REACH Learning Series:

“Do Fiscal Transfers Generate Results? It’s Debatable” event.

Co-organizers: Education and Governance GPs.

NOTES

“The practice of inter-governmental fiscal transfers is the magical art of passing money from one government to another and seeing it vanish in thin air.” (Anonymous)

“Fiscal transfers can create incentives and accountability mechanisms that affect the fiscal management, efficiency, and equity of public service provision and government accountability to citizens.” (Anwar Shah)

These two views of how intergovernmental fiscal transfers work kicked off a cross-sectoral debate on whether fiscal transfers in education can generate key education sector results.

In order to ignite a debate around the topic, Debbie Wetzel, Senior Director of Governance GP and Teresa Curristine from the IMF were asked to argue for and against results-based fiscal transfers. And a great debate it was, even if at the price of Debbie having to suffer from temporary amnesia to be able to defend the counterargument.

What results?

There are three types of results that fiscal transfers can generate:

1. Correcting for vertical imbalance (mismatch of revenue and expenditures)
2. Correcting for horizontal fiscal gap (variation across sub-national governments), aiming to ensure that the sub-national governments all have sufficient funding to offer education services to their school age population

For the purposes of this discussion, the results were defined around the third point -- that transfers could be used to incentivize performance on key sector results i.e. technical efficiency (e.g. improve pass rates), allocative efficiency (e.g. reduce inequalities in service) and student performance (e.g. increase learning).

Evidence Base

The evidence base is currently thin, but Teresa Curristine argued that there is enough evidence to state that results based fiscal transfers have worked and do generate results. Going forward, it’s a matter of putting the evidence together in order to produce a stronger evidence base.

Looking at the existing cases, Teresa suggested that performance based fiscal transfers can be divided into three categories: i) Main funding being performance based, such as financing of higher education in the Nordic countries; ii) Top-up schemes where the entities receive performance bonuses additional to
their regular budget allocation if certain results are achieved, and iii) funding on performance on implementing reforms such as the Race to the Top in the United States.

In the session, two country cases were presented to illustrate how outcome linked transfers can work: Argentina’s Plan Nacer in the health sector and the Mozambique PFM in education. Both programs represent primarily the second case in Teresa’s categorization, with only 1-2% incremental funds being linked to results in Plan Nacer; and the Mozambique PFM as a whole being incremental to the core sector financing, even if within the program almost 80% of the funding is performance based.

Both examples demonstrate how even a small amount in the institutional level can create a strong incentive for improved performance and focus on key results. The transfers in Plan Nacer have also proven to have gradually initiated deep structural changes. It was suggested by Jesko Hentschel, the Country Director for Argentina that implementing more robust reforms should in fact be done gradually, in stages, moving from top-up schemes to systemic reforms over time.

Moreover, the Plan Nacer experience indicates that performance based transfers can contribute to equality of service providers. The transfers helped to improve the performance of the lower performing center disproportionally to the better performing ones. The effects in their performance were immediate, but also remained higher 2 years after the incentive structure was discontinued due to better structured services and improved knowhow.

It is not clear how these particular lessons apply to education sector. Therefore, in addition to building the evidence base, it is also necessary to explore how the lessons from health can help us in implementing the education sector transfers.

Challenges

Debbie Wetzel, playing the devil’s advocate pointed out several key challenges in trying to generate results using fiscal transfers as the vehicle. In addition to the WHAT, she argued, challenges arise with the WHO and HOW. Some of the main concerns highlighted by her, complemented by points raised by other participants include:

1. **Education is a complex process** with a variety of actors and factors directly and indirectly linked to the key outcomes.
   - Who needs to be influenced to generate results?

2. **Fiscal revenue and transfer systems, as well as the overall incentive structures are equally complex.**
   - How to situate reforms properly in a country’s existing intergovernmental financing system, without aggravating the existing transfer systems and affecting the equalizing goals negatively?
   - What kind of improvements are necessary in the public financial management system to be able to implement smart performance based allocation schemes?

3. **Technical aspects can confound program designers.**
• How will results be measured, is the data adequate and are the risks of gaming the data adequately managed?
• What kind of formula to use to reward performance without favoring smaller units and disincentivizing larger ones?

4. Finally, the surrounding politics exacerbate the task at hand.
• How to ensure the political space and willingness to hold the providers accountable?
• How to make sure the programs survive government transitions?
• How to manage the controversial nature of linking funding to performance?
• How to move away from earmarks when most financiers/allocators as well as the providers like to hang on to discretion?

**Mitigating for the risks**

As both key debaters emphasized, the key to success in results-based transfers is in the design, even more so than in traditional programs. Proper problem analysis is essential and the results chain needs to be well thought through before transfer formulas are changed to incorporate a results-based component. Having reliable data on outputs and outcomes is a key, and the good news, according to Teresa, is that in education this data is more readily available and better than in many other sectors.

Solid design was also mentioned by Teresa as the main recipe for mitigating against gaming and corruption. It is possible to design the systems to adjust to them, and “game the gamers”. Moreover, Keith Hansen who chaired the event, pointed out that outcome based transfers pose less rather than more opportunities and “incentives” for corruption or gaming due to the extensive verification processes and cross-checking by third party verifiers and the fact that the end outcomes are harder to falsify.

In terms of continuity of programs, Mexico’s Prospera and Bolsa Familia were given as examples of successful programs that survived through several government changes. To accomplish this, the programs need to be designed in a way that promotes ownership by the users as well as the government, complemented by appropriate accountability measures for the government, and in a way that maximizes their political gains.