

What Determines the Quality of Local Financial Management? The Case of Tanzania

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Abstract

For the public sector to deliver public services and achieve its policy objectives, it is critical that public finances are managed well. Critics of decentralization point out that local governments are often administratively weak, and that poor local financial management can negate the potential benefits from decentralization. While the available research suggests that local financial management outcomes are influenced by more than a local government's financial management practices, little is known in the literature about the determinants of effective local financial management in developing and transition economies. The empirical analysis in this paper uses data for local government authorities in Tanzania in order to explore the relationship between local financial management performance on one hand, and local management practices, local governance, and other local characteristics on the other hand. While the exact local management practices that matter for the quality of local financial management in Tanzania vary depending on how financial management performance is measured, it appears that councils with better financial management practices (e.g., stronger internal audits), better planning and budget processes, and better project implementation practices achieve better local financial management outcomes. In addition, the empirical analysis reveals that local political conditions and other local circumstances such as the poverty level and the urbanization rate also play an important role in determining local financial management performance in Tanzania.



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In order for the public sector to efficiently deliver public services and achieve its policy objectives, it is critical that public finances are managed well. While the efficient and effective use of public resources is a universal concern at all levels of government, the appropriate use of decentralized public resources at the local government level is a special point of contention. This is particularly true in lesser developed countries (LDCs), where local financial management seems to be at a relative disadvantage compared to central public financial management systems.

Whereas proponents of decentralization reform in LDCs argue that decentralization makes the public sector more accountable by bringing the public sector “closer to the people,” critics of decentralization point out that local governments are often administratively weak, that they typically lack sufficient financial management capacity, and that local political accountability mechanisms are generally inadequate to assure that local political leaders respond to the needs and wishes of their communities (e.g., Olowu 2003). Poorly designed intergovernmental fiscal systems and weak local financial management practices would make local government finances prone either to being illicitly diverted by (central or local) government officials before reaching the local community or to being “captured” and redirected away from their intended use by local political elites (Crook 2003). Indeed, the available evidence indicates that the inadequate management of intergovernmental transfers and local government finances results in substantial leakages of local public resources that are intended to fund pro-poor public services such as primary education or basic health services (Reinikka and Svenson 2004). In turn, poor local government performance could reduce popular confidence in the public sector and undermine the support for decentralization reforms (Hiskey and Seligson 2003).

The specific linkages between local government performance on one hand—both in terms of sound local financial management practices as well as in terms of adequate local service delivery—and local government administration and governance on the other hand, have not been the subject of extensive research. While (as is discussed in greater detail below) some empirical research has explored the relationship between local government performance outcomes and the administration and governance characteristics of local governments in developed economies, this question takes on greater urgency in the context of developing economies where overall resource scarcity makes the detrimental impact of local government waste and inefficiency



disproportionately greater. In response, this study seeks to answer a basic question: what factors are important in assuring that local government finances are managed properly in LDCs, so that they can be used for their intended purpose?

In order to explore the relationship between the quality of local government financial management and local government characteristics in a developing country setting, the empirical analysis in this paper uses data for local governments in Tanzania. Although Tanzania is among the poorest developing economies in Sub-Saharan Africa, local governments deliver key pro-poor government services (including primary education and basic health services) as the country has been pursuing decentralization since the early 1980s (Boex and Martinez-Vazquez 2006). Furthermore, good governance reforms—both at the central government level as well as for local governments—have been an important theme in the country’s development strategy since the mid-1990s (United Republic of Tanzania 1999). Recent local government reform initiatives have resulted in the availability of data on local government finances, local administration characteristics, and local government performance that are necessary in exploring the question at hand.

In limiting our attention to Tanzania as a single developing country case, we recognize that the impact of local government management practices, local governance mechanisms, and other factors on local financial management performance are likely to be quite context-specific. In fact, the local administrative practices or local governance mechanisms that contribute to improvements in local financial management performance in Tanzania are likely to be quite different from those that might improve local government performance in other developing countries in Africa, Asia, or Latin America respectively. Nonetheless, given the dearth of research on this question in developing countries, the case of Tanzania provides important insights into the determinants of local financial management performance in a developing country context.

Determinants of Local Government Performance

Before proceeding with the empirical analysis of local government financial management performance in Tanzania, it is useful to briefly explore the measurement of (local) financial management performance in the literature and to assess the available empirical research on the relationship between local government performance and local government characteristics.

Measuring public finance management performance and local government performance

Performance can be defined as a measure of how well an organization meets its objectives given the external constraints placed on it. In the realm of public finance management, budget performance has traditionally been construed in a relatively narrow manner as the ability of the public sector to execute its budget in accordance with the original, approved budget plan. More recently, however, a standardized set of performance indicators was developed to more comprehensively measure the quality of public expenditure management over time and across countries (PEFA Secretariat 2005). This menu of public expenditure and financial accountability

(PEFA) performance indicators seeks to assess not only the aggregate credibility of the budget process (in terms of the actual expenditure outturns compared to the budget plan), but also considers the comprehensiveness and transparency of the budget; the effectiveness of each stage of the budget cycle (including predictability and control during budget execution); as well as the sound management of donor finances. While these PEFA indicators are starting to be used widely at the central government level in many LDCs, their application is yet to be extended to subnational public finance management.

Measuring the broader performance of local governments is equally complex, given that local governments are assigned a variety of diverging responsibilities, including the provision of adequate local government services, engaging in responsive and accountable governance, and assuring sound financial management of the locality's resources. Although the measurement of local government performance and the formulation of sets of different performance indicators is an area of intense interest in the public administration literature, there is little consensus on whether—or if so, how—various dimensions of local government performance should be combined into a single measure. Whereas the comprehensive performance assessment (CPA) of local governments in the U.K. results in an overall performance score for each local authority (Audit Commission 2006), performance assessments of local governments in most other countries rely on sets of different performance indicators for the various different objectives pursued by local governments (Andrews and Shah 2003; Commonwealth of Australia 1997; Maxwell 2002).

Although different approaches are used to measure local government performance in different countries, the management or use of financial resources is commonly incorporated as one of the important dimensions within a local government's overall performance assessment. Indeed, given that the quality of local financial management impacts the local government's ability to execute its responsibilities in all other areas, the current paper focuses exclusively on analyzing the ability of local governments to ensure sound financial management.¹ As such, the empirical analysis in this paper considers the quality or performance of local financial management in Tanzania (the dependent variable in the empirical analysis) by exploring the impact of local administration, local governance, and other local characteristics on local financial management quality.

Empirical research on local government (financial) performance

While we would expect both sound local government administration practices as well as participatory and accountable local governance mechanisms to have a positive impact on local financial management performance, relatively little empirical research has been done to explore the determinants of local government financial management performance. Based on our review of the existing literature, there are a handful of empirical studies that specifically examine the relationship between a government's financial condition or "performance" (as the dependent variable) and the subnational government's financial management practices (as one of the

¹ An alternative and highly relevant line of inquiry would be to analyze how local administration, governance, financial management and other local characteristics impact the quality of local government service delivery. However, such an analysis falls beyond the scope of the current study.

independent variables). Even within this small set of studies, it is relevant to note that no single indicator has emerged as the preferred measure of subnational fiscal performance or financial management performance. Furthermore, virtually all of the available evidence regarding the relationship between local government performance and local government practices is based on developed economy experiences.

For instance, Coggburn and Schneider (2001) analyze the relationship between the quality of management and the budget performance of state-level governments in the United States. In their study, Coggburn and Schneider quantify a state government's financial performance (the dependent variable in their analysis) as a share of public spending that is spent on state-level programmatic priorities. They find that the quality of state management has a direct effect on state policy commitments; more precisely, better-managed states tend to spend more on their programmatic priority areas. Coggburn and Schneider's empirical analysis further reveals that public interest group activity, government ideology, and citizen ideology also have significant effects on the government's performance in funding priorities.

Similarly, Dennis (2004) examines the relationship between a local government's financial management practices and the local government's financial performance for a large sample of municipalities in the United States. In her study, a local government's financial condition (i.e., its performance) is measured as the simple average of four fiscal indicators (including cash solvency, budget solvency, long run fiscal solvency, and service delivery solvency) using a database of over 1,600 U.S. cities compiled by the Government Finance Officers Association. Local financial management practices are measured based on a survey of the chief financial officers for almost 500 of the sample municipalities, incorporating assessments of the local budgeting system, strategic planning system, fall-back system, accounting/reporting system, internal control system, and the local financial leadership system. While Dennis finds statistically significant (albeit moderate) correlations between local financial conditions and local financial management practices among the U.S. municipalities in her sample, regression analysis fails to indicate any statistically significant relationship between a local government's financial performance and financial management practices after controlling for governance and socioeconomic factors. The only two factors that appear to have a statistically significant impact on local financial conditions are the size of the local population (with a negative impact on local fiscal performance), and whether the municipality is subject to a state-imposed limit on annual changes in taxable property values (which displays a positive impact on local fiscal conditions).

Although Coggburn and Schneider (2001) and Dennis (2004) are the two studies that most directly seek to identify the determinants of a local government's financial performance, several other empirical studies seek to relate local spending patterns to local management and/or local political factors. For instance, Balaguer-Coll, Prior and Tortosa-Ausina (2004) explain the efficiency of local spending for municipalities in Spain as a function of local conditions. In a similar vein, Moreno (2005) and Singer (2005) analyze the impacts of local politics and electoral fragmentation on municipal budget choices in Mexico and Bolivia, respectively.

A few empirical studies consider local government performance more broadly, rather than just considering local financial (management) performance. In particular, Andrews et al. (2005) conduct an analysis of the determinants of overall local government performance in the U.K. based on a Comprehensive Performance Assessment (CPA) of all major local authorities in England conducted by the U.K. Audit Commission in 2002.² While the assessment was intended to strictly reflect how local authorities are managed rather than the external conditions that they face, Andrews et al. (2005) find that CPA scores were significantly influenced by the characteristics of the local population, such as social diversity and economic prosperity. Thus poor local government performance in the U.K. appears to be attributable, in part at least, to the more difficult circumstances faced by some local governments rather than exclusively by bad local administrative practices.³

Beyond the scarcity of empirical research on the topic, it is worth noting that the explanatory power of the existing empirical models is rather low, even when the necessary data appear to be available. For instance, Dennis (2004) is able to explain approximately 15 percent of the variation in local financial conditions in the sample of U.S. municipalities, whereas Andrews et al. (2005) are able to explain only about one-third of the variation in local government performance in the U.K. This only underscores the need for further empirical study of the relationship between local financial performance and its anticipated determinants.

Local Governments and Local Financial Management Performance in Tanzania

Since the current study analyzes the relationship between the quality of local government financial management and its potential determinants in Tanzania, a short description of Tanzania's local government structure and Tanzania's local government finance framework is presented to provide the relevant institutional framework.

Local government structure and local government finances in Tanzania

Tanzania Mainland is divided into 122 contiguous local government authorities, with an average population of approximately 300,000 residents.⁴ Local councils are directly elected and are responsible for the delivery of key public services within their jurisdiction. The local council is the authoritative decision-making body at the local level. Although the local Executive Director

² As part of the Comprehensive Performance Assessment (CPA), each local government was ranked in one of five categories from "excellent" to "poor" based on a number of fiscal as well as non-fiscal performance dimensions (Audit Commission 2006).

³ This conclusion by Andrews et al. (2005) is weakened by the fact that the study fails to include any measures of local administrative capacity or local governance practices. If the presence of "more difficult circumstances" (such as greater social or ethnic diversity or local economic hardship) is correlated with the quality of local government administration, then their finding could potentially be the result of omitted variable bias (Greene 1993).

⁴ The United Republic of Tanzania is a federation of Tanzania Mainland (formerly known as Tanganyika) and Zanzibar. Since local governance is not considered a Union matter, Tanzania Mainland and Zanzibar each have their own internal local government structure. For a more detailed description of the local government finance system in Tanzania, see Boex and Martinez-Vazquez (2006) and URT (2004–2006). The number of local authorities reported here is for 2004, which is the latest year for which complete and consistent data are available from the various data sources used in the empirical analysis.

in each council is appointed by the Prime Minister's Office-Regional Administration and Local Government (PMO-RALG), the Director is a local council employee and reports to the council in overseeing and implementing the delivery of local government services.

The functions, duties, and responsibilities of local government councils in Tanzania are defined in the Local (Urban and District) Government Acts of 1982. While the legal framework distinguishes between urban (city, municipal, or town) councils and rural (district) councils, all local government authorities are responsible for providing the same set of government services, including primary education, basic health services, agriculture extension and livestock development, local road maintenance, and local water supply. An average local council employs approximately 1,800 staff (including teachers, health care workers, administrative personnel and so on) and has a budget of 9.2 billion Tanzanian shillings (approximately U.S. \$ 7.5 million).

Consistent with the functions assigned to the local government level in the legislative framework, public expenditures in Tanzania are significantly decentralized with almost 20 percent of public spending taking place at the local government level. While local governments are authorized to collect a number of local revenue sources (including property rates), local own-source revenues only constitute a small and declining share of local government finances (around 5-10 percent). The main source of funding for local government authorities in Tanzania is the intergovernmental fiscal transfer system. Most recurrent local spending (including salaries and non-wage "other charges") is funded by a set of (formula-based) sectoral block grants and a General Purpose Grant which are transferred directly from the Treasury into the local governments' accounts on a monthly basis. In addition, local governments also receive a number of earmarked recurrent subventions from line ministries. On the development side of the budget, funding for local capital development is provided through the Local Government Capital Development Grant (LGCDG) system, as well as through a number of sectoral development funds.

Measuring local financial management performance in Tanzania

A necessary first step in assessing the quality of local financial management in local authorities in Tanzania (and the subsequent analysis of the variations in local financial management performance) is to agree upon a measure of local financial management performance which can tell us how well local governments are managing their financial affairs. As already noted, limited empirical research has been done in this area, resulting in the absence of a consensus approach for measuring local financial management performance in the literature. Whereas the expenditure outturn ratio (or budget performance ratio) has traditionally been the main measure of financial management performance at the central government level, this measure is a lot less suitable as a measure of financial management performance at the local government level, as the main determinants of local budget performance (notably the completeness and timeliness of intergovernmental fiscal transfers) are beyond local control. Accordingly, the current analysis proposes two different measures as proxies of local financial management performance; these measures are later used as the dependent variables in the multivariate empirical analysis to analyze the determinants of local financial management performance.

The first variable proposed for the current empirical analysis as a measure of local financial management performance in Tanzania is the annual audit opinion that is issued by the National Audit Office for each local government. The annual audit report of local government finances is finalized by NAO within 9 months of the end of each financial year and submitted to the Parliamentary Accounts Committee. Based on a financial audit of local government accounts, the Controller-Auditor General (CAG) categorizes each local government into one of three categories: clean (61 councils), qualified (50 councils), and adverse (4 councils) (NOA 2006).⁵ Given the limited number of adverse opinions issued, Table 1 reflects the audit opinion as a dummy variable, where a clean opinion is indicated as unity and a qualified or adverse opinion is captured as zero. To the extent that the audit opinion of a local government's accounts accurately reflects the quality of local financial management, the CAG's opinion provides a relatively objective measure of local financial management performance.⁶ Of course, a disadvantage of using the audit opinion as a measure of financial management quality is the categorical nature of the measure.

A second measure of local financial management quality proposed for the current analysis is the percentage of expenditures questioned by the CAG during the audit process (HakiElimu 2006). Table 1 indicates that, on average, 9.25 percent of local expenditures were questioned during the financial audit of local government accounts for FY 2004/05.⁷ Although the percent of questioned expenditures provides a continuous measure of local financial management (as opposed to the categorical nature of the audit opinion), it is open to debate whether the percentage of questioned expenditures is in fact a superior measure of financial management quality since this measure fails to take into account the degree of severity with which an expenditure item is being questioned. For instance, the revelation that TSh. 1 million were illegally diverted by a local official without corrective action by the local treasurer would lead us to a different conclusion about the quality of local financial management than if the same amount were properly spent by local officials but merely improperly receipted. The application of different audit techniques to different types of councils (for instance, in urban versus rural councils) could also result in different levels of questioned expenditures. Since there is no clear indication which measure of local financial management performance is superior, the empirical model is estimated using both proposed measures.

⁵ The analysis considers the audit opinions for local authorities for FY 2004/05. Seven recently established councils did not receive an audit opinion for FY 2004/05.

⁶ It is recognized that the financial audits conducted by the NAO only provide feedback on one dimension of the quality of local financial management. These audit results do not evaluate the value-for-money attained by local financial management or the outcome-based performance of local government spending. Furthermore, there could be (regional) variations in the accuracy and veracity of the audits conducted by the NAO.

⁷ The percent of questioned expenditures for Njombe District was excluded from the data set due to concerns regarding the accuracy of this data point.

Table 1. Descriptive Statistics

	Mean	Std. Dev.	Minimum	Maximum
Local Financial Management				
CAG Opinion: Clean	0.54	0.50	0.00	1.00
CAG Questioned Expenditures	9.25	13.80	0.00	62.29
Local Government Management				
A: Financial Management	7.74	2.00	2.00	10.00
B: Fiscal Capacity	9.11	4.33	0.00	15.00
C: Planning and Budgeting	16.90	2.97	8.00	20.00
D: Transparency and Accountability	7.57	2.51	0.00	10.00
E: Interaction with LLG	6.35	3.01	0.00	10.00
F: Human Resource Development	7.08	1.93	2.00	10.00
G: Procurement	7.53	2.09	3.00	10.00
H: Project Implementation	7.79	2.47	0.00	10.00
I: Council Functional Processes	4.43	1.24	0.00	5.00
Total Assessment Score	74.50	12.40	38.00	97.00
Local Conditions				
Population (thousands) – 2005	314.30	187.94	44.19	118.97
Poverty rate	34.08	11.89	11.07	67.68
Urbanization rate	24.00	28.39	0.37	100.00
Per Capita Own Revenues, 04/05	1,117.33	1,225.01	54.74	8,367.17
Per Capita Intergov. Transfers, 04/05	12,003.37	3,698.38	6,160.48	25,909.56
Local Political Conditions				
Number of Local Councilors	21.87	8.94	0.00	48.00
Percent of Council, non-CCM	8.28	14.31	0.00	69.23
Registered Voters (as % of pop.)	43.06	7.71	19.12	63.48

Measuring the quality of local management in Tanzania

The logical next step in analyzing why some local governments in Tanzania have better financial management outcomes than others is to quantify the quality with which Tanzanian local governments are administered and managed. Data constraints make quantifying the quality of subnational administration and subnational governance a difficult challenge in any country. However, an important tool in answering this question in Tanzania is an annual performance assessment mechanism for local governments that was introduced in 2004. This mandatory annual assessment was introduced as a requirement to qualify for the new Local Government Capital Development Grant (PO-RALG 2004).

As part of the annual performance assessment of local government authorities for financial year 2004/05, external assessment teams scored all local governments on 37 different practices, covering nine dimensions of local government administration and governance, including financial management practices, fiscal capacity, planning and budget processes, human resource practices, and so on. Local government authorities received total scores (across the nine components) ranging from 38 to 97 points (on a 100 point scale), with an average assessment score of 74.5 points. Descriptive statistics for the total assessment score as well as the assessment scores accorded for each of the nine performance components (referred to as components A

through I) are provided in Table 1. The constituent questions for each of the components (on which each local government was scored) are presented in the Appendix.⁸

Local government conditions

While one might hypothesize that better local administrative and management practices lead to improved local financial management outcomes, we should consider the fact that local financial management performance may also be influenced by factors beyond the immediate control of local government officials. Indeed, a key finding by Andrews et al. (2005) is that socioeconomic characteristics of the local community have a significant impact on local government performance in the U.K. Likewise, Dennis (2004) as well as Cogburn and Schneider (2001) also conclude that exogenous factors have a statistically significant impact on local financial performance at the municipal and state levels in the United States, respectively.

Accordingly, the empirical analysis incorporates a number of local government environmental characteristics, as reflected in Table 1. For instance, in addition to the size of the local jurisdiction's population, the local poverty rate and the percent of the local population that lives in urban areas within each jurisdiction may be relevant to ensuring local participation and accountability, and therefore may have an impact on local financial management outcomes. Likewise, it may be the case that local governments which rely more extensively on own-source revenues (measured in Shillings per capita) may be more accountable to their constituents and—all else held equal—achieve better financial management performance. Similarly, the size per capita amounts of intergovernmental fiscal transfers received might cause stronger local financial management performance.⁹

Finally, a number of local political variables are taken into account in the analysis, based on the assumption that greater democratic representation and participation will lead to improved local governance and better oversight over local financial management. In order to control for such local political factors, the empirical analysis takes into account the number of local councilors elected in each local government jurisdiction in 2000; the share of each local council that was held by opposition parties in 2004; and the number of voters that registered for the 2005 elections as a percent of the local population.¹⁰

⁸ As can be seen in the Appendix, one of the constituent items of Component A (Financial Management) is the audit opinion issued by the CAG. In order to avoid collinearity problems, this item was excluded from the score for Component A in the remaining analysis. The remaining items dealing with local financial management consider the quality of the internal audit, and local follow-up to external audit queries.

⁹ In contrast, the causality might run in the opposite direction: In the absence of sound financial management practices, local residents might get overtaxed by local officials. Likewise, stronger local financial management outcomes might prompt central government officials to allocate greater financial resources to these councils.

¹⁰ The number of registered voters for the 2000 elections was unavailable.

Empirical Analysis: What Determines Local Government Financial Management Performance in Tanzania?

Based on the available data for FY 2004/05, one could hypothesize that local financial management performance in Tanzania is a positive function of local administrative and managerial practices. Two different empirical models are estimated to test this hypothesis, using the two different measures of local financial management performance identified above. The first model estimates the probability of attaining a clean opinion from the CAG using a binomial logistic regression; the second model seeks to explain the variations across local governments in the percentage of questioned expenditures using an OLS regression model. In addition to measures of local management practices, both empirical models control for local political conditions and other local environmental factors.

The results for the two empirical models are presented in Table 2, which shows that substantively different results are obtained depending on the measure of local financial management performance that is used. Indeed, there is only one independent variable that attains statistical significance in both models. Nonetheless, both models have reasonable explanatory power, and the findings of both models are consistent with the results of the few existing empirical studies available in the current literature. The fact that the binomial logit model (explaining the probability of a clean audit) results in substantively different findings than the multinomial OLS regression (explaining variations in questioned expenditures) suggests that the factors that determine the likelihood of receiving a clean audit opinion are in fact different from the factors that determine the share of questioned expenditures. As such, these measures are complementary measures of local financial management performance, rather than substitutes.

The first column of results in Table 2 identifies the factors that determine the probability of attaining a clean audit report by local government authorities (the binomial logit model). These results suggest that only three factors increase the likelihood of a positive audit opinion with statistical significance. First and second, councils with stronger planning and budgeting processes and better project implementation performance (as determined by the annual external performance assessment scores for these components) tend to have a higher likelihood of receiving a clean audit report. Furthermore, local councils with a more urbanized population tend to have a higher probability of receiving a clean audit report. One could speculate why this latter finding could be the case. For instance, this result could be explained by the fact that urban areas are better able to attract qualified personnel in a manner that is not captured in the component score for human resource capacity. Alternatively, it could be that urban residents are in a better position to monitor local financial decisions and therefore are able to hold local officials more accountable. None of the other variables included in the binomial logit model is found to influence the audit opinion with statistical significance.

Table 2. Empirical Results

	Model 1: Binomial Logit Clean Audit Opinion	Model 2: OLS Percent Questioned
Population (thousands)	0.002 (0.015)	-0.017 (0.011)
Poverty rate	0.024 (1.673)	0.358 *** (0.122)
Urbanization rate	0.015 ** (6.518)	-0.043 (0.07)
Per capita own revenues	0.000 (0.110)	0.000 (0.002)
Per capita transfers	0.000 (1.210)	-0.001 * (0.00)
Number of Councilors	0.042 (0.051)	0.166 (0.215)
Share of Opposition	0.020 (0.018)	-0.143 (0.087)
Registered Voters	0.043 (0.004)	0.449 * (0.226)
A: Financial Management	0.191 (0.626)	-2.22 ** (0.957)
B: Fiscal Capacity	0.062 (2.657)	-0.440 (0.303)
C: Planning and Budgeting	0.098 * (2.907)	-0.302 (0.508)
D: Transparency and Accountability	0.122 (0.017)	-0.330 (0.648)
E: Interaction with LLG	0.096 (0.006)	0.103 (0.487)
F: Human Resource Development	0.150 (0.002)	0.489 (0.723)
G: Procurement	0.142 (0.787)	0.234 (0.726)
H: Project Implementation	0.138 *** (8.483)	-1.049 * (0.624)
I: Council Functional Processes	0.224 (0.00)	-0.830 (1.136)
Constant	3.434 ** (5.236)	17.704 (15.64)
R-Squared (Cox-Snell)	0.321	0.312

Note: Standard errors in parentheses. Statistical significance at the 1, 5, and 10 percent levels are indicated with *, **, and *** respectively.

The second column in Table 2 presents the OLS regression model explaining variations in the percent of expenditures questioned by the NAO. The results indicate that two dimensions of local management impact the level of questioned expenditures: all else equal, councils with better financial management practices (Component A) and project implementation scores (Component H) have fewer expenditures questioned.

Local environmental factors impact the level of questioned expenditures as well. For instance, councils with a higher poverty rate tend to have a greater share of their expenditures questioned by the NAO. This coincides with the findings of Andrews et al. (2005) in the U.K. where councils under more difficult circumstances were found to receive lower comprehensive performance scores. Of course, without further analysis, it is unclear whether this result is caused by inherently weaker expenditure management in economically worse-off councils, or whether performance is lowered indirectly as a result of weaker local accountability in councils with a higher poverty rate.

Interestingly, local political conditions are also found to have a statistically significant impact on local financial management performance, as councils with more registered voters (as a share of the local population) are found to have greater share of expenditures questioned by the CAG. Whereas one might expect that greater political activism of local residents results in improved local financial performance (e.g., Cogburn and Schneider 2001), it might be the case that greater citizen involvement can have the opposite impact; greater political activism at the grassroots level may put political pressure on local authorities to engage in irresponsible spending. However, the causality of this relationship is not fully clear. Rather than voter pressure resulting in poor financial management performance, it might in fact be the case that poor local financial management in 2004/05 *caused* greater voter registration for the 2006 elections.

The empirical results suggest that local councils that receive greater intergovernmental transfers from the central government (on a per capita basis) generally have a smaller share of their expenditures questioned by the CAG. Again, the causality of this effect is unclear. One explanation would be that local governments manage transfer resources more prudently than locally collected revenues as a result of central government monitoring efforts. At the same time, to the extent that the transfer system is discretionary, it is possible that the causality runs in the opposite direction: the central government may simply provide greater transfer resources to councils that are perceived to be better at managing their financial resources.

Finally, while the empirical results suggest that a more diverse political composition of a local council in Tanzania may have a beneficial influence on local financial management performance (as local councils that have a greater share of opposition members tend to have fewer questioned expenditures), this relationship just falls short of achieving statistical significance at the 10 percent level ($p=0.101$). This fact notwithstanding, the empirical result raises the importance of effective decentralized political systems as a precondition for sound decentralized financing of public services. This point is further corroborated by anecdotal evidence which suggests that district administrators feel greater scrutiny from a more politically diverse council, when compared to a council that is solidly controlled by the ruling party.

As noted above, out of the nine dimensions of local management practices included in the regression model, we find that only two have a statistically significant impact on the percent of questioned expenditures: Councils with better financial management practices and councils with better project implementation scores have fewer of their expenditures questioned by the CAG. As such, it should be noted that the other seven components included in the local performance

assessment are not found to have a statistically significant impact on the quality of local government financial management. A number of explanations are possible. For instance, this result may be due to limitations of the dependent variables which focus very narrowly on audit outcomes as a measure of local financial management performance. Alternatively, the absence of an impact of other local management dimensions may be caused by limitations of the performance assessment categories that are used to quantify local management practices.

One statistical concern to be addressed in this regard is whether the aggregation of the performance scores for the individual assessment items into nine performance components obfuscates the impact of the individual items. In order to test for this concern, the relationship between the percentage of questioned expenditures and its determinants was re-estimated including the full, unrestricted set of assessment items rather than the nine components. The empirical results of this unrestricted model (presented in the Appendix) suggest that the aggregation of assessment items into categories indeed significantly reduces the explanatory power of the independent variables; the unrestricted model has more than twice the explanatory power when compared to the restricted model ($R^2 = 0.689$). As was the case in the OLS regression model presented in Table 2, however, poverty, registered voters, and the size of intergovernmental fiscal transfers all continue to be significant determinants of local financial management performance in the unrestricted model.

Despite the much higher explanatory power of the unrestricted model, we should note that most of the individual performance assessment items do not contribute in a statistically significant manner to explaining the variations in local financial management performance. In fact, a number of the assessment items have the “wrong” sign; for instance, substantive involvement of lower-level governments in participatory planning (i.e., participation at the village level and community involvement through other participatory mechanisms below the district level) is shown to have an unexpected positive impact on the percent of questioned expenditures. The explanation of this finding may be similar in nature with the earlier result in Model 2 that greater local political participation (in terms of the number of registered voters) is associated with weaker local financial management outcomes. Likewise, it appears that addressing gender and environmental issues and the “proper” functioning of the local tender board worsen rather than improve local financial management performance. This pattern raises the question whether the annual local performance assessment instrument includes the right assessment items, and whether it is appropriate to simply combine the assessment items into nine components. The unrestricted model demonstrates that—if the sole purpose of the instrument is to identify local financial management performance at the local level—much greater explanatory power could be achieved by relying on just a handful of well-selected assessment items.

Concluding Remarks

This study has sought to answer a policy question that is relevant to many decentralizing countries around the world: does the quality of local administration and local governance help determine the quality of local financial management? In other words, can improved local

government administration and management practices improve the likelihood that local government finances are spent well and used for their intended purpose? Whereas the determinants of local government financial management performance will most likely vary from country to country, the case of Tanzania reveals some important lessons about the nature of the relationship between local management practices and financial management outcomes.

While the exact local management characteristics that matter for sound local financial management outcomes in Tanzania vary depending on how the dependent variable is measured, it generally appears that councils with better financial management practices (Component A), better planning and budget processes (Component C), and higher project implementation scores (Component H) generally achieve better local financial management performance. This suggests that specific improvements to local government practices can indeed lead to improved local financial management performance, and therefore, that local administrative practices are a relevant factor in assuring the more effective use of decentralized public finances. In addition, our empirical analysis also reveals that local political conditions and other local circumstances (including poverty and urbanization) also play an important role in determining local financial management performance in Tanzania.

The results from this analysis may inform specific policy actions in Tanzania. For instance, to the extent that the central government is concerned with local financial management performance, it could use the local Capital Development Grant (CDG) system more effectively to incentivize local financial management performance, since each council's grant allocation from the CDG system depends on its performance assessment. Thus, better financial management performance could be secured by increasing the relative weight of the relevant components (i.e., Components A, C, and H) in the annual performance assessment of local authorities. Furthermore, the analysis suggests that caution should be used in the design and interpretation of the performance assessment instrument itself. Our analysis shows that the grouping of individual questions into performance components may be unwarranted; for instance, in some cases local management practices which were expected to be performance-enhancing in fact appear to have a negative effect on the quality of local financial management.

In addition to the application of the empirical results of this study to the Tanzanian case, our results have broader implications for our understanding of public financial management performance and how to strengthen it. As a starting point, this study confirms the practical policy importance of having regular performance assessments of local governments, particularly in countries that are undergoing fiscal decentralization reforms. At the same time, however, the analysis demonstrates the importance of getting the performance assessment instrument "right." While we would expect political, economic, and social institutions to influence the relationship between local administrative practices and local government performance, these relationships are likely to be different in different countries. Therefore, it would not be appropriate to construe performance components as the weighted average of several assessment items without using quantitative analysis in each country case to confirm the validity of the individual items included in the instrument, or the relative importance of each item as part of the broader component.

The analysis also indicates that—even within a single country—empirical models of local financial management performance can be quite sensitive to the specification of the dependent variable, as well as to the availability and level of detail of the independent variables. Since the empirical results uncovered are most likely quite context- and country-specific, an interesting extension of the current analysis would be to apply the current empirical methodology to different countries to determine whether different factors have different impacts on local financial management performance in the context of other (developing, transition, or developed) countries.

Finally, although local financial management performance by itself is an important objective for local government authorities, fiscal decentralization reforms in many developing economies are often motivated by a desire to improve local government service delivery, especially to the poor. As such, we should consider that local management practices are not only an input into local financial management performance, but that local management practices and local financial management performance—in combination with the availability of financial resources at the local level—are key determinants of the quality of local government service delivery. Thus, a final line of inquiry spurred by the current study could consider how the quality of local government service delivery is influenced by local government characteristics, including local management practices; local financial management performance; and the social, economic, and political conditions of the local government.

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Appendix

OLS Regression Results. Dependent Variable: Percent Expenditures Questioned

	Coefficient	Std. Error
Population, 2005 (in thousands)	-0.016	0.010
Poverty Rate	0.225 *	0.129
Urbanization Rate	-0.053	0.068
Per capita own revenues	-0.001	0.001
Per capita transfers	-0.001 **	0.000
Number of Councilors	0.172	0.201
Share of Opposition	0.002	0.093
Registered Voters	0.535 **	0.210
A1: Audit Opinion	-	-
A2: Evidence that External Audit reports have been acted upon.	-8.251 **	3.558
A3: Evidence that Internal Audit reports have been acted upon.	-1.456	0.981
B1: Liabilities as a proportion of Own Revenue	-0.301	0.647
B2: Percent of Own Local Revenue collected against Planned	-0.5	0.746
B3: Percent Increase in Own Local Revenue Collection	0.369	0.535
C1: Clear guidance conforms to planning guidelines	1.473	1.706
C2: Adherence to participatory planning procedures	-1.289	3.688
C3: The MTEF Dev. Plan contains a detailed situation analysis	-5.269 **	2.255
C4: Min. 80% of Development Budget applied to Clusters 1 & 2	-2.616	1.608
C5: Operational costs of investments captured in the Plans	0.659	1.771
C6: Clear linkage between MTEF Dev. Plan and Annual Budget	-9.809 ***	2.799
C7: Involvement of LLGs in participatory planning	8.593 **	3.351
C8: Plan follows the MTEF guidelines / recommended format	-8.203	6.437
C9: Gender and environmental issues are integrated	5.097 ***	1.568
C10: Planning procedures and checklist are used in planning	-1.576	1.454
D1: Indicative Planning Figures (IPFs) for LLGs are posted	-1.571	1.445
D2: Approved CDG projects are publicly posted	1.788	1.469
D3: Project info is communicated to LLGs	-0.259	2.058
D4: Summaries of budget, plan and accounts posted on notice boards	0.27	1.698
D5: Quarterly financial reports are submitted in timely manner	-1.625	1.542
E1: Adherence to revenue sharing between district and LLGs	0.532	0.658
E2: Timely communication of IPFs to Wards	-0.519	0.681
F1: Key local government posts are substantively filled	-0.013	0.837
F2: A fully funded training plan is in place	-0.301	2.561
F3: A staff audit was initiated	1.478	1.756
F4: A staff appraisal was conducted	0.675	1.569
G1: Procurement thresholds for goods and services observed	1.231	2.999
G2: Procurement plans prepared based on budget	-3.613	2.861
G3: Tech. Eval. Committee was properly appointed	-28.722 ***	8.349
G4: Tender Board functions properly	47.715 ***	15.608
G5: Tender awards are posted on public notice boards	-5.479 *	2.777
G6: Adequate records on procurement are maintained	0.927	0.922
H1: Project implementation proceeds as planned	-0.932	0.833
H2: Quarterly M & E reports available and discussed	-0.621	0.725
I1: Finance and planning committee meets as scheduled	-2.314 *	1.195
I2: Committee effective in addressing progress reports	1.018	2.906
(Constant)	30.008	24.642
R Squared	0.689	