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State of Public Finances and Prospects for Reform

1. This note analyzes the state of public finances and the prospects for reform of service provision in the secondary cities of Northern Sindh. The services that are targeted for improvement include water supply and sanitation (WSS) and Solid Waste Management (SWM) and the Taluka Municipal Administrations (TMA) that were studied include ones for Sukkur, New Sukkur, Rohri, Khairpur, Shikarpur and Larkana.

2. This note is primarily based on analyses of TMA budgets and provincial transfers and expenditure patterns. For this purpose, budgetary information was procured directly from the TMAs in hard and soft formats where possible and a simple, smaller data set on TMA finances was created from this information and analyzed.¹ This data set includes TMA budgetary data from 2001-02 to date. Another data set covering receipts and expenditures of these TMAs was procured from SDSSP Social Sector Expenditure data and collates actual expenditures incurred by the TMAs, including all grants-in-aid from other levels, on WSS, drains and SWM. Furthermore, extensive and often multiple interviews were held with key policymakers and managers at all TMAs including Nazim, Taluka Municipal Officers (TMO), Taluka Officer (TO) Finance(F), TO Infrastructure and Services (I&S) and other officials. Some officials were also consulted at the provincial level at the Sindh Devolved Social Services Project (SDSSP) office and at the Finance Department. Field visits were also conducted between June 24 and June 28, 2007 and between July 19 and July 26, 2007.

3. The following issues characterize the state of public finances in the project TMAs.

A. Historical, Incremental Budgeting not linked with Performance

4. The existing pattern of budgeting is based on historical and incremental estimation, based on making increments to the previous year's budget. There is no concept of accrual budgeting or of maintenance of a balance sheet of the TMA including assets and liabilities. The budgetary allocations are not linked with outputs, outcomes or performance. The yearly targets are set in terms of achievement of financial (and sometimes physical) progress and not in terms of service delivery performance or status of the facility. Budget is not expressed in terms of the vision of the Taluka Nazim or linked to the directions for overall planning by the Zila Mushawirat Committees. The outcomes are also not explicitly linked with economic or social objectives or with the approved policy framework of the government like the ones for poverty reduction (PRSP) and for medium term development framework (MTDF) of the federal government. Monitoring is only done for actual receipts and expenditures and not of outcomes.

B. Skewed Allocation Patterns for Salaries and Non Salaries

5. Salaries consume a major part of TMA budgets. Budgetary allocations for non-salary current expenditure lack allocation norms or yardsticks (such as unit cost of service or non-salary expenditure as a percentage of salary expenditure) and are not based on service delivery standards. There is over-staffing at most tiers and under-staffing of front-end service providers: The vacancies of front-end service providers, affect efficient service delivery. Budgeting for salary expenditure is based on the sanctioned posts and not on filled posts which usually results in savings (due to vacancies) at the year end. This saved amount is then re-appropriated to meet other non-salary expenditure. Figures 1 and 2 show ratios of total salary and non-salary

¹ Hard copies of the budgets containing complete budgetary information are available for further analysis by the Financial Advisor and/or other consultants.

expenditures to total current expenditures of the TMA. These confirm the historical pattern but also highlight the recent increase in allocations for non-salary expenses.

C. Excessive Reliance on Vertical Transfers and Low Levels of Own Source Mobilization

6. TMA finances show an excessive reliance on provincial transfers, most importantly the transfer in lieu of Octroi and Zila Tax (OZT). There has been little growth in own source revenue mobilization. Own source revenues consist of a large number of taxes/sources yielding small revenue. These include rental fees of TMA property, cattle tax, slaughter fee, etc. As the following quote from SDSSP Report (Government of Sindh, 2007) shows, it appears that little attention is being paid on own source mobilization.

“Revenues position is particularly problematic in districts and most of the districts did not know what own-source revenues they are generating. Matters have gone so wrong that own-source revenues were submitted in Provincial Account-I in a certain district with no drawing after submission.”

D. Low Absorptive Capacity and Mismatch between Development and O&M

7. Public investment decisions in the project TMAs continue to be made in “scheme”-based mode that focuses on asset creation rather than service delivery. The historical trend has been an over-emphasis on new infrastructure at the cost of optimal maintenance and operation thus generating poor service levels. Analysis of budgets and interviews with TMA officials confirm this assessment. However maintenance and development funding has increased recently due to a significant increase in resource transfers to TMAs from provincial levels. However part of this funding comes in the form of vertical programs implemented through the Public Health Engineering (PHE). In general vertical funding undermines local autonomy and responsibility, often results in duplication and inefficiency and has not been conducive for developing capacity for comprehensive planning. Such programs are often justified on the basis of lack of capacity in the TMAs but they contribute to the weakening of capacity.

8. Despite the increased flow of resources to the TMAs, they are constrained in optimally utilizing these resources. This is illustrated in the large opening balances that TMAs have at the beginning of each financial year (reflecting unspent finances) as shown in Table 1. In some cases, the opening balance or un-utilized funds are larger than the provincial transfers.

Table 1: Opening Balance of Local Fund (General) on 1st July

	2003-04 (Actual)	2004-05 (Actual)	2005-06 (Revised)	2006-07 (Budgeted)
Larkana	9,249,788	26,517,873	65,203,881	66,489,983
Sukkur City	26,852,384	9,396,346	18,536,635	23,728,704
Khairpur	104,777	26,924,548	34,219,817	34,219,817
Shikarpur	16,924,734	15,011,289	13,446,107	13,446,107

Source: SDSSP SSE Taluka proforma data

9. Some part of these large opening balances are explained by the fact that these comprise vertical transfers for development budgets that are transferred to the TMAs with considerable delays or are tied with restrictive conditions. The timing of transfer of funds to the local governments is often related to the timing of transfers of financial flows from the federal government to the province under the National Finance Commission (NFC), which constitute the

major part of provincial resources. Theory and practice of public finance in other countries shows that the timing and predictability of transfer of resources to public agencies promotes efficient allocation and utilization of these resources. Some of the public officials interviewed also highlighted the fact that the release of these funds is sometimes related to political factors, such as the political alignment of the provincial and local governments.

E. Weak Accounting and auditing.

10. Accounting and auditing are used more as a legal/regulatory requirement and less as a management tool to support more informed and timely decision making. Even in terms of legal compliance, there is still lack of proper understanding of budget making and governmental accounts on part of the local governments. The TMAs suffer from lack of personnel with appropriate skills in accounting, auditing and financial management who can better monitor and maintain sector expenditures. This is shown by Table 2. From the available staff, there is inadequate comprehension of the new accounting procedures resulting in a mix of past and present accounting procedures. Apparently there is a problem of capacity at the Local Fund Audit staff as well who are responsible for conducting pre-audit of expenditures on daily basis and for post audit of income. This has reportedly resulted in many accounting lapses.

Table 2. Key TMA Posts and % Vacancies

TMA	Taluka Municipal Officer	Taluka Officer (Infrastructure and Services)	Taluka Officer (Finance)	Taluka Officer (Regulation)	Taluka Officer (Planning)
Sukkur	F(17)	V	F(17)	F(17)	V
New Sukkur	F(17)	F(18)	F(17)	F(16)	V
Rohri	F(17)	F(17)	F(16)	F(16)	V
Khairpur	F(17)	V	V(11) ^a	F	V
Shikarpur	F(17)	V	F(18)	V	V
Larkana	F(17)	F(18)	F(16)	V	V
% Vacant	0%	50%	17%	33%	100%
Sindh Provincial Data (% Vacant)	7%	41%	56%^b	34%	100%

^a Posts considered vacant if underfilled by grade level 15 and below staff.

F=filled; V=vacant.

Figures in parentheses indicate grade levels.

Sources: Local Government Department, Government of Sindh; Draft Sindh Urban Sector Assessment.

11. A SDSSP report (Govt of Sindh, 2007) acknowledges that the capacity of local governments in public financial management is weak and mentions. For instance local governments needed guidance and training even to fill-in SDSSP budgetary forms.

“One important reason of the non-compliance of the TTA (Third Tranche Action) ... is the improper Financial & Accounting record at the district and TMA level ... the manner of financial record keeping of current expenditure in TMAs is office-wise and not sector wise ... This pooling of expenditure has resulted in scattered recording of expenditure and it was difficult for TMAs themselves to know the expenditure patterns under each sector.”

F. Lack of Strategic and Human Resource Management

12. The poor state of finances at the TMA level is linked with managerial issues such as low capacity, lack of well-defined and time-bound administrative and procurement rules, frequent transfers of key personnel etc. The average incumbency of most of TMA officials was found to be less than one year. Rapid turnover of key managerial staff precludes team-building and development of organizational units as better-functioning entities. Continuous turn-over of incumbents of key posts means that there is often too little time for productive and sustained application of new learning and thus nullifies the big investments, often with donor support, in training carried out by the government.

13. Currently there is no organized system for receiving feedback. The SLGO puts the responsibility for tariff approvals in the hands of the local councils, but there is no clear guidance on setting tariff levels and designing tariff structures. There is no concept of justifying WSS projects on the basis of proper demand analysis, financial, economic, environmental and social justification.²

14. None of the project TMAs has a strategic plan, spatial plan or even network maps for municipal functions for which they are responsible. This is partly getting rectified through the ADB-financed SDSSP as TMAs have to prepare Annual Sector Plans (ASP) in order to access funds under the conditional grants mechanism. However these ASPs are pretty basic documents and do not represent a strategic plan.

15. Human capital is often a larger constraint than lack of financial resources. The lack of skilled and professional human capital constrains the TMAs' capacity to raise more revenue and to effectively utilize the existing resources. For instance, TMA officials have limited expertise to manage a revenue earning entity. Currently TMA officials are selected on the basis of seniority from within the department. While many officials have experience, managerial skills are generally lacking and there is very little in-service or on-the-job training or regular institutional support. Also the dual accountability of officials to the provincial and local levels is also an issue constraining a Nazim's ability to hold their staff accountable. Thus while appointment, posting, and transfer authorities for many tiers have been formally devolved to local governments, informal provincial control remains pervasive as the exercise of such powers has often been severely curtailed by countervailing provincial notifications and because control of senior officials still remains with the province. This issue is further elaborated in Para. 30 below.

G. User Charges, Tariff and Cost Recovery

16. In most of the TMAs the user charges fixed years ago are low and are inadequate to meet even the salary expenses on service provision. Recovery of user charges compared to billing is poor. Table 3 shows the current municipal service rates for TMA Khairpur while Table 4 shows the cost recovery for TMA Khairpur which for water supply sector is just 9%. There are almost no charges for sewerage and SWM. In theory, Conservancy Tax can be levied by TMAs to recover the costs of sewerage and SWM but in practice this tax is rarely levied. Thus of the six project TMAs, only TMA Larkana levies it but at a very low level. Thus the budgeted amount for Conservancy Tax for the last two years is a meager sum of Rs. 796,000.

² Asian Development Bank's "TA 4432-PAK Capacity Building for Environmental Management in Sindh: Final Report" (2006) contains a section on utility tariffs and tariff setting (pp. 87-109) describes current tariff structures and issues in tariff reform in Sindh. Further work along the same line can help design a set of guidelines for tariff reform for TMAs.

17. Economic principles for fixing tariffs on the basis of cost of service provision and efficiency and equity considerations are currently not being considered. Unit costs are not being calculated nor is there in place any strategy for moving towards cost recovery. There have been no surveys for checking and regularizing the unauthorized connections.³

18. In many TMAs, the budgeted and actual revenue and expenditure on service delivery are not arranged in a way that may facilitate costing. There is no concept of setting goals of the tariff or using tariff as a tool of public policy.

Table 3: Khairpur Municipal Service Rates

Town / Item	Rate	No. of registered users
Water		
Domestic	Rs.240 per year	4,127
Commercial	Rs.1,500 per year	80
Factory	Rs.10,000 per year	18
Water tanker	Rs.100 per tanker	
Drainage (sewer tax)	Not imposed	0

Source: TMAs, Estimates of PPTA.

Table 4: Khairpur Cost Recovery of Municipal Services

	Expenditure (Rs. 000/yr)	Billing (Rs. 000/yr)	Collection (Rs. 000/yr)	Collection efficiency	Cost recovery
Water Supply	7,685	750	724	97%	9%
Sewerage / Drainage	24,943	0	0	n.a.	0%
SWM	6,127	0	0	n.a.	0%

Note: Billing and collection data are the average of the last three years or of the latest available year.

Sources: TMAs and estimates by PPTA..

19. The inadequate Willingness to Pay (WTP) of consumers that is attributed as the source of low cost recovery is more a function of the unreliability, inefficiency and poor quality of service from public sector and is not reflective of the actual costs borne by the consumers for the service, as revealed by different surveys, field observations and informal interviews with the consumers.

20. According to the CIET social audit survey in 2004, 61% of all respondents in Sindh said they paid for water services at an average of Rs. 472 per month (for both public and private provision). Willingness to Pay (WTP) study for SBUSP showed that households were willing to pay for initial cost, and monthly charges for improved services. This is shown in Table 5 below.

³ Some project TMAs did not seem to have a precise estimate of the total number of connections.

Table 5: Willingness to Pay in Select Cities for Improved Municipal Services

Service	City/Town	Initial Contribution in Katchi Abadis in Rs.	Initial Contribution in Pacci Abadis in Rs.	Services in Katchi Abadis in Rs	Services in Pacci Abadis in Rs
Water	Dadu	1,308	1,408	88	111
	Mithi	500 to 700	-	50	-
	Naushero	571	813	75	100
	Feroze	1,323	1,596	76	120
	Sanghar	1,725	1,480	131	162
	Khairpur	2,075	1,740	174	148
	Larkana	-	-	45	
	Umerkot	-	-	150-60	
	Johi	-	-	80-100	
	Mirpurkhas	-	-	240-260	
	Sukkur				
	Shikarpur				
Badin	-	-	-	-	
Sewerage/ Sanitation	Dadu	1,304	1,123	97	98
	Mithi	500	500	58	120
	Naushero	1,368	1,343	132	121
	Feroze	941	1,234	69	91
	Sanghar	1,322	1,490	125	147
	Khairpur	2,030	1,660	150	143
	Larkana	-	-	100	
	Umerkot				
	Johi				
	Mirpurkhas	-	-	120	
	Sukkur	-	-	100	
	Shikarpur	-	-	105	
Badin	-	-	-	-	
Solid Waste Management	Dadu	611	655	44	58
	Mithi	400	625	40	44
	Naushero	750	684	71	76
	Feroze	460	541	42	46
	Sanghar	798	764	75	80
	Khairpur	874	1,000	65	81
	Larkana	-	-	120	
	Umerkot				
	Johi				
	Mirpurkhas	-	-	120	
	Sukkur	-	-	66	
	Shikarpur	-	-	120	
Badin	-	-	-	-	

Sources: Sindh Urban Sector Assessment; TA 4432 PAK: Capacity Building for Environmental Management in Sindh Consultants Report.

H. Inventory and Database of Municipal Services

21. TMAs do not have an inventory/database of the WSS schemes in the taluka that are being implemented under different programs, discretionary grants, elected representatives, provincial and district development budgets, etc. This increases the chances of duplication in small schemes and is also not conducive to a clear apportionment of responsibility for bearing the operating costs. Some progress is currently being made in this regard recently as SDSSP has been collating detailed quantitative and operational data for different WSS schemes has to be submitted with the Annual Sector Plan of the TMAs intending to obtain conditional grants. Currently no Management Information System (MIS) exists for the municipal services.

I. Transparency and Accountability

22. TMA financial information is recorded in opaque budgetary formats and is not widely disseminated in user-friendly formats that show the justification for each allocation and that link performance with allocations. Corruption in the management of services is also a serious issue. Some anecdotal evidence suggests that the problem and its scale may not be very different from the rest of Sindh's public sector. The draft Sindh Economic Report (World Bank 2006) states:

“There is a growing perception that corruption has become a constraint to further development of the province. Its policymakers themselves have indicated that they see corruption as the number two development challenge facing the province. The entrepreneurs of Sindh placed corruption as the number one barrier to improving the investment climate of the province. Several of government's own evaluation reports in the past have found widespread non-compliance by departments with existing procedures and criteria in the areas of procurement, site selection, and recruitment, as well as the adequacy of systems for the monitoring of staff absenteeism. Reports of the Auditor General of Pakistan show that, while such problems were found in Pakistan as a whole, they were significantly worse in Sindh, particularly with regards to recruitment and site selection. Corruption has been fostered in the system because of a cumbersome and opaque decision-making process, weak procurement laws,⁴ lack of independent monitoring and evaluation, and an inadequate public campaign for policy changes.”

J. Political Factors

23. At the political level, an acute perception of the problem in terms of poor service provision does exist along with a strong realization of a public demand for better services. However this motivation for improving service and more importantly, for improving management systems and institutional arrangements is muted by the political calculus of alienating potential voters.⁵ Presently, the only criteria for fixing user charges is that it should be politically acceptable, with the result that these have not been increased since the last many years. For instance, the TMA Nazim of Rohri had to reverse tariff increase for water supply from Rs. 20 per month to Rs. 30 month. Due to skewed political and institutional incentives, TMAs have not been historically serious about recovering the operating costs of providing services.

K. Prospects for Reform

24. The state of public finances and service provision relating to municipal services in the project TMAs reveals that major financial and institutional constraints plague the functioning of

⁴ This may refer procurement laws often being restrictive, arcane and overly rule-bound, emphasizing formal compliance more than transparency and economic efficiency.

⁵ Two Nazims from the project TMAs acknowledged that disconnecting a user from service on account of non-payment is not a feasible option for them as it will lose them votes. A similar logic went against raising tariffs.

these TMAs. Thus simply building new infrastructure or rehabilitating existing one through the conventional “scheme” mode is unlikely to generate sustainable improvement in service delivery. It is important to break the vicious cycle of poor service provision generating low public expectations and consequently little willingness to pay for publicly provided services which, along with inefficient collection, results in low cost recovery which in turn generates low service provision. This cycle can be broken at several stages – at the political level by creating incentives to elected officeholders to improve service and to be credibly credited with service improvement; at the public level by triggering a change in consumer behavior regarding expectations about and willingness to pay for quality service provision; and at the TMA level by establishing incentive-compatible mechanisms for sustainable service improvement. A window of opportunity lies in uncoupling TMA responsibility for service delivery from actual service provision. This involves distancing Nazims from the role of actually managing services to a role where they monitor service delivery provided by alternate service providers and where they have more time (and resources) left for concentrating on other aspects of their mandate.

25. The recommendations that follow are generic to all TMAs in Sindh. For the participating TMAs the Sindh Cities Improvement Program proposes to improve municipal services through a corporate entity that would involve establishment of a company, named North Sindh Urban Services Corporation (NSUSC) for the purposes of this paper, under the Companies Ordinance 1984. Under this interim arrangement, NSUSC will contract with project TMAs to provide water supply, sanitation (WSS) and solid waste management (SWM) services. NSUSC will be responsible for improving service delivery through managerial initiatives and by utilizing ADB loan funds for construction and rehabilitation of municipal infrastructure. NSUSC will have mainstreamed within it a Program implementation function responsible for implementing selected capital improvements and for preparing for next stage of reform in its shareholding TMAs. The finances of the activities undertaken by NSUSC will be “ring-fenced”. Company revenues will thus be only used for the purposes set out in the special purpose company’s constitution and the service agreements.

26. NSUSC will prepare ground for the next stage of reform which may involve the Corporation entering into long-term management contracts with private operators for provision of WSS and SWM services that will allow operators to use physical assets and collect tariffs but be responsible for meeting specified performance targets on service delivery.

27. The Corporation structure has the advantage of being able to hire from open market for good managers and staff, to be able to provide management bonuses for improved delivery and to reap benefits from economies of scale. It will have an independent skills-based board which can improve accountability whereas multiple ownership reduces risk of capture by any one stakeholder.

28. The Corporation structure is also aligned with parallel reforms in the sector taking place in other provinces, like Punjab. It represents a feasible manner of improving urban services without going through the conventional route of building new infrastructure, often substandard, over-costed and involving massive rent-seeking, through public sector bodies like Public Health Engineering Department while leaving the management of such infrastructure in the hands of municipal bodies that are structurally averse to modern management and to public accountability.

29. Establishment of a new implementation entity, especially in an area that represents uncharted territory in Pakistan, is a large challenge. The entity needs to have the mechanisms (incentives, structure, regulations, environment, etc.) to be able to implement the reforms in a

manner that improves services and that generates further reforms. An encouraging sign is the existence of similar examples of capacity development for public service delivery in Pakistan. An ADB-financed study is currently exploring the dynamics of such cases of positive capacity development in public service delivery in Pakistan (Watson and Khan 2007). Some of the emerging themes from the study are summarized in Appendix 2. Their relevance for this project is that these highlight the crucial role of ownership from the top levels of government, strong leadership, provision of some 'space' to the new organization to develop and special incentives, and the need for flexible planning.

L. Encouraging Private Sector Participation in Provisioning of Public Services

30. The best way to establish incentive-compatible mechanisms for sustainable service improvement in municipal services is to foster private sector participation (PSP) in the delivery of municipal services. The private sector have better-aligned incentives for efficiency and service improvement and can often deliver the same services at a much lower cost than the government. Contracts are also more easily enforceable with the private sector. Currently there are not many private operators functioning in provision of municipal services in the secondary cities of Sindh, other than ones involved in infrastructure construction and those involved in SWM contracts with the TMAs. However given the right incentives and the right institutional environment, middle-sized multinational companies may find it attractive to invest in Sindh, particularly in collaboration with local companies, and some local firms with relevant expertise may venture in the field.

31. There is also scope of trying alternate delivery mechanisms like "delegation" of local level service delivery functions to bodies like the Rural Support Programs (RSPs). But although there is some scope of improvement through such mechanisms, it is important to highlight the limitations of such mechanisms in resolving the structural problems associated with poor service delivery. This is borne out by the example of Punjab Chief Minister's Initiative on Primary Health Care (CMIPHC) under which the Punjab Rural Support Program (PRSP) was handed over the management of all 104 Basic Health Units (BHUs) in the Rahim Yar Khan district. The arrangement is currently being replicated to twelve more districts in Punjab, while the President intends to expand this initiative to other parts of the country. Such 'delegation' is usually done on efficiency grounds as it allows for the adoption of better incentives due to not constrained by the "rules of business" that governments need to follow. But many Nazims argue that the "delegation" lessens their control, creates opacity in the assignment of credit between local and provincial politicians, and reduces the "pressure" to reform the very "rules of business" that constrain the functioning of local governments. This would suggest that as far as municipal services are concerned, involvement of the private sector offers a greater potential for sustainable improvement in services as, if properly designed, it provides sharper incentives for improving performance.

32. A specific intervention under this project is to help GoS reformulate its water and sanitation policy in order to make it more facilitative of private sector participation than it is at present. It is also important that the policy lays down the principle of improving municipal services through market-based processes.

M. Exploiting the potential of Devolution for service improvement

33. Devolution has a significant potential as a driver for service delivery improvement and for pro-poor change. However this *potential* has been compromised so far due to the limited nature of the reforms. For instance, the retention of personnel control by the provincial tier gives it

significant powers over the functioning of local governments and has serious implication for budgetary autonomy at the local level. Most officers continue to be a part of the provincial cadres and all decisions regarding promotions and transfers are taken by their provincial secretariats. Under the law “the Nazim may request but cannot prevent such a transfer” (Manning et. al. 2003). The fact that this provincial control of officers serving at the local level has adverse consequences for local accountability patterns was highlighted in paragraph 13 above.

34. The recent amendments to the LGO by Sindh and other provincial governments have significant implications for the LG system.⁶ These include changes to the mode of local government elections; reduction in the size of union councils, with a parallel reduction in the reserved seats for women and minorities; changes in the procedures for no-confidence motions against Nazims; the provision for the creation of a district service; and, most significantly, increased authority of the Chief Minister to overturn local government decisions and to suspend Nazims. The amendments empower the chief minister to suspend the orders and decisions of the district, tehsil and union Nazims in the "public interest" and to refer the matter to overrule such orders to the local government (LG) commission, a body dominated by provincial nominees. Similarly, the chief minister can "suspend" the resolutions of zila, tehsil and union councils if found in contravention of “the law or the interest of the people” and refer them to the LG commission for inquiry. These amendments have substantially enhanced provincial control at the expense of local governments, have further reduced local government’s managerial authority over front-line service providers and have also restricted financial autonomy at the local level through change of budget rules whereby provincial government can ask local government to revise an approved budget on the grounds that it was not prepared according to rules.

35. The capacity of TMAs to increase own-source revenues must be developed in order to enable them to increase important non-salary and development related expenditures. It is important to create a direct reciprocal relationship between the taxpayers and the main service provider in order to sharpen the incentives for the former to hold the latter accountable (Moore 2001). Furthermore, it will reduce the dependency of the local government on provincial transfers collected outside the local area that weaken the political incentives for the Nazim to tax his/her constituents, which further weakens the fiscal capacity of this tier.

36. Fiscal and administrative devolution needs to be furthered, both de facto and de jure, in terms of greater transfer of resources and administrative and financial powers as it will enable reaping the full benefits of spatial budgeting. This will enhance the capacity of a reform-minded Nazim to respond to his local constituency to affect change. Administrative devolution includes the creation of a district service is required so as to re-orient provincial involvement to more policy, as opposed to personnel, matters. The amended LGO has an added provision for the creation of a district service. A new section 140A in the SLGO states that “... the Government shall, in every district, create a District Service comprising all posts of local governments grouped into district and *tehsil* cadres for decentralized local government functions ... not later than 31st December 2005.” However this provision has not been implemented so far perhaps in view of the demands of this massive administrative exercise and/or the political sensitivities involved. However it is not certain that the establishment of district cadre in itself will result in the promised improvement in public services without broader institutional reform of the government as highlighted in the next paragraph.

⁶ The Sindh Local Government (Amendment) Ordinance, 2005. The Sindh Government Gazette, June 6, 2005.

N. Building Institutional Capacity of the Government

37. Random observations and casual empiricism would highlight the need for a massive capacity building of the local governments. Many functionaries do not have the capacity for the functions assigned to them as identified in LGO 2001. Furthermore, building of the necessary capacity at all levels may also be needed to shift focus from simply the provision of infrastructure to the planning and delivery of municipal services. However poor performance in the public sector at the local level appears to be mostly a function of a dysfunctional operating environment and, as such, cannot be addressed through conventional capacity building programs alone that focus on training of public officials. The fundamental issue relevant for building institutional capacity of the government is one of determining for each service whether the service needs to be provided by the public sector, and/or financed by the public sector with provision to be allocated on the basis of efficiency to a non-state entity, or simply regulated by the public sector. Determination of appropriate role of the government will then determine rationalization of the structure, functions and staffing of the public sector mandated to provide the service. Capacity development of the public agency concerned – possibly involving “contracting-in” of relevant skills and building of such skills among existing staff – should follow this process.

38. In the absence of institutional reform, conventional capacity building programs are not likely to be much effective, given past experience. Literature shows that most all capacity building exercises in Pakistan have been donor-assisted to some degree, but that many such programs have *not appeared to generate sustained capacity in terms of changed and improved practices or service delivery* (Watson and Khan, 2004). However some gains in the form of short-term improvement can certainly be realized by training competent officials from the existing cadre and by linking their compensation with performance. Such training may focus on missing technical, commercial, financial management issues including appraisal and evaluation of investment projects, tariff review and approval etc. The capacity of monitoring committees also needs to be developed.

- (i) TMA officials should be appointed through a competitive recruitment and selection process that is open to both public and private sectors and should be offered renewable, performance-based contracts. TMAs need staff with competencies more suitable to their role as bodies corporate. The required skills include corporate skills like those possessed by MBAs and public administration skills like those possessed by people from District Management Group and/or the Provincial Civil Services. People with such competencies, both from the public or private sectors, are generally reluctant to join TMAs due to issues like lack of prestige, incentives etc. The ADB-financed project can provide incentives to TMAs to hire such competencies at least in the project TMAs and thus demonstrate the need and effectiveness of the approach.
- (ii) TMAs may also contract specialized competencies from the market for jobs such as developing municipal services plans.
- (iii) Sharing of scarce skills with other TMAs, especially for outsourcing and contracting short-term specialized skills from the market, is another option. It is also important to have access to data on access and quality of municipal services and to develop the capacity to utilize this data for planning and management purposes.
- (iv) The coverage of Multiple Indicator Cluster Survey (MICS) should be brought to the TMA level from the current district level so that this data becomes available to the TMAs. As a first step, the results from the current MICS should be made public. Also MICS should be adopted as a regular exercise and publication of its

results should be delinked from government approval. This will highlight the performance of local governments in achievement of social sector goals like Millennium Development Goal (MDG) targets and if linked with appropriately designed rule-based fiscal incentives, this can facilitate improvement in service provision through yardstick competition.

- (v) The capacity of TMAs to utilize data and information, including MICS and other sources, should be strengthened. This can be done through incorporation of evidence-based planning in budgeting and monitoring by utilizing the specialized competencies brought in by SDSSP and other projects focusing on the capacity building of local governments.

O. Budgetary and Financial Reforms

39. Targeted interventions are needed to assist TMAs to enhance their own sources of revenue, assist TMAs to calculate the actual costs of delivering municipal services, and help TMAs design and implement tax policy based on efficiency and equity considerations. Also needed are procurement reforms that regulate tendering and contracting procedures and that can potentially improve transparency and produce large fiscal savings. This issue is discussed in detail in SER (2007). Improved accounting and auditing will also enable TMAs to better utilize the reappropriation of funds, a key financial power that has already been devolved, but whose full potential has not so far been realized. One way of improving accounting is through developing customized software for TMA accounting and then training TMA finance officials in operating this software.

40. **Initiating performance based** grants are another effective mechanism for establishing incentives for improved performance and to shift focus from execution and physical and financial progress to the delivery of outcomes. In view of the increasing reliance on conditional grants or 'rule-based' fiscal incentives from the provinces to the local governments, it is important that the provinces should set up and monitor a transparent regime of rules, ideally through Provincial Finance Commission and involving a set of outcome based indicators, and leave the local governments with enough autonomy and flexibility for achieving the agreed targets. This will ensure that provincial commitments are honored without disturbing local autonomy and accountability patterns. This will also assist in directing the work of monitoring committees and in helping shift focus on the implementation of needs-based planning from the creation of assets. Existing Budget Rules provide a number of formats which can be utilized for performance budgeting such as Policies and proposed activities of the TMA (BSF-1), Service Delivery Performance Targets (BSF-2) and service delivery facility status (BSF-3). These have not been included in the budget documents by any of the project TMAs.

P. Enhancing Transparency and Citizen Accountability

41. Enhancing transparency and accountability of policymakers to citizens can change the incentives for patronage that underlie institutional problems associated with service delivery. This may include use of information campaigns to enable citizens to hold officeholders accountable for their performance on their electoral promises. This is borne out by literature on international experience⁷ where various civic organizations and reform-minded government

⁷ Besley and Burgess (2002) find that governments are more responsive to crises when more citizens have access to the printed press. Brunetti and Weder (2003) find that greater press freedom is associated with lower corruption. Stromberg (2004) finds that governments deliver greater targeted benefits, such as from welfare programs, to informed citizens. The World Bank (2003) provides a number of examples of the impact of increased information.

ministries have pursued innovative campaigns that use information about public programs as an instrument to improve public services. Citizens Report Cards and Public Expenditure Tracking Surveys are examples of such instruments. If District Monitoring Committees are strengthened, then their reports can be used to increase citizen awareness of facility level performance and create the necessary pressures to improve service delivery and to reduce staff absenteeism. Transparency and accountability in public financial management must also be enhanced. One way of doing this is to widely disseminate all relevant information on allocations, spending, procurement and achievements and call for public hearings on these. Monitoring Committees of the Council and Monthly Accounts Committee meetings also need to be made more active.

Q. Decentralization of Property Taxes

42. Property taxation has the potential to become a major fiscal instrument available to TMAs while it is currently being underused. Property taxes currently provide for a negligible amount of local own-revenue due to unclear tax policy, unreliable information base due to outdated manual technology and due to lack of expertise and capacity in administration of the taxes (World Bank 2006). Decentralization of property tax system to the TMA level can provide a big boost to TMA finances. This involves devolving responsibility and authority for tax policy and tax administration to the TMA level. This will promote local autonomy and accountability (and ownership) of TMAs to citizens/taxpayers by establishing a direct linkage between local taxation and service delivery. TMAs will need technical assistance for tackling with the current administrative, regulatory, and technical shortfalls / constraints and in terms of bringing assessment of property tax base closer to market values. Government of Punjab has, with World Bank support, been preparing ground for decentralizing property taxes to the TMAs and this preparatory work can benefit Government of Sindh in making such a move (Urban Unit, 2007).

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Appendix 2

Emerging Common Themes of the Successful Cases of Capacity Development *Extract from EAD/ADB Scoping Study on Capacity Development for Service Development in Pakistan (EAD/ADB 2007)*

1. The following is an extract listing some common themes or characteristics emerging on the basis of a preliminary familiarization with the candidate 'success stories' in capacity development for service delivery in Pakistan that may have some relevance for the sequencing and initiation of reforms in the municipal services of northern Sindh.

2. The preliminary findings are summarized as follows, without comment or qualification. Since this is a 'work in progress', the conclusions and themes are likely to change and develop over time especially after more detailed scrutiny.

- (i) Several of the cases represented essentially 'new' organizational entities or units: officially established, with specific terms of reference; newly-assigned staff (often recruited on merit), and on terms more favorable than ordinary units in the public service.
- (ii) Some form of sealed 'cocoon' is necessary: insulating the (new?) organizational unit from the usual problems of interference, under-funding, poor pay and conditions, and itinerant bosses (themselves subject to frequent transfers).
- (iii) These conditions are authorized by a senior politician or very senior official. This is symbolic of a familiar, oft-quoted characteristic of sound capacity development: top level ownership and commitment.
- (iv) The successful cases all appeared to put great emphasis on generating sound basic information about the sector / domain. A common characteristic was their skepticism of the quality of data they 'inherited'. A new baseline survey / census appeared to be a common feature of sector cases.
- (v) Monitoring progress and basic performance measures was important: and the use of IT in this and in data generation and updating were other common features.¹
- (vi) A common dimension of such data analysis and presentation in several cases was the use of mapping technology (linked to GIS systems) to help identify 'hot-spots; under-serviced areas or populations, distribution of resources, or areas of potential.
- (vii) Successful capacity case teams also analyze and present information strategically and regularly to decision-makers. Information thus generated has been used successfully in communicating with, and ultimately persuading, decision-makers (including politicians). It appears that if sound up-to-date evidence is produced, and presented intelligibly and persuasively, they are prepared to listen, and ultimately tend to endorse reasoned recommended actions by officials.
- (viii) Several of the cases – possibly most – feature a leader who has played a significant role. He or she may have taken an initiative; negotiated favorable terms for the 'environment' of the initiative; enjoyed a close or semi-protected

¹ The most advanced case was the Sindh Water Course Improvement Program: which used electronic reporting in real-time from field staff using personal hand-sets: thus eliminating the need for paper-based reporting and subsequent processing.

status or relationship to an influential figure in the governance environment; contributed a rare skill or applied existing knowledge; have been willing to build a team of dedicated staff over time, in part by setting a good example. He or she may have been confident enough to be willing to innovate inside the 'space' provided.

- (ix) The role of donors and/or Technical Assistance provided through foreign-assisted projects did not loom large in significance. It was undoubtedly a positive factor in some cases. It also appears that there are considerable *indigenous* skills available to the public sector in Pakistan (albeit sometimes from the private or NGO sectors) which can be mobilized if there is a 'will' to develop public sector capacities.
- (x) Where donors' roles have been crucial to the development capacities, they tend to identify and utilize *existing* capacities, and have been willing to be associated with the initiative 'for the long-haul'. This illustrates the oft-heard axiom that 'capacity development takes time'. Trust between the players – donors, consultants or technical specialists, client organizations and other stakeholders, takes time to build up. Yet trust is an essential element in launching innovative (and potentially risky) approaches.
- (xi) Comparative international experience was a factor in influencing developments in some of the cases, but again, not a particularly strong factor. In some cases, it was sought, but donors sometimes failed to deliver for one reason or another. It was unclear whether the reason was connected with their own restrictions on procurement, or some other factor impeding their fast response.
- (xii) Many cases illustrated the importance of flexible planning, and looking seriously at alternative approaches. Unfortunately, some illustrate how the PC1-process adopted by government tends to restrict such planning. The PC1 and subsequent budget approvals tend not only to 'strait-jacket' programs, they are often based on poor initial / base information or inadequate exploration of a full range of alternative approaches to the problem or constraint in question.
- (xiii) The overall environment in which public services are being planned and managed is beginning to change in some provinces. More managerial 'rhetoric' is apparent than ever before. How, and whether, this translates into actions and major changes in the way the provincial government 'does business' remains to be seen.

Figure 1.

Ratio of Salary with Current Exp.

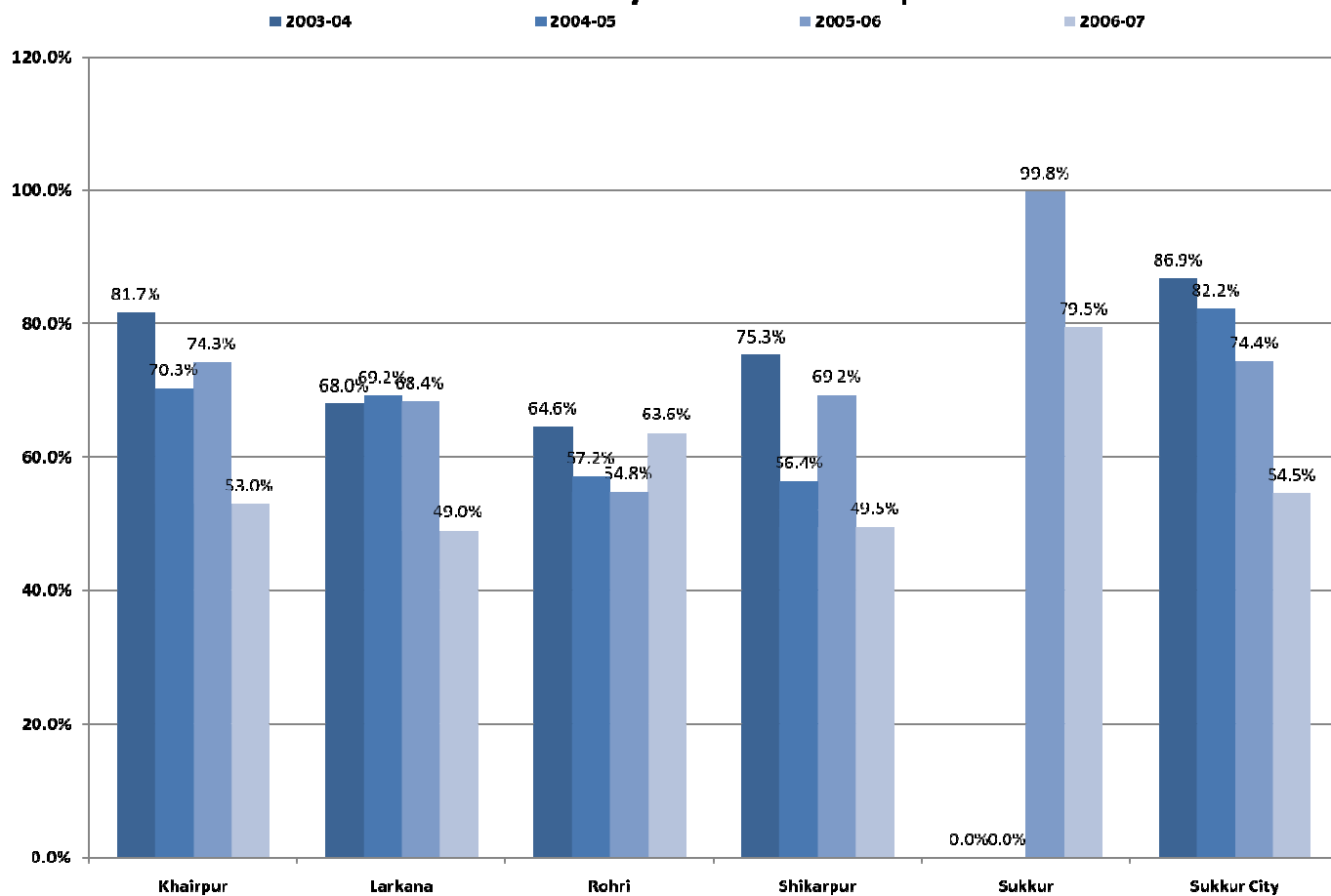
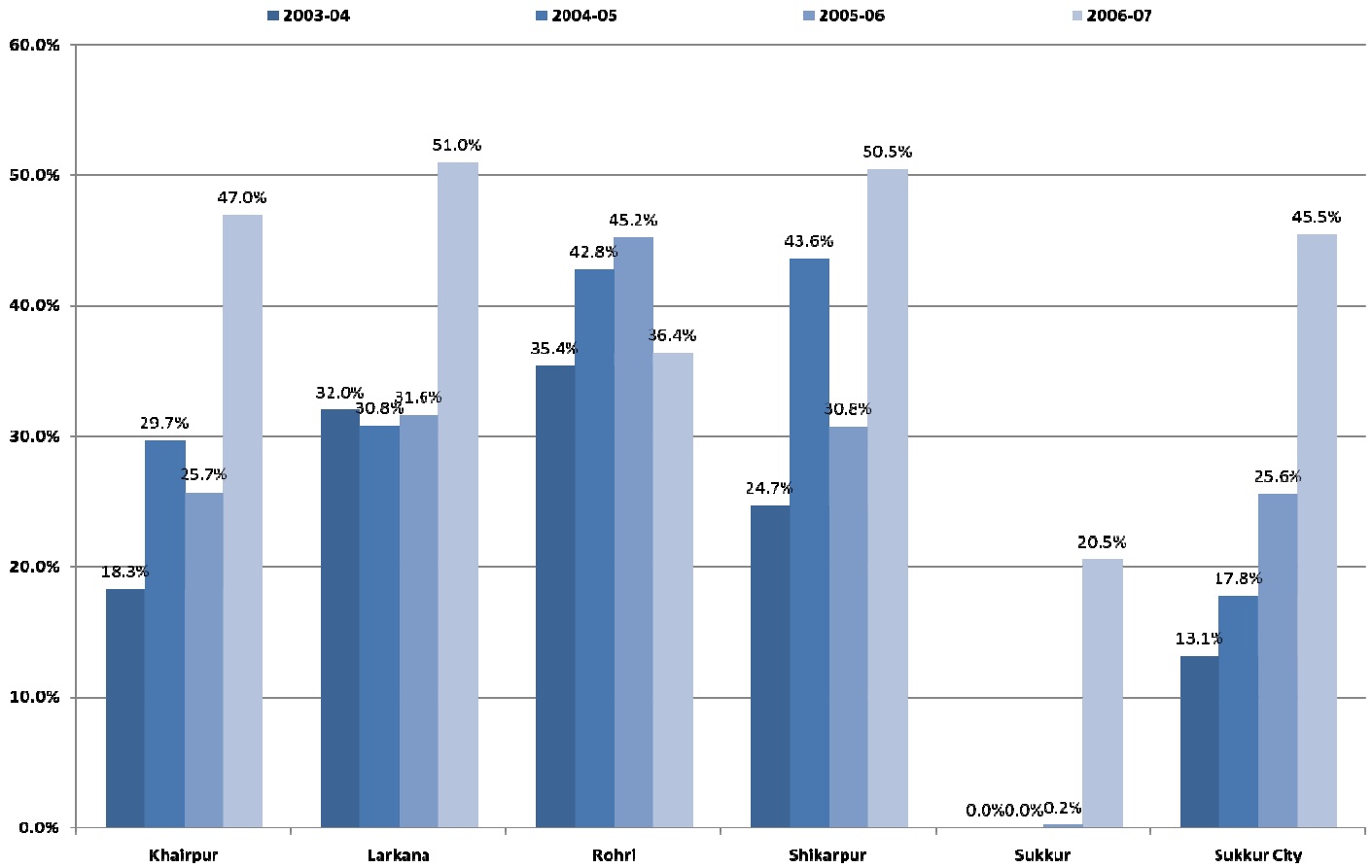


Figure 2.
Ratio of Non-Salary with Current Exp.



ANNEXURE 1

LIST OF PERSONS INTERVIEWED

Kabir Kazi	Program Director, SDSSP
Iqbal Memon	Deputy Program Director, SDSSP
Muhammad Khalid	Water & Sanitation Specialist, SDSSP
Syed Tariq Jaffery	Additional Secretary (LF), Finance Department
Shafique Khoso	DCO Sukkur
Tahir Imtiaz	Taluka Nazim, Khairpur
SarwarGhumro	TMO, Khairpur
Agha Jehangir	TO (F) Khairpur
Nawaz Khand	TO (I&S), Khairpur
Aslam Sheikh	Taluka Nazim, Rohri
Imdad Tunio	TMO Rohri
Nisar Mangi	TO (F) Rohri
Fayyaz Kazi	TO (R) Rohri
Naeem Siddiqui	TMO Nazim, Sukkur
Allah Dino Chachar	TMO Sukkur
Muhammad Nadeem	TO (F) Sukkur
Altaf Soomro	Gov. Specialist, LSU, SDSSP Sukkur
Shakoor Mehr	TO (I&S) New Sukkur
S. Naseem Zaidi	TO (F) New Sukkur
Kh. Shafeeq Ahmed	DCO Shikarpur
Zafar Ali Shaikh	TMA Nazim
Muhammad Khan Magsi	TMO Shikarpur
Ghulam Mustafa Hullio	TO (F) Shikarpur
Ghulam Sarwar Abro	TO (I&S) Shikarpur
Agha Abdul Qadir Pathan	Ex Administrator MC Shikarpur
Inaam Ali Shah	Gov Specialist, LSU, SDSSP Shikarpur
Qurban Ali Abbasi	TMO Nazim, Larkana
Abdul Karim Shaikh	TMO Larkana
Atta Muhammad Channa	TO (F) Larkana
Nisar Siddiqui	Director, IBA Sukkur
Shafiqur Rahman	TMO, Gulshan Iqbal TMA, Karachi
LAHORE	
Nasir Javed	Project Director, Urban Unit, P&D Department, Lahore
Abid Hussainy	Water & Sanitation Specialist, Urban Unit Lahore
Sajid Siddique	Punjab Municipal Development Fund Company (PMDFC), Lahore