



Note for Chairman Provincial Finance Commission Sindh

Subject: DISTRIBUTION OF DSSP Conditional Grants

Terms of reference of the Provincial Finance Commission include determination and preparation of revenue and expenditure benchmarks for intra-governmental transfers and determination of retained and Allocable amount and making recommendations for horizontal distribution of revenues amongst district governments. First Interim PFC Award was given in 2002 laying down different formulas for current and development expenditure for horizontal distribution from divisible pool amongst the district governments.

2. **Second PFC Award** was given in 2004. This time the practice of specifying separate divisible pool for current and development expenditures was done away with and an element of performance based grant was introduced. The horizontal shares of district governments are determined according to the following formula:

➤ Population	50%
➤ Backwardness	17.5%
➤ Tax Collection	7.5%
➤ Transitional Transfers	20%
➤ Performance	5%

However, the exact mechanism for measuring performance was not described in the Award and neither any formula for evaluating performance was devised. All allocations were made on remaining indicators.

3. The Government of Sindh has engaged a consultant firm to propose a mechanism for introducing performance based grants in the PFC Award. The consultant firm, under the auspices of Decentralization Support Program (DSP) and Provincial Finance Commission Secretariat, is in the process of developing a mechanism which would lay out the principles of conditional grants, various design options, the indicators and benchmarks to be used for these grants as monitoring tools and the roles and responsibilities of the PFC and different stakeholders in managing these grants. The firm is still engaged in data analysis and development of various designs as and that part of their work, leading to precise recommendations for a final performance grant design, will require more input. However, the principles of performance based criteria proposed in the current Award is likely to remain unchanged. The Senior Minister for Finance Syed Sardar Ahmed has already committed towards this objective in his meeting with ADB's Review Mission on April 2005.

4. Sindh Devolved Social Services Program (SDSSP) is a direct budgetary support to improve health, education, and water and sanitation. The Program is financed



by Asian Development Bank It aims to support financing, capacity building, partnership building and reforming of Sindh's devolved social services at the District level in Education and Health, and in Water Supply and Sanitation Sector at Town/Taluka Municipal Administration (TMAs). To ensure transparent and objective transfers to LGs, funds under SDSSP are routed through Provincial Finance Commission (PFC). A multiple indicators based formula was devised in PFC Award, June 2004, according to which the grant has to be divided between Districts and TMAs in the ratio of 70:30 on the basis of following distribution formula:

- Population 50%
- Backwardness 30%
- Equal Share 20%

5. The problem of higher per capita unit cost of service provision stems from, besides other factors, sparse population in some jurisdictions than others. Low population density adversely affects the economies of scale when service is provided in thinly populated areas. To account for this issue the indicator of inverse population density is used under which more transfers flow to the areas with sparse populations. Likewise, the transfer of conditional grants on performance based criteria would have the potential to induce local governments to rationalize public expenditures and attain cost efficiency in the public service provision. While the indicators of population and backwardness are considered appropriate for the purpose of meeting fiscal need the component of 20% equal share is proposed to be revised on the following formula; -

- Population 50%
- Backwardness 30%
- Inverse Population Density 10%
- **Performance 10%**

6. The PFC has already approved the performance based mechanism as described at para 2 above however, the exact sectoral indicators and the mechanism of judging performance would be finalized in the light of the PFC study. This concept note is being moved for the purpose of demonstrating our commitment towards rewarding better performance and indicating the new formula for distribution of Sindh DSSP subject to its formal approval by the PFC for year 2005-06.

7. Chairman PFC may approve para-6

Chairman PFC

Malik Asrar Hussain
Secretary Finance

Saukat Ahmad

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