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Social Funds and Decentralization: Optimal Institutional Design¹

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20 March 2006

Summary

Most of the 60+ developing countries that have established social funds (SFs) are decentralizing their governments as well. But the question of how to tailor SFs – originally a highly centralized model – for a decentralizing context has received relatively little attention in the literature. We first examine evidence on the ability of SFs to adapt to a decentralized context. We then lay out the implications of decentralization for SF institutional design step-by-step through the project cycle. The topic is doubly important because social funds can increase their effectiveness, and the sustainability of their investments, by reorganizing internal processes to take advantage of the political and civic institutions that decentralization creates. Local government has an informational advantage in local needs and characteristics (time and place), whereas SFs have access to better technology and knowledge of sectoral best practice. The key is to create institutional incentives that best combine these relative advantages.

Keywords: Social Funds, Decentralization, Institutional Strengthening, Poverty

Alleviation, Institutional Design, Local Government

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1. Introduction

Both social funds and decentralization are major phenomena across the developing world. More than 60 countries across Africa, Asia and Latin America have introduced social funds over the past two decades (van Domelen 2002), while estimates of the number of countries decentralizing range as high as “nearly all countries worldwide” (Manor 1999, vii). Each reform has inspired its own literature. The decentralization literature is enormous, comprising hundreds of studies going back at least to the 1950s (Faguet 2002). The social fund (SF) literature is smaller but has been growing fast lately, as SFs continue to sprout around the world and more and more resources are committed to them.

It is evident from such estimates that most social funds operate in countries at various stages of decentralization. But the question of how the social fund model – originally a very centralized one – can best work alongside decentralized government institutions has not appeared frequently in the literature. This paper takes that question as its central focus. The subject is doubly important as, in our opinion, the two reforms have a strong potential to complement each other. We first examine empirical evidence on whether social funds support or undermine the institutions of government, with particular emphasis on local government. We then explore how SF processes can be adapted to work effectively with local governments, step-by-step through the project cycle.

It is important to note that several fundamental questions about both phenomena: Is decentralization preferable to centralization?⁴ Are SFs beneficial organizational forms? lie beyond the scope of a paper that assumes the existence of both initiatives, and asks: How can a social fund best be adapted to a decentralized institutional environment? This paper accordingly locates itself squarely in the social fund literature, while making use of a

⁴ Faguet (2004) addresses this question directly.

number of theoretical and empirical insights from the decentralization literature. But before we enter into the argument, we must define key concepts clearly.

1.1 What is a Social Fund?

Definitions of what a social fund is abound; the proceedings of the Second International Conference on Social Funds (World Bank 2000d,1) provides one of the simplest and most direct formulations: “Social funds directly finance small community-managed projects, helping to empower the poor and vulnerable by allowing them to become actively involved in their own development.” They are typically organized as autonomous public entities outside existing line ministries or public work agencies and report directly to the president or a privileged minister (of planning, of the presidency) with a coordinating role. Their financial support to communities mostly consists of grants.

Another key characteristic is that social funds typically enjoy a great deal of autonomy with regard to established civil service regulations. Most importantly, SFs usually pay higher wages than the regular public sector, and as a result attract more qualified staff than most line agencies. In addition, most SFs apply private sector oriented management and control systems, and are exempt from slow public procurement procedures. This strong degree of autonomy has enabled many social funds to bypass institutional weaknesses and bottlenecks common in conventional public sector administrations and line ministries. Yet it has also raised concerns as to whether SFs can be effectively integrated into existing public sector policies. We return to this debate below.

1.2 What is Decentralization?

Definitions abound here as well, with authors often providing extended typologies that usually include deconcentration, delegation, devolution, privatisation and others. As Faguet (2004) and Ostrom (1993) have argued, such distinctions may reflect the richness of policy experimentation occurring throughout the world, but they do analysis a disservice by

conflating fundamentally different reforms under a common title. The incentives and institutional forms created by deconcentration and devolution, to pick just two, are not the same, and should not be treated as such. In the interests of analytical clarity, this paper adopts a stricter, narrower definition. Decentralization hereafter refers to the devolution by central (i.e. national) government of specific functions, with all of the administrative, political and economic attributes that these entail, to local (i.e. municipal) governments which are independent of the centre within a legally delimited geographic and functional domain.

From the point of view of public service reform, the key rationale for decentralization is a gain in information and accountability. Local governments will generally be better informed about local service needs and demands, and will be more accountable to their local constituencies as citizens can exercise a more direct control over their local representatives (for example through the electoral process, or direct interactions with local government officials). On the other hand, central government, with its larger resource base and the ability to attract highly-trained staff, will tend to have superior technical capacities to design, implement and supervise projects, and will often be able to reap economies of scale by combining many smaller investments into large contracts.

It has also been argued that decentralization may deepen existing inequalities. This may happen when local governments with lower revenue potential and weaker administrative capacities deliver fewer public services than authorities in economically better off jurisdictions. In addition, it may be the result of power struggles and problems of 'elite capture' at the local level, whereby powerful local interest groups try to redirect local spending away from services that would disproportionately benefit poorer households in

the community (e.g. primary education and health).⁵ As we will see below, addressing such inequalities has become one of the key concerns of SFs operating in a decentralized framework.

2. Do Social Funds Strengthen or Weaken Public Institutions? The Evidence

Concerns that social funds crowd out existing government administrations, and that their strong degree of institutional autonomy may lead to coordination problems with existing public sector policies, are clearly reflected in the evaluation literature on SFs. In an influential review of donors' own evaluations, Tendler (2000) warns that SF autonomy, as well as the diversion of resources away from line ministries that they occasion, serve to *weaken*, and not strengthen, the institutions of the state. Dijkstra (2004) maintains that social funds distort sectoral coherence in water and sanitation, health, and education, and privilege donor priorities over sectoral priorities. The same point is made by a World Bank study of 66 social funds (Carvalho and White 2004), which argues that SF policies are rarely integrated with sound sectoral strategies in the areas in which they operate.

This lack of sectoral integration risks generating negative effects on the ground, as social funds often find it difficult to ensure that investments are maintained and operated by responsible line agencies once project works are completed. For instance, Carvalho *et al.* (2000) point out that while SF facilities usually had better staff and equipment than comparator facilities, their operation and maintenance suffered deficiencies during the operational life of the investments.

⁵ It is generally assumed that central governments will be more immune to such pressures than local governments, because they have more resources at their disposal and are accountable to a larger electorate (Bardhan 2001).

On the other hand, evidence suggests that SF, due to their efficiency-oriented management procedures, were able to operate much more dynamically than conventional ministries and public works agencies. Recent evaluations of SF projects show that this has resulted in a number of positive outcomes on the ground. Van Domelen (2002) cites a six-country study, including over 21,000 treatment households, and many more controls. Her evidence shows that social fund projects⁶ are better targeted to the poor than other government programs, and respond to important local needs. SF investment improved not only the quality of infrastructure in education, health, and water and sanitation, but also access to and utilization of services. And these investments have proved sustainable, with most SF facilities still operating several years after completion. Newman *et al.* (2002) provide similar quantitative evidence for the case of Bolivia: SF health projects raised utilization rates of public services, and were associated with substantial decreases in under-five mortality rates; SF water investments increased the quantity of water available to the poor, and decreased under-five mortality by a similar amount again. In Peru, Paxson and Schady (2002) and Schady (2000) show that, despite political interferences, SF investments in education and other sectors flowed disproportionately to the poor, reaching a larger fraction of them than other, similar programs. Finally, Marcus (2002) draws on evidence from Mali, Tajikistan and Mongolia to argue that social funds provide effective social services, help the poor to build up assets, and enable them to benefit from economic growth.

Social fund autonomy is thus a two-edged sword, capable of improving access of the poor to the most basic services of the state, but capable also of weakening the line ministries that provide those services, and disrupting policy coherence in their sectors.

⁶ Donors usually refer to SF “subprojects”, as their own financing of SF operations are the primary “projects”. For simplicity I ignore this and refer to SF-financed schemes as “projects” (*e.g.* a school, a sewerage system).

What effects do social funds have on local government capacity, and on the state's ability to decentralize more broadly?

2.3 Social Funds and Decentralization

Broadly speaking, there is a risk that social fund operations tend to centralize rather than decentralize the management of local investments. In most countries, including many that have since begun decentralizing, social funds were established as highly centralized institutional mechanisms. This shaped their design and operating procedures, such that many early SFs effectively bypassed local authorities and communities, often carrying out all aspects of social investment themselves: promotion and needs assessment, project design, financing, supervision of execution, and often initial operation and maintenance of the services in question.

On the other hand, social funds have a number of design principles that place them in a better position to adapt to decentralized environments than traditional centralized public sector projects. By their very nature, social funds are designed to respond to local demand and implement local investments with the active participation of local communities (i.e. many social funds required local counterpart payments or local labour to implement projects). Such intensive interactions with communities have enabled many SFs to amass crucial expertise about local investment demands and the specific challenges involved in realizing projects in a highly localized environment (Jorgenson and Van Domelen 1999). As a consequence, it should be expected that SFs are natural candidates to work in a framework where investment priorities are identified locally rather than centrally.

In practice, it is generally accepted that most SFs did pose an obstacle to decentralization in the early years of operation, as they tended to bypass local governments in the identification and implementation of projects (cf. Carvalho *et al.* 2002). The early literature on social funds and decentralization clearly reflect this. The Jamaican Social

Investment Fund, for example, coordinated poorly with local government, leading to low sustainability of its investments. In an innovative analysis of its ability to promote participation and community-driven development, Rao and Ibáñez (2003) show that JSIF projects were driven by local elites, and suffered weak community participation, low responsiveness to *ex-ante* community needs, and improvements in trust and organizational capacity flowing disproportionately to the richest and best educated. Reacting to similar tensions in Mexico, Honduras and Nicaragua, Benería and Mendoza (1995) call for these Central American social funds to embrace community participation and back a deep process of democratic decentralization. Schroeder (2000) also stresses the importance of complementarity between social funds and decentralization. But his evidence on the extent to which this is possible is necessarily scant, as the case he studies – Malawi – had only begun to decentralize.

Several years down the road, however, it is fair to conclude that that most social funds have successfully adapted to decentralization contexts. To begin with, many SFs – such as Honduras, Albania, Armenia (Schmidt 2002) – are explicitly designed to support decentralization reforms. In these cases the roots of the coordination between SF operation and decentralization policy are no longer coincidental coexistence but the result of conscious institutional design.

In other cases where policy choices were less explicit, SFs tended to gradually adjust to new decentralized contexts. Experience shows that this adjustment process works in two directions. First, in countries where decentralization policy was at an early stage, SFs often played a strong proactive role in advancing decentralization agendas via innovations in their own project cycles. For instance, Serrano and Parker (2000: 46) report that in Bolivia the social fund provided significant groundwork for the passing of the national decentralization law, because it had demonstrated that demand-driven investment

planning was possible. Likewise, when decentralization started to gather momentum in Nicaragua, El Salvador, and again Honduras SFs played a decisive role in promoting local government investment by developing and disseminating planning tools (Warren and Serrano 2003, and Serrano 2005). Similar evidence can be cited from African countries, such as Zambia and Madagascar, where SFs were among the first to train local governments and to pilot decentralized project implementation procedures on a large scale (cf. World Bank 2000e, 2001). According to Van Donge (2004), the Zambian SF operates almost entirely through local government, with local officials administering and supervising SF activities at the district level, and SF employees playing a backstopping role.⁷ For many rural communities this represented the first real occasion to gain good hand-on experiences in the planning and management of local public services.

Second, once decentralization is well advanced, it has often created pressures to adjust the design of social funds to the new policy environment. Here, new demands from the central and the local level have tended to go hand in hand. At the national level, decentralization reforms have often provided a beneficial context for central governments to enhance the integration of social funds into existing public sector strategies. For example, most governments in Latin America – where decentralization reform already has a long tradition – have recently begun to redefine the global mandate of social funds, effectively turning them into mechanisms for conditional investment transfers that complement general transfers to local governments (Serrano 2005). In some cases, these reforms even led to the closure or merging of SFs with other development agencies. For example, in Mexico the social fund-type project Pronasol was closed and transformed into a matching grant system for local governments (Serrano 2005). Similar evidence can be reported from Sub-Saharan Africa where some SFs type projects are now integrated into

⁷ We are grateful to an anonymous reviewer for this point.

more coordinated local development programs (e.g. Mali, Ethiopia, cf. World Bank 2005, 2006)

At the local level, pressures to redesign SFs are often the result of changed institutional environments and more complex decision making procedures under decentralization. As implementation procedures are decentralized administrative tasks and contracts that could previously be dealt with internally or in a highly centralized fashion are multiplied and localized. As we will see below this forced many SFs to develop more flexible management procedures and delegate more responsibilities to local stakeholders. In addition, decentralization imposes new demands on the transparency of SF operations as local leaders may seek to exploit SF resources for political gain or as SFs may find themselves drawn into conflict between political parties that compete at the national and local level.

More concretely, once planning and decision making authorities are devolved to the local level, SFs no longer need to act as catalysts for local preference revelation and consensus-building. For example in most Latin American countries (cf. Warren and Serrano 2003), municipalities identify their own local investment plans, and the fund's role is reduced to approving and (co-)financing resulting project proposals. Likewise, when local governments control significant amounts of revenue, SFs typically lose their 'monopoly' position as the sole financier of local investments. Again, this changes the role of SFs to a simple provider of co-financing and, possibly, technical support while reducing its involvement during the identification of local investment priorities. These changes and the challenges they represent for SFs are summarized in figure 2.

Figure 2

Important SF Qualities in an Environment Which Is:	
Centralized	Decentralized
1 Process efficiency	1 Manage complexity
2 Competence throughout the project cycle	2 Negotiation
3 Command and control	3 Listening/Openness
	4 Coordination and delegation

Before turning to the redesign of SFs for decentralization in more detail, it is important to note a general lesson that emerges from the experiences cited above: SFs must work within the bounds and norms of the local government process, and where possible try to enhance it. SF practices which are not consistent with a country's legal and institutional framework for local government will tend to undermine the latter, and may at the limit expose local officials to charges of illegality in the natural course of project business. This is of particular importance since often in the past SF design was a sort of unconstrained maximization, seeking the greatest levels of efficiency while admitting few concessions to existing government procedure. Such temptations must be resisted in a decentralized environment, as working successfully with existing local government and civic institutions is important to a social fund's success, defined both in narrow project terms and broadly as overall social impact. Hence at an early stage SF design should take into account the country's laws, norms, accounting standards, and other institutional framework for local (and regional) government, and design SF processes around these. The remainder of this paper discusses specific examples of how this can be done through the various stages of the SF project cycle.

3. Social Fund Design – The Project Cycle

3.1 Fiscal Allocation Systems

By the sheer amount of resources they command, SFs can and often do provide an important complement to existing fiscal transfer systems. Theoretically, it is possible to envisage two extreme cases. First, SFs can function as a conditional transfer that assigns fixed investment budgets to eligible municipalities under a predefined transfer formula. If these allocation criteria are clear and transparent, and investments are managed directly by local governments (see below), such an approach can provide an important boost to decentralization as it enhances the planning and decision-making autonomy of local authorities. Drawbacks include the large amount of resources required, a possible widening of the gap between decentralized investment decisions and national policy priorities, and the fact that SF allocations may distort local taxation efforts if they are not attached to adequate co-financing arrangements.

Under a second scenario, SFs can be used to direct decentralized spending towards national policy priorities or to redistribute public resources between better-off and poorer regions in the country. By definition this approach will be less conducive to decentralization. Centrally defined priorities and targeting criteria will play a much stronger role in identifying eligible local governments, the choice of investment options will be more restricted and social fund staff will play a stronger role in approving and – possibly – implementing project proposals. On the other hand, targeted approaches of the type described here can be an important complement to ongoing decentralization reforms, particularly if they are used to address regional inequalities or tensions between national and local investment priorities that may arise under a decentralized framework.

In practice most countries under investigation here combine elements of both approaches during the redesign of their social funds. In countries where decentralization is

already well advanced and local governments are given significant command over their own budgetary resources, SFs are often transformed into conditional matching grant mechanisms, designed to favour certain types of investments or regions in the country. The Bolivian SF, for example, assigns indicative allocations to local governments under a poverty and population based formula. These allocations are then disbursed as matching grants with higher shares of central financing if projects correspond to national priorities (Serrano 2005; similar systems now exist in El Salvador and Mexico). In other countries where decentralization is less advanced and local governments have fewer resources at their disposition (for example Madagascar), SFs tend to finance nearly all project costs (with the exception of small counterpart payments traditionally required by most SFs). In a setting like this, the SF effectively can be described as a separate investment transfer mechanism that complements much smaller general purpose grants to local governments. Such funds also often apply poverty based allocation formula and/or specific outreach mechanisms to increase the share of investments going to poorest regions.

3.2 Revelation of Local Demand and Project Identification

Project identification is one of the most important stages of the project cycle. It is the first exposure that rural communities have to SF staff and procedures, and sets the tone for the interactions – cooperative, paternalistic or conflictive – that follow. This first stage of the project cycle consists of two distinct components: (a) determining communities' needs and preferences for public investment, and (b) identifying a project the SF can finance which responds to these needs.

A common critique of SF project identification (but also of other projects that use participatory planning procedures; see Mosse 2000) is that participatory planning procedures used in the process are superficial, and that investment priorities tend to reflect SF objectives rather than genuine local preferences. There are a number of reasons why this

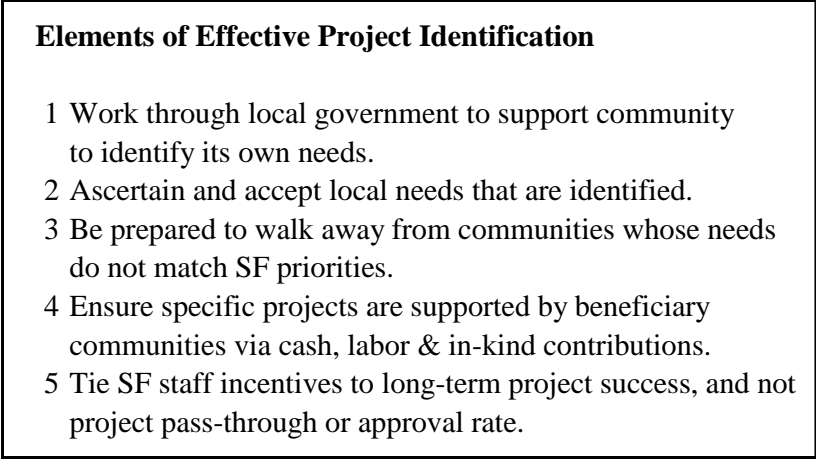
can happen: SF staff may face perverse incentives to speed up the identification process, given the sheer amount of resources and projects they manage; they may use their local prestige and expertise to influence the local decision making process; or local preferences may simply be distorted by fixed project menus that were common in most early SFs. The consequences of such distortions on project quality and sustainability can be grave. Poor communities with limited income and time may be forced to dedicate their scarce resources to projects that don't really reflect their priorities. Likewise, project sustainability may be affected as local users may be unwilling to contribute to the maintenance and operation of infrastructures that are perceived to be the outcome of an externally imposed decision.

There have, however, been positive developments in the area of project planning – and again decentralization reforms and SFs have often gone hand-in-hand in nurturing this change. In the context of decentralization, many governments now legally require local authorities to determine investment priorities through participatory local planning exercises. In countries like Bolivia, Peru, and Madagascar, these new regulations have forced SFs to change their identification procedures and reduce the exposure of SF staff in the planning process. In other countries SFs have played a more proactive role in developing and formalizing local planning tools, which in turn triggered changes in national legislation in order to systematize and harmonize these new procedures (Nicaragua, Honduras, El Salvador; see Serrano 2005).⁸ Regardless of whether municipal investment plans are initiated by the social fund or by national authorities, the consequences are often the same. Once local governments gain sufficient experience with local planning processes, they often emerge as the arbiters of local priorities and progressively push back the influence of

⁸ However, also in countries of the first group, social funds often played an important role in financing and supporting local planning processes. This is notably the case in Madagascar where the social fund financed planning exercises in more than half of rural municipalities (source personal communication with project staff).

social fund staff in the planning process. Key elements of effective project identification that emerge from these experiences are summarized in figure 3.

Figure 3



Another important development is that the context and philosophy of project identification tend to change the longer a SF has been in operation. Compared to earlier years, most SFs now gradually reduce their outreach and planning activities as communities and local governments become more accustomed to their procedures, and knowledge about the availability of SF support becomes more widespread. In addition, many social funds now experiment with relatively open and flexible project menus. A logical next step would be the introduction of simple ‘negative lists’ that provide maximum choice at the local level. Nevertheless, the degree of flexibility a SF can adopt in redefining its project selection mechanisms significantly depends on its overall development mandate and the type of allocation system adopted (see above).

In spite of these positive developments, it is important to note that a number of challenges persist during project identification. Especially in countries that require municipal planning exercises, it is important to ensure that decision-making processes are not ‘hijacked’ by local politicians (or other local elites), and that communities have adequate say during the selection of projects. Where this risk exists, SFs can influence the

quality of local development plans by requiring a minimum of community participation, or by developing and disseminating appropriate planning tools among local government officials.

In addition, identifying a project from a community's expressed needs may be less than obvious. This is because raw community priorities will generally take the form of social problems, such as low literacy or chronic disease, the solutions to which may not be obvious, or – worse yet – about which the affected community may be mistaken. For example, a community suffering from cholera may demand a health clinic when the appropriate intervention may in fact be an education campaign combined with a potable water project. Although social funds will typically have no particular advantage in needs identification *per se*, other than the resources and commitment to facilitate it, they will have the technical ability to turn information on raw needs into viable projects, which communities and even local governments may lack. Cooperation between fund and community can thus optimise the utilization of different types of information available for planning a local project, so long as the fund deals sensitively with community needs and the two agree on the form that a solution to the latter's problems will take. These lessons have been put to good use in Argentina and Bolivia (World Bank 2000a), and ignored at significant cost in Peru (Serrano 2000a).

An important lesson from the field is that a competitive mechanism for project selection can generate important benefits. In El Salvador and Indonesia local governments compete for investment, and in Indonesia – where bidding takes place among villages in the same jurisdiction– this has led local governments to propose investments that have positive externalities for neighbouring municipalities (World Bank 2003, Serrano 2005) . Experience from these projects shows that the introduction of explicit competition into project selection enhances both the quality of incoming project proposals and the

effectiveness with which resources are spent. Another benefit is that competition sends clear signals about investment priorities, selection criteria and the rules of the game more generally. On the negative side, competitive selection can make pipelines lumpy, can lead to operational bottlenecks, and may disadvantage local governments or communities that lack capacity to develop viable proposals.⁹ Hence, whether and under what conditions a competitive selection mechanism should be introduced needs to be determined on a case by case basis.

Lastly, there is a persistent risk that SF staff will continue to face trade-offs between the depth of planning procedures and the number of projects that need to be approved within an area. The best solution to this problem is to permanently review incentives within social funds, as well as to acknowledge that municipal planning – just like project implementation – should become a regular element of SF impact evaluations.¹⁰ We return to these points below.

3.3 Project Design

Once a project based on a community's needs has been identified, it must be designed. Project design transforms a project idea into specific technical plans, with a budget and timetable. This implies resolving important questions like size/scale, technology and location, to name a few, which impact greatly on who will eventually benefit from the project and the character of benefits received – that is, on ultimate project success. From a decentralization point of view the project design process must, again, strike a careful balance between the social fund's technical expertise and efficiency in project design, and the community's specific knowledge about needs and surroundings. For example, the local

⁹ However, Serrano (2005) reports that this latter problem was not observed in the case of the El Salvadorian SF.

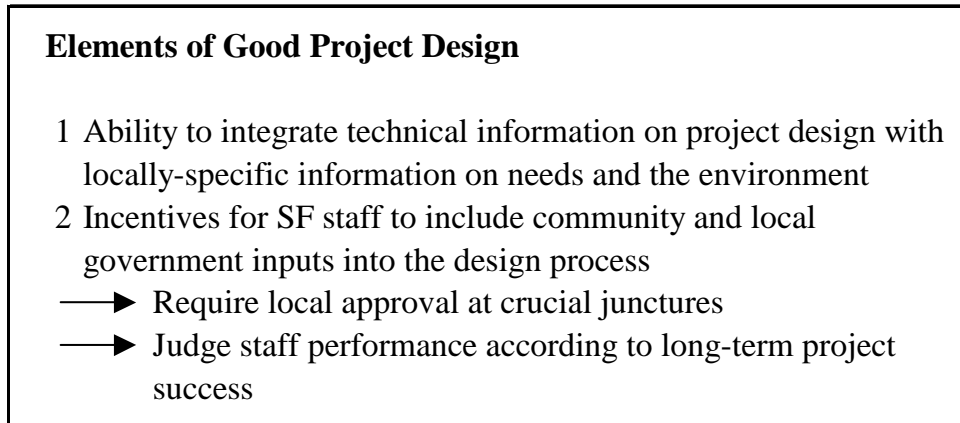
¹⁰ Positive examples include an evaluation of the Jamaican Social Fund, that looked among other things at project identification, and a recent evaluation of local development plans in Madagascar.

population will know better where best to site a school in order to exploit sunlight, avoid floods and facilitate access. But fund staff will be better informed about architectural best practice, and education ministry technical standards for construction. Both types of knowledge are important for project design, which must meld diverse information into a single set of technical and budgetary plans. Hence the design process must contain incentives for each side to contribute its share of the necessary information.

In reality, communities and local government often provide important preliminary inputs during the process of project identification described above (these inputs can include information on the siting of a investment and the specific needs it has to address). But it is often more difficult to ensure active local participation during the actual technical design of a project, particularly when technical capacities at the community level are low. Many SFs respond to this problem by sub-contracting technical designs to specialized planning bureaus or individual technical consultants. Moreover, they typically require that project design respects technical standards developed by sector ministries or the SF itself.

Project design thus represents a step in the project cycle where most SFs could enhance the participation of local government officials and communities. In countries where decentralization is well advanced, some SFs do this by putting local governments and/or communities in charge of managing and monitoring contracts with planning bureaus (e.g. Madagascar, cf. World Bank 2001). In contexts where local capacities are too weak to effectively carry out this monitoring function, social funds should require from accredited planning bureaus that they develop project designs through a closely coordinated exercise, and that approval by local authorities is sought at regular intervals in the planning process. Figure 4 lists key elements of good project design.

Figure 4



3.4 Project Approval

The approval of subprojects is traditionally one of the most important functions of social fund staff. A rigorous approval system is important because it is at this stage that the conditions for success or failure of a project are set: for instance approval process should scrutinizing important questions such as whether a project truly addresses local needs and priorities, whether it has excessive environmental costs, or whether design and maintenance plans are adequate. The drawback of a rigorous approval system is that communities and local governments may feel that they are put at the mercy of social fund staff, particularly when decision making criteria are not transparent or when the reasons for project approvals – and more importantly rejections – are not made fully public, thus preventing staff and communities involved from learning from experience.

In the practical world of many SFs, decentralization has again created dynamics that help to ease these trade-offs. For instance, the introduction of municipal development plans discussed above implies that SFs need to put less emphasis on confirming that the project addresses actual needs – this is generally done during the planning exercise. Likewise, in cases where SFs assign a global investment budget to local governments, the question is no longer whether or not a project proposal will be approved but *when* it will be approved –

local governments can simply improve and resubmit their proposal under the same allocation period.

Finally in the case where SFs operate as competitive matching grant systems, local governments can be given a direct stake in the approval process. For instance, in the aforementioned Indonesian community development projects village authorities of the same area are required to agree on one common proposal. This in turn encourages local governments to propose projects that have positive externalities for neighbouring municipalities rather than isolated smaller projects of interests only to small communities. In the case of El Salvador, the SF provides participating municipalities with simple and comparable information about their performance on different approval criteria in order to enable local decision makers to identify where they need to improve (Serrano 2005).

3.5 Project Implementation

Implementation refers to the construction and initial operation (during a handover phase) of project infrastructure, or the execution of programs (e.g. literacy campaigns, vaccinations). It is especially concerned with oversight of these processes to ensure that technical and social standards set out in the project design are met.

The most important implementation issues concern the types of project execution that are allowed, and the extent of local government and community participation that these imply. The first social funds relied on private contractors or NGOs to realize projects. An important innovation introduced more recently involves the transfer of project funds directly to the local level, allowing local decision makers to bid, contract and oversee project activities themselves. Solutions found in the field either work through community associations (Malawi), local governments (funds in Nicaragua, Honduras, El Salvador, Bolivia), or variably through both local governments or communities (Peru, Honduras, Madagascar, cf. de Silva 2000, World Bank 2001, Serrano 2005).

Although the familiar trade-off of participation vs. efficiency applies here as well, it can be largely overcome by careful calibration of contracting arrangements to project type. Small, relatively simple infrastructure projects, for example, are well suited to direct contracting, and in sparsely populated countries may be more efficiently implemented by communities than by private contractors. In Bolivia, for example, contractors could only be convinced to bid for various types of rural infrastructure projects when they were bundled together into big contracts. But this implied large transport costs and significant coordination problems for urban firms headquartered far from beneficiary communities, as well as non-trivial learning periods for employees unfamiliar with local conditions. Community implementation, by contrast, took longer but often resulted in overall efficiency gains through lowered costs. A cross-country impact assessment of social funds found that closer community involvement and greater community responsibility generally reduced project costs (World Bank 2000d). Project quality can also improve as a result of strong accountability and an intimate knowledge of local conditions.

In spite of these general advantages, the transfer of management responsibilities may enhance inequalities if less developed local governments or communities are not able to execute projects (e.g. Serrano 2005 reports this case for Bolivia). In these cases it may be more appropriate to follow a gradual approach, where different degrees of management responsibility and accompanying technical assistance are transferred as a function of local implementation capacities. For instance the social funds in Honduras and Nicaragua allow local governments to implement projects in several modalities, including one where town hall staff manage projects in almost complete autonomy, a second one where local governments implement projects in communal associations and under close and ongoing technical supervision, and a third one where projects are managed directly in delegated contract management by the SF (Serrano 2005).

A more general solution to overcome initial capacity constraints is to use regular project supervision by social fund staff as an occasion for technology transfer to communities and local governments. In such a process the former – which knows how – teaches the latter – which is interested, present on the ground and able to operate much more cheaply – how to implement and supervise project works. Benefits from such an arrangements can arise for both sides. The fund can use its regular supervision to train local decision makers to organize and run social investment projects, transferring important managerial skills in the process. At the same time, the increased involvement of locally accountable decision makers can help resolve basic issues of compliance (e.g. ensuring beneficiary contributions are paid), and it can help to make fund supervision become less intensive, and more focused on fund staff’s technical and managerial expertise (Alton 1999, World Bank 2000b, Parker and Serrano 2000).

3.6 Operation and Maintenance

Two of the most important questions facing social funds are long term project sustainability, and the extent to which the gestation of these projects strengthens or weakens existing public and civic institutions. Operation and Maintenance directly reflect the quality of processes that a fund uses to prepare projects, and hence each offers a useful lens through which to review and summarize some of the preceding arguments.

Broadly defined, **operation and maintenance** refers to the operation of a project or program once social fund involvement with it has ended. Strictly speaking this is beyond the social fund’s remit in a decentralized framework, because municipalities and communities will tend to be the ultimate owners of projects. Nevertheless how a SF prepares projects strongly affects the chances for long-term sustainability. There are four main solutions to address the problem.

The first and most fundamental solution is to carry out careful project identification, design, approval and implementation, and to ensure that communities and local governments participate at each stage of the project cycle. Where this is done, a project is more likely to benefit from local enthusiasm in ways that make long term operation and maintenance much more likely. Evidence from Peru shows that increased participation in the identification of social fund projects was associated with improved sustainability and an increased probability of project success (World Bank 2000d).

The question of what constitutes sufficient evidence of support for a project is an important one. Early social funds, such as Bolivia's ESF, often relied on simple declaratory evidence of local support, such as community resolutions, letters from mayors and other local leaders, or verbal expressions of enthusiasm. But such evidence is close to costless, and will often be proffered on behalf of projects that are valued marginally by a community with few outside options. By contrast, municipal and community contributions in cash and kind, especially when made up-front in the project identification and design phases, represent a much higher hurdle. They require communities in particular to raise funds and solve the collective action problem, and thus constitute an acid test of their commitment. On the other hand such requirements may penalize the poorest communities, and call for a greater degree of trust on the part of local beneficiaries in both the SF and local governments. Accordingly, community contributions carry a larger danger of disillusion and credibility loss if a project to which communities have contributed fails to reach fruition.

The second solution is to enhance project maintenance through direct technical assistance. Unfortunately, social funds' performance in this area tends to be less than satisfactory. Most social funds focus their capacity building efforts on rather narrowly defined areas of project management but leave aside training on more general local

government competencies such as revenue administration and recurrent service delivery – functions that are crucial if local authorities are expected to operate and maintain projects over time. Funds in Nicaragua and Madagascar have tried to address this problem by setting up maintenance funds (authors' own observations). However, and in particular where local revenue collection is limited, this only provides a transitory solution. Hence, broader capacity building efforts and local revenue reforms are often needed. Whether these additional activities are best addressed by social funds or other specialized local development agencies needs to be determined on a case-by-case basis. But social funds can certainly play a stronger role in this domain (e.g. by providing training funds or technical support).

Third, project sustainability can be enhanced through guarantees from responsible line agencies that newly constructed or rehabilitated infrastructures will be properly staffed and equipped once project works are completed. However, in practice the effectiveness of these agreements is often hampered by financing and planning problems within responsible line agencies. Hence in many cases a more promising approach seems to be to organize the operation of sub projects with the help of community based groups such as parent teacher associations, water user groups etc. For SFs this means that closer collaboration needs to be sought with reform initiatives and projects that try to delegate management responsibilities to community groups from within existing line agencies.

Finally, social funds should actively investigate whether or not their projects are successful over time. How is such success measured? Doing so with high precision is a thorny issue, and should not be attempted in this context. Instead, funds should institute a simple and quick program in which all projects are visited at regular intervals after completion, say three and five years, and assessed according to simple criteria as to whether they are still operational and delivering a reasonable flow of benefits. Likewise, the quality

of maintenance of a municipality's/community's completed projects should be turned into an approval criterion when new projects are assessed. Aggregate results from this process could then feed into the continuous improvement of SF procedures, as well as the evaluation of staff performance.

4. Conclusions and Recommendations

The evidence we discuss in this paper suggests that the social fund model is broadly compatible with, and even beneficial to, decentralization. The existence of SFs like those presented here, that work closely and well with decentralized institutions, represents a powerful counterargument to claims that social funds inevitably undermine local institutions. Indeed, many social funds have actively spearheaded decentralization through innovations in the project cycle and the weight of the portfolios they manage. Likewise once decentralization is under way, SFs have demonstrated their ability to adapt to new demands from the local level and/or function as a platform through which more coordinated decentralization programs can be implemented.

It is nonetheless important to remember that SFs remain large-scale organizations that necessarily face trade-offs between the depth of support they provide to local governments and the number of projects they must bring to fruition in a given time and area. In closing, we want to suggest some general reforms that would help to tackle this trade-off throughout the project cycle.

At the staff level, the best way to address trade-offs between depth and efficiency is through the incentives SF employees face, and not through general organizational directives. For instance, staff managing a super-abundance of project proposals at the earliest stage of the project cycle, where few resources have been invested in any given one, will be more likely to abandon an unpromising proposal than those seeking to nurse a few

projects to approval. Likewise, the performance of staff involved in project implementation should be based in part on the ultimate success of projects in the medium and long term, and not entirely on the number of projects managed.

A related solution is to change the evaluation culture of social funds. Project quality and longer term outcomes should be evaluated at regular intervals, and results from these evaluations should feed into recurring reassessments and adjustments of a fund's implementation procedures.

Finally, evaluations incentives should not only exist for SF staff – they should also be binding on communities and local governments. To do this, SFs should create rough-and-ready performance and sustainability indices by which local governments and communities are ranked in terms of the results they achieve. The nationwide dissemination of such an indicator would allow communities to compare their performance on fairly transparent, standardized terms, and contribute to the transparency and quality of local governance more generally.

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