Fund (LDF) to provide funding to non-JPLG districts. This would provide a vehicle for channelling additional State and external donor resources to districts for development.
- Strengthening district PFM systems, especially for non-JPLG districts. The Government should issue harmonised guidelines for planning, budgeting, procurement, accounting, reporting and other aspects of PFM. Support will be needed to establish and embed these guidelines, and the functions which provide oversight of their application (internal audit, finance committees).

Some of these reforms have already begun. Notably, the JPLG programme has helped some local governments build their capacity for PFM and revenue management. However, even in these districts, the substantive policy questions over how much of the State budget should be allocated for local government services, to which districts and for what purposes are yet to be resolved. These debates need to be initiated within the government.

Strengthening sectoral service delivery

Unlike core municipal functions, the delivery of services such as health and education requires fundamental dialogue and changes in the way the services are currently managed. Most are implemented directly by the State Government through regional and district offices (such as education) or by NGOs with support from the State Government (such as health).

The aim of the strategy is to initiate a process to resolve the key issues in each sector in a consistent manner, so that at the end of the processes the challenges are identified, the respective mandates of districts and the State are agreed and resources identified to allow them to fulfil those mandates. Resolving these issues will take time, but the approach recommended is to start by:

- Improving the design and implementation of service delivery transfer pilots so as to further test the mechanisms for planning, financing, management and oversight of service delivery and draw lessons for informing the future refinement of financing arrangements for the services under the mandate of local governments.
- Initiating a process of discussing and resolving policy issues required to strengthen service delivery including deciding the challenges hampering service delivery, the functions that can be better delivered at the LG level, the required systems and capacities and the role of the State to ensure the proper delivery of these services.
- Developing mechanisms to ensure that if a decision is made to decentralise services, the LGs are provided with financial resources to implement the decentralised functions.
- Establishing a process for managing service delivery including establishing and supporting the operation of structures and coordination mechanisms for developing a coherent approach to resolving policy issues, ensuring the appropriate design and overall management and financing the delivery of services.

Management of Fiscal Decentralisation

An effective decentralisation process requires strong State Government systems – for oversight, dialogue and coordination. Currently, the State structures in the MOF, MOI and line ministries do not have sufficient human or financial capacities to provide the necessary guidelines, support and oversight to local governments to deliver services and manage transfers effectively. There is also limited dialogue between the State Government and districts on issues related to local government and the financing of local services. Finally, fiscal decentralisation is currently fragmented across three sets of reform processes – one focussing on decentralisation, the second on PFM, and the third on civil service – which are not closely coordinated.

For these reasons the strategy proposes ways to strengthening the capacities for management of fiscal decentralisation at the State level in three areas:

- Strengthen the capacities of state agencies to: (i) develop policies and systems in partnership with LGs; (ii) manage the system of fiscal transfers; (iii) support LGs to perform; and (iv) enforce adherence to a fair set of rules.
- Ensuring that the PFM, decentralisation and civil service reforms are well coordinated and consistent
- Facilitating and ensuring regular dialogue between State Government and LGs on issues regarding financing decentralised service delivery

The implementation process

The strategy is intended to give a sense of direction rather than a blueprint. The implementation will focus on government ownership and attaining quick wins by starting from improving the existing system. It emphasises ongoing dialoguing and an organic process of resolving policy issues within and across sectors. The strategy also focusses on strengthening the State Agencies to perform their support and oversight roles but also to own and coordinate the overall process for reforming and improving the delivery of services.

The strategy is accompanied by an Action Plan that details the issues, identifies short-term priorities and assigns indicative responsibilities for resolving the key issues under each theme. It is not the aim to provide a fixed plan for implementation, which would not fit the changing political, economic and social context in Puntland or the realities of institutional reform. Key policy issues will change as reforms develop and so will responsibilities. Therefore, the Action Plan focuses on short-term planning horizons which will need to be updated periodically – ideally at least every three months – in order to remain a relevant tool for coordinating reforms in a changing context.

The State and Local Governments will require a lot of support to manage the process of implementing the strategy and action plan described above. The support will range from technical assistance to further design the systems, for institutional strengthening and ongoing support for reform design and implementation, coordination as well as for financing some of the elements of the reform e.g. the broadened discretionary development grant and sector transfers that may be introduced.

1 Introduction

1.1 Purpose and Objective

This strategy elaborates the strategies and processes for developing and strengthening the systems and capacities for financing the delivery of basic services at the local level in Puntland.

Puntland is a member state in the Federal Government of Somalia, but performs all the functions of an autonomous state, including the provision of security and raising revenues from all sources. The State Government is divided into Regions and every region is divided into Districts and Villages. The districts are classified in grades “A”, “B” or “C” according to their production, population and size.

In the Decentralisation Policy (2013-2020), the State Government has set out a vision for decentralising services for roads, water, sanitation and hygiene, natural resource management, health and education. Most of these services are currently centralised. Whereas grade “A” and some “B” districts already have the basic human and financial resources to perform core municipal functions¹, most of the social service delivery functions in health, education, and water are provided by the State Government through regional and district departments and by donor-funded organisations. This raises a number of policy questions that need to be addressed in order to strengthen the delivery of services in social sectors.

Three mutually reinforcing pillars have to be in place in order to decentralise, improve the accountability and responsiveness of Government and delivery of services by local governments (LGs). These are:

- a) **Political decentralisation** so there are incentives for LGs to use resources to promote services for their constituents, usually institutionalised through councils who oversee the performance of LGs and account to citizens;
- b) **Administrative decentralisation** so LGs have the required staff and authority to manage the delivery of services; and
- c) **Fiscal decentralisation** so LGs have the financial resources (and financial management systems) needed to deliver the services under its mandate.

In addition, LGs need a strong centre that develops the policies and systems, supports and inspects the LGs to ensure that they adhere to the set guidelines and improve the delivery of services. These relationships are summarised in figure 1 below.

Figure 1: Decentralisation Pillars

¹ Including public works, solid waste management, sanitation, natural resource management and local security



The purpose of the Fiscal Decentralisation Strategy for financing LGs to deliver services is to set out the direction of reform and a process for:

- a) The identification of practical steps that can be taken to improve the existing situation now (quick wins);
- b) Resolving large policy and operational questions/issues; and
- c) Greater communication and a partnership between the State and LGs

The overarching objective is to improve accountability, responsiveness and service delivery.

This strategy is deliberately not prescriptive. It is unlikely that a blueprint for reform would identify the most appropriate solutions. Instead it highlights the major policy choices and sets a direction for reform, and a process for managing the reform as they are established.

1.2 Structure of the LG Financing Strategy for Service Delivery

The strategy is composed of three components:

- a) **Component 1: Making the existing systems work better:** Some districts have local councils, staff and do manage some of the core municipal functions including public works and solid waste management. To implement these core functions some LGs are collecting own source revenues, others used to retain a share of the customs collected from their areas of jurisdiction, a few receive State government transfers. Albeit still nascent, systems and capacities for planning, budgeting, management and reporting for resources are emerging especially in JPLG participating districts. Component 1 focusses on making these existing systems at LG level work better.
- b) **Component 2: Strengthening sectoral service delivery:** Financing the delivery of services is being piloted in education, health and water in a few LGs. However, there is neither clear demarcation of roles and responsibilities between the state and LGs nor an adequate dialogue to discuss the challenges that hamper the effective delivery of services; whether these challenges can better be addressed through decentralising the services to LGs and if so the systems and capacities required at the LG level and how they should be put in place. If the decision is taken to decentralise services, then funds, must be available to LGs to take these functions on. And this process needs to be well managed and coordinated within and across sectors. Component 2 focusses on managing a process of

resolving policy questions and ensuring that the decentralised functions are adequately financed to strengthen sectoral service delivery.

- c) **Component 3: Management of fiscal decentralisation:** Most of the state level agencies have inadequate financial and human capacities to develop guidelines for local service delivery, and support and ensure adherence to these guidelines by LGs. Fiscal decentralisation is currently fragmented across three reforms – one focussing on decentralisation, the second on PFM and the third on civil service. There is also limited dialogue between the State Government and LGs on issues related to local government and the financing of service delivery. Component 3 focusses on strengthening the capacities for management of fiscal decentralisation.

The LG Financing strategy was informed and is supported by the **Local Government Financing Assessment Report** that provides detailed information on how currently LGs: are structured and functions; are financed and spend resources; budget, execute budgets and account for resources; and relate with the State Government.

To guide the implementation of the LG Financing Strategy, **an Action Plan** has also been developed outlining the roles and implications to the different stakeholders whilst emphasizing the need for flexibility and short-term planning horizons to respond to the changing context.

The three components have **elaborated the statements and goals in the Decentralization Policy regarding fiscal decentralization as shown in text box 1 below.**

Box 1. The Fiscal Decentralization Strategy in the Context of the Decentralization Policy

This text box explains where and how the statements in the Decentralization Policy related to fiscal decentralization have been elaborated in the Fiscal Decentralization Strategy.

The policy statement regarding **expenditure assignments of public service functions** have been elaborated in component 2 strengthening sectoral service delivery, output 2 that elaborates the process that should be followed to discuss and decide functions that can be better delivered at the LG level, the required systems and capacities and the role of the State to ensure proper delivery of services as well as output 3 that focusses on ensuring that LGs are provided with financial resources to implement the decentralised functions.

The policy statement regarding **LG own source revenue mobilisation** has been elaborated in component 1 making the existing system work better, output 1 that focusses on increasing the volume and improving the administration of revenues collected by LGs for the LGs to continue and increase funding of basic operations, contributions to capital investments and service delivery.

The policy statements regarding the **intergovernmental transfers** have been elaborated in component 1 making the existing system work better, output 2 that focusses on improving the state transfers to LGs by introducing an unconditional grant and output 3 that focusses on institutionalizing the capital window of the LDF into a Discretionary Development Grant. In addition it has been elaborated in component 2 strengthening sectoral service delivery output 3 that focusses on ensuring that LGs are provided with financial resources to implement the decentralised functions.

Detailed guidelines on **borrowing and debt** have been elaborated in the Municipal Financial Policies. Therefore the strategy has emphasized the need to harmonise policies and procedures for among others short-term borrowing and debt that ensures that LGs do not incur debt financed expenditure that may require State Government bailout.

To ensure **a vertical balance of LG expenditures and revenues** to close the fiscal gap of the funding requirements, the strategy has emphasized the need for the State Government to allocate a larger and known share of the total domestic State revenue under Component 1, output 2 and 3 that focusses on

introducing the unconditional grant and institutionalizing the DDG respectively as well as Component 2 output 3 where the State Government will be lobbied to allocate more funds to services devolved to LGs.

The LG financing strategy has also elaborated that **the transfer allocations formula** should be transparent and objective and that it should be negotiated between the LGs and State agencies under Component 3 output 3 that focusses on initiating dialogue between State and Local Governments.

1.3 Process of developing the LG Financing Strategy

The LG Financing Strategy has been developed through a consultative process.

The United Nations Capital Development Fund (UNCDF) under the United Nations Joint Programme on Local Governance and Decentralised Service Delivery (JPLG) commissioned the Overseas Development Institute (ODI) to work with the Puntland State of Somalia to develop a strategy for financing LGs for them to perform their mandated functions.

The assignment started with an inception phase where the consultant reviewed the documents and consulted with Development Partners supporting the PFM systems and delivery of services in Puntland to elaborate the approach.

To inform the development of a customised Fiscal Decentralisation Strategy, an assessment of how LGs are currently financed in Puntland was conducted. The objective of the assessment phase was to collect and analyse the available data, and to work with government to come to a common understanding of the challenges and issues faced. The focus of the assessment was on four thematic areas: (i) LG structures and functions; (ii) LG revenues and expenditures; (iii) LG systems for budgeting, expenditure management and reporting; and (iv) intergovernmental fiscal relations.

The assessment involved both desk-based research and analysis of available data and consultations with stakeholders in the crosscutting government ministries, departments and agencies; the sector ministries/departments responsible for primary education, water and sanitation, and primary health care, JPLG team members and LGs (Garowe and Qardho). A validation workshop was held in Garowe on March 23, 2016 where the findings from the LG financing assessment were presented to the key stakeholders from the state agencies, LGs (including those not consulted), donors as well as non-state stakeholders. The validation meeting was also used to get guidance on the direction of travel and pointers to the FDS design. The detailed findings are presented in the LG Financing Assessment Report.

The consultant used the validated LG financing assessment report and documentation of international experience, to draft the Fiscal Decentralization Strategy simultaneously with the Implementation Action Plan. A validation workshop was held in Addis Ababa in May 2016 where the contents of the FDS and action plan were discussed and endorsed and short term priorities to kick-start the implementation identified and agreed.

2 Component 1: Making the Existing System Work Better

The basic building blocks of a decentralised system are in place and functioning. Further, LGs are implementing activities in sectors such as roads, solid waste management and rural water.

Politically, some LGs have Councils in place with potential to ensure accountability and to provide oversight to the administrative staff. Administratively, finance and administration staff are employed by LGs and technical staff like Engineers are in place especially in grade A and B districts. Fiscally, LGs are able to collect revenues from a range of sources. There are transfers to Garowe Municipality and ad hoc transfers to other LGs but they are neither reliable nor transparent. There is a highly discretionary Local Development Fund (LDF) being used to construct local infrastructure. The LG PFM Systems have also been established in some LGs, particularly those with support from the JPLG Programme.

However, there are important issues that need to be resolved. There are significant inequities in LG revenues from all sources, which naturally translate into inequities in spending power. Bosaso, Galkacyo and Laascaanood districts used to retain 2.5% of customs revenues which made resource allocations even less equitable. These powers have been revoked by the legislature, but have raised important questions about how services in these three urban areas will be financed, and to what level. Fiscal transfers, including the LDF, are restricted to a limited number of LGs and are widely viewed as unreliable.

This component focuses on making the system of transfers and local revenue generation work better, in a more equitable, transparent and predictable manner to ensure that LGs have sufficient resources to finance and account for the delivery of core municipal services and rural water.

Strengthening these systems and services will involve:

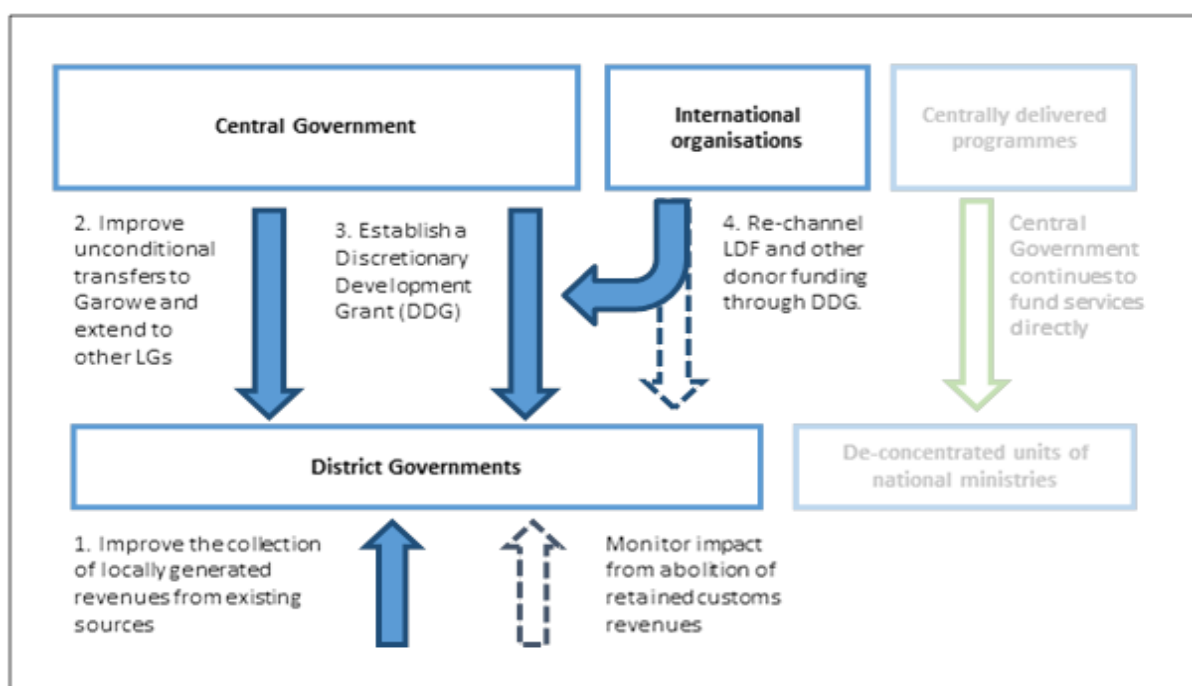
1. Having improved collection and administration of locally raised revenues to fund LG operations as well as recurrent service delivery;
2. A well-managed unconditional/block grant initially to Garowe Municipality but thereafter replicated to other LGs;
3. An institutionalised and broadened Discretionary Development Grant that is used by the LGs to finance development needs; and
4. A strengthened system of LG budgeting, accounting and reporting processes of transfers.

Box 2. Vision for Component 1: Making the existing system work better

The ultimate objective of this component is that all grade A and B districts will have the finances and capacities to deliver their core municipal functions:

- Improved local revenue collection in all grade A and B local governments
- A transparent, timely and equitably distributed unconditional/block grant
- A discretionary development grant that finances infrastructure investment and incentivises capacity improvement rolled out to all grade A and B local governments
- Strong planning, budgeting, accounting and reporting systems that allow local governments to effectively perform their functions, and allows State government to effectively monitor performance. This is illustrated in Figure 2 below.

Figure 2: Making Existing LG Systems Work Better



2.1 Improved collection and administration of locally raised revenues

There are a number of virtues related to the collection of local revenues by LGs. Local revenue provides autonomy to LGs to allocate resources for salaries, recurrent costs, capital investment and operations and maintenance of services. Local revenue also strengthens local accountability as the public are more likely to demand for quality services if they know that they contribute towards them directly.

In Puntland, there are many local revenues collected by LGs, but the main ones are taxes on livestock, markets and property, as well as business licenses. Among JPLG-supported districts, LGs receive between 10% and 60% of their revenues from local fees, fines and taxes such as these. For districts which do not receive funding from LDF, these currently constitute the only means for financing LG services.

A number of reforms are already being implemented to improve local revenue collections. The UN's JPLG has provided considerable support to enhance own-source revenues – especially property taxes. There is also a process to resolve disputed revenue assignments, which started in December 2015. Tariff rates are also supposed to be harmonized across LGs following the 2012 Tax Harmonisation Act. These represent important efforts to build on.

The aim of this strategy is to increase the volume and improve the administration of revenues collected by LGs for the LGs to continue and increase funding salaries, basic operations/recurrent costs, contributions to capital investments and service delivery.

The indicative tasks to attain this output will include:

- a) **Support to enhance own-source revenues:** This will involve: (i) implementation of holistic (ILO, UN-Habitat, UNCDF) district revenue enhancement programmes in all JPLG participating districts; and (ii) replicating revenue enhancement plans beyond JPLG districts. These should include support to the development of Revenue Enhancement Plans, registration of properties and businesses, and systems for billing and enforcement.
- b) **Resolving disputed revenue assignments:** This will involve further discussions between the various stakeholders to agree on which level should be responsible for collecting the disputed taxes including: taxes on property; taxes on rental income; parking charges at airports and ports; business licenses; taxes on grass and charcoal; taxes on telecommunication service sales; local NGO and international NGO licenses; and taxes on underground and air telecommunication cables. Box 3 provides some guiding principles.
- c) **Harmonising tariff rates across LGs:** This will involve the Ministry of Interior in consultation with MoF issuing standard tariffs for some LGs as per the LG Tax Harmonization Act 2012 and ensuring adherence by LGs to the rates.

Box 3: Tax assignments

There are a few principles that may help guide discussions on tax assignments:

- The mobility of the tax base: Taxes are levied on a base (e.g. property value or personal income). If rates go up in one LG but not another, it would be relatively easy to move jobs, so personal income is considered a moveable tax base. In contrast, it is not possible to move a house or plot of land, so property value is considered an immobile tax base. Generally, LGs should set the rate of tax if the economic base is not easy to move – i.e. on the immobile tax base. In contrast, the State should tax more mobile bases.
- The benefit principle: As long as public goods or services are excludable, it is efficient to make those who use the services pay for their costs. In other words, if one person benefits then that person should pay the full cost through fees and fines. (In practice tax systems are rarely designed with this principle in mind).
- Revenue powers follow spending responsibilities: overdependence on grants may undermine accountability and the quality of LG services. There is no fixed way to guide this, but a useful rule of thumb is to assess what proportion of local revenues the richest LGs can raise. If these local governments are dependent on grants for much of their revenue, this suggests that there may be a benefit to decentralising further revenue sources.

2.2 Introducing the Unconditional/Block Transfers to LGs

In most developing countries, local governments raise a relatively small share of their overall revenues directly, and depend instead on central government transfers or revenue sharing

arrangements. In Puntland, the systems of intergovernmental fiscal transfers are still developing and provide the bulk of funding to just seven out of 43 districts.

Effective March 2016, the State Government is supposed to transfer 1.5% of total domestic revenues to Garowe Municipality. In addition, some LGs also receive smaller, ad hoc grants. Whereas effective 2016, the state legislature stopped Bosaso, Galkacyo and Laascaanood districts from retaining a share of total customs taxes collected by the State Government, in practice Bosaso and Galkacyo continue to request resources in order to maintain their expenditures on services such as solid waste management. The transfers are used at the discretion of the LGs (unconditional). However, there are delays and inconsistencies in the transfer of these funds to LGs leading to budget shortfalls and the value of the state transfer is not clearly established before the LG budget is finalised.

The aim of this strategy is to improve the management of transfers to Garowe Municipality as well as Bosaso, Galkacyo and Laascaanood districts that will provide lessons for introducing unconditional/block grants to other LGs. Principal aims are to improve the transparency and reliability of these transfers, and integrate them better into budget preparation and reporting.

The tasks to achieve the output include:

- a) Improving the management of transfers to Garowe Municipality: This will involve:
 - i. MoF informing Garowe Municipality of the transfer allocations before the start of the LG budget process so that Garowe makes a budget based on realistic revenue forecasts.
 - ii. MoF including the transfer to Garowe in the State budget as State Government expenditure, with a dedicated code in the chart of account (as an economic item).
 - iii. Garowe Municipality including the transfer from the State in the municipal budget with a dedicated code in the chart of accounts (as an economic item).
 - iv. MoF making regular and reliable disbursements to Garowe Municipality preferably on a monthly basis, on the basis of the amounts allocated in the budget rather than a share of actual domestic state revenues (customs or otherwise).
 - v. MoF communicating/publicising the transfers made to Garowe Municipality
 - vi. Garowe Municipality managing and accounting for the transfers as per LG PFM guidelines
 - vii. MoF including the transfers in the national budget execution reports

- b) Improving the management of transfers to Bosaso, Galkacyo and Laascaanood districts: This will involve:
 - i. Developing a simple, transparent and objective formula for allocating resources to Bosaso, Galkacyo and Laascaanood, and deciding if these will also apply to the Garowe transfer or not.
 - ii. MoF informing Bosaso, Galkacyo and Laascaanood of the transfer allocations before the start of the LG budget process so that they make budgets based on realistic revenue forecasts.
 - iii. MoF including the transfer to Bosaso, Galkacyo and Laascaanood in the budget as State Government expenditure.
 - iv. Bosaso, Galkacyo and Laascaanood including the transfer in their respective budgets
 - v. MoF making regular and reliable disbursements to Bosaso, Galkacyo and Laascaanood preferably on a monthly basis, on the basis of the amounts allocated in the budget rather than a share of actual domestic state revenues (customs or otherwise).
 - vi. MoF communicating/publicising the transfers made to Bosaso, Galkacyo and Laascaanood

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- vii. MoF including the transfers in the national budget execution reports
 - c) Roll-out the block/unconditional grant to all qualifying LGs: This will involve:
 - i. Increasing the share of the of total domestic revenues to cover all qualifying LGs in addition to Garowe, Bosaso, Galkacyo and Laascaanood
 - ii. Developing clear eligibility criteria and a simple, transparent and objective allocation formula of the resources allocated to LGs
 - iii. Apply the transfer management principles outlines above.

2.3 Institutionalised and Broadened Discretionary Development Grant

The most established transfer that funds district expenditures is the LDF. UNJPLG/UNCDF together with both the State and District Governments contribute towards the LDF which provides capital grants to seven LGs. The level of allocation is partly dependent on a local government performance assessment conducted each year. Grade A districts mainly spend the LDF on roads projects but Grade B districts have had a more diverse portfolio of investments, including health, education and community projects. The LDF has generally been welcomed and provides some important lessons including how to allocate, transfer, manage and account for resources using government systems. It also demonstrates that LGs already have the necessary capacity to deliver infrastructure projects, particularly roads.

The aim of the strategy is to institutionalize and broaden the capital window of the LDF into a Discretionary Development Grant in order to fund more equitable investment between districts. The Grant would be transferred from the State to LGs and will retain the performance component so that LGs are incentivised to further develop systems and capacities for executing capital investments. As with the LDF, the DDG could also be used to channel donor financing to districts.

There are a number of factors which will affect the cost of such a grant, which must remain affordable. Will it apply to all Grade A and B districts, and in the same way? What eligibility criteria will be used? What level of per capita allocation is appropriate? What share of allocations will be linked to performance and what size will be the equal share to all LGs?

Extending the 2015 LDF to all Grade A and B districts would cost between \$2.7 million and \$4.7 million. That represents an extra cost of between \$1.2 million and \$3.2 million per year, roughly equal to 2-6% of the domestic revenue budget. At the low end of the estimates, per capita allocations in Grade A districts would be around \$0.60, while the upper bound assumes all districts receive a per capita allocation of at least \$1.00. The State will not be able to cover the full costs immediately. In the short-run, the State will need to encourage external donors to co-finance the grant, while gradually increasing the share of resources provided by the State.

The following tasks will need to be fulfilled. The details of how and who should perform these tasks are presented in the implementation action plan.

- a) **Mobilizing funding for the DDG:** The funding for the DDG will be mobilized from the following sources:
 - i. State Government: The State Government will be required to increase the percentage of State contribution to JPLG LDF from 10% in 2016; to 20% in 2017; and to 30% in 2018². In addition the State Government should be encouraged to allocate a larger share of the total domestic state revenues to

² Proposal extracted from JPLG LDF Strategy 2016 – 2018.

introduce the DDG to other LGs beyond JPLG thereby introducing the discretionary development grant to other qualifying LGs³.

- ii. District Governments: All beneficiary districts will be required to co-finance the DDG⁴. The co-funding percentage the LGs are required to make will gradually increase to provide incentives to LGs to collect local revenue and to allocate an increasing share to development priorities.
 - iii. Development partners: JPLG/UNCDF will continue to allocate funds to the DDG but as a smaller share of the total transfer compared to the current LDF arrangements (where JPLG contributes 85% of the total funding). The State Government will mobilize development agencies and DFIs (e.g. World Bank) to contribute to the Government managed DDG and associated technical assistance. The State will also lobby DPs who cannot provide support directly to Government, to use the same procedures and materials as those used by the DDG managed by Government (shadow aligning).
- b) **Designing the DDG systems:** it is possible to learn from the experiences of the LDF to design the DDG. Key elements of the design include how it should be allocated by the State, but also how it should be budgeted, used and accounted for by LGs. Some of the key issues that should be addressed during the design of the system include:
- i. **Local Government Coverage:** The discretionary development grant should be provided to all Grade A and B districts that meet the minimum requirements as currently assessed under JPLG participating LGs. JPLG/UNCDF will continue to support districts within its universe and as per its graduation strategy.
 - ii. **Allocation formula:** The DDG should be allocated based on a transparent and objective formula. The formula should be simple, objective; rules based, generally acceptable, equalising and putting into consideration the roles as well as the revenue potential of different LG categories. The State should consider the formula used to allocate the LDF under JPLG.
 - iii. **The performance of a LG should impact on the DDG allocations:** to ensure compliance with PFM, local revenue and governance best practices and procedures, a share of the DDG should be allocated based on the performance of the LG.
 - iv. **Eligible activities:** The DDG should be used to finance core municipal functions currently performed by Grade A and B LGs. These include capital infrastructure in roads, gardens, markets, slaughter houses, water sources, education and health facilities etc. as well as associated non-capital development expenditures e.g. sanitation, hygiene, and solid waste management etc.. Guidance should be provided on how the LGs should budget for the DDG including investment in social and economic capital infrastructure with associated project development costs and the non-capital development expenditure.
- c) **Preparing the LGs to receive the grants:** not all districts have the systems in place to ensure that DDG transfers are used and accounted for properly. This will involve:
- i. Designing and implementing a coordinated technical support and institutional strengthening strategy to cover all LGs (see details in 2.4 below);
 - ii. Issuing indicative allocations prior to the start of the LG budget process; and

³ The State Government was reported to be currently setting aside 1% of the State budget to meet its 10% LDF co-funding obligations. The State Government should be lobbied to increase the share to between 2% and 6% of domestic revenues.

⁴ The requirement for the LG to co-fund the JPLG LDF is proposed to increase to 10% by 2018.

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- iii. Assessing the LGs to determine whether they meet the minimum conditions for receiving the grants. The performance assessment manual applicable across all LGs will be developed building on the one being used under the LDF;
- d) **Executing and managing the DDG.** The grant management process for the block grant to Garowe and other LGs should be used as a basis for managing the DDG. As described in section 2.2, this will involve:
- i. Publishing the transfers in national budget so funding can be traced to each LG;
 - ii. Making regular and reliable disbursement of funds as per the budget allocation; and
 - iii. Accounting for the transfers including publishing budget execution reports.

2.4 Strengthened budgeting, accounting and reporting by LGs

Financial management systems are needed to ensure LG resources are used appropriately. This includes the districts' own management, its local stakeholders, residents, donors and the State Government which provides oversight through the MOI, MOF and Auditor General.

Seven districts have received support from the UN's JPLG to establish basic financial management systems. On the other hand, non-JPLG districts seem not to have developed the same financial management capacity. Even within JPLG districts systems are still being harmonised in a way that will permit more effective oversight from the State Government.

The aim of this output is to strengthen the capacity of LGs to budget, execute and account for resources – whether local revenues or transfers – used in the delivery of services.

The tasks to attain this output will include:

- a) **Government issuing of LG PFM and associated systems and training materials:** The procedures for planning, budgeting, procurement, accounting, reporting, etc. that have been developed and tested by JPLG will be formally issued by Government and used by all LGs across the country irrespective of the source of funding (donor and Government) and the service provider⁵. Government should build on existing tools and provide clear guidance to LG on planning, budgeting and accounting. In addition, there will be a phased introduction of the new IFMIS system to LGs based on the capacity existing at the LG level⁶. The purpose is to ensure harmonised policies and procedures for among others: budgeting; budget execution; payroll management; financial reporting; and short-term borrowing⁷. Whereas all LGs may not use the IFMIS, they should use the same Chart of Accounts (CoA) to ensure comparability of expenditures.
- b) **Support to the roll-out of the LG PFM system:** Institutional strengthening of LGs should involve the provision of a mix of formal classroom training and hands-on support to LGs staff responsible for day-today PFM functions in budgeting, accounting, procurement, reporting etc...
- c) **Ensure that LGs adhere to the LG PFM and associated⁸ requirements:** This will involve:

⁵ Government has to make a decision on the systems e.g. Municipal Financing Policies and Procedures or PEM Manual that should be used for the different aspects of LG PFM.

⁶ World Bank intends to roll-out to Garowe, Bosaso and Qardho first

⁷ The purpose is to ensure that LGs do not incur debt financed expenditures that require central government bailout which underscores a need for clear limits and conditions on sub-national borrowing.

⁸ For example Human Resource Management requirements

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- i. Strengthening the oversight and accountability role of councillors and committees: developing training materials and training the councillors on their roles and responsibilities regarding oversight and accountability.
 - ii. Strengthening Internal Audit functions in LGs. Discussions will have to be held whether the internal audit function should be performed at the LG or regional level. Irrespective of the level where it is performed, a lot of support will be required to strengthen the internal audit section.
 - iii. Implementation of the LG performance assessment system to provide incentives for improving performance.
 - iv. Developing and implementing a system for the community members to air complaints and complements and for receiving feedback from LGs

3 Component 2: Strengthening Sectoral Service Delivery

Whilst aspects of roads, sanitation, and solid waste management are being implemented by LGs, sectors such as health and education are still largely centralised and there are bigger policy and operational questions/issues that need to be resolved.

Politically, State ministries not LGs are in charge of the vast majority of education and health service delivery. Administratively, teachers and health workers are employees of the State Government and there are no sector specialists in the districts. The same is largely true of the inspection services in each sector, which are managed through the state ministries' regional and district offices. Fiscally, whereas some LGs are making investments in social sectors from discretionary resources, staffing costs and most operational costs are centralised. Nevertheless, service delivery pilots show that the centre and LGs themselves are willing to allocate resources to operational costs of service delivery and LGs can make good use of resources.

The second component will focus on continued piloting of service delivery financing whilst establishing a process to resolve sectoral service delivery issues in the context of decentralisation and ensuring that the functions that have been decentralised are sufficiently financed and the process is well managed within and between the sectors.

Sectoral service delivery will be strengthened through

1. Improving the design and implementation of the service delivery transfer pilots
2. Initiating a consultative process to discuss and resolve policy and operational questions in order to strengthen services in education, health and water sectors
3. Institutionalizing the financing arrangements for the different aspects of service delivery to be implemented at the LG level
4. Establishing structures and mechanisms for coordinating the process of designing and implementation of sectoral service delivery.

Box 4. Vision for Component 2: Strengthening Sectoral Service Delivery

The ultimate objective of component 2 is that Puntland State of Somalia has, through a consultative process, clearly identified challenges to the delivery of basic services, and has agreed a strategy for improving service delivery that addresses these challenges.

This will clearly identify whether or not services should be decentralised, and if they are to be decentralised, will identify the finances that need to be devolved to local governments together with these services, and will identify the capacities and systems necessary for local governments to effectively manage and finance these services. The role of central government in overseeing local service delivery will also be clearly articulated.

These decisions will be taken through a consultative and collaborative process that brings together the different State and local government agencies to jointly diagnose the challenges faced and to jointly develop proposals to address these problems

3.1 Service Delivery Transfer Pilots Improved⁹

Under the JPLG, service delivery transfers are being piloted in a number of sectors to test mechanisms for transferring the responsibility for planning, financing, management and oversight of service delivery to LGs.

The aim of the strategy is to further test these mechanisms and draw lessons for financing the services under the mandate of LGs.

The tasks that will be implemented to achieve this output include:

- a) **Improve the design of the service delivery pilots:** This will involve:
 - i. Increased contribution by State and LGs to the service delivery pilots: The sector ministries and LGs have demonstrated willingness to use some of their revenues to contribute to the service delivery transfer pilots which is a precursor for mainstreaming the pilots into the Government transfer systems (see 3.3 below for details).
 - ii. Service delivery transfer pilots incorporated in the LG budgets and expenditure: Ensure that the service delivery transfer pilots are part of the overall LG budget process and incorporated in the LG budget and budget execution/expenditure reports.
 - iii. Developing of simple operational manuals for service delivery transfers explaining how the pilot transfers should be planned and budgeted for, accessed, used, management and reported.¹⁰
- b) **The service delivery pilots to use and strengthen government systems:**
 - i. The funds for the service delivery transfer pilots should start to flow through the Government system. (i) from JPLG to MoF Bank Account in a Commercial Bank; (ii) from MoF bank account to LG bank account on the recommendation of the respective sector ministry after ascertaining that the LG has met all the requirements; (iii) then the respective district departments/service delivery unit should requisition the funds from district bank account for implementing the activities following the prescribed procedures in the LG PFM system.

⁹ Activities financed under the natural resources, LED and public works pilots will be covered under the Discretionary Development Grant and are not repeated here.

¹⁰ Currently the guidelines for managing the service delivery transfer pilots are contained in the MoUs which are neither widely distributed nor easily accessible.

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- ii. Supporting the different levels of Government to perform their respective roles to strengthen and enable the use of Government systems.
- c) **Improving execution, management and oversight of the service transfer pilots:** This will involve:
- i. Clarifying the roles of the different levels of Government in regard to the planning, budgeting, implementation and reporting on the activities being implemented under the pilot.
 - ii. JPLG transferring funds to the Treasury in bulk instalments: This will help to ensure that service delivery pilot funds are transferred reliably and on time to LGs.
 - iii. Strengthening the LGs to manage and oversee the transfers: This will involve strengthening the Finance and Administration Department to budget and execute the transfers as well as improving the management and oversight role of LGs by strengthening the Social Affairs Department (SADs).
 - iv. Improving the reporting and accountability of the transfers: The LGs should start to provide both financial, physical progress and outcome/impact reports following prescribed formats¹¹. These reports should be reviewed and analysed by the respective sector ministries that should provide feedback to LGs.

3.2 Issues required to strengthen service delivery resolved

There are number of policy questions that need to be addressed in order to strengthen services in the social sectors. Yet, there is inadequate dialogue held to discuss the challenges that hamper the effective delivery of services; whether these challenges can better be addressed through decentralising the services to LGs and if so the systems and capacities required at the LG level and how they should be put in place.

The aim of the strategy is to discuss and decide the functions that can be better delivered at the LG level, the required systems and capacities and the role of the State to ensure the proper delivery of these services.

The tasks that should be implemented to achieve the output include:

- a) **Identifying and analysing the main challenges in sectoral service delivery that needs to be addressed**¹²: Each of the sectors will conduct a process involving the review of documents; discussions with stakeholders at the State, regional and district offices; consultations with LGs; service delivery units as well as citizens to identify the challenges hampering the proper delivery of services. The indicative challenges identified during the LG financing assessment include: (i) disconnect between the policy provisions and practice; (ii) unclear demarcation of roles and responsibilities between the state (including deconcentrated regions and districts offices) and LGs; (iii) insufficient fiscal resources (transfers, own source revenues and donors funding) allocated for service delivery; (iv) human resources capacity gaps; and (v) weak systems and capacities for planning, budgeting, management and reporting for resources.
- b) **Identifying potential roles of LGs and the State in the different aspects of sector service delivery**: Discussions should be held to identify the respective roles of States and LGs regarding: (i) the different aspects of human resource management for frontline staff (e.g. teachers and health workers) and district managers responsible for the planning,

¹¹ Considerations should be made to design a simple system LGs should use to capture their revenues, expenditures and outputs.

¹² It is proposed that initial focus is put on primary health care, primary education and rural water and sanitation.

management, inspection and oversight (recruitment, reporting, supervision, pay etc.); (ii) meeting the operational costs of service delivery units and SADs; (iii) construction of infrastructure at service delivery units. The decision on which role should be devolved to LGs should consider expertise requirements as well as economies of scale. In addition, the LGs should be provided with resources to implement the devolved functions (see 3.3 below)

- c) **Identifying the systems and capacities required to address the challenges and implement roles:** The systems and capacities could range from public finance management, human resource management, oversight and accountability, information management etc...
- d) **If the functions are devolved, develop an implementation action plan:** An action plan/strategy outlining activities that should be undertaken to put the systems and capacities in place to implement the devolved functions will be developed. The strategies will be able to address both crosscutting issues (e.g. financing and public finance management) and sector specific issues. The action plan will be owned and endorsed by the key stakeholders involved in implementing the reform. A monitoring strategy will also be developed to establish whether the implementation of the action plan is on track.
- e) **Articulation of the role of LGs in the respective sector strategic plans:** The roles of LGs will be articulated in the respective sector strategic plans alongside the roles of Service Delivery Units (SDUs), community management structures and state Government.

3.3 Mechanisms for financing of sectoral service delivery Developed

Currently, the State Government and donors provide sector services for education, health and water – including staff, recurrent and investment costs. Communities also play a significant role in establishing and funding services.

The aim of the strategy is to ensure that if a decision is made to decentralise services, the LGs are provided with financial resources to implement the decentralised functions.

The tasks to attain this output include:

- a) **Systems for financing the different aspects of service delivery:** The financing arrangements will cover: operating costs at service delivery unit and for LG management and oversight; salaries; and capital investment at the LG level. Discussions will be held to determine whether funding for sector service delivery should be done via a single discretionary block transfer (Kenya, Ethiopia) or earmarked sector transfers (e.g. Uganda, Tanzania). Specific lessons will be drawn from the implementation of the service delivery models as well as the LDF/DDG.
- b) **The sectors allocating the existing budgets for services devolved to LGs to the LGs:** The sectors will decentralise funds alongside the devolved functions.
- c) **Lobbying State Government to allocate more resources for service delivered by LGs:** The current funding for service delivery is meagre. The State Government will be lobbied to allocate more funds to services devolved to LGs.
- d) **Donor funding using and strengthening Government systems:** The bulk of service delivery financing is from donors. Discussions will be held with donors on how the current donor funding can be harmonised with or use the Government systems including the role of sector donors for systems strengthening.

Box 5: Grant types and conditionality

Often, transfers to local government are referred to as conditional or unconditional.

- **Unconditional allocations** can be used for any local government activity permitted in the law. They are typically provided in order to allow local authorities to finance their mandated responsibilities at their own discretion.
- **Conditional allocations** are used for more specific purposes and sometimes can only be accessed if certain conditions are met.

There are three ways in which allocations can be conditional:

- **Earmarking or input conditionality** where resources need to be spent on a specific type of expenditure. Resources are tied to a specific sector, project, service or item.
- **Policy and results conditionality** where resources are tied to delivering against performance criteria or indicators for a given function, process or service.
- **Grant management conditions** where transfers are dependent on a sub-national governments' adherence to certain processes related to the grant management cycle. These may include the preparation of a work plan or budget in advance and the provision of reports.

A key policy decision is to determine not only how much will be transferred to districts, but what for and with what conditions. Some countries use a high degree of conditionality (Uganda, Tanzania) others provide mostly unconditional grants (South Africa, Kenya). In practice, each country works out its own compromises. However, it is important to ensure that districts have enough flexibility (at the margin) to adapt their spending to differences in local needs. It is also important to ensure that reporting requirements are reasonable and commensurate with the funding provided.

3.4 Process for managing service delivery financing established

There is need to establish and support the operation of structures and coordination mechanisms for developing a coherent approach to resolving policy issues, ensuring the appropriate design and overall management and financing the delivery of services.

The structures and coordination mechanism should ensure among others: involvement of senior leadership of the respective ministries; information-sharing within and across ministries; regular overall monitoring to determine progress towards attainment of policy commitments; proper representation and having membership that participate in real activities, and that is organic in nature to respond to the emerging needs. Such a process will require strong facilitation to reach agreement on common approaches and principles.

The structures and coordination mechanisms should build on and strengthen the existing ones including:

The IMC on Decentralisation: This is the policy organ that should give strategic guidance on crosscutting local service delivery issues.

The Technical Working Group (TWG) composed of Director Generals (DGs): This should be responsible for overall technical guidance, coordination and harmonization of plans and approaches across sectors and programmes, monitoring implementation progress and for submitting policy issues to the IMC for approval.

Working committees focussing on crosscutting issues including: LG financing; overseeing sub-national institutional strengthening in PFM, HRM and the overall enhancement of the capacity of LGs to execute their mandates related to service delivery and governance; and establishing systems for oversight and accountability

Working committees focussing on sector specific issues: These should focus on areas of need per sector while regularly reviewing the scope of their activities to respond to need. For example education may focus on teacher deployment and inspection yet health may focus on transferring the management of health facilities from NGOs to LGs etc.

There is also need to have a strong secretariat with sufficient support to ensure that the different sector working committees are properly coordinated, share information and remain on track regarding the design and implementation of reforms.

Further there should be coordination arrangements and structures as well as dialogue mechanisms between LGs and state Government which are described under component 3 output 3.



4 Component 3: Management of Fiscal Decentralization

State Government has started the process of developing the policies and systems to support the implementation of decentralised service delivery.

However, most of the state level agencies (e.g. MoF, MoI, sector ministries, OAG etc.) have inadequate financial and human capacities to develop guidelines, support and ensure adherence by LGs.

Fiscal decentralisation is currently fragmented across three reform processes: one focussing on decentralisation, the second on PFM and the third on civil service. These reforms have different and parallel oversight and technical committees as well as secretariats and are poorly coordinated. Yet there are a number of aspects of the PFM reform that has implications for LGs and fiscal decentralisation e.g. planning and budget preparation, tax policy, accounting and financial reporting, FMIS, external and internal audit,

An effective system of fiscal decentralisation requires a strong State government. Whilst the State Government plays some of its roles well, it has yet to take a strong leadership. In particular the Ministry of Finance needs to play a key role in managing fiscal decentralisation.

The third component of the fiscal decentralisation strategy focuses on improving the management and coordination of fiscal decentralisation.

Component 3 of the strategy will focus on attaining three outputs

1. The capacity of MoF, MoI and line ministries to oversee fiscal decentralisation and the management of transfers strengthened.
2. Decentralisation and PFM reforms coordinated and consistent
3. Dialogue between CG and LGs facilitated

4.1 The capacity of State Agencies to oversee LGs Strengthened

Effective decentralisation needs not only effective LG systems, but strong State functions as well. Functions include developing guidelines, supporting implementation and providing oversight to ensure adherence by LGs to financial management and service delivery standards. Currently, most of the state-level agencies (e.g. MoF, MoI, sector ministries, OAG etc.) have inadequate financial and human capacities to deliver these functions as demonstrated in the table below.

Table 1: State Government Oversight of Local Governments

Selected Function	Indicative Lead State Agency	Status	Remarks
Development of criteria for demarcation of LG boundaries and present to Parliament	<ul style="list-style-type: none"> Ministry of Interior, LG and RD 		<ul style="list-style-type: none"> LGs are graded into three categories “A”, “B” and “C”. However boundaries of Grade “C” districts are not clearly demarcated
Establishment and training of Local Councils	<ul style="list-style-type: none"> Ministry of Interior, LG and RD 		<ul style="list-style-type: none"> Councils have been established in many of the LGs but are being selected based on clan structures
Establishment of LG Administrative Structures	<ul style="list-style-type: none"> Ministry of Interior, LG and RD 		<ul style="list-style-type: none"> Standardised LG structures developed but neither approved nor used
Clarification of roles to be performed by LGs (functional review and expenditure assignments)	<ul style="list-style-type: none"> Sector ministries with support from MoI 		<ul style="list-style-type: none"> LG perform some of the core municipal functions Sectors have identified some operation activities to devolve to LGs on a pilot basis. However most of the selected activities are not core service delivery and the roles LGs should perform are not yet articulated in the respective sector strategic plans¹³
Clarification of revenue collection mandates between the State and LG (revenue assignments)	<ul style="list-style-type: none"> Ministry of Finance 		<ul style="list-style-type: none"> Whereas discussions have been initiated between ministries of interior, civil aviation, information and telecommunication, trade and fishing and JPLG target districts no consensus has been reached to-date
Issuing transparent and equitable guidelines on the allocation and management of transfers to LGs	<ul style="list-style-type: none"> Ministry of Finance 		<ul style="list-style-type: none"> An objective allocation formula and transfer system has been put in place for the LDF. However, neither a transparent allocation formula nor a credible transfer system has been developed for the government resources
Development and issuing of LG PFM manuals	<ul style="list-style-type: none"> MoI, MoF, AG 		<ul style="list-style-type: none"> PEM Manual have been developed and officially adopted and Municipal financing policies have been developed but none of them has been formally issued by the State as the LG PFM guideline
Inclusion of LG financing in the State budget process	<ul style="list-style-type: none"> MoF 		<ul style="list-style-type: none"> LG financing per LG is currently not reflected in the State budget.
Requisitioning for release of the transfers	<ul style="list-style-type: none"> MoI for block/discretionary grants 		<ul style="list-style-type: none"> MoI determines the LGs eligible to access the LDF. Transfers to Garowe not requisitioned by MoI
Release of the transfers	<ul style="list-style-type: none"> MoF and AG 		<ul style="list-style-type: none"> Whereas MoF releases the LDF

¹³ The Decentralization Policy Implementation Road Map requires each sector to develop a decentralization strategy. Emphasis should be made to ensure that decentralizing of functions is an integral part of the respective sector strategic plans rather than being a stand-alone strategy.

			and transfers to Garowe, these were reported not to be predictable
Supporting the LGs to meet the accounting and reporting requirements	• AG, MoI		• Not done
Receiving, reviewing and analysis financial (and physical progress) reports	• MoI for block/discretionary grants		• Done for the LDF
External oversight and audit	• OAG, Parliament		• OAG is conducting pre-audits not external audits as LGs do not produce annual financial statements
Consultation with LGs	• MoI and LG Associations		• Whereas an IMC and TWG are in place, there is no regular fora that bring together all LGs with the national government to discuss fiscal issues

The strategy aims to strengthen the capacities of state agencies to: (i) develop policies and systems in partnership with LGs; (ii) manage the system of fiscal transfers; (iii) support LGs to perform; and (iv) enforce adherence a fair set of rules.

The tasks that will be implemented to attain the output include:

a) Institutional Capacity Assessment of State Agencies and Strategy Development:

Assess the current systems and capacities of state level agencies (e.g. MoF, MoI, sector ministries, OAG etc.) to implement the roles assigned to them in the FDS implementation action plan. Based on the needs identified develop an Institutional Strengthening Strategy for the different agencies.

b) Implement of the Institutional Strengthening Strategy¹⁴ for the State level agencies to perform their respective roles: This would involve:

- i. The establishment of either units or dedicated staff with capacities in the respective ministries/agencies responsible for LG financing¹⁵. For Ministry of Finance, there is a need to strengthen a Fiscal Decentralisation Unit to oversee fiscal decentralisation. The roles of the unit would include: (i) coordinating the process for agreeing the allocation formulae and shares of LGs in the national budget; (ii) managing transfers including their allocation to LGs based on agreed shares, allocation and reliable disbursement; (iii) monitoring adherence to conditionality and finance policy; and (iv) policy and oversight for locally raised revenues.
- ii. Train the staff in the units and develop systems for the units to play their role, including Information Management Systems for fiscal transfers and revenue
- iii. Support the state agencies including their regional and district offices to support and supervise LGs

¹⁴ For MoF this should be done in coordination with the restructuring and change management plans under the WB Capacity Injection programme

¹⁵ In particular, the capacity of MoF should be built to oversee fiscal decentralisation and the management of transfers. While Ministry of Interior have policy responsibility, very little of real substance will happen if the Ministry of Finance is not on board and committed to making fiscal decentralisation a reality.

4.2 Decentralisation, PFM and Civil Service Reforms Coordinated and Consistent

Fiscal decentralisation is currently fragmented across three reforms – one focussing on decentralisation, the second on PFM and the third on civil service. These reforms have different and parallel oversight and technical committees as well as secretariats and are poorly coordinated.

Table 2: Coordination and Consistence between Decentralisation and PFM Reforms

Issue	Decentralisation Reforms	PFM Reforms	Remarks
Oversight/Policy Committee and membership	Inter-Ministerial Committee on Decentralisation Chaired by the Vice President	PFM Reform Oversight Committee (ROC) Chaired by the President	MoI is not represented on PFM ROC yet a number of PFM reforms will have implications on LGs
Technical Committee and membership	Technical Working Group consisting of the Director Generals, together with the Mayors of the seven LGs participating in the JPLG, and LG Association	The Technical Steering Committee (TSC) chaired by MoF	
Secretariat	Decentralisation Champion's office in the Office of the Vice President	The PFM reform secretariat	There are no links between the two secretariats

Yet there are a number of aspects of the PFM reform that has implications for LGs and fiscal decentralisation e.g. planning and budget preparation, tax policy, accounting and financial reporting, FMIS, external and internal audit.

The aim of the strategy is to ensure that the PFM and decentralisation reforms are well coordinated and consistent

The tasks planned to achieve this output include:

- a) **Coordination of oversight bodies:** This would involve:
- Revising the composition of the PFM Reform Oversight Committee to include representation from the MoI to ensure involvement in discussion of issues that have implications on LGs.
 - Ensure representation of MoF on civil service reform oversight committee
 - Creating a subcommittee to deal with LG PFM reform and Fiscal Decentralisation focusing on issues that have implications to LGs. The subcommittee should report to the IMC as well as the PFM reform oversight committee. Such sub-committee should be chaired by the Ministry of Finance.

b) **Coordination of the Technical Committees:** This will require

- Regular sharing of information between the Technical Working Group consisting of the Director Generals, together with the Mayors chaired by MoI and the Technical Steering Committee (TSC) in charge of PFM reforms chaired by MoF
- Quarterly implementation review meetings between PFM (TSC) and Decentralisation reform (TWG)

c) **Coordination of the secretariats:** This will require:

- Regular sharing of information between the Decentralisation Champion's office in the Office of the Vice President and the PFM reform secretariat
- Quarterly PFM and Decentralisation reform implementation review meetings

4.3 Dialogue between CG and LGs Facilitated

Whereas an IMC and TWG are in place, there is no regular fora that bring together all LGs with the national government to discuss fiscal issues.

The aim of the strategy is to ensure regular dialogue between State Government and LGs on issues regarding financing decentralised service delivery

The tasks planned to attain this output include:

a) **Strengthening the Association of Local Governments in Puntland (ALGPL):** The LG Association (ALGPL) would be responsible to among others: conducting research and policy analysis, lobbying and advocating for the interests of LGs, and quality assurance of activities performed at the LG level. To perform these roles, the LG Association would need to:

- Ensure that the governance structures are in place and functional representing the interests of all member LGs.
- Strengthen the Secretariat involving: reviewing the staffing structure and recruiting qualified staff; staff development using a mix of strategies; introducing and implementing an incentive package for staff based on performance; provision of adequate tools for staff; and provision for short-term technical assistance where the LG Association has inadequate in-house expertise.
- Mobilise revenue: the LG Association should be supported to develop an overall financing and sustainability plan and strategy focusing on generating resources from both own revenues and external funding.
- Organise dialogue meetings between the State Government and LGs to advocate and lobby for the interests of LGs

b) Establishing regular forums for interaction on key issues prior to the budget process

- Organising of LG budget workshops where the State Agencies provide the budgeting guidelines and policy directions to the LGs
- Organising budget negotiation meetings where the LGs discuss with the respective sectors and agree on the key service delivery modalities in the respective sectors.



5 Implementation of the LG Financing Strategy

As mentioned earlier, the strategy is intended to give a sense of direction rather than a blueprint. The implementation will focus on:

- a) Ensuring government ownership of the overall process for reforming and improving the financing the delivery of services whereby Government will be supported to establish and operationalise coordination structures and mechanisms.
- b) Attaining quick wins by starting from improving the existing system.
- c) Emphasising ongoing dialogue and an organic process of resolving policy issues within and across sectors regarding whether services should be decentralized and if so the capacities, systems and resources required by the different levels
- d) Strengthening the State Agencies to perform their support and oversight roles but also to own and coordinate

The strategy is accompanied by an Action Plan. However, the aim of the Action Plan is not to provide a fixed plan for implementation, which would not fit the changing political, economic and social context in Puntland or the realities of institutional reform. Key policy issues will change as reforms develop and so will responsibilities. Therefore, the Action Plan details the issues and assigns responsibilities for resolving the key issues under each theme whilst focusing on short-term planning horizons which will need to be updated periodically – ideally at least every three months – in order to remain a relevant tool for coordinating reforms in a changing context. The action plan is a flexible, operational tool to guide the implementation of the strategy.

To manage and coordinate the process of implementing the strategy described above, both the State and Local Governments will require a lot of support.

The State level agencies will require support to among others:

- a) Design mechanisms for financing the different elements of service delivery;
- b) Develop systems and programmes for institutional strengthening at both the State and LG levels
- c) Facilitate the dialogue within and between sectors to resolve a number of policy issues;
- d) Provide institutional support to State level agencies to among others allocate resources, budget, execute and ensure the accountability of transfers
- e) Support the State level to mobilise resources from development partners to fund the broadened discretionary development grant; sector transfers that may be introduced as well as systems strengthening programmes.
- f) Ensure that accountability and oversight arrangements for both donor and Government resources have been put in place and functional.

The Local Governments will require a mix of classroom based and hands-on support to implement the reforms including managing and accounting for financial resources and ensuring the management and oversight of the devolved functions.

6 Annexes/Volumes

The other volumes that should be referred to while implementing the Fiscal Decentralisation Strategy are:

Local Government Financing Assessment Report, Puntland State of Somalia

Fiscal Decentralisation Strategy Implementation Action Plan: Puntland State of Somalia