

Decentralization Analysis Cell (DAC)

Responsibility of the cell:

The decentralization analysis cell (DAC) would be responsible for analysis, evaluation, monitoring, and development of the intergovernmental fiscal system. The unit will be essential in providing the basic analysis and intellectual leadership that will allow government to make its decisions about the system. At the time the State Finance Commission is constituted, the DAC may provide technical and data support to State Finance Commissions Secretariats. This would improve the quality of inputs available to the work of the State Finance Commission, and thereby make its results far more satisfactory and make them more likely to be accepted.

While DAC would initially focus only on rural bodies it would be expected that at a later state it would also oversee the urban local governments. This is necessary because the vertical share of revenues for urban and rural local governments is drawn from the same pool of state funds, there are economies of scale in training and in EDP development, there will be uniform accounting rules, a fiscal information system will need to be maintained for all local governments, etc. Moreover, this would allow the state to think about all of its local governments in formulating expenditure assignments, taxing policies, and intergovernmental transfers. Urban and rural governments might end up receiving separate treatment, but this should be done in the context of the goals of the overall system of government finance. Finally, there is need to have a clear transition that leads to graduation of a local government from rural to urban status. The DAC would have three tasks: monitoring the fiscal and service delivery performance of rural local governments; evaluating the performance of the intergovernmental fiscal system; and reporting to government and the public. Intergovernmental fiscal system means the finances of local governments (e.g., taxes, charges, expenditures, budgets) and the finances of the state government that effect the fiscal position of local governments (e.g., grants, shared taxes, payment of entitlements, regulatory policies, etc.). Duties of DAC would be as follows:

DAC will be responsible for leading the design of the system, overseeing the submission and correction of data each year, handling questions and providing technical assistance, and organizing the data in such away that it can be used by government agencies and researchers. DAC would carry out annual tracking of the fiscal performance and fiscal health of each local government. This will include budgetary outcomes in terms of spending and revenues raised, budgetary balances and shortfalls, tax effort, and the match between budget projections and actual outcomes. This tracking would rely heavily on data produced by the fiscal information system. This is discussed in detail in the following points:

Formula Evaluation. Whatever formula is put in place to distribute funds among eligible local governments, there is need to continuously assess the efficacy of this formula. For example, the questions that might be asked at every evaluation include whether the system is equalizing, whether there are unacceptable “outliers”, whether it is encouraging or discouraging local tax effort, etc. The responsibility of the DAC will be to analyze and to propose adjustments to the formula to better achieve government objectives. This could be done on a regular basis, and could be a much larger effort when done every fifth year as part of the work of the State Finance Commission.

• ***Monitoring of Compliance.*** The State will lay down certain conditions as part of its fiscal restructurings, and it will be the job of the DAC to track the compliance with these conditions. For example, the state may require that property tax rolls be updated, and the DAC will examine data to determine the extent to which this has been done, etc.

• **Revenue Mobilization Analysis.** An important question that the DAC can help answer is whether local governments in Karnataka are increasing their rate of revenue mobilization. It can also provide analytic work that can point to why some local governments are doing better than others. As decentralization proceeds, local government revenue mobilization will almost certainly move higher on the agenda of policy goals of the state, and detailed information on local government tax effort will be needed. There is much interest in developing revenue sources for rural local governments. The DAC could produce an index of revenue effort and could track the change in tax effort over time. It could also evaluate alternative programs that were designed to improve revenue effort.

• **Best Practice.** Many local governments will be innovative under a decentralization system. The DAC could identify instances of best practice, evaluate these, and disseminate them to the sector.

• **Expenditure Assignment.** DAC could carry out continuing analysis of the efficacy of assigning certain functions to the *gram panchayat* level, relying for information on the monitoring of service delivery outcomes. This might include estimating the cost implications of reassignments of expenditures. A second major function of the DAC is evaluation of the intergovernmental system. To what extent is the system achieving its objectives? What would be the impact of various reforms that have been proposed? It is a reasonable expectation that Gram panchayats will be changing in the future and the intergovernmental fiscal system will likely have to keep up with change. Hard analysis of the impacts of alternative proposed changes would be necessary to inform the decisions that the government must make. The following are some examples of evaluation work that the government will likely ask of DAC.

• **Expenditure Disparities Tracking.** A concern in Karnataka is the disparity in public expenditure levels among the 5,700 rural local governments in the state. The DAC could track this disparity on an annual basis and could model the determinants of these differences. An annual evaluation of fiscal disparities within the state would be an important responsibility of the DAC. For all *gram panchayats*, what is the variation in key indicators of fiscal activity among local governments? This would include per capita expenditures, per capita revenues raised, revenue effort, and the like. The goal will be to track the extent that the equalization grants of the state government and the central government reduce the fiscal disparities.

• **Annual “Intergovernmental Review”.** Every year, the DAC could take the lead in preparing an intergovernmental review. It could be circulated widely, and could be the subject of an annual seminar. The basic purpose of this review would be to report on the state of sub national government finances in Karnataka, in a way that this information could be widely disseminated and understood. This would assist the state in building a better understanding of fiscal decentralization, and getting more participation from numerous public and private sector organizations in further developing the decentralized fiscal system. The first such review is scheduled for calendar year 2007.

• **Reporting.** An important function of the DAC is to report to the government and to the public. By increasing the flow of accurate and timely information, the DAC could play an important role in improving public policy towards decentralization and ultimately toward improving service delivery. Reports that DAC might issue regularly could include: (i) *An annual review of the intergovernmental system in the state.* This could be a volume that both described outcomes for the entire state, and offered

in-depth analysis of particular issues. It would be a compendium of data and explanation. This would increase the transparency of the system, and might stimulate reform discussion both inside and outside government. (ii) *A website*. This could be used to present data for those who would examine the system (government agencies, lending agencies, researchers, etc.). It could also be the place where DAC research, best practice analyses, and assorted fiscal notes would be posted. All *gram panchayats* could not access (because of skill deficiency), but many of them could. (iii) *A research reports series*. This would be a periodic issue, depending on what research had been completed. The DAC would develop a list of “clients” to whom these reports might be made available.

The DAC may provide technical and data support to State Finance Commissions Secretariats, when the latter is functioning. Among the other possibilities are that the DAC could convene periodic seminars to inform government and others about a particular issue on which they have carried out research. It is important, however, that the duties of the DAC be kept within the bounds of policy research and that this unit not be folded into some other department.

Staffing of DAC. A large overhead cost in the form of staff that does not have well defined functions needs to be avoided. However, the duties of the DAC could be considerable, especially if the urban as well as the rural sector is included in its mandate.

Staffing would be as follows:

- **Director:** A senior person, capable of providing intellectual leadership to the team. Must know the subject matter, and must be very interested in it. He/she must be capable of understanding what every technical staff member is doing, be able to define the work program for the staff, and be research oriented.

The Director also must be capable of presenting the work of the DAC in forum with higher-level government officers and political leaders. The success of the DAC will, to a large extent, be determined by the capability of the Director. The director will report jointly to the Departments of Finance and RDPR.

- **Staff members (4)**, who will lead the specific projects as outlined above. These would be people trained at the master’s level, preferably in public finance or with a graduate degree in a related field and commensurate experience in public finance analysis. These should all be research-oriented people with a background in research.

- **Senior staff (1)** who would be responsible for monitoring and upgrading the fiscal information system, and assuring that appropriate data from the system would be distributed to the FAU and to those in other institutions producing research on this subject? One IT staff will also be needed here.

- **Junior staff assistants (5)** who would be responsible for backing up the seniors? These would be younger people, but would be college graduates with appropriate backgrounds and would be candidates to grow into senior positions. These junior assistants would also be candidates for more training. Their duties in the DAC would be to carry out some of the basic research, under the direction of the senior to whom they are assigned.

The Monitoring System for *Panchayats* would cover both fiscal performance and service delivery aspects. The system will change as the needs and performance of local governments change, and as the goals of the state for its intergovernmental system change. But these changes need to be made in a

thoughtful and measured way, and therefore need to be led by careful research, such as will come out of a monitoring and evaluation system. Underlying the monitoring system will be a fiscal information system.

These are the basic data that will be used to quantitatively assess and update the performance of the system. The performance monitoring can only be as good as this database will allow. The following are likely to be the fiscal behaviors that are monitored:

- ***On what functions do local governments spend their funds?*** This will lead to an annual compilation of expenditure patterns of local governments. The basic question in which government is interested is whether local governments are actually spending to promote the development of basic services.
- ***Assess changes in basic service levels.*** This could be done either by setting a minimum per capita level of spending for each function and comparing this to actual outcomes in each GP, or by attempting to establish minimum (measurable) service levels in physical terms.
- ***What is the progress of local revenue mobilization?*** Have local governments increased revenues, expanded the base for each tax, and increased collection rates? This should be reported each period, based on data from the fiscal information system, and probably supported by data gathered from questionnaires for each GP.
- ***Are certain local governments identifiable as being under particular fiscal stress?*** This would allow preparing a remedial program for these local governments, and at a minimum would identify them as candidates for special assistance of one kind or another.
- ***Have fiscal disparities been reduced, and to what is this reduction (increase) attributable?*** The DAC will examine spending patterns for each GP, and will study the pattern of fiscal disparities and their pattern of increase or decrease, with an eye toward whether the intergovernmental transfer system needs adjustment in terms of the formula distribution.
- ***Are intergovernmental transfers being distributed according to the formula, and are full entitlements being distributed?*** In a sense this is the DAC monitoring the GOK in terms of its following through on distributing grants by the agreed formula.
- ***If transfers are being distributed with some conditions, to what extent are the GPs meeting those conditions?*** This would be done in conjunction with the line agencies imposing the conditions. The service delivery monitoring system would complement the fiscal performance monitoring system. The underlying issue related to whether decentralization is “working” is whether citizens are getting better public services. The term “better” is a hard one to define. One could be conventional and ask whether there are improvements in the levels of services offered, quantity or quality, and look for physical measures. The DAC should do an inventory of services provided at the beginning of this period, and look for ways to update these physical measures as a way to identify the progress of service delivery under fiscal decentralization. For this it would make use of the Service Delivery Surveys administered by the District and which would be aggregated to the state level. The measures might include percent of housing units with access to various kinds of water supply, number of streetlights per capita, etc. But “better services” can also mean that people are getting more of what they want. And, this is the essence of fiscal decentralization; local populations are empowered to demand those services that they want.

Finding a systematic way of collecting the data for monitoring. The department of the *Panchayati Raj* in the state of Karnataka introduced a new survey to be administered by the *Gram panchayati* members in January 2004. This survey instrument is used to collect data on income, land holding, type of house, sanitation, assets, education, means of livelihood and debt levels. The purpose of the survey is mainly to create accurate lists of the citizens who are BPL.

This instrument could be used as a platform (means) to improve each *Gram panchayats* own data collection and monitoring as well as providing policy makers with accurate information. Over time, they could build a database (panel data) that would help them understand what their constituency looks like on basic indicators. They could also compare themselves against other neighboring *gram panchayats* on indicators of importance. In addition, more specific questions on standard economic indicators (income and consumption) as well as other human development indicators should be added to the existing questionnaire. This would serve as a powerful statistical tool to analyze causal relations. It is important to note that the difficulty in the first round of this survey was that the interviewers (mostly *gram panchayat* members) were misinformed about the purpose of the survey. The confusion that this survey would be used to identify those eligible for benefits provided to the BPL must be rectified. Awareness about the purpose of this survey needs to be increased.

- ***Conducting quality checks on the data.*** The data that is collected by the *Gram panchayati* members should be verified on a regular basis. Since the sample size would be significantly large, random checks on the surveys should be carried out by DAC. A penalty should be instituted if inaccurate data is found. This would set a precedent for the other *Gram panchayats*. The form of the penalty could be monetary or something like publishing this information in the local paper.

- ***Setting up a baseline for evaluation.*** Given that the objective of the evaluation is to find out whether citizens who have access to block grants make better choices, a vignettes based approach can also be used along with citizen perceptions surveys, i.e., scorecards. The baseline data will be collected by an independent group at the beginning of the project and at the end of the project thus creating panel data. A difference method can then be used to assess the impact. This component would also support policy studies related to decentralization. These studies would be commissioned by DAC and would cover issues such as (i) strategies for enhancing local revenue generation at the *Panchayat* level; (ii) a review and detailed proposals on expenditure assignments, in particular in separating better the functions of the three tiers of *Panchayats*; and (iii) issue in service delivery in specific sectors.