

## **Section 7**

# **Institutional and administrative dimensions of local government finances**

The policy design of a framework for financing local governments cannot be separated from considerations as to how it is to be implemented. This, in turn, makes it necessary to consider the role of administrative practices and institutions in the context of the recommended strategic local government financing framework. This includes, on the one hand, the role of local revenue administration and local expenditure management issues, and on the other, the administrative arrangements at central government level necessary to support the system. Of course, the role of local tax administration is already dealt with in Section 4 of this Final Report.

Indeed, the ultimate benefits from decentralization (both in the quality of local services as well as the nature of the local revenue system) are often determined by the manner in which fiscal decentralization reforms are actually implemented, which may differ significantly from its original conceptualization. It is possible, for example, that an expenditure program designed to be progressive in its incidence becomes highly regressive as a result of failure to implement or administer the program as intended. The administrative dimension is thus crucial to the reform of local government finances.

As indicated, the implementation of local government finance reforms takes place in two distinct realms. The first realm relates to changes in local government finance at the local level, whereas the second relates to changes at the central level necessary to support a devolved system of public finances. The local component has, in turn, two different dimensions. The first dimension relates to the establishment of sound revenue sources – including ensuring that the set of local government taxes is successfully administered as intended.<sup>1</sup> The second dimension relates to the use of financial resources at the local level: local planning, budgeting and financial management processes should be in place to assure that local governments make the appropriate choices around how they allocate their resources, and how this translates into effective service delivery. These dimensions are intrinsically related: there is widespread evidence in Tanzania that the legitimacy of local taxes (and thus the willingness of residents to pay them) is strongly compromised

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<sup>1</sup> As noted earlier, the issue of local revenue administration is addressed more fully in Section 4 of this report.

by the perceived failure of local authorities to use local revenues appropriately and effectively. While an important part of this failure is systemic,<sup>2</sup> an important part of the solution lies in improved financial administration and management. Too often local financial management is viewed as encompassing mainly good accounting practices. While accounting is a crucial component, the essence of sound financial management (especially at the local level) lies not in “accounting” *per se* but in the wider concept of “accountability”. The need to strengthen and transform local budget processes and local government financial management techniques –in order to assure participation, transparency, and accountability at the local level- is further addressed in Section 7.1.

**Box 7.1**  
**Feedback from the Second Stakeholder Workshop (May 2005):**  
**The Institutional Framework for Decentralization**

The second stakeholder workshop on the development of a strategic framework for local government finances –held in Dar es Salaam in May 2005- was presented with the following statement for discussion and debate: “The institutional framework for fiscal decentralization needs to focus on building a ‘center of gravity’ within the central government, as well as stimulating bottom-up demand for a sound system of local government finance.”

Unanimous agreement and consensus exists with regard to this statement.

Stakeholder feedback concurs that effective coordination on local government finance policy issues is quintessential to the sustainability of decentralization reforms. As such it was suggested that policy coordination should occur as close to the nerve center of policy decision-making as possible. In order to achieve this, a policy coordinating committee on local government finance issues was recommended to include all key stakeholders at the PS level, including PO-RALG, Ministry of Finance, PO-PSM, PO-P&P, and the Prime Minister's Office. ALAT may be called upon as an observer on behalf of local government authorities.

With respect to increasing bottom-up demand for decentralization reform and involvement of local governments themselves, it was noted that more extensive vertical consultation is needed through ALAT. However, it was further noted that ALAT is currently not in a position to adequately represent the diversity of local authorities in the country. For this purpose, it was suggested that ALAT restructure itself to better represent specific subsets of local authorities, including urban authorities as well as rural authorities.

The second “local” element of local government finance reform relates to the need to assure that the central government is appropriately structured to deal with policy issues surrounding local government finance. In order for the central government to be able to coordinate local government finance issues among the various central government stakeholders and in order for the center to effectively support the local government level,

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<sup>2</sup> As discussed in Section 2, the absence of an unconditional grant requires local governments to bear an inefficiently large burden of local government administration costs from own sources.

there is a need for a competent and clear “center of gravity” at central government level as the basis for relating to decentralized government. Channels for financial and other relations between the center and local governments need to be as clear as possible; when there is a multitude of different processes and channels through which the central government relates to local governments, these often become contradictory and confusing. An assessment of the institutional framework in support of fiscal decentralization –and suggested improvements in this institutional framework- are made in Section 7.2.

The reader should be reminded that it is the intention of this report to develop the broader framework for local government finances. As such, it is not the purpose of this section to develop detailed and comprehensive recommendations for the technical details on improving local fiscal management. Instead, this section seeks to add a discussion of the administrative and institutional dimensions to the proposals on the overall local government financing framework. The ideas and challenges identified herein should thus be addressed further by the relevant stakeholders as the particular reforms to the system of local government finance are selected and implemented.

## **7.1 Building legitimacy for decentralized local governance through improved local financial management**

The effectiveness of the tax system at the local level depends crucially on the perception taxpayers have about the effectiveness and honesty of local governments. Taxpayers’ willingness to comply voluntarily depends critically on whether they perceive they get a fair deal in services from their local governments. Therefore, local governments must build legitimacy among their constituencies. This can be accomplished in a variety of ways.

### 7.1.1 Financial management and the creation of effective local government authorities

Many problems in the management of local finances are understood as being administrative problems. There is no doubt that if financial administration is poor, good governance is severely undermined. However, while good financial administration is a necessary condition for sound governance, it is not a sufficient condition.

Moreover the problem of establishing sound financial administration is often seen as a problem of procuring suitable technical skills, such as accounting. There is little doubt that accounting skills are important; but, if the success of local finances were only contingent upon the employment of accountants, the solution to poor local financial management would be comparatively simple.

*Characteristics of an effective authority.* Effective financial management requires an effective local authority overall. An effective local authority will be able to marshal resources, spend them appropriately in ways which elicit real and desired benefits for the

community, and gain popular support in doing so. This in turn will be accompanied by a greater readiness to pay taxes on the part of the community.

Broadly, effective authorities display three key characteristics, namely good leadership, good strategies, and good ability to implement. Implementation capacity is usually dependent, in turn, upon a combination of sufficient skills, well designed systems and structures, and adequate financial resources.

The objective in building effective decentralized systems is to create the conditions for effective authorities to emerge. Creating such conditions does not guarantee effective local authorities. Of the three core characteristics cited, good leadership is often the key. Good leadership will generally be able to develop good strategy, and over time develop the capacity to implement. But systems can only encourage but not assure the emergence of good leadership.

*Leadership and the appointment of senior officials.* Leadership consists of both political and administrative leadership, embodied and led by the head of the council and the head of the administration. In bigger councils and cities it is critical that these individual leaders are able to gather a senior leadership team of political representatives on the one hand and officials on the other if they are to be successful. The relationship between the political and administrative leadership is crucial to success. The degree of trust between the two will have a significant influence on the effectiveness of the authority. It is possible but very difficult for an effective administrative head to operate in the absence of good political leadership. It is similarly difficult for an effective political head to operate effectively in the absence of good administrative leadership.

Political leadership is elected. Thus there is little that can be done in terms of system design to assure good leaders. It is important that political parties recognize the importance and complexity of running decentralized governments. In doing so the status of the local leadership will be elevated, which in turn, will attract better caliber leadership. At the administrative level the issue of who appoints senior local leadership flows from this debate.

In Tanzania there is currently vacillation between whether appointment of senior administration officials should be by the central government or by the local council. Many in favor of decentralization would urge local appointment. They would argue that only if local councils are able to appoint their senior leadership will they be able to be held responsible for delivery. This in turn is the basis for local democracy. Furthermore, local appointments would create the basis for building trust between political and administrative levels.

The counter to this is that local politicians may not be in a position to truly understand the nature of skills required to effectively run a municipality. It is often argued (particularly by central government officials) that if local politicians are given the power of appointment they will use it inappropriately and nepotistically. The stakes are high, too,

because local government is not just responsible for the delivery of purely local services, but for the national priority services, too.

The optimal position is probably to be found in a compromise where local leadership have the power to appoint but from a set of people who meet certain qualitative criteria, such as skills and experience, which are determined and vetted by central government. This appears to be the direction which Tanzania has adopted but not yet properly implemented. It is crucial that a clear and well considered position is developed on this issue, since it is one of the most important in building a decentralized system. Certainly it is crucial, inter alia, to the nature of financial administration which eventually emerges.

*Developing a capacity to implement.* The National government has a substantial role to play in creating effective capacity to implement. Firstly, it should create a framework for the emergence of successful systems and structures. Secondly, in the Tanzanian context, as has been stated already in this document, it has a role to play in the provision of sufficient financial resources to enable a sound local administration to be put in place. Thirdly, it can enable and encourage skills development, although it would be desirable that these processes are driven by associations of local authorities. In particular, ALAT should play a key role in this respect.

The broad framework for systems and structures should be established in national legislation. Legislation on structures should govern issues such as how councils are elected and structured; this is largely in place. Legislation on systems should govern issues such as principles of public participation, human resource management, performance management, procurement, delegations of authority and the governance of public-private partnerships. Legislation is also required to establish the principles of financial management.

#### 7.1.2 Financial management and clarity of accountability

At the heart of effective financial management lies clarity of accountability. Since the management of resources often lies at the center of local effectiveness, creating clarity around financial management procedures and patterns of accountability within the financial domain is crucial.

The starting point for sound financial management lies in determining the responsibilities of the political and administrative heads and the procedures and sanctions to be applied in cases of non-performance. All responsibility ought to lie ultimately with the local political authority and the administrative head of council, with clarity about the division of responsibility between these two. In some systems independent power is given to the head of the treasury in an attempt to enforce better financial management. However, such approaches rarely work, since key decisions cannot effectively be made over the heads of the administrative head and the political authority. Once the division of responsibilities between the political authority and administrative head is established accountability can be delegated appropriately, with some guidance in national legislation.

The Local Authority Financial Memorandum (LAFM) published by the Prime Minister's Office in 1997 in terms of the Local Government Finances Act No. 9 of 1982 provides a good basis in this regard, but needs to be updated as the system evolves. It is our understanding that a review and update of the LAFM is currently underway by LGRP. As part of the review of the local budget processes and financial management framework, the regulatory framework should clarify the overall strategic approach that "finance should follow function". In addition to greater clarity surrounding the assignment of expenditure responsibilities, key issues to be addressed in the review of the local budget and financial management processes relate to the budget process, establishment of a common accounting framework for local governments, procedures for reporting, principles of revenue and expenditure management, procurement of goods and services, borrowing and the management of investments.

An issue to be considered is the extent to which the framework should be defined in legislation or in memoranda, as is currently the case. Defining the framework in a memorandum offers greater flexibility, but runs the risk of being contradicted by legislation in other sectors. Whichever approach is taken, the advantages of establishing common, nationally standardized systems are significant, especially in an emerging system of decentralization such as in Tanzania where significant system development is required. Legislating systems in this way, provided that the legislation is well designed, provides for a degree of standardization which in turn greatly facilitates transparency, clarity, and the development of skills. In a system where such a large proportion of the expenditure of local governments is on the concurrent national priorities, and funded from the center through grants, it is imperative that the central government plays an appropriate role in policy and monitoring.

Once the standards are established skills development of individuals and capacity development of local government authorities can proceed in a much clearer and more focused manner.

### 7.1.3 Transparency and local involvement

The key driver for effective government, particularly at the local level, is the local electorate. Broadly, systems should be established to enable the local electorate to determine what services it wants, to contribute resources to enable the delivery of such services (in conjunction with appropriate resources from the center) and pronounce through the ballot box and other mechanisms on whether it is satisfied with the delivery achieved through either re-electing or replacing political leadership. Systems where the key decisions are taken by central government, as is the determination as to whether councils have succeeded or failed, are ultimately weak and generally ineffective.

The key to local involvement is transparency and access to information. Two spheres of access to information are required. On the one hand, technical information, such as accurate financial accounts, and details about procurement decisions need to be made

public. Even in countries with relatively low levels of technological presence, the scope for using the internet for making such information easily available is significant. While this is premature for most of Tanzania, it may not be long before it becomes more feasible<sup>3</sup>. Such information will generally not be accessed by voters. However, it does provide for easy monitoring by independent and official bodies to a significant effect. Where such systems are accompanied by legislation which requires the publication of certain key information, the transparency engendered is significant.

The second sphere of information access is at the local level to ensure that local citizens have maximum awareness of council issues and decisions. Simple tools such as public notice boards can be useful in enhancing local transparency, although a notice board in itself only provides the hardware.<sup>4</sup> Mechanisms also need to be developed for conveying information and receiving feedback in contexts where literacy levels might be low. This creates a basis for local involvement in determining council actions.

Techniques for doing this effectively need to be developed. Building a culture of local involvement in council affairs can take time. Yet if it can be established the rewards in terms of better governance can be substantial. One such technique successfully used in developing and developed countries is holding a number of council meetings open to the public and providing time and opportunity for citizens' participation.

Realism is required around the type of involvement that is likely from the public. The public tends to respond on an issue-by-issue basis rather than in a more comprehensive and systematic manner. Expecting the public to engage with the budget process in the manner councilors should do so is unrealistic and usually benefits only a very small sector of the public. But facilitating involvement in broader questions around discussion of pressing issues can be highly beneficial to all.

While ensuring technical skills are available to administer council finances is of critical importance, developing these broader mechanisms for accountability lie at the heart of establishing effective financial management over the long term.

#### 7.1.4 A single, credible budget process

A prerequisite for transparency is a single, credible budget process. There will always be differences between the budgeted and actual figures. However, the credibility of the budget process depends to a large extent on budgeted and actual expenditures and revenues being reasonably close. This seems not to be the case in a number of instances in Tanzania. For instance, public expenditure tracking surveys suggest that there is a

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<sup>3</sup> It should be feasible already for Dar-es-Salaam councils and a handful of the other bigger councils

<sup>4</sup> The "real" (technical) challenge is to achieve the increased participation, transparency and accountability sought with notice boards by developing the contents that should be posted on a notice board. How should local budget data be presented in order to usefully inform the local community, without overwhelming residents with incomprehensible information and without excessively raising the data-collection burden for local officials? Civil society organizations and NGOs should be able to make significant contributions to answering this question.

substantial gap between budgeted OC allocations for priority sectors and the manner in which these resources are actually spent. Similarly, there seems to be quite a difference between personal emoluments that are budgeted for local councils and realized PE spending. Very little effort is exerted in the budget processes (both at the central and local government levels) to verify that the budget is executed as planned. The manner in which the budget is presented should allow stakeholders (local residents and central government officials alike) to verify to what extent the budget is executed as planned. Such monitoring should occur both at the central government level (as grants disbursed from the treasury) as well as at the local level (as part of the local budget reconciliation at the end of the budget year).

In addition to allowing a comparison between budgeted local expenditures and actual local expenditures, presentation of the local budget should also allow some link to be drawn between inputs and what is produced. Such a link is implicitly made in the “MTEF approach” advocated and followed by the Ministry of Finance, which is actually a rudimentary form of a performance-based budget approach. In contrast, the current tendency to present the personnel expenditure as a single item separate from each of the sectoral items is misleading. Personnel is generally the largest part of any budget, so failing to link the personnel costs in each of the sectors to other expenditures by sector makes it extremely difficult to assess resource utilization by sector, let alone by outcome.

Of great importance in order to achieve coherence in the process of making resource allocation decisions is that there should be a single budget process. Where resource allocation happens through a number of different and separate processes the ability to make clear trade-offs is absent. A multi-channel flow of funds, where the actual amount available through each channel becomes known at different times reduces transparency. This can be a problem where there are large aid flows (i.e., TASAF) or earmarked ministerial subventions which are not aligned in a transparent manner as part of the core budget process (e.g., PEDP capitation funding from pooled donor funds embedded in the MOEC budget).

#### **Box 7.2**

##### **Local Government Budget and Accounting Procedures in Tanzania**

Local governments are gradually adopting locally operated Integrated Financial Management Systems (IFMS) for the overall management and control of local public finances. Already 32 councils have an Epicor-based IFMS system in place; the remaining councils are expected to be brought on the Epicor system with support from the Local Government Reform Programme in 2005 and 2006.

The introduction of an improved framework for local government finance offers an excellent opportunity to review and improve the local government budget and accounting procedures in Tanzania. Some features of Tanzania’s local government budget practices are outdated or can be improved to strengthen the system of public finances. For instance, the budget classification and reporting systems could be improved in order to (a) assure a more comprehensive local budget approach, which is (b) consistent with national PRS II approach and (c) standardized to enable the



center to monitor local government compliance with grant conditionalities.

Furthermore, the current financial management procedures support outdated financial management principles, by effectively promoting the creation of a multitude of local government accounts. Rather than serving as a control mechanism on local financial accounts as intended, the presence of multiple accounts in fact gravely complicates local budgeting and financial management, and increases the potential for non-transparency and financial abuse.

The systematic reliance of local governments on multiple accounts stands in contrast to the “best practice” in public sector budgeting which in principle promotes reliance on a single account. Cash management is much simpler when relying on a single bank account; local treasurers do not have to shift resources from one account to the other from time to time to remedy temporary cash-flow shortfalls in specific accounts, which makes the local accounts significantly more transparent and easier to audit.

In some cases, more complex financial management systems may indeed use multiple budget accounts, but in most cases these additional sub-accounts are used for accounting purposes only. In this scenario, for instance, a payment of user fees for refuse collection could flow from the single revenue account through the refuse collection account, but the payment would be cleared through this account on the same day, so that all sub-accounts have a zero balance at the end of each business day. This approach would provide both the cash-flow benefits of a single revenue account, as well as having the advantage of systematically producing bank records for specific spending categories. However, given the advances in the introduction of computerized accounting software, it is questionable whether this level of complexity is even necessary for local authorities in Tanzania.

#### 7.1.5 Recommendations and next steps to improve local budgeting and expenditure management

Improvement of local financial management system has been a critical component of the LGRP/ Finance Component’s activities since the inception of LGRP. The improvement of local financial management has largely focused on the introduction of a computerized integrated financial management software (a version of Epicor software modified for local governments) at the local government level. Yet while a credible, comprehensive local budget planning and process is needed for an efficient, transparent and accountable system of decentralized local government finance, current budgetary processes at the local level in Tanzania do not appear to provide a comprehensive system, severally reducing the legitimacy of the local government finance system. Major problems arising from the current local financial management systems include:

- When LGAs are asked to report their outlays, major gaps exist between self-reported local expenditures and (much lower) reported funding inflows. Clearly the financial management and reporting systems are out of synch if LGAs report spending twice more than their resource inflows. Further investigation is needed whether (or to what extent) local governments are over-reporting outlays (for

- instance, accidentally or purposely double-reporting expenditures in local accounts) or underreporting resource inflows.<sup>5</sup>
- The use of multiple earmarked accounts at the local level within the regular local budget process (as opposed to single treasury account approach) is not considered best practice. Although multiple accounts can serve the purpose as a cash-flow management control, multiple budgetary accounts can also complicate local financial management and significantly decrease transparency as a result of frequent inter-account transfers (see Box 7.2).
  - In addition to the multiple accounts within the regular budget process, there are numerous extra-budgetary funding mechanisms that run parallel to the local budget (e.g., TASAF). In order to assure a comprehensive local budget process, these extra-budgetary funds should be integrated into the local budget to the extent possible; at a minimum, the local budget process should report on the activities funded by parallel mechanisms.
  - The Ministry of Finance and PO-RALG do not properly coordinate the guidance given to LGAs on local financial management issues. For instance, there are differences and disagreements on the budget classifications to be used by LGAs, and there is a lack of coordination on the role of MTEF and NSGPR in local budget preparation. The belief that local budgets are not responsive to these national policies detracts from the legitimacy of local government finance.
  - Local governments do not have a unified budget which properly integrates recurrent spending and capital development spending. Although the accounting structure provides for a Development Account at the local level, some sectoral programs (e.g., PEDP classroom funding) route capital expenditures through the sectoral OC account.
  - Public expenditure tracking surveys (PETS) conducted in Tanzania report significant outflows or diversion of sectoral OC. This is not consistent with the majority of audits of LGA accounts, which do not seem to flag this issue. This inherent contradiction might arise if the audit strictly focus on compliance with accounting standards, and do not look at compliance with other budget practices or conditionalities.
  - Many local government budgets report all personal emoluments in a single line item. Breaking down staffing by sector, and possibly even including the exact location (service post) of staff postings by sector in the local budget could be a tremendous boost to community monitoring of local staff and prevent ghost workers. The budget process currently lacks such basic measures to enhance transparency and participation in the local budget process.

While many of these shortcomings of the local budget processes can be “explained”, they nonetheless significantly impede the credibility of the system of local government

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<sup>5</sup> In a positive light, this imbalance might be the result of spending that is funded through parallel systems (e.g., TASAF) that is entered as an outflow but not as an inflow. A more negative scenario is that this might be the result of spending getting recorded more than once, on different accounts. For instance, due to the multiple parallel funding flows in existence, a classroom could be built and billed to two different accounts (say, TASAF and PEDP) with a relatively low chance of detection.

finance. As consistently argued by Fjeldstad (2004), the lack of trust in the finances of local government authorities is an important contributing factor to local tax compliance. In order to strengthen the broader framework for local government finance, there is an ongoing need to review and revise –as necessary- the local government finance regulations and accounting procedures.

The recommended review of the local financial management would need to take place in several sequential steps:

- First, a serious assessment needs to take place of the regulatory framework for local government budgets and financial management: to what extent is the regulatory and administrative framework consistent with a participatory, transparent, and accountable local budget process.<sup>6</sup> Is the regulatory framework adequate, or is there a need to provide different (or additional, or more consistent) guidance to LGAs? The mantra that local government financial management is more about “accountability” than “accounting” should be an important theme in the review of the local budget process.
- Next, an external assessment should be conducted to determine whether local financial and accounting regulations are being followed? If not, where are the (main) discrepancies between the regulated and actual practices? What are the causes of the deviations? What oversight mechanisms should be strengthened or put in place to correct this failure?
- Finally, an assessment of the auditing process of LGAs would need to take place. Are the breadth and depth of audits for LGA budgets and accounts adequate for the purposes at hand? Particularly given the increased importance to LGAs of a clean (or at least, non-adverse) audit report as a minimum access condition for the LGCDG, it is important that the audit process is objective and accurate. Failure to have a credible audit process reduces the credibility of the entire local government reform process.

As a matter of process, in assessing the current local budgeting and financial management process in Tanzania, it would be very important to involve CBOs, local government officials, NGOs and other organizations within the private sector and civil society. There is a (partially valid) perception in some circles that local government reform in Tanzania has largely been a “top-down” exercise that has largely eschewed bottom-up inputs. Given that the local budgeting and financial management processes are evolving from a predominantly centralized, vertical system of control to a more horizontal system of participation, accounting and control, feedback is needed from a wider variety of actors. The review and reform of local government planning, budget and accounting processes provides an appropriate entry-point for the private sector, civil society organizations, CBOs and NGOs to make specific suggestions and positive contributions to discussions on how to improve the current system of local government budgeting and financial management.

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<sup>6</sup> The regulatory framework includes –but is not necessarily limited to- the Local Authorities Accounting Manual, the Local Authorities Financial Memorandum, Local Tendering Regulation, Epicor user documentation, as well as program-specific budgeting and accounting regulations.

## **7.2 The institutional framework for central-local relations**

Effective financial management at the local level also requires coherence at the central government level. The complexities of running local government are often not sufficiently appreciated. The complexity is driven, in particular, by the multitude of role players which local governments must deal with. At the local level there are numerous political representatives on a single council, often with varied and even conflicting agendas; this is unlike national government departments where there is generally only one political head (the Minister) responsible. Local governments are in direct contact with the citizenry who make direct demands in relation to services delivered; they sometimes have to manage large numbers of employees, which can be complex; while, on the other hand, local governments tend to have fewer resources and less access to power.

Beyond this, local governments often have to manage the demands of a multitude of central government departments, agencies and donors, often with divergent or even conflicting requirements. They are unlikely to have a similar degree of access to national level information which the other role players have.

### 7.2.1 Organizing the center to reduce complexity at local level

If local governments are to be able to operate effectively, it is crucial that, firstly, there is coherence at the central government level between different departments and role players. Secondly, that the relationship between the center and local governments is based on predictability, transparency and simplicity.

A critical area is in the flow of funds to local government. Ideally these should flow through a single channel in a predictable manner. While it may be appropriate to set certain conditions on these funds, these should be clear and easily reported upon. Ideally one set of reporting should be sufficient to address all reporting requirements arising from the central government level. It should be desirable, particularly once the new fiscal framework is clearer and somewhat established, to be able to provide indicative figures for grants from the center three years in advance. These should all be published in a government gazette, and no grants should be allowed to flow to local government from the center unless published. This will provide for much greater clarity, transparency and predictability.

The relationship between the Ministry of Finance and PO-RALG is critical in establishing a coherent “center of gravity” at the center as a basis for relating to the local level. A strong and well founded relationship between these two departments, with support from the highest political levels is generally the key to ensuring coherence at central government as a whole, including the line departments. These two departments

must focus on building this solid relationship and use it as a basis for networking across all departments at central government level.

While the driver for enhanced effectiveness at the local level is the local community, the role of the center in monitoring is crucial. Monitoring should not be aimed at placing the central government in a better position to direct local government where it is regarded as not meeting required standards. Rather the aim of monitoring is to be able to gain a much better strategic understanding of what is happening in local governments across the country, publicize widely accurate and relevant information about local actions, developments, achievements and failures, and to put the central government in a position to both support and put pressure on local authorities to comply with the requirements. This then allows the relevant stakeholders in different situations to act accordingly, putting pressure where it is due. The conditions placed on local grants have been rationalized to focus on financial reporting and compliance with certain engineering and other standards on the delivery side. As indicated in a previous section, these need to be more closely monitored.

It is typical for central governments and others to seek to design transfer systems such that there are sanctions in cases of non-performance. While there is scope for this under certain circumstances, implementing sanctions is often extremely difficult. Where a system has sanctions designed into it, but they are not enforced for a variety of reasons, the outcome is often worse than having no sanctions designed initially.

### 7.2.2 Overview of institutional progress and challenges at central level

Coordination is needed in the various aspects of intergovernmental relations: coordination between the central government and local governments (so-called vertical coordination) on the execution of local government responsibilities; coordination between the central government tax system and the local tax system (involving the Ministry of Finance, the Tanzania Revenue Authority and PO-RALG); coordination between PO-RALG, Finance, and the various line ministries regarding the structure of the system of intergovernmental transfers; coordination in the development of the framework for local government borrowing. Coordination between central government agencies on intergovernmental fiscal issues can be referred to as “horizontal” coordination.

Recognizing the importance of the institutional context of central-local fiscal relations, during the consultations held during the inception phase of the study, the Ministry of Finance specifically noted the need to address the institutional framework as an integral part of this current study.

In many centralized countries, the Ministry of Local Government (or the President’s Office – Regional Administration and Local Government, as is the case in Tanzania) is tasked with the exclusive responsibility of monitoring and coordinating most aspects of intergovernmental relations. However, as local government reforms in Tanzania are gradually decentralizing the public sector, PO-RALG is neither well-positioned nor

equipped to act as the only link between central government and local governments.<sup>7</sup> As such, alternative or supplementary mechanisms are needed to provide proper intergovernmental coordination in a more decentralized system.

While PO-RALG continues to take a leading role on local government finance issues – particularly through the activities of the Local Government Reform Programme (LGRP)-, much has happened since 2003 that has enhanced the coordination between the institutional actors involved in local government finance:

- The joint government-donor Fiscal Decentralization Task Force has provided an effective forum for identifying opportunities and priorities for reform, and holding the Finance Component of LGRP to task on these issues.
- Coordination between the Ministry of Finance and PO-RALG (including LGRP) was strengthened substantially by the Intergovernmental Grants Study, which was overseen jointly by the two ministries. In the aftermath of the study, the implementation of the formula-based block grant system further fortified this relationship between the Ministry of Finance, PO-RALG, and the involved sector ministries by the establishment of a Coordinating Block Grant Implementation Team (see below for further details).
- Sectoral ministries that have policy responsibilities for services delivered at the local government level have been pulled into the discussion of local government block grants and other relevant intergovernmental finance issues through their inclusion in the Coordinating Block Grant Implementation Team and the establishment of Sectoral Block Grant Implementation Teams (for education, health, agriculture, water and roads, respectively).
- In September 2004, the first Local Government Fiscal Review was published under the auspices of the Coordinating BGIT. Envisioned to be an annual publication, this Review provides broad access to the state of local government finance and provides a platform to inform the policy debate on important policy issues.
- During the budget formulation process of FY 2005/06, much closer coordination was pursued between the development of the Budget Frame by the Ministry of Finance and the Budget Guidelines issued to LGAs by PO-RALG. The improved coordination –which was made possible in part by the harmonization of the local budget cycle with the central government’s fiscal year- allows for much greater consistency between the policy decisions in the budget frame and the local budget guidelines.

However, the evolution of the institutional framework –from one that worked in a centralized system of local government, to one that will work well in the context of a

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<sup>7</sup> For a more detailed account of this issue, see Jamie Boex and Jorge Martinez-Vazquez. 2003. Developing the institutional framework for intergovernmental fiscal relations in Tanzania. LGRP Technical Report 2003-9.

decentralized public sector- is still in its early stages, and the local government finance system can benefit significantly from further institutional strengthening.

This section discusses the institutional framework in which central-local fiscal relations take place in Tanzania, and identifies options for strengthening this framework. Within the context of the assessment matrix presented in Table 3.1, the institutional framework is covered by a number of cells in the matrix, predominantly in the top row (structure and scope of the public sector) and in the final column (participation by civil society and the private sector). Challenges pointed out in Table 3.1 regarding the institutional subtext for intergovernmental fiscal relations include:

- The evolution of PO-RALG from an institution controlling local governments to a ministry facilitating local governments.
- The need for ongoing improvements in coordination between PO-RALG, the Ministry of Finance, sector ministries and other stakeholders.
- The need for actors outside the central government (including LGAs through ALAT, as well as other NGOs) to have a stronger voice in the development of the local government finance system.
- The relatively weak participation of civil society at the local level in local budgetary decisions, including the setting of local tax rates and local expenditure priorities.

As part of its mandate, this study considers what steps should be taken to improve the institutional framework for central-local fiscal relations. To this end, the remainder of this section reflects on the respective roles of the main central government stakeholders on intergovernmental fiscal issues, including PO-RALG and the Ministry of Finance (subsections 7.2.3 and 7.2.4, respectively). We further discuss the need for institutional coordination on local government finance issues at the technical level (subsection 7.2.5) as well as at the policy level (7.2.6). Line ministries should also consider their organizational structure and how they interact with local authorities (subsection 7.2.7). Finally, we address the need for a stronger role of local governments and civil society in the national policy debate surrounding fiscal decentralization and local government finance issues, as well as a stronger role for civil society on local government finance issues at the local level (subsection 7.2.8).

### 7.2.3 The role of PO-RALG in intergovernmental fiscal relations

In Tanzania's institutional and legislative framework, the President's Office – Regional Administration and Local Government (PO-RALG) is the ministry responsible for administering local government affairs, including the coordination and oversight of local government finance issues. According to the Local Government Finance Act (1982), Part IV (Finances and Resources), Section 33, the Minister responsible for local government (i.e. PO-RALG) "shall, in relation to a local authority under his charge, subject to the provision of the [Local Government] Act and of this Act, be responsible for:

- a. Ensuring the proper management of the finances of the local government authority;
- b. Facilitating the securing of funds for the operations of the local government authority;
- c. Promoting the timely preparation of the annual budget of the authority and securing that the authority operates within the limits of the budget as prepared.

While the Act provides PO-RALG with a broad mandate to deal with local government finance issues, consistent with a decentralized finance framework, the intention of the Act appears to be for PO-RALG to be in a facilitating and oversight role:<sup>8</sup>

- With regard to the securing of funds (including intergovernmental grants) for the operations of local government authorities, PO-RALG is mandated to play a *facilitating* role in this regard; the Ministry of Finance and the sector ministries play a lead role in the final determination of the amount of resources available for the various local government activities.
- With regard to ensuring proper budget formulation, the oversight role of PO-RALG is executed through the issuance of budget guidelines, procedures, and instructions on the development of the local budget.
- With regard to ensuring proper budget execution, PO-RALG facilitates sound financial management through the provision of technical support and capacity building (including supporting the roll-out of the EPICOR financial management system); and the auditing of local government budgets to assure that local budgets are implemented or executed as planned.

In other words, PO-RALG's legislative mandate gives it a prominent role in developing, monitoring and guiding local government finances. The leading role of PO-RALG on local government finance issues is generally respected by the other stakeholders,<sup>9</sup> and this strong mandate should continue to be recognized and respected in the evolution and strengthening of the institutional framework for intergovernmental relations in Tanzania.

**Box 7.3**  
**The successful role of LGRP's Finance Component**  
**in the reform of the local government finance system**

The Local Government Reform Programme (LGRP) was established in 1999 following acceptance of the Government's Policy Paper on Local Government Reform (MRALG, 1998) to

<sup>8</sup> Contravening this apparent decentralized policy design, the Local Government Acts continue to give PO-RALG substantial control over local government affairs and local finances, including the power to post or transfer local government staff – along with the requirement to fund this post- without explicit council approval.

<sup>9</sup> The main area of local government finance where PO-RALG does not appear to have played a decisive role is the recent reforms of local government revenues in 2003 and 2004, where the Ministry of Finance took a leading role.



be the implementing arm of PO-RALG for local government reform.

LGRP has played a highly effective role in moving forward the reform of the local government finance system, particularly in the development of a formula-based system of intergovernmental transfers. The success of LGRP's Finance Component was highlighted by the Joint Government-Donor Review of 2004 (JGDR, 2004). In addition, in contrast to experiences in some other decentralizing countries, the policy successes of the LGRP Finance Outcome area have been achieved with relatively limited resources: the policy activities of the Finance Component are currently staffed by one Outcome Manager and one Finance Advisor,<sup>10</sup> with less than full-time external technical support on policy matters.

LGRP's success in the area of fiscal decentralization reform can be attributed to the confluence of a number of factors:

- Commitment and leadership at the highest level within PO-RALG.
- Good inter-ministerial coordination at the PS-level (through the Inter-Ministerial Technical Committee) and political support at Cabinet level.
- Good cooperation within the donor community and between government and the donor community, providing positive pressure from the Fiscal Decentralization Task Force and the LGRP Basket Fund Steering Committee.
- The introduction of the formula-based transfer system was successfully used as a technical entry-point for reform, which in turn now drives the reform of other decentralization issues (such as local service reform and improved local financial management).
- The realization that the lack of appropriate institutional mechanisms to coordinate and allocate public resources was a predominant constraint (not the absence of resources *per se*). Thus, the introduction of a formula-based transfer system has focused systematically on laying the groundwork for improved inter-ministerial and intergovernmental coordination and institutional strengthening.
- The ability of LGRP to achieve consensus on the vision of a single government-driven intergovernmental transfer system, instead of fragmentation of resources due to parallel funding mechanisms, such as sectoral parallel basket funds and area-based capital development programs. Development partners such as donors and the World Bank have accepted this vision and are aligning their programs with the Letter of Sector Policy. For instance, instead of developing the World Bank's Local Government Support Project as a stand-alone project, LGSP was designed as an integral part of the Local Government Capital Development Grant System.

Although LGRP's Finance Component has been quite successful in advancing a constructive agenda of local government finance reforms, in many other ways the institutional capacity of PO-RALG to administratively deal with local government finance issues could be deemed rather weak. In fact, in response to these concerns, an organizational review of PO-RALG was conducted last year with the purpose of strengthening the institution's organizational structure.<sup>11</sup> The associated capacity building

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<sup>10</sup> The Zonal Reform Teams (ZRTs) are assigned Finance Experts. However, these experts predominantly contribute to strengthening local financial management, and generally do not contribute to policy reforms.

<sup>11</sup> See: PO-RALG. Proposed Functions And Organisation Structure of The President's Office, Regional Administration And Local Government. February 2004.

and institutional strengthening of PO-RALG that is required for it to more effectively fulfill its functions in accordance with the new organizational structure is to be implemented with support from LGRP and LGSP.

While it is beyond the scope of the current study to critique the newly adopted organizational structure, the reorganization does raise a number of opportunities (and in fact, some concerns) about PO-RALG's institutional ability to facilitate local governments as part of a sound system of intergovernmental fiscal relations:

- A positive feature of the new structure is the presence of a data gathering unit which would manage the Plan-Rep system to gather fiscal and non-fiscal local government data. Currently, gathering of local fiscal data is done on an ad hoc basis through the ZRTs.
- Another positive feature of the new organizational structure is the expanded focus on information sharing and communications through the introduction of an Information, Education and Communication Unit.
- At the same time, there is some concern that the new Division of Sector Coordination has the potential for becoming a little “government within the government”. Although intended as a link between sector ministries and local authorities, the directorate has the potential to become an unnecessary layer in the central government hierarchy, thereby duplicating efforts within sector ministries.<sup>12</sup> Alternatively, the directorate risks absorbing itself into implementing sector projects in a centralized manner that will actually be a stand-in-the-way for real sector devolution.
- Further fragmentation of the organizational structure may encourage the establishment of “fiefdoms” that may make it increasingly hard to coordinate local government finance issues horizontally within PO-RALG.
- Beyond the re-organization proper, LGRP currently falls outside the organizational structure. Yet many of the core responsibilities of RALG are currently performed by LGRP; for instance, preparation of local budget guidelines. The absence of a formal division of responsibilities between LGRP and PO-RALG creates some confusion and limits the sustainability of the strengthened capacity of LGRP.
- Local government finances fall under the Director of Local Government; there is no separate Director for Local Government Finances. This provides a relatively weak position to the LGA Finance Section, which has far-reaching responsibilities in overseeing the local government finance system. This section will be responsible for producing LGA Budget Guidelines and bear ultimate responsibility for ensuring sound local financial management and for local compliance with these guidelines; supporting LGAs in the implementation of a sound system of local revenues; coordinating with the DPP/PORALG, the Ministry of Finance and other stakeholders on the size of intergovernmental

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<sup>12</sup> Actually, sector ministries rarely have a single focal point for local government issues. As such, different divisions within a line ministry may prepare circulars for LGAs without adequate sectoral coordination within the sector ministry itself.

transfers to local government (as part of the development of the annual Budget Frame). It is thus critical that this unit is extremely well-capacitated.

**Recommendations.** PO-RALG is institutionally well-positioned to continue its leading institutional role in the coordination of intergovernmental fiscal relations, particularly with the expertise embedded in LGRP. The study team supports the recommendation made by the JGDR (2004) to upgrade the status of PO-RALG as a central ministry, which should further strengthen its role in coordinating intergovernmental affairs. It should be hoped that the reorganization of PO-RALG will support the development in the medium term of PO-RALG's LGA Finance Section into an organization that provides both oversight and facilitation to local governments on local government finance issues.

Although the LGRP Finance Outcome component should ultimately be re-integrated into (the LGA Finance Unit of) PO-RALG proper, there is no question that this component within LGRP will continue to function as a driving force in the institutional framework for local government finance reform. In fact, given the very narrow human resource base of the LGRP Finance Component, it would be prudent to expand the component with several professional staff to allow it to more effectively implement reform in the areas of local government finance that need continued attention (including local financial management, local revenues, and the recurrent and capital transfer systems). It would be appropriate to include, at least, two additional full-time experts/manager to manage the transformation of the local revenue system and to guide the other proposed reforms.

Perhaps the biggest institutional challenge faced by PO-RALG is that the change that is needed from PO-RALG is a change in mentality, from PO-RALG serving as a hierarchical boss to local governments to being true facilitators. It is hard to see how the current re-organization positions PO-RALG better as a facilitator, but it does not necessarily stand in the way either (with the possible exception noted above). We note that the recent step to post a website is a small but significant first step in the right direction. The website could become, not only a point for policy documents from LGRP, but ideally evolve into a "one-stop" service center for information and access for LGAs on a wide variety of local government (finance) issues.<sup>13</sup>

#### 7.2.4 The role of the Ministry of Finance over local government finance issues

As part of its mandate under the Public Finances Act (2001), the Ministry of Finance is responsible for the efficient allocation of public resources in the public sector. As such, it has several direct and indirect responsibilities for the system of local government finance

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<sup>13</sup> While many LGAs may currently not be in position to extensively use the internet, such a step would reflect a more transparent, open, and less hierarchical mentality of PO-RALG towards LGAs (and donors that are active at the regional level do tend to have such access). One could envision part of the PO-RALG web site dedicated to LGAs to contain relevant information for local government officials, including financial management documents (budget guidelines, EPICOR support); regulatory and procedural guidance (tender regulations; hiring procedures); sectoral regulations and guidelines; local revenue forms, regulations and materials, and information, forms and documents needed for the LG Loans Board.

in Tanzania, including responsibilities for the public sector's tax and revenue systems (including local government revenues); the use of intergovernmental grants to assure appropriate funding of local government expenditure responsibilities and local capital development; and the local government borrowing framework.

Unlike many Finance ministries in decentralized countries, Tanzania's Ministry of Finance does not have a separate Director or Commissioner for Local Government Finance, who would oversee local government finance issues. Instead, the responsibilities for local government finance issues are fragmented between several different departments and sections within the Ministry. Although the Policy Analysis Division (PAD) has clear responsibilities in overseeing a number of local government finance issues as part of the government's fiscal policies, there is currently no Section Head for Local Government Finance; instead the responsibility for local government finance issues are further fragmented between Section Head for Macroeconomic Policy (covering the inclusion of intergovernmental grants into the budget process) and Section Head for Tax Policy (covering local government tax issues). Since not a single Finance official has policy oversight over local government finance issues, local finance issues that should truly be considered in unison are often addressed in isolation of one another.

In fact, the highest-level official within the Ministry of Finance responsible for local finances is found within the Budget Division. As part of the Ministry of Finance's responsibility to assure the efficient allocation of public resources, the Regions and Local Government Section of the Budget Division (BD/RALG, led by the Assistant Budget Commissioner for Regions and Local Governments) has the responsibility to "monitor" (i.e., track, study, and analyze) the finances of the local government sector in order to assure the overall integrity of the system of public finances. The main duties and responsibilities of this Section include:

1. To receive and analyze the Recurrent and Development Budget for Regions and Local Government
2. To monitor and follow-up budget implementation
3. To carry out periodic review and analysis of budget performance
4. Preparation of necessary budget adjustments through reallocation with supplementary estimates.
5. Sectoral Budget analysis and interaction.
6. To finalize Regional and Local Government Estimates for Consolidation with Ministerial Estimates.
7. To appraise demands for reallocations, supplementary funds, Civil Contingency Funds and provide recommendations.

Some observations regarding the role of the Budget Division, Local Government Section (BD/RALG) in central-local fiscal relations include:

- In the past, the lack of linkages between this Section and the other stakeholders in the local government budget process (particularly PO-RALG and the sector ministries that deliver services at the local level) contributed to a structural

disconnect between fiscal policies at the local level and their financial inclusion in the budget.

- In contrast to the decentralized role of local governments, the budget process (through BD/RALG) continues to be oriented in a manner that treats LGAs like central government budgetary units. For instance, key activities of BD/RALG is to capture LGA budgets, and code them into the national budget books at a high level of detail. However, the value of this exercise is highly dubious, as grants are disbursed from the Treasury as block grants, and no reconciliation of local budgets with their budget plans is ever done. In fact, BD/RALG does not even systematically reconcile planned transfers with actual disbursements for PE and OC.
- The role of the Local Government Section has been (and will continue to be) impacted rather substantially by the introduction of formula-based grants, towards a much more pro-active role, which will require critical analysis of local government finance issues. For instance, it should be the unit to compute the size of block grants, monitor compliance with conditionalities, and to monitor disbursements to assure that they match the budgeted transfers.
- There continues to be an overlap (and/or lack of coordination) between BD/RALG and PO-RALG/LGRP as to their interaction with LGAs. For instance, at the current time, BD/RALG rolls out its own financial management training for LGAs (e.g., on the implementation of MTEFs). This role is legally part of PO-RALG's mandate. If nothing else, improved coordination is needed between the training and instructions provided by MOF and by PO-RALG.
- Furthermore, the Ministry of Finance is unable to fulfill its policy analysis role and its monitoring role without a rudimentary reporting system that would provide it with the basic local government finance statistics needed to get such a complete picture. Currently, the data collection and consolidation by PO-RALG for such purposes is not adequate, as it is not sufficiently timely and incomplete.

***Recommendations.*** The study team has three main recommendations for improving the institutional structure of the Ministry of Finance to contribute to sound central-local relations.

First, while the Ministry of Finance increasingly recognizes that local government finance plays an important role within its mandate, the Ministry is also becoming increasingly aware that dealing with LGAs and local government finance requires a structurally different approach than dealing with MDAs and the rest of the budget. Recognition of these facts should be reflected in the Ministry's organizational structure. Given that local government finance represents well over 20% of public sector finances, the Ministry should consider establishing a separate Commissioner for Local Government Finance. While such a move is desirable and worthy of serious discussion by the Ministry's leadership, the study team recognize the low probability that such a substantial change in the Ministry's organizational structure will be acceptable and materialize in the short run.

Second, a structural re-orientation of BD/RALG is needed. This Section should move away from an “accounting section” for local government budgets to a much more proactive section, that (a) interacts systematically with key stakeholders involved in the local government budget process (including the education and health sectors); (b) produces regular and informative analyses as part of its mandate to assure proper inclusion of local government finances into the budget as well as proper execution of intergovernmental grants, as well as (c) interacts with LGAs as appropriate, in coordination with PO-RALG. Within Finance, it is this Section that is bearing the bulk of the responsibility for assuring that the new formula-based system is correctly included in the national budget. This responsibility will be further expanded when the Local Government Capital Development Grant is fully implemented. Failure to expedite the reorientation and continued capacity building of this section could have serious consequences for the successful implementation of local government finance reform initiatives.

Third, the study team recommends the introduction of a small Local Government Finance Section in CPAD, headed by an Assistant Commissioner for Policy Analysis for Local Government Finance. As for the Ministry’s policy responsibility over local government fiscal issues, this technical person would have the ability to consider local government finance issues in a comprehensive manner, across the current divisions of responsibilities.

The study team recognizes that these recommendations will not be adopted overnight, even to the extent that they may be acceptable and desirable by the Ministry of Finance. As such, we recommend one intermediate step to be pursued immediately in order to achieve (or at least, move gradually towards) the other recommendations. The Ministry of Finance is highly recommended to immediately attract a Local Government Finance Expert/Advisor who –for the time being- would formally report directly to the DPS/ Finance. This Expert/Advisor position would bring in international expertise and experience on a temporary basis (for 2-3 years) to help re-direct how Finance thinks about and deals with local government finances. For instance, the Expert/Advisor would support the Assistant Budget Commissioner for RALG in the restructuring of the BD/RALG; support the ACB/RALG with the Secretariat role of the FACG; see below); while also assisting in preparing the introduction of the Local Government Finance Section under CPAD. After this temporary intervention, the BD/RALG should be properly re-oriented and restructured for its new role, and the Policy Analysis Department’s new Local Government Finance Section should have adequate capabilities to analyze relevant local government finance issues.

#### 7.2.5 Technical level coordination: Local Government Fiscal Analysis & Coordinating Group

The respective roles of the Ministry of Finance and PO-RALG can best be distinguished by stating that while PO-RALG –as the central government’s implementing arm for local government policies- monitors, guides and supports the implementation of local government finances “on the ground” on a day-to-day basis (i.e., monitoring and analysis in support of proper local financial management), while the Ministry of Finance -in its

role as the steward of the nation’s public finances- globally monitors and analyzes “the big picture” of local government finances (i.e., monitoring and analysis of so-called “macro policy issues” surrounding local government finance).

This division of responsibilities is mutually complementary, but requires systematic coordination between PO-RALG and Finance, as well as other technical-level stakeholders involved in local government finance issues (including key line ministries as well as other central government agencies, such as PO-PP and PO-PSM). However, as we noted earlier, the Regional and Local Government Budget Section of the Ministry of Finance historically lacked proper institutional connections to other key stakeholders. Due to the key role that the Section plays in preparing local government budget allocations and grants, this could easily lead to miscommunications and could result in a disconnect between policy intentions and budget execution. During the introduction of the formula-based grant system, an institutional link was built between the Ministry of Finance, PO-RALG, and the other stakeholders through the Coordinating Block Grant Implementation Team (Coordinating BGIT). The Coordinating Block Grant Implementation Team –officially led by the DPS/Finance- meets on a regular basis (approximately quarterly) in order to discuss and coordinate the implementation and proper introduction of the formula-based sectoral block grants into the national budget.

**Recommendation.** The study team recommends capturing the institutional gains made by the Coordinating BGIT by transforming the team into a Local Government Fiscal Analysis and Coordinating Group (LG FACG), a permanent inter-ministerial technical working group. The LG FACG –which would be anchored within the Local Government Budget Section, but with significant membership from other key stakeholders- would fill this gap by providing a direct linkage, at a technical level, between the Ministry of Finance and the other stakeholders involved in local government finance issues. The TORs of the various contributing members of the FACG should be modified to reflect and recognize their contributions to this inter-ministerial working group.

#### **Box 7.4**

##### **Proposed composition of the Local Government Fiscal Coordinating Group**

- Deputy Permanent Secretary, Ministry of Finance (or possibly in the future, MOF Commissioner for Local Government Finance), Co-Chair
- Deputy Permanent Secretary or Director for Local Government ,PO-RALG, Co-Chair
- Assistant Commissioner for Budget (Regions and Local Government), Secretariat
- Director for Local Government, PO-RALG
- DPP from involved sectoral ministries (MOEC, MOH, MA&FS, MoW&L, Works)
- Representatives from central agencies (PMO, PO-PP, PO-PSM, NBS)

What specific tasks will the Local Government Fiscal Coordinating Group perform? The Regional and Local Government Budget Section within the Ministry of Finance (MOF) would continue to be responsible for its routine budgetary tasks within the budget process. In addition, however, the LGFACG would provide a platform for coordinating local government finance issues at the technical level. Concretely, the activities of the Local Government Fiscal Analysis & Coordinating Group would include:

1. Acting as the focal point for maintaining a comprehensive data set on local government finances (this task would obviously be closely coordinated with PO-RALG);
2. Maintaining the authoritative set of allocation factors to be used for formula-based allocations, and compute formula-based allocations to individual councils based on the directions of the PO-RALG;
3. Synchronized with the national budget cycle, preparing an annual “Local Government Fiscal Review” which would include analyses of:
  - a. the overall expenditure patterns of local governments
  - b. the overall revenue collection patterns of local governments
  - c. the overall functioning of the system of intergovernmental grants
  - d. local government borrowing and debt, as appropriate
4. Informing the policy process by producing specific analyses and reports on local government finances and local government fiscal issues, as needed or requested
5. Providing advise on the application of grant formulas, accessibility conditions, grant conditions and grant procedures, as needed or requested;
6. Providing any necessary background information in support of the inter-ministerial coordinating mechanism on local government finance issues at the policy level (see immediately below).

#### 7.2.6 Policy-level coordination on local government finance issues

One of PO-RALG’s current responsibilities is to coordinate the interactions of the different central government ministries with the local government level. As local governments become increasingly autonomous in their functioning, PO-RALG, in its current organizational set-up, will not be as well-positioned to play this role in the future. As such, Tanzania’s modality for different central government ministries to coordinate their interactions with the local government level ought to evolve over time.

While the recent improvements in technical coordination on intergovernmental fiscal issues provide for a marked improvement in coordination of central-local fiscal issues, it is insufficient to focus on coordination at the technical level alone; a regular and systematic policy-level coordinating mechanism on local government finance issues is critical to assure coordination at the policy-level and to serve as a platform for the recommendations from the technical level. For instance, interest has been shown in the past by some to establish a Local Government Fiscal Commission. Although international practices offer a number of options for intergovernmental coordination (as discussed in the box below), the study team proposes for PO-RALG and MOF to jointly convene an



annual Local Government Fiscal Consultative Forum, at which policy issues can be discussed at policy level and taken forward into the budget process. The study team sees this option as preferable over the alternative coordinating modalities that are possible.

#### **Box 7.5**

##### **International practices in coordinating central-local fiscal relations**

International practices offer four more or less standard options for intergovernmental coordination.<sup>14</sup> These options include (1) continued exclusive reliance on PO-RALG to coordinate intergovernmental relations; (2) introduce one of several types of Local Government Finance Commissions; (3) rely on parliament to monitor and coordinate intergovernmental affairs; (4) formal reliance on a local government association (ALAT) for intergovernmental coordination. Below, we discuss the extent to which each of these options would be well-suited in Tanzania's case.

***Continued exclusive reliance on PO-RALG.*** It is recognized by all stakeholders in Tanzania – including PO-RALG itself- that local governance is an issue that extends well beyond the mandate of PO-RALG, and that extensive coordination is needed among central government agencies on one hand, and between the center and local governments on the other hand, to assure the successful function of the system of intergovernmental (fiscal) relations. As such, an approach that exclusively relies on PO-RALG and that fails to build linkages to the other central government stakeholders is not a viable solution.

***Local Government Finance Commission.*** During the 1990s, it appears that the “standard” solution to the challenge of intergovernmental coordination in decentralizing LDCs was the introduction of a Local Government Fiscal Commission. However, in fact, the term applies to basically three types of coordinating mechanisms (vertical, horizontal and autonomous), which have distinctly different objectives. Whether or not an LGFC is an appropriate mechanism depends very much on the objective to be achieved.

***A vertically-oriented LGFC.*** Some LGFCs are predominantly comprised of various representatives from the local government level and are mandated to represent the interests of the local government level at the center. Examples of such commissions include the LGFC in Uganda and the Finance Planning Council in Germany. While in decentralized countries it is important for local governments to have a voice in policy decisions concerning local government finance issues, such “vertically oriented” commissions can have a number of draw-backs. Most importantly, in many LDCs the primary problem within the realm of intergovernmental coordination is the lack of coordination between central government agencies. If this is the case, building an additional bureaucracy to consider local government finance issues may not only be a costly affair that fragments institutional responsibilities and disperses (often limited) human resources, but (in the absence of strong leadership at the center) it can actually worsen the coordination problems at the center. Given that in many ways LGRP effectively fulfills the role of a champion and catalyst for decentralization reform, the study team does not believe that such a

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<sup>14</sup> A more complete discussion of the types of available intergovernmental coordinating mechanisms is contained in Boex and Martinez-Vazquez. 2004. *Developing the institutional framework for intergovernmental fiscal relations in decentralizing LDCs*. International Studies Program Working Paper Series.

vertically-oriented LGFC would be able to contribute significantly to the discussion on local government finances at this stage of reform in Tanzania.

***A horizontally-oriented LGFC or Local Government Fiscal Forum.*** A second type of finance commission is predominantly comprised of central government stakeholders, and serves to more effectively coordinate intergovernmental policies “horizontally” at the central government level. For instance, this is the role for Indonesia’s Regional Autonomy Advisory Board (DPOD). While such horizontal policy-level coordination is indeed one of the institutional challenges in Tanzania, a “horizontally-oriented” LGFC or Local Government Fiscal Forum might be somewhat duplicative in the institutional context of Tanzania. Tanzania’s Inter-Ministerial Technical Committee (IMTC), a regular meeting of all Permanent Secretaries, is currently proving to provide an excellent mechanism for policy coordination between different ministries once a specific policy issue has been identified. Thus, setting up a LGFC that comprises a large number of the same members of the IMTC would likely be considered unnecessary and duplicative. However, while the IMTC provides the right platform for considering local government policy initiatives and moving them to Cabinet once specific policy issues have been identified, one “shortcoming” of the IMTC (as a policy-level coordinating mechanism for intergovernmental fiscal issues, at least) is that its membership is too broad and too senior to function as a sounding board for local government finance issues.

***An autonomous LGFC.*** A third arrangement is the establishment of an independent commission, comprised neither of local government representatives nor central government stakeholders. Such independent finance commissions –which typically comprise leading academics, technocrats, policy experts and sometimes senior statesmen-, are used in some countries to obtain independent recommendations on the state and direction of the system of intergovernmental relations, without either level of government dominating the discussions. As noted earlier, with the limited technical capacity on local government finance issues in a country like Tanzania, such an arrangement would be superfluous and might even distract from the ongoing policy reforms.

***Reliance on parliament for coordination on intergovernmental issues.*** Some countries rely on parliament to play a leading role in monitoring, coordinating and defining the system of intergovernmental relations. This is particularly true in parliamentary political systems in which parliament plays a strong role. For instance, one can consider the role that the Fiscal Analysis Office played in Ukraine’s intergovernmental fiscal relations. Although it is important to increasingly involve Tanzania’s parliament in discussions surrounding local government finance issues, the relative strength of the executive branch in Tanzania’s public sector currently makes this an impractical solution for the purpose at hand.

***Reliance on local government associations for coordination on intergovernmental issues.*** A fourth institutional arrangement used sometimes to coordinate intergovernmental relations is a formal reliance on local government associations (such as ALAT) for monitoring and regulating the system of local government finances or other non-governmental organizations. Although most types of intergovernmental institutional arrangements somehow include local government associations as an institutional partner, in some countries the local government associations have a much more exclusive and formal role as the central government’s key partner in making local government finance policy. Although the study team believes that ALAT should play an increasingly important role in policy discussions surrounding the evolution of Tanzania’s system of local government finances, ALAT currently has neither the technical nor the organizational capacity to play a leading role in intergovernmental coordination at this stage,

**Recommendations.** Since the majority of resources provided to the local government level come in the form of sectoral block grants, we deem that the greatest institutional need is to assure ongoing and effective coordination between PO-RALG, the Ministry of Finance, the different sectoral ministries, and the local government level. While institutional coordination is needed between the various central government ministries, we feel that there is no need to establish a (semi-)autonomous body to manage central-local fiscal relations at this time. Yet as the scope of unconditional grants in the system of local government finances grows over time, a (horizontal) Local Government Fiscal Commission might be an appropriate mechanism at some point in the future to assure cross-sectoral oversight over the pool of resources made available to the local government level.

Given that the Inter-Ministerial Technical Committee in many ways allows policy-level coordination among Permanent Secretaries, in the current context an LGFC would be rather duplicative. Instead, PO-RALG could easily pursue the intergovernmental coordination function and the required consultations on local fiscal issues under its current legal mandate by hosting a regular (i.e., annual) Local Government Fiscal Consultative Forum. Terms of reference for such a Forum or Conference could be drafted at once.

Given the mandate of PO-RALG, the Local Government Fiscal Consultative Forum would appropriately be chaired by the Minister responsible for Local Government (PO-RALG) and co-chaired by the Minister of Finance. Other ministries could be invited on a case-by-case basis, depending on the focus of the policy discussions. The technical-level Local Government Fiscal Analysis & Coordination Unit would be well-positioned to function as the Secretariat of this Forum, and could present its annual Local Government Fiscal Review as the basis for identifying the key policy areas that require attention or that need to be taken on board in the next budget cycle. The consultative Forum could meet once or twice per year to monitor the overall functioning of the system of local government finances; to endorse any changes to the proposed (sectoral) allocation formulas; to approve the allocation of grant resources to individual LGAs based on the application of the allocation formulas; and to approve the qualifying or disqualifying of local authorities who have failed to meet access criteria for certain intergovernmental grant schemes. The main annual meeting of the Forum could take place in October of each year, at the outset of the central government's budget cycle.

It is important to note upfront that the main function of the Consultative Forum would be to provide a platform for coordination, dialogue and communication between the different central government stakeholders, and (to a somewhat lesser extent) between central and local government officials. As such, the membership of the forum would mainly include central government stakeholders (including PO-RALG, the Minister of Finance, PO-PSM, and certain sector ministries) as well as a limited number of local government representatives (ALAT). Although greater involvement of local governments and NGOs is needed (see next subsection), the forum is not envisioned to add an additional independent voice in the local government policy debate. As such, the forum

activities would follow more along the lines of a coordinating council such as the German Financial Planning Council or Indonesia's Regional Autonomy Advisory Board (DPOD), rather than as a local government finance commission with independent views on policy issues, such as Australia's Commonwealth Grants Commission or Uganda's LGFC.

#### 7.2.7 Interaction between line ministries and LGAs

It is fair to state that line ministries in Tanzania often still think of local governments as an extension of the central government apparatus, without according LGAs the role of autonomous government authorities in the public sector; many line ministry officials clearly still tend to think in terms of deconcentration and delegation, rather than devolution. This attitude is clearly reflected in the lack of an organized approach with which line ministries coordinate their relations with LGAs. Currently, it is generally the case that different directorates within the various line ministries issue circulars, guidelines and directives to sectoral section heads at the local government level, without much or any systematic coordination within the sector ministry. This lack of coordination at the sectoral level could potentially result in the issuance of contradictory instructions and guidelines to the local government level, as well as unrealistic expectations about local government performance in the delivery of sectoral services.<sup>15</sup>

In order for line ministries to resolve this lack of institutional coordination, each ministry that has policy responsibility for devolved public services should actively consider how to streamline and structure its communication and interaction with local government officials. One possible suggestion is for these sector ministries to introduce a Director of Local Government Coordination, which would coordinate the sector ministry's relationship with LGAs. Not only would such a department be able to coordinate sector policies at the local government level, but this structure would also give local government officials a single contact point within each sector. Such organizational reform would be in line with the recent reorganization of PO-RALG, which introduced a Directorate for Sectoral Coordination. A less far-reaching proposal -which would possibly be more acceptable to the sector ministries- would be to clearly assign responsibility for sectoral coordination with local governments to a dedicated official within the DPP of each sector ministry.

#### 7.2.8 The role of ALAT, NGOs and civil society in advocating a sound system of local government finance

A paradox about decentralization reforms –including the reform in Tanzania- is that it requires a strong central government to introduce a more decentralized government structure. Indeed, Tanzania's decentralization reforms have been very centrally driven by

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<sup>15</sup> For instance, the Director for Primary Education may set objectives and norms for the desired level and quality of public education provision. Likewise, other departments provide further instructions that mandate certain expenditures of the local level. However, LGAs may not be able to respond to the various instructions given the limited sectoral funding provided to them through the sectoral block grant.

PO-RALG through the LGRP. Although this has proven to be an effective management structure which resulted in substantial progress over the past few years, the centralized nature of the reforms has limited the inputs of local governments and local government officials (including ALAT), non-governmental organizations and civil society on the reform of local government finance. Although until recently the predominant institutional concern, correctly, has been to enhance the capacity within the central government to develop and manage a sound system of local government finances,<sup>16</sup> an evenhanded decentralization strategy should not lose sight of the fact that a decentralized approach can only succeed through the involvement of local governments, as well as civil society and the private sectors.

While a more limited role for local governments, civil society and the private sector were desirable and perhaps even appropriate during the initial stages of decentralization reform, in order to consolidate the progress made on the local government reform agenda it is increasingly important to be more inclusive and participatory in the system of local government finance. This is true both at the central level –where local government representatives, sectoral representatives and civil society should play an increasing role in the policy-level discussions- as well as at the local level, where the local government finance system should accommodate civil society involvement through transparent and participatory budget processes.

The most obvious non-governmental representative of the interests of local authorities is the Association of Local Authorities of Tanzania (ALAT). However, ALAT is currently too dependent on the central government for its existence, lacks adequate resources, and does not have the policy-level expertise to be in a position to assertively advocate the position of local governments.<sup>17</sup> We believe that as decentralization reform proceeds, the capacity of the local government sector –among others through ALAT- should be strengthened to play a more active role and to contribute its own views and positions to the evolving policy debates surrounding local government finance issues. In addition, it is important for PO-RALG to actually *encourage* a more independent role of ALAT, as a stronger local voice that would benefit the decentralized environment. In addition, the center may wish to encourage the development of other (parallel or sister) organizations for local government officials, such as a Local Finance Officers Association, which might focus specifically on local government finance issues.

ALAT and other civil society organizations have the potential to play important roles in the system of local government finance. Currently, there is no institutional framework (either within or outside central government) that provides capacity building support to local governments on financial and non-financial issues; that provide independent information to LGAs on fiscal issues; or that engages in research and advocacy on local

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<sup>16</sup> This capacity development (focused mostly on the Ministry of Finance and PO-RALG) is taking place in the context of the recommended establishment of the Local Government Fiscal Analysis & Coordination Group. There is no doubt that these institutional capacity strengthening activities need to move forward without delay.

<sup>17</sup> For instance, ALAT sits within a complex of government offices. Furthermore, ALAT predominant activity –the annual meeting- is dominated by officials from PO-RALG. As such, ALAT continues to serve more as a top-down dissemination mechanism rather than give a voice to the local government level.

government finance issues. This is not an appropriate role for the public sector to play: if LGAs are only able to access information about their (fiscal) rights and responsibilities from the central government or regional representatives at the center –without independent verification–, then the centralized monopoly on power could be perpetuated even in a decentralized system.

As such, information sharing, analysis, advocacy and capacity building could potentially be an important niche for non-governmental organizations and private sector, especially given the expected demand in the near future for capacity building by local governments under the Capital Development Grant system (which incorporates a Capacity Building Grant for non-qualifying districts). Since ALAT lacks the internal institutional capacity to deliver such services in-house, it might benefit from forming partnerships with other like-minded organizations such as universities, research centers (such as REPOA), or the Institute for Public Administration. In fact, substantial benefit could be gained from the establishment of an Institute for Local Government –closely aligned with ALAT and other existing organizations– as a knowledge center on local government (finance) issues in Tanzania.<sup>18</sup> Although the establishment of such an institute would require a significant commitment by the reform program and its development partners, the potential of such an institute to inform the policy debate on local government reform issues on a sustainable basis is tremendous.

A final proposal with regard to development of the institutional framework for intergovernmental fiscal relations in Tanzania is the need to develop the capacity of local government actors to be involved in local fiscal decisions. An important part of this activity involves publicly providing information about the participatory local government budget process at the local level as well as on the rights and responsibilities of various local stakeholders. In addition, stakeholders, both at the central as well as the local levels, should be broadly sensitized as to how they can participate in identifying local priorities and monitoring their local governments. In addition to country-wide seminars for local government officials and councilors themselves, such sensitization activities could include academics, journalists, parliamentarians, policy experts and analysts, local chambers of commerce, and NGOs. NGOs that are likely to have a particular interest in being involved in the local government fiscal process include advocacy groups with a sectoral focus –such as Haki Elimu– or NGOs that focus on improving public sector accountability and reducing (local) corruption.

***Recommendation.*** The study team notes that previously, donor support for institutional strengthening was concentrated where it was needed most: within the central government’s agencies in charge of managing local government affairs. Yet in order for decentralization to be “locally owned” and for local government reforms to be sustainable in the long run, the time is right to broaden the institutional framework by assuring a more independent role for ALAT and for other like-minded civil society organization in the debate surrounding local government fiscal issues. ALAT already has made some

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<sup>18</sup> Such an institute would no doubt also work closely with LGRP on the many areas of common interest. However, the envisioned institute would be autonomous from the center and would set its policy agenda based on the interests of the local authorities (through ALAT), which would be its primary clientele.

small steps in this direction with support from international development partners. However, in order for local governments to achieve a true voice in the policy debate surrounding fiscal decentralization, a much more concerted effort will be needed. The establishment of an Institute for Local Government (for instance, following Ghana's model) that is closely aligned with ALAT (and could work together with LGRP), could be a key mechanism for local information sharing, analysis, advocacy and local capacity building.

### **7.3 Concluding remarks**

This section has sought to broaden the discussion from the more narrowly defined local government finance issues such as the design of grants and local taxes to questions of administration and implementation. It has sought to highlight some of the critical issues inherent in actually implementing a sound system of local government finance. Furthermore, this section has sought to elicit a recognition that establishing sound local finances is predicated upon establishing effective local government authorities in general, and that questions, for example, around how senior management is appointed, or how local leadership functions have a profound impact upon the effectiveness of financial management.

This section has addressed institutional challenges at the central level in some detail, including specific recommendations for institutional strengthening and reform. Our recommendation –which were presented at the stakeholder workshop in May 2005– include:

- The Coordinating Block Grant Implementation Team should become a permanent inter-ministerial Fiscal Analysis & Coordinating Group (led by MOF and PO-RALG)
- MOF should refocus itself to pay appropriate attention on local government finance with support from LG Finance Expert/Advisor
- PO-RALG/LGRP needs to build solid capacity in staffing the LGA Finance Section
- A Local Government Consultative Forum is needed rather than a 'Local Fiscal Commission'
- Sectoral line ministries should analyze their organizational structure in order to assure that coordination and communication with LGAs occurs in a streamlined manner.
- In order for decentralization to become sustainable, top-down reform mentality should shift to broader support. As such, PO-RALG should promote an increasing voice to local governments and NGOs in shaping the framework for LG finance policies and practices.

Likewise, general suggestions have been put forth to improve the processes that guide the formulation and execution of local government budgets, in order to assure that the system of local government finance becomes increasingly participatory, transparent, and accountable. To this end, we propose that PO-RALG/LGRP undertake a comprehensive review of the various aspects of the local planning and budgeting process (participatory

planning process, account structures and budget classifications, comprehensiveness of the budget, horizontal and vertical reporting requirements, audit processes, and so on) in order to identify areas for improvement of the local budget process. Progress on this front should be considered an inherent part of sound local government finance system; after all, without participatory and accountable local governance, the potential efficiency and equity benefits from fiscal decentralization will surely fail to materialize.