

The Political Economy of Designing Programs to Reach the Poorest

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Reaching the poorest and hungry groups of the population, including those who might be left out of the Millennium Development Goals, involves input from policymakers at the central and local levels of government. Although there has been considerable focus on appropriate targeting mechanisms to reach the poor, attention as to which level of government should be involved, as well as the interactions among levels of government in reaching the poor, is more recent. From a policy perspective, it is important to examine the instruments available at each level of government in order to meet the needs of the poorest. If the responsibility for these groups is seen primarily as that of the central government, direct federal or central government programs—effectively targeted but building on local information—come into focus. If the primary responsibility is local, the policy focus shifts to own-source revenues for financing the expenditures and for greater local accountability, together with a modicum of equalization transfers to ensure that all local governments will have similar capacities to provide for the poorest.

For a more extensive version of this chapter see E. Ahmad and G. Brosio, eds., *Does decentralization enhance service delivery and poverty reduction?* (Cheltenham, England: Edward Elgar, 2009). Helpful discussions with Giorgio Brosio, Mercedes García-Escribano, Stuti Khemani, Jean-Phillipe Platteau, Ugo Panizza, and Joachim von Braun are acknowledged. Note that this chapter does not provide a treatise on decentralization per se. For a review of the more recent literature in this area, readers may consult E. Ahmad and G. Brosio, eds., *Handbook of fiscal federalism* (Cheltenham, England: Edward Elgar, 2006). The chapter does not attempt a survey of targeted programs either but uses selective illustrations to examine differing approaches to meeting the needs of the poorest groups in society.

Designing central programs to reach the poorest may be difficult without local information. This is because the central government, particularly in large countries such as China and Mexico, lacks the ability to precisely define marginal groups or households that may not benefit from more general growth and prosperity. Yet local officials may not share the central government's objectives, and they may prefer to divert central funds to meet objectives of higher value to them. This policy dilemma illustrates difficulties with overlapping responsibilities between different levels of government and in designing effective special-purpose programs, financed centrally but implemented by local governments.

The constraints of designing effective, centrally determined, special-purpose programs in developing countries are legendary. To some extent these are similar to the problems of designing foreign assistance strategies that effectively reach the poorest target groups in the recipient countries: countries' elites may not share the altruistic objectives of donors. The issue is to design policies that build on local information yet minimize local incentives to divert resources from the target groups. Similar issues arise in the context of foreign assistance designed to reach the poorest groups of the population.

Local governments with the most limited resources and tax bases may also have the greatest requirements for supporting the poorest groups and individuals. Thus, providing for these groups in the poorer localities may require the central government's assistance, even though the central government may also have concerns for poorer groups living in the relatively well-to-do localities. Urban poverty, even in the richer areas, is becoming an increasing problem in addition to more traditional rural poverty. Reaching these groups may not be easy and could generate moral hazard difficulties as local officials attempt to minimize their financing of such activities and shift the burden to the central government. A continuation of pockets of extreme poverty in richer localities tends to reflect the divergent preferences of officials in the central and local governments. Local politicians and officials may not be particularly interested in such groups, and indigent people frequently do not have a significant political voice.

Relatively incomplete information is available to central governments either on poor and hungry people lacking family support or on subnational budgetary operations. This lack of information generates incentives for subnational governments to divert central funds allocated for the poorest.

This policy chapter examines the fiscal instruments available to different levels of government and how they interact to enhance the effectiveness of public policies for the poorest and hungry groups. Addressing the leakages associated with central funding and local implementation requires that programs be designed to incorporate competition for resources—both across jurisdictions and over time. This requirement also involves increasing the results orientation of budget processes

and improving mechanisms for intertemporal feedback in the future allocation of resources.

Insights from Successful Programs to Reach the Poorest: Examples from China and Mexico

Depending on the circumstances, either centralized or decentralized approaches may be adopted to address the needs of the poorest. The options are highlighted by the experiences of two large countries—China and Mexico. Mexico has a successful central government program to reach the poorest, whereas China has relied on effective local programs. Despite the successes of both types of programs, challenges and difficulties continue in both cases. There may well be a convergence of solutions in the future, with a more significant role for the central government in China and for state and local governments in Mexico.

Mexico, which is a federal state, has effectively built a safety net on the basis of a centralized conditional cash transfer program, *Oportunidades* (formerly *Programa de Educación, Salud, y Alimentación*, or *PROGRESA*, created in 1997). The program's targeting has worked effectively; however, the model has been difficult to replicate, even in smaller countries, because administrative overheads are substantive. Also in Mexico, success has been somewhat of a handicap, and successive governments have added new objectives and responsibilities that make the program unwieldy and distortionary. The question is whether the program, with its increased mandate, can maintain effective targeting in Mexico and be replicated elsewhere in Latin America. In China, a unitary state, programs such as *Wu Bao* (discussed later) were used in the past to provide support for the poorest groups in rural areas. Such programs were predicated on locally generated information and management. With increasing inequality in China since the economic reforms of the 1990s and dispersion of local government revenues, the issue now is whether local governments have the incentives and resources to continue to effectively provide support to the poorest groups. Each type of program faces challenges and difficulties as described below.

Centralized Provision

As mentioned, a central government might want to carry out the social assistance program itself, with or without local identification of recipients. Given the success of *Oportunidades*, Mexican administrations have tried to use it as a compensation mechanism for different adjustment policies over time, and the mandate and coverage of the program has increased significantly. At the end of 2005, *Oportunidades* benefited 24 million individuals (5 million households)—roughly a quarter of the total population or 70 percent of the rural population. In contrast, the Chinese programs were more tightly targeted, with the number of people receiving social

relief in the early 1990s, including recipients of both the Wu Bao and the more extensive Pinkun Hu programs (in terms of poor household support), at around 6 percent of the rural population.

Another federal program in Mexico, Seguro Popular, has also been designed to provide direct support for health care for the uninsured population. It has been criticized on the grounds that, together with Oportunidades, it encourages expansion of the informal sector and poses a constraint to the orderly development of formal sector activity. This has a disincentive effect on labor markets and also limits the growth of tax revenues. Thus, these programs may perversely perpetuate the problems that safety nets should solve.

The issue of overlapping responsibilities also creates difficulties in Mexican intergovernmental finances. Whereas Oportunidades has been effective in meeting its initial objectives, it is seen as encroaching on a typical area of local responsibility. Indeed, given the presence of significant federal transfers earmarked for basic education and health care, states and local governments have effectively begun to treat these areas as the responsibility of the federal government—despite a decade-long effort to decentralize.

As previously mentioned, it has proved difficult to replicate Oportunidades elsewhere in Latin America. Attempts were made—for instance, in the Red Solidaridad in El Salvador and Tekoporā in Paraguay—but these are small and homogeneous countries relative to Mexico. The centrally designed programs in these countries have involved significant administrative costs in establishing effective management and the eligibility of beneficiaries. Attempts to involve local governments in the programs have not been particularly successful because the political benefits are thought to accrue to the central governments, whereas the political costs are expected to be borne locally.

In general, direct provision by the central government could be achieved via relatively broad targeting—albeit at a fiscal cost in terms of leakages to the less poor. It may be more efficient to design mechanisms that better utilize the information available to local governments (including at the community level) but with the central government equalizing the capacity of the relevant levels of governments to undertake the projects. But would the local governments have the appropriate incentives to do so?

Local Provision

A good example of local identification of and provision for the poorest comes from rural China. Since the establishment of the People's Republic, a key element in reaching the poorest has been the mechanism known as Wu Bao, or “five guarantees.” It relates to the minimum provision of food, health care, shelter, clothing, and funeral costs for all citizens—hence the term five guarantees. The program

operates based on local (often village- or community-based) information to identify the poorest groups in society that are without extended household support, particularly in rural areas where the reach of formal social security instruments is at best limited. As is evident, the families and individuals served by Wu Bao are often among the poorest. Over time, the term came to denote a special category of persons—those who are unable to earn a living and lack relatives for support. These are predominantly orphans and the elderly or disabled. As is clear, the identification of the vulnerable without family support has to be based on local knowledge. Such individuals also tend not to be associated with elites or interest groups that often have an interest in “capturing” resources accruing to the localities.

The social protection mechanisms in China are undergoing significant change. While the market orientation of the past decade has brought about rapidly rising real incomes, particularly for families able to participate in the labor market, it has generated greater vulnerability for some of the poorest. The social protection system has come under strain as the resources available to lower-level local governments, particularly in the poorer regions, have been subject to greater constraints. On the one hand, there has been a recentralization of the main sources of revenue, and on the other, additional spending responsibilities have devolved to lower levels. Thus, the resources available to provide support or social assistance to the poorest, including those distributed through Wu Bao, tend to vary by locality. Moreover, with growing inequalities, “local capture” may become a problem in China, as it is in other parts of the world.

A more recent intervention, Di Bao, is a largely urban program providing conditional cash transfers to individuals below the poverty line. It started in 1999 and now provides support to around 22 million people, or 6 percent of the urban population—roughly the same number as those served by the rural anti-poverty programs (Wu Bao and Pinkun Hu). Local governments select recipients, and the central government provides co-financing. The proportion of central government financing varies by province—from zero in the rich coastal regions to 100 percent in Tibet. In principle, the program encompasses two key characteristics: local identification of need and a degree of equalization in the financing arrangements. One study by Ravallion, however, finds that despite the central equalization the richer localities can support higher income levels for program eligibility than can poorer ones.

The policy design issues in China are complicated by its multitiered administration, based on nested budgeting decisions. The central government decides how much to allocate each province; then a series of further transfers is carried out from the provinces to the prefectures, from the prefectures to the counties, and finally from the counties to the townships. Allowing the localities to determine eligibility criteria gives them the responsibility but at the possible cost of excluding some of the deserving

poorest. Tighter central government determination of eligibility would move Di Bao closer to the Oportunidades model although still relying on local identification and administration. This change could also make the central government's costs open-ended and would not preclude diversion of centrally provided funds.

The Policy Options

An ideal system of transfers would involve the provision of clearly identified criteria by the central government to local governments to assist them in looking after the poorest. But for overall budgetary constraints and efficiency of spending, this requires that local governments accurately disclose information on the extent of need and also that they not divert central funds to other uses. It is not clear that local governments have the incentives to disclose this information; on the contrary, the localities may distort the information in order to maximize transfers from higher levels.

Thus, central governments face a dilemma. Reaching some of the poorest requires local information for effective identification and targeting. This information cannot be obtained without the cooperation of local governments. Direct central provision is possible but requires administrative capabilities and resources and may generate negative effects, such as incentives to remain in the informal sector. Local governments may have the information, but the poorer ones lack both the financing to carry out the functions and the incentives to use central transfers as intended.

Financing Instruments for Social Programs

The interaction of instruments matters, as does the budgeting framework—especially the use of contracts, together with new multiyear budgeting techniques that focus on the results or outcomes of specific programs. These mechanisms build on regional and intertemporal competition, even if there are overlapping responsibilities. Each issue is discussed sequentially below.

Tax Instruments

A key element in accountable self-governance at the subnational level is access to own-source revenues at the margin so that a jurisdiction is able to raise the additional funds needed for its key local spending. This is also a fundamental precondition for the establishment of hard-budget constraints at the subnational level, without which no-bailout conditions are barely credible. However, whether a local jurisdiction has incentives to use its own tax instruments is heavily influenced by transfer design; if a local government could rely on transfers rather than own-source revenues, it probably would, with resulting erosion in accountability. This has been the recent experience in Mexico.

Another drawback to primary reliance on local tax bases is that these tend to vary considerably, especially in large countries. For instance, in Mexico, the Federal District accounts for roughly half of all property tax collections, which are in any case low even by Latin American standards. Thus, with considerable local variation in revenue bases and limited or no control over rate structures, the responsibility for providing a modicum of social services, especially in the poorer regions, generally passes to the higher levels of government (Table 18.1).

There is a tendency to administer broad-based taxes—such as a value-added tax (VAT) and corporate income tax—centrally, as in Mexico in the late 1980s, where a number of state-level taxes were abolished on efficiency grounds to make fiscal space for a centrally administered VAT. The states effectively ceded their tax bases to the central government for guaranteed transfers. Also, in China in 1994 the establishment of a VAT to be administered by a central State Administration of Taxation was a critical element of the fiscal reforms. More recently, in Australia a range of state taxes were replaced by a VAT, which is administered centrally, although all revenues collected are redistributed to the states through the Commonwealth Grants Commission.

In all cases, transfers have been established to compensate for the loss of sub-national revenues (particularly state or provincial sales taxes, among others) eliminated as a result of the establishment of the VAT. In China, the equalization transfer introduced in 1994 has gradually increased in importance as additional funds have been made available. Mexico had a complex system of untied and earmarked transfers but did not have an equalization framework. The weak own-source revenues of the lower tiers of government, together with limited accountability and an opaque

Table 18.1 Local government sources of tax revenues in selected countries, 2001
(% of total revenue)

Country	Income tax and tax on profits	Payroll tax	Property tax	General consumption tax	Taxes on specific goods and services	User charges	Other taxes
Australia	0.0	0.0	100.0	0.0	0.0	0.0	0.0
Austria	37.7	19.1	10.0	22.7	3.8	1.7	5.0
Belgium	85.8	0.0	0.0	1.4	7.9	4.6	0.3
Canada	0.0	0.0	91.6	0.2	0.0	1.6	6.5
Germany	77.1	0.0	16.6	5.2	0.5	0.4	0.2
Mexico	0.0	0.1	88.5	0.0	1.9	0.9	8.6
Switzerland	83.1	0.0	16.6	0.0	0.2	0.1	0.0
United States	6.2	0.0	71.5	12.4	5.1	4.8	0.0

Source: F. Ambrosiano and M. Bordignon, Normative versus positive theories of revenue assignments, in *Handbook of fiscal federalism*, ed. E. Ahmad and G. Brosio (Cheltenham, England: Edward Elgar, 2006).

and complex transfer design, probably explains why a central program in Mexico has been its most successful poverty reduction instrument. Lower levels of government lack the incentives or financing to effectively replicate Oportunidades at the subnational level.

Transfer Design

The central government may try to equalize fiscal capacities, as has been the case in many countries of the Organisation Economic Co-operation and Development, so that each local government has the capability of providing similar levels of services at similar levels of fiscal effort. This is the basis for equalization transfers in countries such as Australia.

The principles of the Australian system—focusing on spending needs and revenue capacities—have been adopted in China, and resources available for equalization purposes are gradually being increased. Information flows and the political process are important in ensuring that local officials are held accountable for the use of untied funds. Thus, in less developed countries, where information flows are problematic and incomplete, there may not be adequate moral suasion to ensure that the basic services are actually provided at the subnational level with sole reliance on “equalization transfers.”

Alternatively, the center may choose to provide such services directly or through special-purpose transfers designed to finance local provision of public services, say education or health care. This is the typical case, but it does not guarantee that the poorest will be reached because execution is typically undertaken by subnational governments. The difficulty is that any earmarked transfer from the central government imposes a constraint on the local government. Matching arrangements have been used extensively in some advanced countries, especially the United States, in order to obtain some “buy-in” from the local governments. However, in developing countries, need is likely to be greater in the poorer localities with weaker sources of own revenues. Hence, establishing matching criteria might actually exclude some of the poorest localities and therefore deserving recipients.

The linkages between transfer design and accountability, as well as incentives to raise own revenues and manage spending efficiently, are complex but very important. Typically, a range of transfers is used for different purposes. If the central government were to include “gap-filling” deficit financing among the set of transfers, it could viti-ate any of the other “incentives” to ensure the accountability of local officials.

How to Make Special-Purpose Transfers Work

Can adequately targeted expenditure programs that are financed by the central government but implemented by local governments be designed to minimize the incentives of local governments to divert central transfers for their own objectives?

This has been a perennial problem in China in cases such as ensuring minimum standards in education (for example, the number of years of schooling). Can communities determine priorities and monitor implementation? At the one extreme, there is a danger that funds could be diverted, and at the other, that unfunded mandates might be created; in both cases it is possible that services would not be provided effectively. Moreover, the priorities may not reflect the interests of the poorest, particularly the most vulnerable members of society without sources of family support; the benefits from the transfers might accrue largely to powerful interest groups or officials.

The central government's (or donors') challenge is to design appropriate special-purpose or targeted transfer programs that meet the needs of the poorest but are executed by recipient agencies or subnational governments. (The challenge is similar when an international agency or donor country provides financing for special purposes to be implemented in a recipient country.) The objectives of the center and the recipient governments are often likely to be different: the recipients may have less concern with providing for the poorest because the responsibility for these groups may effectively lie with the central government. In any case, in the absence of full information, the recipient local governments receiving funds could use them for other purposes without significant penalty in the traditional single-period budgeting framework.

A study by Ahmad, Tandberg, and Zhang models a three-tier hierarchical structure of government that may be relevant for large countries such as China or Mexico; in this structure the central government is at the top level of the hierarchy, several provincial (state) governments constitute the middle layer, and a few local or county-level governments within the administrative area of each of the provinces form the lowest tier. The interest of leaders of provincial and local governments is to maximize perquisites and their overall budgets.

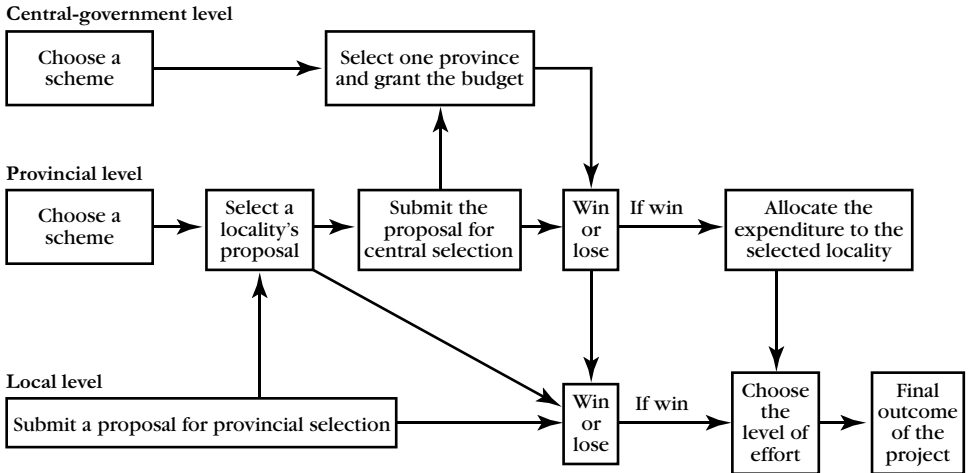
The central government sets aside a certain amount of financing for specific programs to be carried out by the localities (assuming that the central government cannot contract directly with the localities either due to high transaction costs or for political reasons). The interaction between the provincial and local governments is nested in the central selection process. Prior to the submission of its bid, the provincial government arranges a bidding process among its localities. Each county within the province offers a bid proposal. The provincial government selects one and formulates the provincial proposal based on the selected local proposals. If the province wins the program in the central selection, it will receive the amount equal to its budget bid. Next the provincial government decides the proportion of the budget to be allocated to the locality to carry out the program. Then the local government determines the amount of effort it will exert to implement the program. This decision subsumes "local capture" or other diversion of funds and is not directly observable by the higher levels of government.

Figure 18.1 presents a simplified decision diagram of the three levels of governments. The analysis required is similar to that used in the classical “prisoner’s dilemma.” It is generally not possible to obtain an efficient solution in a one-period game of this type. Unless the game is repeated or constricted in some other way, officials in transfer-receiving jurisdictions will make decisions that are individually rational but lead to suboptimal solutions and may not meet the objectives of the donor governments. There must be multiperiod interactions among the different levels of government. If the game is of only one period, local governments will bid as low as possible to obtain the transfer and may not implement the scheme effectively. In a multiperiod game in which the governments care for their reputation in the future, it may be possible to identify low-cost agents and to limit the possibility of a diversion of funds or inefficient implementation.

In order to mitigate against problems of asymmetric information, there must be some element of competition between different governments at the same level. There should be more than one province bidding for the program in the central selection and more than one locality in the provincial selection. To avoid moral hazard, the transfer scheme must include elements of punishment and reward from the higher administration to the lower levels of government based on the evaluation results of the final outcome. The punishment or reward serves as either a carrot or a stick in terms of its impact on the agents’ probability of winning future programs. The scheme also provides a “learning mechanism” whereby the outcomes in one period have an impact on the central government’s assessment of the abilities of lower levels of government to meet their objectives in subsequent periods. Indeed, in one set of observable programs “reputation” might be used as a proxy for likely effectiveness in program implementation in general—although there may be more incentive for local governments to implement investment projects rather than provide support to the indigent.

In order to be able to select the program bids through a competitive process, the central government must be able to specify elements of programs very precisely and to monitor the degree of compliance against these specifications. The objectives of the program should be measurable, be standardized across the localities, and involve as little subjective judgment as possible. After implementation, it should be possible to evaluate whether these objectives have been achieved with minimal ambiguity. Unless these conditions are met, agents may be able to influence the central government’s selection of program sites by providing substandard services in areas that are insufficiently defined in the program specifications.

Key elements of the scheme (consistent with what is observed in reality) are that the central government is able to set the policy agenda and also that it is able, in principle, to cut off funds for noncompliance with agreed conditions. However, threats to cut off funds for the poorest groups may not be credible, especially given

Figure 18.1 Decision diagram for three tiers of government

Source: Adapted from E. Ahmad, E. Tandberg, and P. Zhang, On national or supranational objectives: Improving the effectiveness of targeted expenditure programs, IMF Working Paper 02/209, International Monetary Fund, Washington, DC, 2002.

the overlapping responsibilities found in China or Mexico, but cross-conditionality involving threats to cut off investment funding strongly desired by local officials may be effectively utilized.

The design of policy to provide support to the poorest groups would involve cross-conditionality, whereby outcomes for provision for the poor could be built into the agreement or contract to provide investment funds for the localities. Thus, by virtue of setting the agenda, the central government could ensure that resources were adequately used for the poorest by threatening to withhold funds for projects or investments that were evidently preferred by the localities.

A central result of such policy design is for future transfers to be made conditional on policy reforms or on past performance. In practice, however, funds distributed by the central government are often independent of the past success of the program, given the typical single-year budgeting framework with little feedback based on outcomes. In many cases, there is an incentive for a donor government to continue to give transfers for the program, not just because of incomplete information but because funds that are not distributed might lapse. This places the emphasis on clearly identifying “outcomes” of policy actions that could be monitored and on ensuring that future budgets are linked to the achievement of the outcomes—a repeated-game perspective. In more advanced cases, this means of operating has led to the development of “contract federalism.” The findings of the model echo those

from the foreign aid literature, suggesting that the donor government's ineffectiveness in providing incentives to improve the performance of targeted expenditure programs may be the consequence of a time-consistency problem.

A policy option is to increase the effectiveness of targeted expenditure programs by introducing competition among local governments in different districts and across time. This formulation echoes the recent developments in the fiscal federalism literature that base efficient outcomes on enhanced competition. This allows the central government to distribute all the available transfers and is shown to solve the time-consistency problem just described. The funds that local governments receive depend implicitly on the central government's confidence in their ability to use them effectively. Therefore, even without explicit contracts, a local government may be induced to consider the central government's interests when deciding on its own actions. This increases the local government's likelihood of receiving more transfers in the future. In a one-period game approximating an annual budget process, recipient governments have incentives to cheat. Horizontal competition helps but is not sufficient to eliminate incentives to cheat.

A combination of both horizontal and intertemporal competition eliminates incentives to divert resources from the objectives of the central government. The competition elements have implications for the information flows and budget models that might be relevant to ensure that funds for programs to reach the poorest are not diverted to other uses.

Budget Processes and Transparency: Ensuring Accountability

The flow of standardized information is critical in providing a basis for evaluating how monies are used within and across jurisdictions. This involves the establishment of a common structure for budget classification, such as the International Monetary Fund's standard for economic classification—the *Government Finance Statistics Manual 2001*—or the United Nations' classification of the functions of government. This structure needs to be harmonized across all jurisdictions. In addition, most advanced countries use systems of treasury single accounts to manage and track the government's cash. In multilevel countries it is also critical to set up standards for disclosure and reporting by subnational governments.

Efforts to establish all of these requirements for information flows are under way in China but are only beginning in Mexico. In both countries, the immediate issue remains to formulate policies and implementation plans in the context of incomplete information on the use of funds. To some extent, the use of multiyear budgets and competition for the use of funds across local governments and over time should be feasible in the relatively short term, even if the main public financial management reforms are likely to take time to implement fully.

Without adequate systems to track and account for financial flows, attempts by central governments to introduce performance budgeting at all levels of government are unlikely to be successful. Indeed, experience has shown that these attempts may even delay the formation of the basic information building blocks that will be needed in the longer term. Without standardized information that can be used by households to compare performance across jurisdictions and to discipline local officials, it is not clear that reliance on citizens' action groups and communities to self-police spending will be sufficient to prevent misuse or divergence of funds, except perhaps in egregious cases.

The longer-term goal must remain to establish standards for information flows and reporting that lead to transparency across and within governments. These are critical in achieving accountable operations at all levels of government. However, an immediate measure that can be implemented in most cases is to begin to use feedback mechanisms in the budget process that take into account the effects and outcomes of programs in meeting the needs of the poor.

Policy Implications

Direct central provision of programs to support the poorest may be feasible in some countries but may pose significant administrative difficulties in most countries. Local design and implementation have the advantage of using local information, but in large countries the variance in resource levels across localities may make it essential that there be some central transfers for the poorest. The difficulty is that with centrally earmarked transfers, recipient governments have incentives to divert resources.

The typical one-period budget process encourages inefficient use of central transfers even if diversion is not intended. The central government would generally like to make transfers conditional on policy reforms or past performance. One of the key policy implications is that a multiyear budget framework, including multiyear appropriations, would greatly facilitate the achievement of central government objectives because it would open up the possibility of intertemporal competition across lower-level jurisdictions. Within-year and intertemporal competition across lower-level governments is important in mitigating the problems of asymmetric information. This also helps in controlling costs and ensuring efficiency in spending.

Cross-conditionality in the design of transfers is important to address political economy issues. Threatening to withhold funds for the poorest groups of society might not be credible. However, it is feasible to withhold investment funds if the poverty reduction objectives are not met. This cross-conditionality affects elements that are generally important in addressing the preferences of local officials and politicians.

The central government must precisely set the specifications of programs and the conditions to be met; it must also monitor the degree of compliance against these specifications. Although it might take time to establish proper financial information management systems at all levels of government—which applies to both China and Mexico—both outputs and outcomes should be carefully defined to prevent misuse or misallocation of resources.

It would also be helpful to be able to draw up actionable contracts between the central and local governments. Given that the allocation of inputs is not easily observable, as far as possible the contracts should be able to specify identifiable outputs (even if the outcomes may not be simple to specify or monitor in many developing countries).

In more advanced countries, it might be possible to move toward performance budgeting at all levels of government, although the preconditions for this are quite demanding. But, in the short run, there is considerable promise in clarifying responsibilities, defining outcomes, and using targeted transfers within a multiyear budgetary context.

For Further Reading

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