



## **Exploring Afghanistan’s Subnational Fiscal Architecture: Considering the Fiscal Linkages between Villages, Districts, Provinces and the Center**

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Although the Afghan Constitution provides a framework for a unitary and highly centralized public sector, the Constitution also recognizes the importance of subnational governance. Among other provisions, the Constitution mandates that “[t]he government...shall delegate certain authorities to [provincial] administration units for the purpose of expediting and promoting economic, social, and cultural affairs, and increasing the participation of people in the development of the nation” (chapter 8, art. 2).

The country’s policy framework for subnational governance and intergovernmental relations is contained in the Sub-National Governance Policy (SNGP) which was adopted by Cabinet in March 2010. Within the context of the relevant constitutional provisions and the sub-national governance policy framework, numerous efforts are underway to strengthen different aspects of sub-national governance and service delivery. Most recently, as part of the Tokyo Mutual Accountability Framework (July 8, 2012), the government has made specific commitments in the area of subnational governance, including a commitment (1) to enact a legal framework to clarify roles, and responsibilities of government agencies at national, provincial and district levels, in line with the 2010 Sub-National Governance Policy; and (2) to develop a provincial budgeting process that includes provincial input into the relevant ministries’ formulation of budget requests, linked to a provincial planning process in which Provincial Councils have their consultative roles.

Despite considerable efforts over the past few years by the government and its development partners, only limited progress has been made on improving the effectiveness as well as the inclusiveness of subnational governance and service delivery. As international military forces are set to draw down in 2014 and as the international development community is increasingly handing the responsibility for public service delivery over to the Afghan public sector, it is clear that the current pace and scope of subnational governance reforms is inadequate and that concrete steps towards minimally effective subnational governance, financing and service delivery arrangements are urgently required.

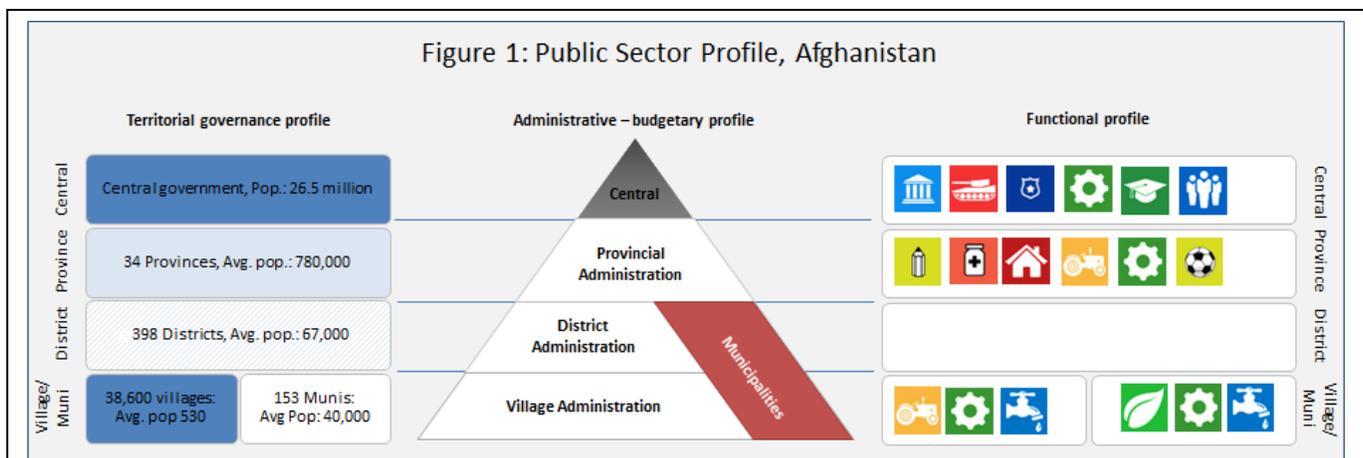
Although the overall vision for a more effective and responsive public sector set forth in the SNGP is laudable, in practical terms, the SNGP and the ensuing implementation efforts have fallen short from the envisioned transformation of the subnational public sector. The most fundamental obstacle to progress on subnational governance reforms is the absence of consensus—among government officials, policy makers, and development partners alike—on the organizational and budgetary status of subnational entities at the provincial, district and village levels.

In the absence of any institutional or budgetary authority at the subnational level (as is currently the case, as illustrated in figure 1 below), it is essentially impossible for provincial departments, districts or villages to be meaningfully empowered. As a result, little or no improvement in the responsiveness or effectiveness of public service delivery at the subnational level will be possible unless broad-based agreement is reached on significant strengthening of the country’s subnational institutional and fiscal architecture.

### Subnational fiscal architecture: options and lessons from international practice

Conceptually, three institutional and budgetary options are available for subnational governance entities in Afghanistan below the central government level. The first option for provincial departments (and in principle, for public sector entities below the provincial level) is to continue the status quo by continuing to function as *deconcentrated, non-budgetary organizational entities*. This means that provincial line departments have neither a legal (governance) status separate from their respective line ministries, nor are they recognized in the Chart of Accounts as a formal budget entity within their respective ministries (i.e. they are not a sub-organization in the organizational classification scheme). Under this scenario, provincial line departments are fully under the institutional and budgetary control of their respective line ministry, making it impossible for provincial line officials to be empowered in any meaningful way.

A second option for provincial departments is to be accorded the status of *deconcentrated budgetary entities* within their respective line ministries. This means that while provincial line departments would continue to function as an



Note: In the territorial-governance profile, dark blue indicates a territorial level or entities with elected political leadership, while light blue indicates an administrative level with an elected advisory council. In the administrative-budgetary profile (pyramid), red segments indicate local bodies that have the features of devolved local government entities; grey segments indicate administrative tiers that are recognized as budgetary units; while white segments indicate local bodies that do not have neither their own institutional/legal or budgetary status.

integral (hierarchical) organizational part of their respective line ministries (i.e. without their own legal status), they would be recognized in the Chart of Accounts and in the national budget as formal secondary budget units (i.e. sub-organizations) within their respective line ministries. This option would allow provincial line officials to be delegated a degree of discretion over the financial resources needed for them to implement the responsibilities that would be assigned to them in accordance with the Constitution.

A third option would be for provincial line departments to be given a legal and/or budgetary status that is typically reserved for *devolved provincial governments*. In the most restricted version of this option (limited budgetary devolution), provincial officials would be given the authority to make certain financial transactions in bank accounts that are held outside the national treasury system. In the most extreme case of devolution, this approach would imply that provinces would become separate legal entities that would be allowed to prepare, adopt and manage their own budget plans. This option is not consistent with Afghanistan's current constitutional and legal framework, and is therefore the least likely to be politically and practically viable in the near future (and not further pursued here).

Although the policy environment in Afghanistan is unique in some ways, there are scores of countries around the world that have pursued subnational governance reform under difficult circumstances. As such, getting Afghanistan's subnational institutional and fiscal architecture right, and deciding how to sequence its implementation, can be meaningfully informed by this body of international practices. Five specific lessons regarding subnational governance and intergovernmental fiscal architecture that can be drawn for Afghanistan based on international experiences in similarly situated countries include:

1. In the process of state building, subnational administration and governance systems matter for effectiveness, accountability and legitimacy reasons.
2. Many post-conflict countries rely on a deconcentrated state administration system with budgetary deconcentration.
3. Deconcentrated systems evolve from the top down; creating an effective district level is the work of decades, not years.
4. Deconcentrated countries tend to have a responsive village level at the bottom of the formal public sector.
5. Intergovernmental fiscal reforms are inherently political and typically incremental, as reforms require a careful alignment of champions in order to succeed.

### **Implications and recommendations for the provincial level**

The delegation of functional responsibilities to the provincial level—as mandated in the Afghan Constitution—cannot be realized unless provincial departments and their lead officials are provided with the organizational and fiscal space to administer their delegated responsibilities with some degree of separation from their respective line ministries. Within the context of a deconcentrated public sector structure, international experience suggests that provincial line departments need to be given, first, recognition in the budget structure as budgetary (sub-)entities and, second, some degree of control over the budgetary resources provided to them. Without this as a building block, subnational government reform at the provincial level would be meaningless.

Creating the space for provincial budget authority (within a vertically deconcentrated budget structure) is technically easy to do: provincial line departments could be established as secondary budget units (sub-organizations of their respective line ministries) by the Minister of Finance by amending the organizational codes within the Chart of Accounts. Legally, the budgetary space for provincial line departments

can be created by amending a few sentences within the Public Finance and Expenditure Management Law. The most important legislative change would be the modification of section 32 of the law in order to state that in addition to appropriations for each central unit [headquarters] of administrations in the fiscal year, the annual budget (the revenue and expenditure plan) also ought to make separate appropriations for each local unit [provincial department] of administrations in the fiscal year, as appropriate.

It should be noted that pursuing vertical budget deconcentration (by which provincial line departments are given a degree of budget authority but fully remain within the hierarchical structures of their respective line ministries) is in line with Afghanistan's constitutional and legal framework and would continue to allow the central government to set overall budget priorities between (as well as within) sectors and programmatic priorities, while at the same time allowing provincial line officials greater flexibility and control over their service delivery responsibilities.

### **Implications and recommendations for the district level**

Experiences from other countries (e.g. Cambodia, Mozambique) suggest that forming a deconcentrated district level is a difficult and expensive proposition which takes many years to accomplish. Beyond the implementation challenges and expenses that would be involved with staffing almost 400 district offices, none of the subnational fiscal “plumbing” is in place for districts to become deconcentrated budget entities. Furthermore, districts are even further removed from the center of decision-making in Kabul than the provincial level. Furthermore, an excessive focus on the district level would risk fragmenting scarce public sector management resources too thinly across too many jurisdictions. As a result, building and strengthening a full-fledged deconcentrated district level should be a relatively low priority

on the subnational governance agenda in Afghanistan at this time.

### **Implications and recommendations for municipal governments**

Municipalities in Afghanistan have a constitutionally-mandated role in Afghanistan's subnational governance structure in urban areas. Until now, however, financial support to municipalities has been limited to in-kind transfers of infrastructure and other support under the USAID-funded RAMP-UP projects. This projectized approach is increasingly unsustainable, especially in light of the shifting security situation post-2014. It would be much more efficient, transparent and appropriate to funnel support to municipalities through an on-budget municipal grant scheme.

The introduction of formula-based, performance-based municipal grants would be an important step towards increasingly responsive governance and increasingly effective municipal service delivery. If well-designed, even relative small annual municipal grant scheme—\$20 million per year, for instance—could have a substantial impact on urban governance and services. While the World Bank and other development partners have extensive world-wide experience with the introduction of formula-based (and even performance-based) municipal grants to strengthen urban infrastructure and urban service delivery, the MOF has been hesitant to support the introduction of municipal grants despite the inclusion of such a municipal grant scheme in the SNGP.

### **Implications and recommendations for the village (or community) level**

A final element of the subnational institutional and fiscal architecture that remains to be decided is the institutional and fiscal nature of the village or community level. Although the constitution conceives of villages as a consultative level of the state administration, in reality, the state administration is not able to effectively reach the grassroots through hierarchical, deconcentrated

structures below the provincial level. Nonetheless, international experience suggests that there are substantial potential gains in legitimacy, social capital and effectiveness (in terms of the public benefit to the community) that can be achieved by steering some public funding as close as possible to the grassroots. In the short run and medium term—in the absence of a functioning district administration—this means creating an institutional and financial modality that can reach the grassroots level.

A leading option at the village or community level would be to replace Afghanistan’s National Solidarity Programme (NSP) with a mainstreamed Village Development Block Grant. The preferred option would be to transform groups of current CDCs across the country into formalized Village Councils, where Village Councils are elected under the supervision of the Independent Electoral Commission. In order to become the recipients of Village Grants, however, such Village Councils would have to become corporate bodies legally capable of opening their own bank accounts and managing their own finances.

If the establishment of (essentially) devolved village councils is not a politically or legally viable option, a secondary option would be to fund these community-level activities by continuing to treat CDCs (or preferably, groups of CDCs consolidated into larger jurisdictions) as quasi-government entities—which are formally outside the public sector and legally equivalent to NGOs—but which would otherwise operate as local public sector entities and which would be provided Community Development Block Grants through the national budget.

### **Implications for the way forward**

The current implementation of subnational governance reforms has almost exclusively pursued these reforms from a technical angle. This has prevented the government (along with its development partners) from achieving a clear

consensus on the institutional and budgetary nature of the subnational public sector. Nothing is gained, however, from failing to address these institutional and political economy obstacles.

What is needed instead is a broadly political dialogue about decentralization—what powers and resources are better retained at the center and what functions and resources are better delegated to the provinces. In reality, these key decisions have not yet been made, and such decisions are not minor technical details that can be relegated to project staff or to drafters of a resulting law. Instead, they are policy decisions that require a national dialogue about both the speed and direction the country wishes to move in terms of decentralization. This is a dialogue that involves not only a select group of officials from ILDG or the Ministry of Finance, but rather, these are policy questions that require broad-based consensus among all these key stakeholders from across government and the development community.