Social Protection Discussion Paper Series

Social Funds: A Review of Public Sector Management and Institutional Issues

Mukhmeet Bhatia

May 2005

Social Protection Unit
Human Development Network
The World Bank

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Abstract

While acknowledging the role of Social Funds in making effective investments to meet community needs, this study focuses on another crucial dimension: their impact on overall public sector management. The key question addressed is the role of social funds in building institutional capacity for designing, implementing, and delivering economic and social services. The areas considered for analysis include autonomy, budgetary issues, accountability, political interference, the effects on decentralization, the long-term role of social funds, and exit strategies. The study reveals that a clear vision of the role of social funds with respect to other public and private institutions can help in a program design that integrates public sector management and institutional issues into all stages of the project cycle. More specifically, the study recommends that social funds should be designed to act as catalysts toward public sector reforms, by grafting their positive features and incentives onto government structures.
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<td>BEEP</td>
<td>Basic Education Expansion Project</td>
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<td>CIF</td>
<td>Community Investment Fund</td>
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<td>DIF</td>
<td>District Investment Fund</td>
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<td>ECDF</td>
<td>Eritrea Community Development Fund</td>
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<td>Social Investment Fund, Argentina</td>
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<td>ICR</td>
<td>Implementation Completion Report</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IDB</td>
<td>Inter-American Development Bank</td>
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<td>IGR</td>
<td>Institutional Governance Review</td>
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<td>MASAF</td>
<td>Malawi Social Action Fund</td>
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<td>MPU</td>
<td>Microproyect Unit, Zambia</td>
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<td>MTR</td>
<td>Mid-Term Review</td>
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<td>NGO</td>
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<td>Project Appraisal Document</td>
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<td>PPAF</td>
<td>Pakistan Poverty Alleviation Fund</td>
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<td>PPAR</td>
<td>Project Performance Assessment Report</td>
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<td>PSR</td>
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<td>RSDF</td>
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Executive Summary

1. Although social funds have established themselves as quick and efficient systems for making investments to meet the needs of communities, there is considerable debate about their impact on overall public sector management. One key question is whether they help build institutional capacity for designing, implementing, and delivering economic and social services or whether they displace or weaken existing institutions such as sectoral ministries and departments. There also are concerns about budgetary issues, accountability, political interference, the effects on decentralization, the long-term role of social funds, and exit strategies. This study is designed to contribute to a better analysis of social funds by bringing institutional and public sector issues into the frame of analysis. A clear vision of the role of social funds with respect to other public and private institutions can help practitioners improve the design, implementation, and monitoring of social fund projects.

2. This study, based on a desk study of 15 social funds, examines some of these issues, stressing the need for systematic analysis of the public sector management and institutional context into which social funds are introduced. Its broad findings, presented in the form of an analysis rather than a definitive study, include the following:

3. **Autonomy.** Concerns about autonomy stem from the principle that government, not independent agencies, should make decisions about the allocation of scarce public resources. Most social funds are part of the overall public sector, and they owe their agility and responsiveness largely to the managerial and operational autonomy they are given. This autonomy may take the form of partial exemption from existing public sector laws and regulations, such as civil service salaries and procurement and disbursement regulations. One defining feature of social funds is their use of operation manuals for day-to-day functioning. But social funds have very little policy autonomy since their policies are predetermined and overseen by boards or steering committees on which government officials hold a significant share of seats.
4. **Staffing and Salaries.** Base salaries are significantly higher in social funds than in the public sector, but the two are not strictly comparable because public sector employees enjoy greater job stability and receive generous housing, medical, and pension benefits not available to social fund employees. A more revealing comparator is operating cost per unit of investment. Social fund salaries are often aligned with private sector salaries. There is very little evidence of officials moving out of government agencies to social funds. Funds may even decrease staff movement out of the public sector.

5. **Procurement and Disbursement.** Although social funds are often criticized for lacking rules beyond those imposed by donors, there is little evidence to suggest that social funds distort procurement or disbursement any more than other World Bank– and donor-funded projects. On the contrary, social funds usually promote much more transparent, simple procurement practices than line ministries do. In many cases, social funds have tested new approaches to traditional practices and found more innovative ways of doing things. Social funds have been at the forefront of pioneering work to simplify community-based contracting procedures that promote simple, transparent procurement practices by maintaining unit costs for commonly procured items and establishing registers of contractors. This work has led to the effective and speedy implementation of numerous small, localized subprojects.

6. **Budgetary and Accountability Issues.** Social funds are being increasingly integrated into national budgets, but the donor portion of funding needs to be much more integrated. The concern that social funds add to the recurrent costs of government is being addressed through improved coordination with sectoral agencies and advance identification of sources for meeting recurrent liabilities. There is little evidence that social funds “crowd out” local spending or lead national governments to decrease financial commitments to certain sectors. In fact, social funds may be instrumental in attracting funding from other sources (foreign donors, community contributions) for investment or recurrent costs that would not otherwise exist.
7. **Relationship with Sectoral Agencies.** This is by far the most contentious issue in the relationship between the public sector and social funds. Although social funds are accused of undermining sectoral coordination and weakening line ministries, the current generation of funds has developed several ways to enhance synergies between the two. They also contribute to institutional development and to demand for sectoral reforms by engaging communities and civil society in the quest for better service delivery. Better sectoral coordination in the current generation of social funds has enhanced prospects for investment sustainability.

8. **Decentralization.** Social funds are increasingly working to balance the long-term objective of building capacity in the permanent structures of local government and the immediate need to deliver services to poor people in the most efficient and cost-effective way. A steady shift of responsibilities from social funds to decentralized agencies is simultaneously becoming a key objective of funds. The effect of social funds on intergovernmental fiscal transfer systems is an interesting issue that needs further study.

9. **Exit Strategy.** The decision to extend the life of a social fund needs to be made after an objective, rigorous cost-benefit analysis that explicitly acknowledges the need to have a long-term, durable system of addressing the basic service needs of communities. With newer social funds playing a greater role in institutional development instead of providing basic infrastructure, the emphasis is now shifting from devising exit options to crafting evolution strategies.

10. **Political Economy.** There is not enough evidence to prove that undue partisan politics affects the allotment of funds. Nor is there enough evidence to prove that investments in government programs are subject to less influence than social fund investments. Some of the analytical tools being developed in the Public Sector Group of the World Bank can shed light on this issue.
11. **Corruption.** A key hypothesis raised in this study is that social funds are cost-effective primarily because they reduce corruption. There is insufficient evidence to come to a definitive conclusion, but this study emphasizes the high degree of transparency in social fund operations achieved through computerized management information systems, widely distributed operation manuals, frequent audits, and sustained information campaigns. When social funds reduce corruption, the net effect plays out in three important dimensions: offering an alternative that is less corrupt, reducing dependence on existing corrupt systems, and creating other positive externalities that increase pressure for corruption-free services from other public agencies.

12. **Relationship with the Public Sector.** The nature of interactions between social funds and the public sector have changed as social funds have evolved—a theme that runs through this study. The learning curve of social funds has been steep, and it is important to regularly reevaluate interactions with the public sector. Most of the issues highlighted here are equally relevant to a large body of lending by the World Bank and other donors. Social funds are often a target of criticism that is actually more generic.
1. **Introduction**

1.1 Social funds, among the many instruments available to alleviate poverty and foster development, have existed for more than 17 years. Initially tailored to cushion the impact of macroeconomic stabilization policies in Latin America, social funds now have a more mainstream role in facilitating development investment at the community level. The World Bank has been a significant supporter of social funds, financing almost US$4 billion in social fund–type projects in some 60 countries. This financing has been leveraged by an additional US$5 billion from other multilateral, bilateral, and domestic resources.¹ Given their innovative and high-profile approach to community development, social funds have been both extolled and criticized by a spectrum of development professionals.

1.2 Social funds are generally regarded as quick, efficient investment mechanisms that allow communities to take the lead in setting priorities. Because social funds attract external resources and efficiently execute investments, they have rapidly grown in terms of the level of investment and in the expansion of their mandate. Though there is no universally accepted definition of social funds, the most commonly accepted one describes them as agencies that finance small projects in several sectors targeted to benefit poor and vulnerable groups based on demand generated in a participatory manner by local groups and screened against a set of eligibility criteria (Jorgensen and Van Domelen 2001). Social funds operate as intermediate agencies that appraise, finance, and supervise implementation of social investments identified and executed by a wide range of actors, including local governments, nongovernmental organizations (NGOs), local offices of line ministries, and community groups. Objectives of social funds include providing compensation to poor people during economic crisis and adjustment, achieving long-term poverty alleviation, creating social capital in marginal areas and among marginal populations, and building and rehabilitating social infrastructure.

¹ The Inter-American Development Bank has been another important player, investing US$2.7 billion in more than 40 such funds.
1.3 Although this study looks specifically at social fund programs, it raises issues equally relevant to other multisector, demand-driven, fund-based programs for local development and poverty reduction. These programs generally follow the community-driven development (CDD) approach, go by many different names, and have different operating characteristics depending on objective and country—but they all share an emphasis on local development and community engagement.² Although the design of social funds varies considerably, most funds share the following features:

- Autonomy or semi-autonomy on managerial and operational matters.
- Flexible operating procedures for recruitment, remuneration, and project approval.
- Demand-driven processes, beginning with identification of subprojects by communities.
- Direct financing by communities.
- Community management of subprojects.
- Projects that work across sectors, depending on the needs of particular communities.
- Community contributions that partially cover subproject costs.

As a result of these common design features, quick and efficient implementation of community subprojects is the hallmark of social funds.

Recent Findings

1.4 The proliferation of social funds has led to extensive studies focusing on poverty targeting, efficiency, effectiveness, and sustainability. These include two exhaustive studies piloted by the World Bank.

² Many programs termed social funds concentrate on building social infrastructure but not all of them.
The first study (Rawlings and others 2004), based on field surveys in six countries, concluded that:

- Social funds reach poor people—including the poorest people—at both the geographic and household levels.

- Community-level investments reflect expressed local priorities.

- The quality of social infrastructure and level of service is better in areas served by social funds than in ones served by other agencies.

- Social funds do not always have lower unit costs than other kinds of agencies, but there is notable variation across countries and sectors.

- Social fund subprojects mobilize complementary inputs in most cases, but social funds by themselves cannot improve living standards.

The study acknowledged, however, that, “Broader institutional questions about the appropriate role of social funds within the government framework, and potential effects, both negative and positive, on other public sector actors were not explored. The role of community-level investments in broader strategies to reform public sectors and build national poverty alleviation strategies is an important area of future research.”

A separate study by the Bank’s Operations and Evaluation Department (World Bank 2002a) included a more detailed section on the institutional development impacts of social funds. Its key findings were:

- Social fund implementing agencies are characterized by organizational effectiveness and innovation in project management.

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3 For Armenia, Bolivia, Honduras, Nicaragua, Peru, and Zambia, the study asked four fundamental questions: (i) Do social funds reach the poor? (ii) Do social funds impact living standards? (iii) What is the quality and sustainability of social fund infrastructure investments? (iv) How do social fund investments compare with institutions undertaking similar investments?
• The role of social funds in relation to line ministries has been inherently unclear, and coordination problems exist.

• Social funds can be subject to undesirable political influence.

• Social funds can influence government capacity through direct assistance, demonstration, and learning-by-doing effects.

• Social funds may inhibit sectoral planning and may displace or undermine sectoral reform efforts.

• Social funds significantly affect local governments, both positively and negatively.

• Social funds have had a generally positive effect on the private sector and NGOs.

1.7 Though the second study identified some of the institutional issues, the focus was largely on targeting, cost-effectiveness, and sustainability. Subbarao (1997), referring to social assistance programs in general and not specifically to social funds, discusses the institutional concerns that have not received adequate attention: “Institutional autonomy and positioning of social assistance programs are issues in many countries. On the one hand, autonomy allows for rapid, transparent action that bypasses public sector bureaucratic procedures (which are often costly and time-consuming), reduces administrative costs, and directly channels benefits to the poor. On the other hand, there is the issue of longevity of extra-institutional social assistance programs; neither their budgets nor their operating procedures have any permanent guarantees. If such programs are considered short-term measures during periods of adjustment or recovery, then institutional autonomy is less of a concern. If they are considered longer-term complements to social sector policies, then it is usually necessary to establish institutional links.”
Rationale for this Study

1.8 Because social funds are usually set up as temporary units, their long-run position in the government has not been clearly defined. Several disparities between social funds and line ministries and local governments need to be addressed if social funds are to become integral parts of government efforts to address poverty. Line ministries must follow normal government budget processes, for example, but generous donor financing makes social funds more independent. And relying on foreign funding often makes social fund managers answerable to donor requirements as well as national development norms and policies. Special exemptions also allow social funds to pay higher than normal salaries, which attracts better technical staff than ministries do. Moreover, dispensations from certain national laws, such as procurement laws, have enabled social funds to act more swiftly and project a “can do” image compared with the mainstream bureaucracy (IDB 1998).

1.9 These issues have not received adequate attention, but the need to address them has grown as social fund operations have expanded. To improve overall public sector management, this study seeks to help the Bank and its clients minimize the potentially distortionary effects of social funds and better align funds to the specific institutional contexts of the countries where they operate. Given this background, the objectives of this study are to:

- Summarize the main concerns expressed about the impact of social funds on public management issues.

- Analyze the validity of the concerns by (i) reviewing what has been published and (ii) looking at 15 social funds through a desk review.

- Suggest research questions for an analytical agenda on this topic.

This study looks only at social funds, but the World Bank and other donors support several other autonomous institutions. Given the wide variety of these institutions, both in form and
function, it would be futile to try to extrapolate the findings of this study beyond social funds. But the findings discussed here could form the basis for a separate study of these other institutions.

**Methodology and Scope**

1.10 This study draws lessons from the experience of social fund programs. Predominantly desk-based, it focuses on 15 World Bank projects, with an appropriate mix of recently completed and ongoing projects (annex 1).\(^4\) The documents studied include the Project Appraisal Documents (PADs), Project Status Reports (PSRs), Mid-Term Reviews (MTRs), Implementation Completion Reports (ICRs), and Project Performance Assessment Reports (PPARs) by the Bank’s Operations Evaluation Department. Interviews with task managers, experts in the Public Sector Group, and other stakeholders in the Bank supplemented these reports (annex 2).\(^5\)

1.11 The scope of the study is admittedly limited. This study does not look at issues that have been extensively covered in the Bank’s two recently concluded studies or in a number of impact-evaluation and beneficiary-assessment studies, such as poverty targeting, efficiency, effectiveness, and sustainability. Moreover, this study is limited to social fund projects that were aided by the Bank, and it excludes many instructive cases of social funds financed wholly by governments. Even under the “public sector and institutional” umbrella, it is not possible to cover all the issues. This study emphasizes those that are more universal and that apply to a broad spectrum of social funds. It concentrates in particular on issues that affect the future design of social funds. Certain other public sector issues, such as the role of social funds in decentralization, are being increasingly studied elsewhere and are not a prime focus of this study.

\(^4\) The regional breakdown of the 15 social funds is: Africa—5, East Asia and Pacific—2, Europe and Central Asia—3, Latin America and the Caribbean—3, Middle East and North Africa—1, South Asia—1. This selection is broadly a reflection of the distribution of social funds in the various regions.

\(^5\) Versions of this paper were presented and discussed with national program managers and staff at the Regional Workshop of the Social Network of Latin America and the Caribbean in Ocho Rios, Jamaica on February 26–
The remainder of the study is divided into four sections. Section 2 looks at the theoretical underpinnings of an institutional analysis of social funds. Section 3 looks at the public sector management issues that have been the subject of intense discussion. Certain issues that are not directly the focus of criticism but are equally relevant to this study are examined in Section 4. Section 5 provides some concluding comments, offers some broad recommendations, and identifies areas where further research is needed.

2. Social Funds through an Institutional Lens

2.1 This section examines the analytical underpinnings of this study. The first subsection places social funds in the broader context of “autonomization”—that is, the establishment of autonomous and semi-autonomous entities in the public sector. The entire institutional debate is centered around whether a country should invest in a separate social fund to support the provision of basic social services rather than focus on directly fostering change. Consequently, the issues that acquire relevance are coherence of staffing, procurement, and investment policies of social funds with those of public agencies; coordination with sectoral and decentralized agencies; and the long-term role of the social fund. The second subsection explains the need to look at public sector and institutional impacts in evaluating decisions to establish a social fund (or make any other development investment).

Social Funds as Autonomous Institutions

2.2 The decision to adopt a social fund–type of intervention is often dictated by the capacity of public institutions and how effectively they meet their mandates. The World Bank’s Public Sector Group has highlighted the importance of three mechanisms that promote public sector effectiveness and good governance (World Bank 2000):

- Internal rules and restraints, both in countries and in individual organizations—for example, internal accounting and auditing systems, a civil service, and budgeting rules.

- “Voice” and partnership—for example, the empowerment of communities through decentralization and the use of service delivery surveys to solicit client feedback.

- Competition—for example, competitive social service delivery and private participation in infrastructure and certain market-driven activities.

While the importance of internal rules and restraints and competition has long been understood, it also is recognized that they need to be supplemented by greater attention to
voice. Social funds can enhance voice and competition or undermine internal rules and restraints.

**Government Agency and Social Fund Risks**

2.3 Many social funds were formed when privatization and contracting were not considered viable. So many governments had to choose between channeling development investment through social funds or through the existing machinery of the government (mainly line agencies). Embedding ongoing programs in line ministries and setting up separate autonomous or semi-autonomous agencies each carries its own unique risks (Van Domelen 2000):

- **Government agency risks**
  - A weak civil service that may not know or be responsive to the preferences or needs of local communities. (This problem is often manifested by a preference for large infrastructure projects.)
  - Weak management and an inability to attract trained personnel.
  - Too little participation and empowerment from the community.
  - Inability to innovate.
  - An incentive structure that does not promote performance.

- **Autonomous fund risks**
  - Limited impact on poverty if not scaled up.
  - Reduced sustainability from weak outreach and transfer of capacity.
  - Lack of integration with the rest of the public sector and with central government priorities and sectoral strategy.
• Duplication of effort with other programs.

• Risks shared by both arrangements
  • Corruption and political manipulation.
  • Benefits being captured by nonpoor people.
  • Inability to reach or engage the most vulnerable groups.
  • Disarticulation with other actors at central and local levels.
  • Self-interested contractors and intermediaries that discourage active community participation.
  • Financial structure constraining ability to scale up.

2.4 In addition to government agencies and autonomous funds, local governments have an increasingly important role in development efforts (annex 3).

Autonomization

2.5 The process of setting up autonomous and semi-autonomous entities in the public sector is often referred to as “autonomization.” The Public Sector Group within the Bank distinguishes between two main types of autonomization (World Bank 2003):

• Type 1. Agencies are expected to improve operational efficiency in service delivery through greater managerial discretion and flexibility combined with relatively secure funding and organizational autonomy. Some typical examples are social funds and road funds.

• Type 2. Agencies are given statutory independence to carry out activities, such as long-term policymaking or judicial or regulatory functions, that require protection from
politicians’ short-term orientation. Independent central banks and supreme audit institutions are good examples.

2.6 In developing countries and transitional economies, setting up agencies is often proposed as a means of protecting important functions from poor governance in core government (Laking). But autonomous agencies can harm the public sector as a whole. According to a World Bank (2003) study, some of the potential hazards are:

- **Policy lock-in.** Autonomous agencies may undermine policy objectives by creating constituencies that compel governments to maintain existing policies.

- **Policy creep.** Autonomous agencies may adopt quasi-fiscal activities that stretch beyond the original policy intention of government.

- **Budget balkanization.** Autonomous agencies may undermine the coherence of the budget.

- **Patronage den.** Autonomous agencies may facilitate political patronage.

- **Special privileges.** Autonomous agencies may distort public sector incentives.

2.7 A key question is why should a donor or country invest in autonomous agencies to support the provision of basic social services, rather than focus on fostering change directly. As an example, the experience of low-income countries under stress (LICUS)\(^6\) suggests five reasons for adopting a solution that bypasses the public bureaucracy altogether, to deliver basic services (box 2.1):

- Basic health and primary education services may be particularly poor because governments are disinclined or unable to provide them.

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\(^6\) Low-income countries under stress (LICUS) are characterized by very weak policies, institutions, and governance. Aid does not work well in these environments because governments lack the capacity or inclination to use finances effectively for poverty reduction. The strategy for improving basic social outcomes is to supplement weak central government delivery of social services by strengthening multiple alternative channels (World Bank 2002).
• Fundamental change in mainstream institutions may take a long time to achieve, and neglect of basic human services of health and education may do irreparable damage in the meantime.

• Support for institutions that provide primary education is likely to promote broader change, and quick provision of health, water, and sanitation services will help curtail diseases that have international effects.

• Electorates in developed countries have come to regard primary education and basic health as particularly legitimate uses of aid.

• By visibly helping poor people improve their access to education and health, donors can increase the perceived legitimacy of their efforts to produce change (World Bank 2002).

Box 2.1 Innovations in Service Provision: Independent Service Authorities

A possible model for financing basic services in low-income countries under stress is an independent service authority that would:

• Be largely autonomous from government, with transparency, financial accountability, and intensive donor scrutiny of performance.

• Have appropriate incentives.

• Be a wholesaler, contracting with multiple channels for retail provision—private, nongovernmental organization, local government—with performance at the retail level properly monitored so that cost-effectiveness could be compared.

• Finance both capital and recurrent costs as necessary, financing a flow of services rather than pump-priming projects.

• Coordinate donor efforts in basic service provision, functioning like a multidonor trust fund.

• Ensure that extra donor resources would be matched by extra government financing rather than offset by reduced government spending.

• Be a transitional body, serving while governance is weak and subject to a sunset provision.

These features are found separately in existing institutions and already mostly incorporated into social funds. Independent service authorities can be and should be specifically tailored for the distinctive problems of each low-income country under stress.

2.8 The low-income countries under stress task force cautions that donor-financed programs characterized by good organization, ownership by the society, integration at the local level, and approval by the central authority can only be a transitional solution. Of course, the duration of such a transition may be quite long. (The issue of the appropriate lifespan of a social fund is discussed in section 3.)

The Need for a Broader Framework

2.9 Evaluations of the efficiency of social fund investments often look at only economic and social gains. But that approach ignores two important types of impact that may not be substantial in the short term, but are important in the long term: the gains or losses in community capacity and the effects on existing institutions.

Community capacity-building

2.10 Community capacity-building refers to the enhanced skills, abilities, and knowledge that communities gain from direct involvement in development initiatives. It consists of gains both at the individual level, in the form of technical skills, and at the collective level, in the form of greater organizational capacity. It also includes growth in social capital and increase in empowerment.

2.11 Though often used interchangeably with the term capacity-building, institutional development is used in this study to refer to impacts on actual organizations, while capacity-building is used only in the context of communities. Institutional development impacts can be positive or negative. For instance, if decentralized bodies are bypassed on economic efficiency grounds that could weaken them. On the other hand, if NGOs are used as implementing agencies, they might be strengthened as organizations, producing an institutional gain. The World Bank’s Operations Evaluation Department defines institutional development impact as “the extent to which a project improves the ability of a country or region to make more efficient, equitable, and sustainable use of its human, financial, and
natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements.”

**Box 2.2 Counterfactuals for Nicaragua’s Emergency Social Investment Fund**

Given the public nature of the social and economic infrastructure targeted at poor communities that Nicaragua’s Emergency Social Investment Fund (FISE) finances and the scarcity of private and public funds available for these investments, the most likely counterfactual would be for line ministries to reabsorb the responsibilities FISE has for infrastructure investments. While quantitative analysis of this alternative presents certain comparability problems, several factors favor the project’s approach:

- Reabsorption of FISE’s investment functions by line agencies would significantly reduce national capacity to address the investment needs in social and economic infrastructure and social services. Despite assistance from numerous financing agencies, including the International Development Association, modernization and reform of the line ministries has been a slow process.

- Overall costs would likely be higher for the standalone projects that individual ministries would run to carry out sectoral investment programs. FISE’s ability to operate efficiently (operating costs were about 10% in 1997) and on a massive scale has had much to do with its specialization and economies of scale.

- FISE’s design also produces allocative efficiencies that would be difficult to replicate in standalone sectoral investment projects: by promoting local participatory decisionmaking, FISE empowers communities to allocate scarce resources across sectors, thereby ensuring that resources are applied optimally in response to local priorities.

- FISE has proved able to mobilize resources that might otherwise remain untapped. By promoting participatory decisionmaking and by requiring commitments and contributions from communities and municipalities, FISE mobilizes additional resources for investment and maintenance.


**Counterfactual**

2.12 The net impact of a social fund is the sum of its impacts on economic and social welfare, community capacity-building, and institutional development. Combining all these impacts produces a simple framework (annex 4). If the net value of these impacts is positive, it makes sense to invest in a social fund. But to completely validate a decision to invest in a fund, examine the counterfactual: could an investment in some other mechanism have been more productive? Other options include channeling the investments through local government, line agencies, or civil society organizations. Box 2.2 illustrates some of the
counterfactuals offered for Nicaragua’s Emergency Social Investment Fund (FISE). As a World Bank (1997) study cautions, “The rationale and appropriateness of social fund projects should be considered explicitly in each country in relation to the requirements and alternative approaches for extending services to the poor, enhancing sectoral performance, and improving public investment.”

2.13 Many studies have been done purely from the economic and social efficiency point of view. Evidence suggests that community projects implemented through social funds perform better than ones implemented through “government-as-usual” processes. Capacity-building gains also have been discussed extensively, but because the impacts are often intangible, very little headway has been made in developing units of measurement and comparison. Institutional impacts are the least studied, often relegated to the background. They are not very amenable to quantification, have a longer time frame in which their effects persist, and are accorded less importance because of their low visibility. But institutional impacts are the focus of this study.

2.14 In communities with well-functioning administrative systems, the net impact of a social fund on institutional capacity may be small, and the investment resources provided through it may just as well be channeled through existing structures. On the other hand, some public agencies deserve to be crowded out. When existing institutions are worse than having no institutions—say, because of corruption—the net impact of social funds on the quality of public administration could be larger than the gross impact. This suggests that when assessing social funds, analysts must be explicit, if only in qualitative terms, about the nature of the institutions being replaced.

2.15 With this framework for analysis, this study will now examine the public sector management issues behind the debate over the institutional impact of social funds.
3. Public Sector Management Issues

3.1 The public sector and institutional issues involving social funds can be broadly classified under the following categories:

- Autonomy.
- Staffing and salaries.
- Procurement and disbursement.
- Budgetary and accountability issues.
- Relationship with sectoral agencies.
- Decentralization.
- Exit strategy and limited long-term role.
- Institutional development of other agencies.
- Political economy.
- Corruption.

The first seven topics will be discussed in this section, because they are the ones that are most often cited by the critics as areas of concern. The last three are equally important and will be discussed in section 4.

Autonomy

The Concerns

3.2 A World Bank (2000) study of the public sector observed that, “Where the institutional starting point is very weak, or where the political window of opportunity for reform is narrow, a common approach is to begin by creating institutional ‘enclaves.’” Social funds are cited as a prime example of the “enclaving” approach. They can serve as highly
visible islands of success on which to build and can help loosen constraints to sustained
development. But their potentially harmful long-term effects must be taken into account. As
the study argues, “The establishment of project implementation units within or outside
ministries and agencies can subordinate the coherence of the machinery of government to the
narrow goal of project implementation and their achievement of short-term gains that might
not be sustainable.” The Inter-American Development Bank (IDB) echoes these concerns.
Characterizing the proliferation of social funds as a case of “funditis,” it says, “Rather than
using the line ministries to implement social or agricultural programs, governments are
creating many special funds because they appear to be more efficient and can attract
international financing. Although there have been some advantages in creating specialized
funds, there is always the danger that they may duplicate each other, or that they become
‘shadow governments’” (Goodman and others 1997). The existence of these special enclaves
can engender inconsistencies in policy, which can be detrimental to existing departments, the
new institutions, or both.

Analysis

3.3 There is no simple definition of autonomy when it comes to social funds. In practice,
social fund autonomy varies according to the political and administrative profile of a country.
Van Domelen (2000) points out that, “Programs embedded within line ministries may have
many attributes of autonomy. For example, many project implementation units have separate
financial management systems, procurement guidelines, and even staff compensation policies
different from those of the line ministries of which they are a part. ‘Autonomous’ agencies
may have their key policy and budget decisions determined by actors from within the
government structure.” To understand the issue better, it is useful to look at three types of
autonomy: structural, policy, and operational (a fourth dimension, “political” autonomy, is
examined in the section on “Political Economy of Social Funds” below).

3.4 Structural Autonomy. Most social funds are established by a formal decree or law and
are usually placed under the nominal responsibility of the prime minister, president, or the
economic or finance minister, but there are variations. The Pakistan Poverty Alleviation Fund (PPAF), for instance, was set up as a nonprofit company under the Companies Ordinance of 1984. In Thailand an existing agency, the Government Savings Bank, is the implementation agency. A few of the social fund agencies were not created as a direct result of World Bank intervention. Peru’s National Fund for Regional Development (FONCODES) was set up in 1991, well before the Bank began contributing to its operations in 1993. PPAF also was set up independently of any Bank program. The first social fund in Zambia also preferred to use an existing implementation structure as its operational arm (box 3.1).

**Box 3.1 Capitalizing on an Existing Implementation Unit in the Zambia Social Recovery Project**

In 1991, when Zambia’s first Social Recovery Project (SRP) was being designed, a Microproject Unit (MPU) sponsored by the European Community had already been functioning for more than four years, providing grant financing for microprojects and supporting small community initiatives. There was no discussion of moving the unit out of the Ministry of Finance to place it outside the bureaucracy. It was found that the unit could benefit from additional staff, so that staff could visit communities during microproject identification, appraisal, and implementation.

The SRP doubled the size of the existing program and supported the institutional strengthening of the MPU. The lessons learned from the European Community–sponsored project provided valuable lessons for the design of the SRP. Instead of setting up a separate structure, the World Bank capitalized on this existing institution and entrusted it with the implementation responsibilities of the SRP.


3.5 *Policy Autonomy.* Funds have very little policy autonomy because their policies are determined at creation and overseen by boards or steering committees on which government officials hold a significant number of seats. This lack of policy autonomy is understandable given the need to align social funds with government sectoral policies. Ethiopia typifies how government policy may constrain the way social funds allocate money and how this lack of policy flexibility is essential to ensure that fund activities are consistent with national priorities (box 3.2).
Box 3.2 Policy Constraint in the Ethiopia Social Rehabilitation Development Fund

The federal formula initially used to allocate Ethiopia Social Rehabilitation Development Fund (ESRDF) resources to the regions was generally poorly aligned with the implementing capacity in each region. Some regions (Tigray and Gambella, for instance) had overdrawn their allocations and therefore were not expected to receive additional funds. Other regions, such as Amhara and Oromiya, were able to fully disburse their supplemental allocations within a couple of months. These regions would have had no funds to operate until the new social fund was approved. Other regions, despite their low absorptive capacity (and low disbursement performance), received additional funds to implement new community projects, but given their past record, they were unlikely to disburse them by the closing date of December 31, 2003.

A World Bank mission therefore recommended that the government consider some regional reallocation within the Supplemental Credit, commensurate with the absorptive capacity of each region. The absence of a reallocation would have several negative impacts on ESRDF:

- The highest performing regional offices would not be able to retain their staff.
- ESRDF could lose the momentum acquired during four years of operations, particular with respect to community relations.
- Restoring ESRDF regional capacity for a follow-up phase ESRDF II after a disruption would be costly.

For the government to accede to this request of reallocation would mean making an exception to the federal policy of allocating development resources.

Source: World Bank staff.

3.6 Managerial and Operational Autonomy. Social funds owe their agility and responsiveness largely to the managerial and operational autonomy they are given. This autonomy can take the form of exemption from existing public sector laws and regulations, such as those on civil service salaries or procurement and disbursement regulations (details are discussed later in this section). One defining feature of social funds is their use of operation manuals in their day-to-day functioning. Using manuals, legitimized by the credit agreement between the host country and the donor and protected by the presence of a board or steering committee, facilitates transparent and professional decisionmaking. But the presence of a board creates the risk of undue interference in the day-to-day activities of funds. In the first Romania Social Development Fund (RSDF I), lack of experience led the steering committee to become involved into micromanagement, especially in the beginning of the project. Although the steering committee’s involvement helped start the project, it continued too long. During the formulation of the RSDF II, a better clarification of roles was needed at both the executive and steering committee level. The steering committee was
advised to focus on the broad strategies and policies, leaving the responsibility of daily management to the executive level (World Bank 2002e).

3.7 The Eritrea Community Development Fund (ECDF) was able to continue operations with resourcefulness and agility despite war-related shortages of labor and materials. This led the ECDF to support other Bank-financed projects, a development not originally envisaged in the project documents. Similarly, the operational flexibility of the Malawi Social Action Fund (MASAF) has been a big asset for the government as it grapples with a continuing drought (box 3.3).

**Box 3.3 Malawi Social Action Fund: Responding to the Drought**

The current drought in Malawi has had a two-fold impact on the Malawi Social Action Fund (MASAF).

The direct impact was to slow implementation of community subprojects, as individuals preferred to spend time on income-producing activities, had to search for food, and were unable to make demanding community contributions. As a direct response to this, MASAF reallocated funds from the community subprojects component to the public works program component.

At the same time, the drought created opportunities to utilize the operational efficiency of the fund. At the request of the Malawi government, the World Bank is formulating an Emergency Drought Recovery Project, tentatively budgeted for US$45 million. MASAF will implement the public works component of the project, budgeted at US$6.3 million. The government of Malawi also channeled Malawi Kwacha US$113 million of its own funds through MASAF to start a Cash for Relief Work program, which allows district assemblies to launch small public works projects after a quick approval process.

MASAF was chosen because of its record in social fund procurement. MASAFs organization and management were deemed sufficient for it take up the work in addition to its existing responsibilities of implementing MASAF II. This Public Works Program is expected to enable participants to save funds so that they can obtain improved seeds and fertilizers at the onset of the growing season.

*Source: World Bank staff.*

3.8 Despite being agile and flexible, social funds always risk being gradually overwhelmed by bureaucratic procedures, thereby losing the basic quality that contributed to their efficiency. RSDF II has recently warned of creeping bureaucratization and suggested that the fund may become increasingly like other public bureaucracies, having lost its ability to deliver better services than others.
3.9 In a review of social funds Marc and others (1995) refer to Bolivia’s experience as, “an interesting model for dealing with the thorny tradeoff between autonomy and coordination. The Bolivians recognized that any payoff from autonomy is a short- to medium-term phenomenon, unlike the long-term concern of linking the social fund to other government departments. They adopted a phased approach, first using a highly autonomous agency, the ESF, to deal with short-term issues, then handing over many of its responsibilities to another newly created but less autonomous institution, the Social Investment Fund (SIF), which had a longer-term, developmental mandate. In the short term, the ESF generated temporary employment, social and economic infrastructure, and a powerful demonstration effect. The government showed it could manage a public investment program in concert with NGOs and community groups, while community groups, in turn, saw that they could be partners with government in development. But these gains would have been transient at best if they could not have been institutionalized. This was the role of the SIF, which unlike the ESF, had to coordinate its activities with sectoral policies and strategies defined by the Ministries of Health and Education” (Marc and others 1995). (The issue of autonomy is closely linked to the budgetary and accountability issues since it often is alleged that social funds operate as parallel lending structures. A subsequent section, below, analyzes those concerns.)

**Staffing and Salaries**

*The Concerns*

3.10 There are three broad areas of criticism of staffing and salaries. Social funds are frequently accused of luring competent staff away from government agencies by paying inordinately high salaries compared with public sector wages. Some critics contend that this movement of staff is large enough to disrupt the normal function of some line agencies. Others say social funds distort the incentives faced by bureaucrats, leading them to make decisions in order to curry favor with donors, rather than to promote overall welfare. Still others contend that the huge disparities in salaries demoralize regular government employees.
who essentially perform the same functions as employees of social funds. The first area is examined here, but the other two require more field data to arrive at any broad conclusions.

Analysis

3.11 The payment of market-based salaries to employees or consultants in project units such as social funds creates a two-tiered structure of compensation within the bureaucracy. The result may be one or more of the following:

- Resentment of mainline government officials by project implementation unit staff, which can weaken project execution and reduce sustainability.

- “Brain drain” from the civil service into project implementation units.

- Lack of attention to the underlying problem of insufficient compensation for public officials (Boyce and Haddad 2001).

Higher salaries may also make it prohibitively expensive to integrate social funds into line ministries.

3.12 Social funds generally pay much higher salaries than regular public agencies. Employees of social funds often earn as much as seven to eight times what public employees earn. But that analysis is limited to base pay, only one component of civil servants’ compensation (table 3.1).“

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7 *Base pay* is the amount a civil servant regularly (usually fortnightly or monthly) receives from the government by virtue of being on the payroll. Base pay is usually linked to the employee’s position and is uniform across similar positions.
Table 3.1 Rewards and Incentives for Civil Servants

<table>
<thead>
<tr>
<th>Current rewards</th>
<th>Contractually provided</th>
<th>Noncontractual or intangible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base rewards</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1. Base wage or salary</td>
<td>3. Job security, prestige, social privileges</td>
</tr>
<tr>
<td></td>
<td>2. Health insurance</td>
<td></td>
</tr>
<tr>
<td>Allowances</td>
<td>4. Transportation, housing, meals, telephone, travel, cost-of-living adjustment</td>
<td>6. Trips abroad, training</td>
</tr>
<tr>
<td></td>
<td>5. Transportation, housing, meals, travel</td>
<td></td>
</tr>
<tr>
<td>Future expectations</td>
<td>7. Pension</td>
<td>9. Reputation, reemployment after retirement</td>
</tr>
<tr>
<td></td>
<td>8. Housing, land, and the like</td>
<td></td>
</tr>
</tbody>
</table>


3.13 In a typical social fund, total compensation is restricted to cells 1 and 2, and depending on the social fund, to some of the benefits in cells 4, 5, and 6. Moreover, social fund salaries are not strictly comparable to public sector jobs, which often come with greater stability (continuity) of appointment and are supplemented by generous housing, medical, and pension benefits unavailable to social fund employees.

3.14 In most social funds, wage scales are comparable to private sector salaries. Where the scales have been kept comparable to public sector salaries, funds have suffered persistent staff attrition. Ethiopia clearly illustrates this tradeoff (box 3.4). The Eritrea ICR (World Bank 2002b) identified a “lack of incentives to attract and maintain qualified staff” as one of the major factors affecting implementation and outcome. The Romania ICR (World Bank 2002e) similarly identified recruitment and retention of highly qualified staff as an important risk that had to be addressed during project implementation. The government agreed to appropriate salaries for the RSDF staff at the time of negotiations, but the steering committee, which set the salary levels, did not always agree to periodic updates. There were also a few instances in which staff and consultants trained by RSDF chose to work for other
institutions; while this helped in facilitating institutional development more broadly in Romania, it was a risk to project implementation.

**Box 3.4 Staff Attrition in the Ethiopia Social Rehabilitation Development Fund**

The Staff Appraisal Report (SAR) for the Ethiopia Social Rehabilitation Development Fund (ESRDF) clearly states that, “ESRDF has its own salary structures designed to attract, motivate and retain high-calibre staff, and special allowances for posts in isolated areas” (World Bank 1996a).

But the SAR notes that as many as 33 well-trained, high-level staff left the ESRDF central office and regional offices in the previous year, many to join nongovernmental organizations, the private sector, or other government projects. It also says that ESRDF faces severe difficulties in finding replacements, mainly because ESRDF salaries and other benefits are coming closer to those of the public service. In fact, public service salaries increased between 15% and 23% in January 2002, while ESRDF salaries did not increase at all. And ESRDF staff do not benefit from employment security or from the public pension scheme.

The SAR recommends that the salary structure of ESRDF be reevaluated to remain competitive with the program’s main competitors. Failing to do so could jeopardize ESRDF’s excellent track record and ability to smoothly proceed to its second phase. This also prompted the mission to include “retaining high caliber staff” in the “critical risks rating” and to raise the risk from modest to high.

*Source:* World Bank staff.

3.15 The payment of high salaries should be examined in the context of total operating costs. A social fund may have higher operating costs per employee than a similarly sized government program, but the operating cost per unit investment is more relevant. Compared with line agencies, social funds are leaner and more professional and therefore have a much lower operating cost per unit investment (or output).\(^8\) (It would also be instructive to compare the salaries of social fund staff with those of other donor-funded staff of project implementation units.)

3.16 Despite frequent criticisms, there is little evidence of movement to social funds by government officials. A study by the World Bank’s Operations Evaluation Department (2002a) concludes that, “Field research did not find evidence of social funds displacing skilled manpower on any significant scale from government agencies.” This suggests that social funds may actually contribute to a crowding in of quality to the public sector. Competent staff of government agencies more often leave to work in the private sector rather

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\(^8\) Philippe Dongier provided this observation.
than for social funds because the private sector tends to pay more than either government agencies or social funds, especially in countries where civil servants’ salaries are barely sufficient to meet basic needs and where the internal institutional environment of the government is very weak. Consequently, even if social funds do attract government employees, this may still help keep human capital in the overall public sector (which includes social funds) rather than see it lost to the private sector. It may also lead to more efficient allocation of labor because jobs in social funds are better matches than jobs in the private sector for people leaving government.\footnote{Anton Dobronogov distilled this counterargument.} A new tool being used by the Bank, the “Public Officials Survey,” analyzes the incentives of civil servants working in various parts of government. In countries with social funds, these surveys could be expanded to include a section that looks at how civil servants perceive social funds.

**Procurement and Disbursement**

*The Concerns*

3.17 To avoid bottlenecks, social funds usually receive special exemptions from complicated national procurement rules and are allowed instead to function under their own, simpler procedures. This enables them to award contracts directly to private consultants and construction firms using simplified competitive procedures, a situation that has greatly sped the preparation and execution of small investment projects. But critics say this undermines existing procedures and is difficult for line agencies that still have to follow the old cumbersome procedures. The multiple procurement and disbursement procedures of donors can also add to administrative burdens and inhibit the development of coherent domestic systems.

*Analysis*

3.18 Marc and others (1995) note that for development investments in general, and for social funds in particular, three important kinds of costs can result from poor administration...
of complex procurement procedures. “One cost relates to time. The acquisition of goods and services for small-scale infrastructure subprojects can be delayed for weeks or months as the result of an inadequately functioning process. Another cost relates to the participation of intended target groups. A poorly run procurement process may discourage small-scale contractors from getting involved; this goes against the grain of many social funds which aim to boost the small-business and artisan sectors.” Finally an inefficient procurement system reduces overall efficiency by impairing competition in the provision of goods and services.

3.19 At the macro level all social funds are subject to the same level of fiduciary safeguards as other World Bank projects—they receive no special concessions. Disbursements and withdrawal procedures are based on the World Bank Disbursement Handbook (1992 edition) and use the principle of “statements of expenditures.” Since most social funds are financed by the International Development Association (IDA), procurement activities are carried out in accordance with the Bank’s Guidelines for Procurement under IBRD Loans and IDA Credits. Some newer social funds have begun to coordinate with the national agencies responsible for procurement. The Zambia Social Investment Fund’s (ZAMSIF) Management Unit, in consultation with the Zambia National Tender Board, has developed a set of guidelines for certifying the procurement worthiness of districts.

Box 3.5 Strengthening Municipal Contracting in Nicaragua’s Emergency Social Investment Fund

The main objective of project cycle decentralization is to delegate the functions of acquiring and hiring private design services, supervising public works labor and projects, and strengthening local entities through other means. This process is executed under a set of rules and procedures clearly defined in the operating manual of Nicaragua’s Emergency Social Investment Fund (FISE), written within the framework of national contracting law.

The results of the pilot program in nine municipalities showed efficient and transparent bidding and contracting processes, with greater participation by local entities, less time, and lower costs. The most important results were: a reduction by 40–50% in the time needed in the bidding process; more participation by local contractors, which helped to reduce costs by 7–14%; and participation in the bidding committees by interested ministry delegates and community representatives, who witnessed the bidding process. The municipal technical units have shown skill in designing, implementing, and supervising their own projects, as well as hiring others to perform these tasks.

Source: Email communication from FISE.
3.20 At the micro level social funds have helped introduce innovations such as a community-based procurement (contracting) system. Most social funds allow community-based contracting for projects below a certain predetermined limit. De Silva (2000) points out that, “The Bank’s procurement and disbursement procedures were originally prepared for large investment projects, and provide little guidance for these new types of investments that include hundreds and sometimes thousands of community-level subprojects. Social funds have been at the forefront of some pioneering work done to simplify community-based contracting procedures and allow effective and speedy implementation of these numerous small, localized subprojects.” What’s more, social funds usually promote much more transparent, simple procurement practices than line ministries do. In many cases, they have tested new approaches to traditional practices and have found more innovative ways of doing things. For example, direct financing of communities basically promotes the delegation of contracting functions for small investments directly to community groups. This not only promotes transparency, it also results in significant cost savings over traditional, centralized procurement systems. The current generation of Central American social funds is actively working with municipalities to reform their procurement processes (box 3.5).

3.21 Most social funds maintain regularly updated databases of unit costs to help control costs and assure that contract selection is transparent and economical. Unit costs are established for the most commonly required items based on project costs during the previous three months or on a random sample of suppliers and employers. The general principle of using a unit cost database to estimate—and in the case of direct contracting of third parties by the social fund, to set—contract amounts is common to most social funds and community-driven development investments. But many social funds providing direct financing to communities have much more detailed databases of supply costs (from nails to roofing sheets) that are used to verify budgets sent in by communities and to develop standard price lists for communities to use. Some projects have district and national databases that take into account regional price differences. Some social funds also maintain databases of local contractors for communities that do not have prior experience working with contractors.
3.22 Overall, there is little evidence to suggest that social funds distort procurement or disbursement any more than other World Bank– and donor-funded projects.

Budgetary and Accountability Issues

3.23 Critics hypothesize that social funds provide an easy avenue for donors to avoid the planning delays associated with having all funds approved by parliament. Tendler (2000), for instance, argues that, “The management and staff of social fund agencies in borrower countries have far fewer bureaucratic masters to serve than ministries and other existing agencies and are therefore more easily accessible to donor project officers and more able, if willing, to carry out their suggestions for improved service.” While social funds may be an easy way to overcome the failure of the existing budget process in a country, the critics contend that this extrabudgetary funding undermines democratic accountability institutions. The criticism arises at the different stages of the financial management cycle: budget preparation, budget execution, and audit. In addition, concerns have been expressed about “crowding out” and fungibility. Each of these concerns is discussed separately.

Budget Preparation: Integration with the National Budget

3.24 Like many multisector programs, social funds are accused of being financed off-budget: they do not enter a government’s investment budget and are not subject to the same financial oversight as on-budget expenses. Kingsbury (1994) argues that, “While this approach might be said to increase the flexibility of policymakers in allocating resources, in most cases say critics, the reality is otherwise: the lax control leads to waste, mismanagement, and resource allocations based on political expedience rather than on any rigorous determination of development priorities.” In a similar vein, social funds are often accused of being large block grants without specific details and substantive guidance on how

10 This subsection borrows liberally from a series of email exchanges between the Social Funds Thematic Group and the Public Sector Group. In particular, the internal note prepared by Nick Manning, PRMPS, “Some notes on the question of Social Funds and public management” was very useful.
to use the money. Once money is paid into the fund, through the regular budget or directly by a donor, it is no longer part of the government’s general funds and therefore is not subject to annual lapsing (the requirement that unspent balances revert to the consolidated fund and be subject to a revote in order to be available for spending the next year). By escaping the annual budget process, social funds may be able to spend money in years not originally sanctioned by parliament—a prospect that could skew spending priorities, according to critics. “If the social fund increases in size, then in combination with other earmarked funds (roads funds, health funds) it can leave significantly less in the general fund budget. Soon these funds collectively start rivaling the common fund in size, and transparency, contestability, legitimacy, and democratic accountability suffer.”

3.25 Analysis. All 15 funds in this study were required to open special accounts at commercial banks into which World Bank funds were transferred. A survey of 29 task managers revealed that social funds were included in government budgets in 86% of the cases (annex 5). The four exceptions were Albania, Bosnia and Herzegovina, Egypt, and Pakistan. The budgeting system was less complete in picking up the foreign-financed portion of social funds. In 45% of cases the government budget captured both local and donor financing. In 55% of cases only local financing was included.

3.26 These figures are not precise because they are based on task manager responses. A more focused and intensive study of financial management arrangements is needed. To determine whether social funds distort normal budget procedures, how a country’s other aid is accounted for must be examined. Most multilateral and bilateral aid donors confront the same issues:

- Their aid is not part of general government funds and is therefore not subject to annual lapsing. In other words, aid money continues to be used well beyond the initial year in which it was made available to the government.
• Conventional financial rules and regulations are not applicable to these funds, which are usually governed by their own special rules.

• These funds are usually audited according to norms established by lending institutions.

At a more macro level, the World Bank’s Public Sector Group (World Bank 2000) suggests that “The traditional application of the Bank’s lending instruments has resulted in projects that typically ‘enclave’ government functions (including budgets, personnel, procurement, and financial oversight); in countries with high aid inflows, donors’ activities can fragment governments and undermine their ability to function effectively and in an integrated way.” The challenge for the Bank is to channel financing in ways that respect and build on national processes of budget management (World Bank 2002f).

3.27 The alleged distortions attributed to social funds are part of a much wider problem, encompassing all the aid flows to a country. To make a stronger case for social funds to be part of the budgetary and financial framework of a country would require all external aid flowing into a country to do likewise. But the resulting tradeoffs—namely, lost agility and slower response times—will need to be considered.

**Budget Execution: Nature of Spending**

3.28 Social fund expenditures are usually governed by the funds’ own special rules rather than the financial rules and regulations that apply to conventional government spending. The establishment of a separate fund may mean that the legislature does not need to be provided with a plan for how the money is to be spent. Legislatures approve some general criteria for the operation of social funds, including the obligation to produce an annual report, when they pass enabling laws creating the funds. If a social fund is created to implement modest programs that are innovative and require spending flexibility not available within usual budget rules, the adverse impact is minimal. But if the social fund is implementing very large

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11 From an email by Michael Stevens, AFTPR.
programs or if its activities overlap with mainstream implementation of government programs, this can introduce serious perverse incentives. Social funds often are accused of skewing expenditures toward capital cost, because they make very little provision for recurrent costs, which are the responsibility of line ministries. This, critics say, undermines operational efficiency by focusing on capital investments with no certainty that the necessary recurrent budget funds to ensure adequate maintenance will be found. The burden of maintenance invariably falls on the line ministries (or local governments) that are mandated to run the capital works.

3.29 *Analysis.* The issue of whether social funds skew expenditures toward capital cost has two dimensions. First is the argument that too little is invested in repairing old infrastructure even though the output per unit cost would be higher than it would be for investing in new infrastructure. Second is the notion that creating new infrastructure saddles line departments with additional, unfunded maintenance responsibilities.

3.30 For the first issue the evidence suggests that communities drive the choice of subprojects based on a clear incentive structure and that there have been several cases of communities opting to repair old infrastructure. The appraisal criteria for subproject selection are structured to provide incentives for repairing existing infrastructure. Given that most subprojects have a component of community contribution, it makes sense for communities to opt for the most cost-effective and efficient option. Other design features employed by many social funds (such as provision of fixed budget allocations to local jurisdictions) can further enhance the economic incentives leading to efficient decisions. The issue of additional recurrent costs on line ministries is complicated because precise recurrent costs may be difficult to pin down when the government sets its annual budget. The following procedures have been developed to address this challenge:

- Prior approval of line agencies is being required so that sectoral coordination issues are resolved before implementation, and future recurrent budget liabilities are identified.
Having recognized the role of local governments and communities in operation and maintenance, social funds are taking such measures as providing training and establishing preventive maintenance funds.

For example, in Cambodia’s social fund line ministries define the fund’s sectoral policy guidelines and standards for infrastructure construction. The line ministries also provide a “no objection” clearance to projects before they are funded. In ZAMSIF and MASAF local government officials accompany fund staff on appraisal visits and participate in desk reviews of project proposals. They are also actively involved in monitoring subproject implementation.

3.31 In Yemen initial analysis showed that newly constructed health units had a staffing problem. Yemen’s Social Fund for Development (SFD) decided to support only those subprojects that had a strong commitment from the government to make staff available. In addition, the SFD shifted its focus by concentrating on training and activities that ensured the availability of mid-level health staff, especially females, in remote rural areas. The SFD is also helping the Ministry of Health’s health institutes to expand capacity and improve education quality.12 Yemen demonstrates how often “maintenance” and “staffing” are often viewed interchangeably, though the implications (especially fiscal) are much greater for staffing. Community involvement can improve prospects for operation and maintenance, but the issue of staffing has much wider ramifications.13

3.32 Rawlings and others (2004) systematically analyzed the staffing patterns in infrastructure built by social funds, and the findings were relatively positive. In Nicaragua the number of teachers in social fund schools rose 20% after social fund intervention. In Armenia, Peru, and Zambia additions to teaching staff were observed as well. In Honduras student-teacher ratios remained constant despite a 40% increase in the number of students enrolled. Similarly, health facilities supported by social funds were staffed as well or better

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12 World Bank staff.
13 Lant Pritchett, Harvard University, highlighted this distinction.
than comparable ones not supported by social funds, although both maintained staff levels below ministry norms in some countries. In the three countries with data—Honduras, Nicaragua, and Zambia—social fund facilities were more likely to have both professional staff (doctors, nurses, nurse aids) and nonprofessional staff, including community volunteers. Assuming, as many assert, that social funds are driving social investments into poorer and more rural areas than had been reached in the past, these staffing patterns imply that social funds are driving not only investment, but also recurrent expenditures into poorer and more rural areas.

“Crowding Out” of Other Development Initiatives at the Local Level and Fungibility

3.33 That grants predominate with social funds often has unintended adverse consequences on some regular government programs that operate on loan principles. Tendler (1999) cites an example in her field study. Some existing agencies were offering loan financing to municipalities or communities for similar projects, and some agencies were trying to switch from grant to loan financing, often at the urging of the donors themselves. In such cases, communities or municipalities understandably preferred the free funding of the social funds. A World Bank (1997) study found that in some cases, communities—even poor communities—are willing to contribute to a service that would meet their needs and that they knew they would receive. But if communities could get the service for free or with less arduous requirements through a social fund, the social fund would undermine the sectoral reforms that had been in place for some time. Even at the national level, “crowding out” is an issue. Critics contend that funding from social funds can be an excuse for not making allocations from the central government when ministries reduce allocations to sectors targeted by social funds. Fungibility is a fundamental issue that, in the view of critics, proponents of social funds have not adequately addressed.

3.34 Analysis. The fact that social funds receive funding from many sources and for many different projects has two consequences. First, funds may crowd out projects that could have been implemented anyway by government agencies or other sources. Even though social
funds do not explicitly aim to foster private sector participation, they should not crowd out private sector or government investment. Second, social funds may attract funding from other sources (foreign donors, community contributions) for investment or recurrent costs that would not otherwise be present. Such crowding in creates positive incentives for greater public and private investment. The key question is whether overall allocation to the sectoral increases or decreases due to the presence of a social fund.

3.35 To assess crowding out, two questions have to be answered: (i) have communities shifted from private to social fund provision of services and (ii) have social funds replaced government funding for certain activities? The answer to the first question is straightforward. Because of the abysmal poverty levels in most of the countries served by social funds, there are scarcely any private capital or funding sources for the communities being served by social funds. Thus, there is no crowding out of the private sector. On the contrary, some social funds are providing incentives for private sector participation, especially in microfinance.

3.36 As for the second question, the data reveal that social funds generally do not really compete with government units in providing investment funding. Often, the social fund budget is negligible compared with the amount of government spending that goes into core sectors like education and health. Moreover, the social fund targets activities that complement, rather than substitute for, government activities (box 3.6).

3.37 In Egypt the central government explicitly cut allocations to local government because of expected inflows from the social fund. And a study by the World Bank (1997) reveals that allocations for the Ministries of Health and Education in Honduras declined at the same time local governments received resources from social funds. A recent review (World Bank 2000e) of data for 1991–98 suggests, however, that the Honduras Social Investment Fund (FHIS) did not crowd out investment that line ministries would otherwise have made. The inherent risk of crowding out seems to be high in the education sector, for instance, given the 1997 national policy directive to have FHIS formally take responsibility
for school rehabilitation and construction from the Ministry of Education. But the Ministry of Education had been investing so little in infrastructure (in the early 1990s, about 2% of its total budget) for so long that it probably would not have been able to channel as much money into education infrastructure as FHIS has. Furthermore, spending by FHIS may well have created greater space in the ministry’s budget to finance noninfrastructure investment.

### Box 3.6 Crowding in and out of Expenditure in Yemen

The following table shows the amount of government spending on education and health in 1999, as well as total spending in the same categories in 1997–99 by Yemen’s Social Fund for Development (SFD). The amount spent by the SFD is about 5% of total government spending, even lower when the three-year span of SFD expenditures is considered.

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>Education</td>
<td>400</td>
<td>21</td>
</tr>
<tr>
<td>Health</td>
<td>100</td>
<td>5</td>
</tr>
</tbody>
</table>

As for crowding in, the SFD has been instrumental in attracting foreign funding for its projects. The International Development Association increased its commitment from US$31 million in phase I to US$75 million in phase II, based on SFD’s performance in phase I. The evolution of donor support for social activities implemented by the government of Yemen shows that crowding in has occurred. During the first phase, the Arab Fund provided the first new loan (US$24 million) to Yemen after a long break. The U.S. government, after a long hiatus, provided US$7.1 million in additional money for the social fund. The European Union contributed US$4.5 million and the Dutch government US$15 million. In short, the SFD was able to leverage US$50.6 million in addition to the US$31 million invested by IDA.

The SFD requires communities to make significant capital contributions up front. This results in crowding in of funds from the main stakeholders—the beneficiaries themselves. The share ranges from 5% to 10% for education projects and from 10% to 20% for water projects. Lower contributions are sought from poorer communities.


3.38 Although social funds may not crowd out other investment, they can skew some of the incentives in development projects and may have some unintended adverse consequences. For example, in the early 1990s, the social fund in Bolivia financed municipal water and sanitation systems on a grant basis in poor municipalities and neighborhoods, while the National Fund for Regional Development (FNDR), the municipal bank, financed the same systems through lending. Due to the lack of common rules on project eligibility (technical standards and poverty criteria), projects rejected by FNDR because of technical inadequacies were financed by the social fund on poverty grounds (World Bank 1997).
addition to preventing this situation from arising, the eligibility criteria for grants should take into account whether projects can be financed through private investment or commercial credit.

3.39 Apart from coordination within countries, better coordination is needed across Bank and donor projects. Establishing minimum criteria for appraising sectoral investments has become standard for the recent generation of social funds. The Rural Water and Sanitation Toolkit, a recent operational strategy tool in the Bank, is an example. In Cambodia the Social Fund of the Kingdom of Cambodia (SFKC) lists “improving donor coordination and cofinancing” as one of its project development objectives. Social funds can also have a salutary effect on the nature of government investments. By focusing on rural areas, the social funds in Zambia have added balance to the regular government investment program, which is largely concentrated in urban centers.

Audit

3.40 Social funds are often criticized for not being subject to review by the office of the auditor general. In particular, they are accused of undermining the normal obligation of the auditor general to report to the legislature each year the opening and closing balances of all funds established by the government.

3.41 Analysis. Three basic types of audit constitute the comprehensive audit framework: financial auditing, which assesses the accuracy and fairness of an organization’s financial statement, compliance auditing, which checks whether government revenue and spending have been authorized and used for approved purposes, and performance auditing, which determines whether taxpayers have received value for their taxes (World Bank 2001). Government audits often focus more on the financial statements, whereas some of the newer social funds are better aligned toward a comprehensive audit framework. For example, FHIS V audit reports are to include a review of subprojects both in execution and after completion, covering both their processing and implementation.
As a tool of financial management and internal control, the Social Fund of the Kingdom of Cambodia (SFKC) has three levels of audit:

- **Expanded Scope Audit Report**: This is done by a qualified auditor of international repute. In fiscal 2001, it was done by PricewaterhouseCoopers.

- **Audit Oversight Panel**: The panel provides independent advice to the SFKC board on operations and financial management. The Audit Oversight Panel does not conduct regular audits itself, but responds to the issues and questions pertaining to SFKC management that do not appear to be addressed adequately by the board and external auditor.

- **Internal Audit Unit**: The fund undertakes a regular review of financial and accounting records relating to subproject disbursements and contract management. A large part of its work revolves around field visits.

*Source*: World Bank staff.

3.42 All 15 social funds in this study provide for auditing by independent auditors acceptable to the Bank. The auditing requirements are in line with other Bank investments, and there is no evidence to suggest that social funds impose any additional burdens on recipient countries (box 3.7). A survey of 29 social funds reveals that the vast majority of social funds were audited by national auditors, often supplemented by international firms. In 71% of cases the social funds are covered in the auditor general’s report to parliament, in 17% of cases no such report exists, and in 13% of cases social funds are not included. Similarly, there was a high likelihood of scrutiny by the public accounts committee (79%). And almost all social funds for which there was information had accounting officers responsible for answering to parliament on the proper use of funds (annex 5). Looking at the auditing issue from a broader perspective, however, a recent note (World Bank 2001) pointed out that the World Bank and other donors often establish parallel auditing systems for their projects that undermine developing countries supreme audit institutions, on whose work they cannot always rely. That demonstrates that this issue is not specific to social funds, but that it is part of the wider impact that donor funding has on recipient countries.
Relationship with Sectoral Agencies

3.43 In a social fund’s relationship with line ministries and sectoral agencies, the primary challenge is to coordinate sectoral activities while ensuring that they do not weaken sectoral agencies. These two concerns will be taken up separately.

Sectoral Coordination

3.44 The operational experience of social funds suggests that their effectiveness depends largely on close coordination of activities with the policies, planning, norm-setting, and budgeting of line ministries and other public agencies. But critics say that social funds have been poorly coordinated with sectoral policies and investment priorities—a problem exacerbated by the special concessions that leave social funds with no incentive to maintain consistency with sectoral plans or policies. Tendler (2000) exemplifies this argument, asserting, “What’s more, the prized autonomy and special privileges of social funds also reduce the opportunities and likelihood of their working complementarily with existing institutions of government.”

3.45 Analysis. Coordination with other sectoral agencies is by far the most contentious issue for almost all social funds. Most of the ICRs for the 15 funds in this study identify coordination with sectoral and line agencies as one of the biggest challenges confronting social funds. Most line agencies are severely constrained by limited budgets. The responsibility for providing complementary inputs for the subprojects created by social funds usually devolves to the sectoral agencies, therefore increasing the need for better coordination. Mechanisms to coordinate social fund activities with recurrent sectoral budgets and technical standards typically depend on (i) line ministry representation on social fund steering committees, (ii) framework agreements between social funds and line ministries that define cooperative arrangements at various stages of the project cycle, and (iii) line ministry approval for subprojects (World Bank 2002a).
3.46 The presence of line ministry representatives on a steering committee builds a channel of communication between funds and sectoral agencies. But anecdotal evidence suggests that board meetings do not significantly enhance cooperation—partly because of the nature of the meetings and partly because representation is usually at the level of senior ministers, while most coordination problems exist at the subproject level.

3.47 To ensure that its activities are consistent with the policies and development strategies of line agencies and other relevant stakeholders, FHIS established and updates framework agreements with the Ministry of Education; the Ministry of Health, Culture, Arts, and Sports; the Ministry of the Environment; the Honduras Institute for Child and Family Welfare; and the Ministry of the Association of Honduras Municipalities. Similarly, FONCODES has signed formal agreements, convenios, that smooth coordination with the Ministries of the Presidency, Health, Education, Agriculture, and Energy and Mines, and with local authorities. These agreements stipulate that FONCODES will not, for example, create school or health posts unless the line ministry in question agrees to staff it and meet all additional recurrent costs for personnel, supplies, and maintenance.

3.48 Better sectoral coordination enhances the prospect of sustainability. In Zambia’s first Social Recovery Project (SRP I), the credit agreement included a covenant that the government would provide evidence of increasing its annual budgetary allocation for nonremuneration recurrent costs for health and education in real terms. In Cambodia a post-handover and monitoring unit visits completed subprojects and reports on maintenance and technical quality and on the required complementary investments by local governments, cofinanciers, and community groups.

3.49 Line agencies need to be involved at all stages of the project cycle, which did not happen in Ethiopia. The zonal and regional health bureaus were consulted during the initial stages of planning, but were not informed of progress during implementation. As a result, many sectoral bureaus were caught by surprise when the facilities were ready for handover,
and many of the posts were not operational or functioned suboptimally due to lack of money and labor, as well as the presence of drugs.\textsuperscript{14}

3.50 The ICR of the Armenia Social Investment Fund (ASIF) emphasized that the fund needed to make more progress in ensuring that its activities and microprojects were consistent with social sector strategy priorities, government reform programs, and activities of other agencies. While the ASIF team made efforts, the MTR and subsequent Bank missions indicated the need for further improvement in intersectoral and interagency coordination, particularly with relevant sectoral policies (such as health and education) and investment priorities. The report went on to recommend that ASIF develop a more effective strategy for information, outreach, and communications and maintain regular working-level contacts with line ministries, NGOs, donor agencies, and Bank project management units (World Bank 2001e).

3.51 Social funds are being increasingly viewed as integral components of the public sector, rather than as standalone projects, which gives coordination with the sectoral agencies more importance. The larger the overall social fund investment relative to each sector, the more important it is that they conform to the sectoral development strategy and that evolving sectoral good practice are observed.

*Weakening Sectoral Agencies and Incomplete Pass-Through of Benefits*

3.52 The key question is whether social funds help build and strengthen the institutional capacity for designing, implementing, and delivering social services or whether they displace and weaken existing institutions, such as sectoral ministries and departments. One school of thought holds that, “Wherever possible, social development should be carried out by ministries and institutions responsible for it on a long-term basis. There may sometimes be inertia and bureaucratic sluggishness, but the practice of creating a new institution in times of crisis will usually not result in permanent progress” (as quoted in Reddy 1998). Critics

\textsuperscript{14} World Bank staff.
suggest that social funds offer a path of least resistance for governments by providing an alibi for not reforming dysfunctional service-delivery systems. Further, “resources and efforts directed toward autonomous [social funds] administrations are at the cost of revitalizing ailing existing social ministries” (Reddy 1998). Social funds may also represent an opportunity cost by creating a second-best alternative to capacity-building and institutional reform within government and taking away pressure to improve mainstream structures. Where social fund functions overlap with those of line ministries, resources devoted to social funds may undermine the long-term effectiveness of ministries and social service delivery more generally. They may represent an unnecessary duplication of effort. Even when closely coordinating with line ministries and other public agencies, social funds have had difficulties mainstreaming their innovations, operating principles, and techniques through the public sector. Given that social funds are temporary structures that ultimately have to give way to regular government agencies, this lack of diffusion strengthens the argument against creating separate agencies.

3.53 Analysis. “Social funds can make positive contributions to the institutional framework in which governance and adjustment take place. The programs, acting as intermediaries, can create links between the ‘bases’ and ‘center’ and create both upward and downward links in society. In addition, through high visibility and demonstration of a new, efficient method of government operations, they can exert pressure on public officials for better performance and greater accountability” (Marc and others 1995). Many service delivery systems have the problem of “path dependency.” Because these systems have evolved incrementally, rapid improvements in performance may not be practical in the short term. Do social funds mitigate the adverse consequences of this path dependency by offering new perspectives and solutions to seemingly intractable service delivery problems? There is no clear answer, but a good starting point in the search for one is a look at the different forms of institutional development.  

15 The framework of dividing institutional development into five different components has been adapted from a study by the World Bank’s Operations Evaluation Department (2002a) that identifies two additional types of effects: (i) resource mobilization and allocation effects and (ii) systemic planning, budgeting, and accountability effects. These have been discussed in some of the earlier subsections.
• **Direct Effects.** These arise when a social fund project includes an explicit institutional-development component, such as providing training or technical assistance to other organizations. For example, ZAMSIF has an explicit component for monitoring and analysis designed to strengthen the institutional, technical, and financial framework for sustainable monitoring and policy use of poverty information. It includes support to the Strategic and Operational Unit in the Ministry of Finance and Economic Development. In Ethiopia the Welfare Monitoring Unit of the social fund has been named the focal point for the proposed monitoring system. Yemen’s SFD has started to provide several capacity-building services to selected directorates of the Ministry of Education. Support has been provided to the directorate of statistics and to a number of education supervisors. The other areas of support are community participation and school mapping since the SFD has an advanced Geographic Information System.

• **Demonstration and Catalytic Effects.** These arise when new approaches, procedures, or methods demonstrated by the social fund are adopted by other agencies or when a social fund prompts new thinking and approaches. For example, ECDF contributed to improvements in national standard designs for social infrastructure (such as health and education facilities), improving responsiveness to varying climatic conditions in the region. Several regional governments adopted requirements for community contributions for non-ECDF subprojects. Some line ministries have adopted approaches, technical standards, and procedures (World Bank 2002b).

• **Learning-by-Doing Effects.** These result when other agencies gain experience using new approaches, procedures, or methods by engaging in subproject decisionmaking, planning, or implementation. For example, in ECDF, the Savings and Micro Credit Program achieved reasonable success, and preliminary work is under way to prepare the legal foundation and establish the framework by which the program can be spun off into an autonomous legal entity with proper governance, adequate funding for capital and operations, and required staffing levels (World Bank 2002b).
• *Competitive Effects.* These are when other agencies improve their own efficiency to stay in competition for resources and power; or negatively, when other institutions withdraw from tasks and responsibilities that the social fund is taking on.

For example, Yemen’s SFD built schools at about 30% of the cost of government schools and averaged 7 months to complete the building compared with 24 months for line agencies. Based on this demonstration of community participation, a subsequent Bank-sponsored project, the Basic Education Expansion Project, specifically provided for a community capacity-building unit. The Community Participation Unit, established within the Ministry of Education in December 1999, consists of four staff members at the Ministry of Education headquarters, four in Sana’a Governorate, and two in each of the other governorates. Undertaking work that was previously never considered important, the Basic Education Expansion Project prepares annual work programs, coordinated with other ministries, for activities to increase community participation in education programs, including: (a) community assessment and mobilization for access programs, with the aim of increasing community participation; (b) community mobilization for school operations and maintenance, with the aim of increasing community participation in school management and contributions for school routine maintenance, educational classroom kits, and innovative programs for girls’ education, such as providing transportation; and (c) information dissemination to increase the knowledge and awareness of all stakeholders regarding the role of communities in basic education reforms and their experiences.

MASAF’s experience with community mobilization and participation was the benchmark for the World Bank–aided Primary Education Project to finance construction and furnishing of about 1,660 classrooms. The construction was supposed to take into account cost, time effectiveness, and community participation and ownership as key deciding factors. Rating the project “Unsatisfactory,” the ICR observed that, “Although the success and sustainability of the project hinged on community participation, there
seems to be no evidence that effective community mobilization and social marketing of the project were undertaken. In addition, MASAF’s positive experience with community mobilization and participation seems to have been ignored” (World Bank 2001a). At the completion of the project, many schools remained incomplete. Finally, MASAF was entrusted with the responsibility of completing the civil works. This illustrates that the counterpart line agency was unable to replicate the success of the social fund, despite efforts to apply the same principles of community participation and ownership.

- **Demand Effects.** These arise when social fund activities generate additional demand at the community level for the services of government agencies, stimulating enhancement of government capacity to meet that demand or when social fund activities stimulate broader demand effects for the services of private contractors or NGOs. For example, the Social Funds 2000 study clearly indicated that social fund–supported health facilities generally showed as good or better availability of medical equipment and furniture as other facilities. The study also found that health centers supported by social funds typically experienced significant increases in utilization rates.

3.54 The extent to which these institutional development effects will bring about positive changes in government institutions depends on several factors and will vary by level of government. Positive experiences alone will not suffice. Adoption of institutional reforms depends on the constituency for reform in public institutions.

3.55 Social funds offer the public sector opportunities to contract out in areas where it does not have a comparative advantage, permitting sectoral agencies to work in areas where they can have a greater impact. For example, Eritrea’s Ministry of Education could get private contractors to rehabilitate schools in big cities, but it could not get them to go out to poorer, more difficult to reach places. So, the ministry used the social fund to reach those areas. It was not more expensive, even though the locations were more difficult to reach.16 One of FHIS’ justifications for having a separate social fund is its role in modernizing the public

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16 Lynne Sherburne Benz provided this example.
sector on the principle that line ministries should concentrate on the core tasks of developing policies, norms, and regulations, while other private and public institutions deliver services.\footnote{For some other common justifications see box 2.2.}

**Decentralization**

3.56 As emphasized in section 1, the role of social funds in relation to the decentralized local governments is not the prime focus of this study. But it is useful to reiterate concerns and the initiatives to address them. The ultimate aim of any decentralization initiative is to bring planning and implementation to the local level—goals that the social funds have been able to achieve with reasonable success (box 3.8). Indeed, the greatest achievement of social funds by far has been shifting of the decision making to the local level.

<table>
<thead>
<tr>
<th>Box 3.8 Prioritizing Investments in the Honduras Social Investment Fund</th>
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<tbody>
<tr>
<td>The Honduras Social Investment Fund (FHIS) has evolved through three stages in its approach to identifying and prioritizing investments.</td>
</tr>
<tr>
<td>It started, as many other social funds did, by receiving proposals from a variety of agents (community groups, NGOs, local governments, line ministries). Around 1995, realizing that this approach was undermining local coordination and planning, it started requiring all community proposals to have the mayor’s signature of approval.</td>
</tr>
<tr>
<td>A few years later, however, FHIS found that the mayor’s signature was not enough to guarantee good local coordination and that, in general, a more transparent and participatory process of project selection, consistent with good local planning processes, was needed. In 1998 FHIS decided that every municipality had to prepare a Municipal Social Investment Plan (Plan de Inversion Social Municipal) with all communities in the municipality expressing their preferences and setting priorities through different stages (first at the community level, then at the zonal level, and finally at the municipal level). Municipalities also set investment priorities for funds obtained from non-FHIS sources.</td>
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**The Concerns**

**Inimical to Decentralization**

3.57 The impact of social funds on decentralization has been a contentious issue, and a serious research agenda has only recently been initiated. Tendler (2000) sums up the
concerns: “For all the talk of social funds as decentralized, they are in some ways the opposite of decentralization, even when they are demand-driven. They are run by entities of the central government, which are often newly empowered and transformed by their association with international donors and by the corresponding direct support they receive from the president of the borrower country. The majority of social funds do not formally devolve power and responsibilities to local governments.” Social fund practices that are inconsistent with a country’s legal and institutional framework for local government may undermine that framework. This is particularly important for social funds, since they were often designed to seek a sort of unconstrained maximization—the greatest level of efficiency with the fewest concessions to existing government procedures (Faguet 2002).

Reluctance to Withdraw in Favor of Decentralized Local Institutions

3.58 Critics argue that social funds should gradually withdraw in favor of local government, but they say it rarely happens, leaving social funds to continue to expand and flourish, even when decentralized bodies have developed enough capacity to take over.

Political Tool for Delaying Decentralization

3.59 Proponents of decentralization suggest that central leaders often use social funds to reach the poor without involving the decentralized bodies. This is more evident when the political affiliation of the central leadership is different from the local leadership. When a local government is run by the opposition party, the political calculus of the central government may dictate that the social fund circumvent it and work directly with communities—or not operate there at all—while working through local governments in the districts headed by the faithful party (Goodman and others 1997).
Two recent studies have discussed at length the relationship between social funds and decentralization. Faguet’s (2002) study was intended as a manual for designing social fund projects in decentralizing or recently decentralized environments. Its major findings are:

- Decentralization reduces the tension between social fund efficiency and poverty targeting by helping to redress the institutional and organizational disadvantages of poor communities.

- Incentives for consultation and consensus between the social fund, community, and local government must be generated at the identification and design stages of the project cycle.

- Good project identification and design combines different sorts of information from local governments, the community, and the social fund into project plans and budgets.

- Social funds can provide crucial support for decentralization through institutional strengthening and social investment, but they should not be primarily responsible for its success.

Parker-Serrano (2000) sought to address two key concerns: (i) the appropriate division of responsibilities between social fund mechanisms and support for decentralization institutions and (ii) how to realize the synergies of poverty-targeted, community-based approaches and the efficiency gains generated through decentralized implementation. The study emphasizes that both are complementary components of an overarching governance agenda. Its main conclusions are:

- If the social fund does not take into account the decentralization framework, it is likely to have negative impacts on local governance.
When the legal, fiscal, and political intergovernmental framework in which social funds operate includes some form of decentralization, social funds can contribute to local governance if their procedures are consistent and reinforce those of decentralized structure.

Without a decentralization framework, social funds are unlikely to reach their greatest potential, though they can make an important contribution to jump-starting broader decentralization.

3.62 Both studies started with the a priori assumption that social funds and decentralization coexist. But governments are often confronted with a choice between a “big-bang” decentralization and a gradual decentralization in which social funds have an enabling role. Critics often argue that once a government decides to adopt a decentralization program, there is little justification for setting up a separate social fund. However, others argue that even in the case of rapid decentralization, social funds can have an enabling role linking communities with local bodies and enhancing the accountability of local bodies. The funds focus on community capacity-building—important for creating a more capable and active citizenry that can engage in local governance and service provision. And social funds have recognized the importance of fostering links between community and local governments. There is clearly a tradeoff between the long-term objective of building capacity in the permanent structures of local government and the immediate need to deliver services to poor people in the most efficient and cost-effective way, social funds can contribute to both objectives. The government of Zambia’s decision to use ZAMSIF for both these purposes is one way of reconciling these two different sets of objectives (box 3.9).
As is the case in many African countries, the delivery of services (social services in particular) became more inefficient in Zambia because of the absence of a strong, competent, and empowered system of local government. Building on a decade of experience working with district staff (both local government and representatives of line ministries) as part of the project cycle, the new Adaptable Program Loan to support the Zambia Social Investment Fund (ZAMSIF) intends to create better local government structures. ZAMSIF has opened a new window of financing for local governments in addition to its existing window for community-managed microprojects.

The District Investment Fund (DIF) component, pegged at 17.5% of the total project cost of US$74.2 million, aims to create the capacity to devolve ZAMSIF functions to eligible districts. The social fund recognizes that districts have varying capacities to undertake the activities required of the Community Investment Fund (CIF). The role of districts is determined by the level of capacity they are judged to have. Districts move up, gaining more responsibility for planning and implementation. Level 1 is limited to capacity-building and limited function (desk appraisals and monitoring) of microprojects. After demonstrating more capacity, districts take on larger roles within the CIF project cycle (through participatory identification processes in communities) and gain access to and control over DIF funds. The ultimate goal, level 5, is for districts that show good performance of councils, have basic poverty information systems, and demonstrate effective subdistrict planning processes. These districts would be eligible for annual block grant allocations of both DIF and CIF funds.

At the start of ZAMSIF, the baseline placed all 72 district governments at level 1. Districts are assessed annually, and the graduation or demotion from one level to the next is based on specific performance indicators.

**Source:** World Bank 2000b and Van Domelen and Rashidi 2002.

3.63 While the disconnect between social funds and local government was significant, the present generation of funds are becoming more and more embedded in decentralization efforts. Some notable examples include Bolivia, El Salvador, Honduras, Malawi, Nicaragua, and Zambia. Building on the experience of the first two social funds, MASAF III has taken the form of a 12-year Adaptable Program Loan aimed at empowering communities, community-based organizations, NGOs, and local district assemblies. The project has been designed with the strategy drawn up in 2000 by the Ministry of Local Government, which explicitly acknowledges that “decentralization is a long-term process, and the implementation process will cover a period of 10 years divided into crash, medium, and long-term program.” The community development component of financing has been subdivided into a part to be implemented by the community and a part to be implemented by the district assemblies. At the end of the 12 years, the district assemblies will take over implementation of community-managed investments with their own staff as MASAF reduces its staffing levels. The vanguard role of MASAF has been recognized by the Malawi Poverty Reduction Strategy Paper, which states that MASAF is “one of the key instruments that government has
put in place to promote community participation in national development, and enhance and deepen the decentralization process.”

3.64 Another critical issue is whether social funds crowd out funds that normally would have been allocated to local governments. Those concerned with the fiscal integrity of local governments argue that transferring resources through parallel channels undermines the credibility of the nascent intergovernmental fiscal system. The effectiveness and efficiency of resource management at the local level requires local government budgeting systems to be comprehensive (minimizing off-budget expenditures), contestable (subjecting all resources, including those provided by social funds, to the same appropriations process), and transparent. Another concern is the risk that capacitated and resourced local governments will fail to be inclusive. Parallel funds can be seen as a way to ensure that the specific investment needs of local communities are met until communities develop the capacity to participate in local government budget processes.

3.65 Given the low level of intergovernmental fiscal transfers to decentralized bodies in very poor countries and the overwhelming share of donor funding instead of government funding in social funds, there probably is no crowding out. Nevertheless, the effect of social funds on the intergovernmental fiscal framework needs to be studied further. There is also a need for greater coordination between intergovernmental transfer policies and social fund policies.

Exit Strategy and Limited Long-Term Role

The Concerns

Absence of Sunset Clause

3.66 Social funds are seen as interim measures to protect public spending of vital importance to the poor or to direct more resources to activities that benefit the poor until
efficient and equitable planning and budgeting procedures can be installed in government institutions (World Bank 1997). The absence of a coherent and time-bound exit strategy is one of the biggest criticisms leveled against social funds. Goodman (1997), for instance, asserts that, “Social funds, which in almost all cases were launched as temporary institutions (four to six) years directed toward short-term poverty alleviation, appear to be turning into permanent fixtures in the countries’ institutional social policy frameworks.” The continuation and extension of a social fund agency is consistent with the fund’s self-interest. Many World Bank–aided social funds have been extended by drawing up additional phases to the original social fund. The argument generally proffered is that the gains of the first phase need to be continued and consolidated.

**Limited Planning Horizon**

3.67 Many use the metaphor of a firefighter to understand social funds: they are trained to play the reactive role of dousing development failures and providing temporary assistance. But long-term issues are rarely addressed, both because of the uncertainty surrounding the social funds’ own existence and the need to deliver short-term, visible results. It is often argued that social funds have a limited planning horizon and that the preponderance of community infrastructure schemes attests to their myopic approach to development.

**Dependence on External Funding**

3.68 Most funding for social funds comes from external sources. This can make funds unsustainable, since donors do not continue funding indefinitely. After noting that most Latin American governments with social funds have financed less than 20% of their social fund operations, IDB evaluators warned that “donors cannot claim that the funds are successful and sustainable” until countries make a greater contribution (Goodman 1997). As with all other aid disbursements, the external funding of social funds is accompanied by future

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18 Entire paragraph taken from an internal note by N. Poupard, N. Girishanker, and D. DeGroot, all of the World Bank.
liabilities, which are often ignored in the desire to provide some immediate semblance of service.

*Design Flaws*

3.69 Most social funds are specifically designed for short-term compensatory measures and are constrained in their ability to take on functions that exceed their original mandates. As a result, there are concerns that as a social fund attempts to cast itself as a long-term player, there will be a fundamental dissonance between its design and the modified role it is expected to take on. Critics contend that cosmetic changes, often passed off under the guise of adaptability, fail to address the new challenges that emerge with changing mandates.

*Analysis*

3.70 Purists in the public sector argue that a social fund should discontinue its activities at the end of its originally mandated life and distribute responsibility for managing and implementing development objectives to sectoral ministries and local governments. A study of the Latin American social funds hypothesized that, “The positive experience of the region’s social investment funds would motivate more countries in the region to use this mechanism. But at the same time it cautioned that while social funds can contribute significantly to poverty alleviation, their role is limited. They are financial intermediaries, not policymakers. They can complement but cannot take the place of fundamental reforms, such as decentralization, that are needed to improve the scope and effectiveness of service delivery to the poor” (Glaessner 1994).

3.71 Many argue, however, that the notion that social funds are temporary needs to be reevaluated. Arguments made for continuing ASIF are typical of those who hold this point of view: (a) the sectoral ministries, with their top-down and overly bureaucratic approach, would not be sufficiently responsive to community-driven project proposals and would not have the flexibility to adjust to emerging local demands in a short time; (b) cost-effectiveness
studies have shown that the costs of microprojects completed by ASIF are lower than those carried out by traditional government departments; (c) experience has shown that the development objectives of social funds are best achieved by autonomous entities with minimal bureaucratic processes; (d) compared with other donors, the Bank has a comparative advantage in drawing from the international experience in financing such programs and in designing a viable and institutionally sound framework to implement social investment fund activities; and (e) capacity would be strengthened at the local level by carrying on community-driven microprojects in the future (World Bank 2002d). Zambia typifies the dilemma faced by a country that must decide whether to close down an efficient instrument. Despite the government’s commitment to terminate the social fund after its second phase, the social fund was continued into a third phase (box 3.10).

**Box 3.10 Zambia’s Continuing Use of the Social Fund Instrument**

When the second Social Recovery Project (SRP II) in Zambia was being negotiated in 1995, the government of Zambia and the Bank agreed that the International Development Agency–supported Microproject Unit (MPU) would not be continued beyond the life of the project, and that, “It was likely that at the time of the Mid-Term Review, the capacity of district agencies will have been sufficiently strengthened to allow the District Development Coordinating Committee, with funds from the proposed District Investment Fund, to gradually assume the functions of the MPU using its approaches and processes.” During the MTR, however, it was found that, “The progress in strengthening local government authorities had been slower in general than expected at credit negotiations. It should therefore not be assumed that the MPU should be discontinued in the year 2000, and that while the MTR should examine further the decentralization of the MPU and progress in capacity building of the district staff, the MTR will not plan for the discontinuation of the MPU in the year 2000” (MTR report for SRP II, September 29, 1998).

The government of Zambia rejected the original idea of discontinuing the project's activities in 2000. In June 1999 it submitted a document to the Bank outlining its vision for future activities of SRP and requesting Bank support. The document stated that, “While during the preparation of SRP II it was felt that no additional phase for the project was going to be needed, the actual decrease in basic social indicators, acute economic crisis, increase in poverty, both rural and urban, and increased impact of HIV/AIDS and other epidemic diseases make a powerful case for continuing the activities of SRP, which so far has been one of the most successful instruments put in place by the government of Zambia to alleviate poverty and reduce the negative impact of social and economic crises.”

It was agreed that ZAMSIF would not only build upon the positive experiences made during the implementation of SRP I and II, but also would expand its focus and strategy in order to become the platform to develop the national poverty reduction strategy.


3.72 There is a valid question about the natural limits to the number of infrastructure projects required in a country. Once the need for community infrastructure has been fulfilled,
a social fund has to transform into a new agency or cease functioning. With the newer social funds playing a greater role in institutional development rather than providing basic infrastructure, the argument about the need for an exit strategy acquires a new dimension. As incubators of innovation in the public sector, their longer term role becomes embedded in the public sector and helps reduce the divide between the community and the public sector agencies.

3.73 While these arguments are compelling, there are valid concerns about the ability of social funds to deliver, given the uncertainty about their exact term of existence. Without an adequate long-term institutional strategy, it is inconceivable that social funds can become platforms for the development of national poverty reduction strategies.

3.74 Each social fund has tackled the exit issue in its own way. Nicaragua’s FISE is funded from the government’s investment budget, not the current budget. As a result, it will cease to exist as soon as investments end, unless a specific provision is made in the investment budget. MASAF III has incorporated a sunset clause in its key performance impact indicator that envisages the conversion of the management unit into a self-financing training and capacity-building institution for the community-driven development approach. RSDF also has clearly identified an exit strategy for itself based on its core competencies (box 3.11). In Honduras a proposal is under consideration for altering the character of FHIS into an institution responsible for capturing funds and monitoring disbursements and implementation programs; it would coordinate its efforts closely with ministries and sectoral agencies, but it would rely on private contractors and NGOs for technical assistance, services, and civil works.19

19 World Bank staff.
Box 3.11 Exit Options for Romania’s Social Development Fund

The second Romania Social Development Fund (RSDF II) has just become effective and is expected to end in August 2006. Even at the early stage of implementation, there is a conscious desire to discuss the exit options. It is certain that a final decision from among the following options, will be made during the SDF II Mid-Term Review.

- **Enhancing RSDF’s role as a national institution.** Financing projects that are initiated at the grass-roots level by community based institutions. RSDF could use both public funds and resources from other international agencies (European Union, private investment funds, World Bank);

- **Transforming the RSDF into a center of excellence in community-driven development.** The RSDF staff could be engaged in facilitation, appraisal, and supervision of activities for new projects, monitoring and evaluation, poverty alleviation measures.

- **Linking the RSDF closer with the decentralization program, possibly merging it with other agencies that finance local activities.**

As a step toward this exit strategy, the law on the RSDF establishment, organization, and operation was amended (Law 129/1998 republished) to allow delivery of social development training, assistance, and consulting services. RSDF has already consulted on a World Bank–financed biodiversity program and acted as an implementing agency for a part of the funds under the Bank-financed Rural Development Program. RSDF is also negotiating with the Ministry of Industry and Resources to implement a part of the Bank-financed project for Mine Closure and Social Impact Mitigation.

*Source:* World Bank 2001b and personal communication from Lilliana Vasilescu, Executive Director, RSDF.

3.75 In some sense there is a conflict of interest when a decision is to be made about the longevity of social funds because the three main parties have an interest in their continuation. Host countries want to get continued mileage from efficient mechanisms that contribute to efficient service delivery at the community level. The Bank wants to maintain an efficient investment mechanism. And the social fund agency wants to preserve itself. The issue of continuing a social fund should be subject to a rigorous cost-benefit analysis that explicitly acknowledges the need to have a long-term, durable system for addressing the basic service needs of the community. The decision to exit should revolve primarily around the availability of an alternative mechanism to continue with the mandate of the social fund.

3.76 This section addressed some of the key concerns that critics have about the impact of social funds on the public sector. In addition to the issues delineated in this section, an attempt will be made to understand the “corruption-inhibiting” role of social funds.
Furthermore, going beyond the public sector, the institutional building role of social funds in the context of civil society organizations and the private sector will also be discussed.
4. Other Issues

4.1 This section examines other issues that are not the focus of criticism but that are still important because they complement issues discussed in the previous section. The influence of social funds on three important actors—social fund agencies, civil society, and the private sector—is also important. (A fourth actor, the donor community, is not covered in this study.) In addition, the political economy of social funds and their role in reducing corruption will also be discussed.

Institutional Development of Other Agencies

4.2 The framework in section 2 stressed the importance of the institutional impacts of social funds on agencies other than the central government and its line agencies. This section discusses the impact of social funds on social fund agencies themselves, on civil society, and on the private sector.

Social Fund Agencies

4.3 Some early social funds had a specific provision for institutional development, but their money was used primarily for the day-to-day operational and administrative expenses of their management units, so there were often no separate funds available to support other institutions, such as NGOs and local governments. The emphasis was on internal institutional building. Some more recent funds have started making separate provisions for the institutional development of other agencies. Out of a total project cost of US$19.88 million, for instance, the Moldova Social Investment Fund Project provided US$1.53 million for the operating costs of the project management unit and US$1.26 million exclusively for building the capacity of the community and local government.

4.4 The institutional development of social fund institutions is closely related to their longevity. If social funds are truly temporary agencies, what level of investment should be
made in their management units? If a social fund management unit takes on another role after completing the social fund cycle, there is valid case for making larger investments in management units. The RSDF has a clear exit strategy, justifying the continued investment in its management unit (see box 3.11). But if the social fund is to be concluded in five years, there should be clear justification for spending on internal institution-building.

4.5 There are at least two important dimensions to the institutional development of a social fund agency: its capacity to deliver services and its capacity to transfer knowledge to other agencies. The second role is growing more important for newer social funds. There have been suggestions that a social fund should have a clear division of its investment funding and capacity-building functions. Many organizations that attempt to fund and build capacity find that funding tends to take precedence over capacity-building unless they are kept separate. Having separate organizations focus on each activity would also permit the design of separate incentive structures for each, rather than incentive structures that must be compatible with both. But since social funds do so much of their capacity-building in the process of “learning by doing,” separate organizational structures may not be justified. With the continuous evolution of social funds and the diverse country contexts in which social funds operate, the relative importance accorded to each activity varies.

4.6 For example, some social funds have now been given the mandate of building capacity in local governments. But it is unclear whether these funds have the “internal capacity” to carry out such an ambitious program. For a social fund agency, the transition to a capacity-building role is by no means seamless, as a recent mission document illustrates: “ZAMSIF has made good progress in its capacity building efforts toward empowering district administrations and communities to take on increased responsibilities in the development planning and implementation process. However, the shift from the Social Recovery Project framework—in which the central implementation unit had major responsibility from the application to the monitoring of community level projects—to the ZAMSIF framework—in which the district teams are conceived as the interface with the

20 “Concept Note on ESRDF’s future,” an internal note from the World Bank provided by N. Poupart.
communities from the identification to the monitoring of community level projects—is taking much longer than foreseen in the project design.”

Civil Society Organizations

4.7 The ongoing institutional debate tends to concentrate on the four main actors: the community, the social fund agency, the permanent public agencies, and local governments. The relationship between the social fund and civil society organizations is the least studied and analyzed. Any institutional analysis needs to account for civil society organizations, whose participation may take many forms—ranging from being a member of a social fund board to being an implementing agency for a subproject. Social investment funds are an important dimension of the World Bank’s involvement with civil society.

4.8 The participation of civil society organizations in social funds is determined to a large extent by the enabling environment created for their engagement (box 4.1). Although FONCODES worked well with the communities, it lost the opportunity to work with NGOs and local governments because the political climate at the time discouraged government institutions from working with these sectors. As a result, several government efforts, most visibly PROFINES (a program intended to bring local organizations together in a participatory planning process), were closed. The number of projects with NGO participation dropped from 63 in 1997 to just 1 in 1999. The same pattern was observed on local government participation: in 1997, 890 projects involved local governments, in 1999 only 75 did (World Bank 2001c).

4.9 Almost all social funds have some sort of civil society representation on their boards or steering committees. The Benin Social Fund Board has two NGO representatives, the MASAF Board has the Executive Secretary of Council for NGOs in Malawi, and the PPAF Board has 8 representatives from civil society on its board of 12 members.

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**Box 4.1 Enhancing NGO Involvement in Social Fund Projects**

Measures that can enhance NGO participation in social fund projects include:

- Establishing clear policies and guidelines for NGO involvement in the social fund.
- Early in project design, conducting an NGO sectoral assessment to identify NGOs that have links with poor communities, determine their capacity and specific areas that need strengthening, and identify and elaborate potential roles for NGOs throughout the project cycle.
- Devising a strategy for communicating with NGOs, starting with the project design phase and continuing throughout implementation of the project.
- Adapting procedures to facilitate NGO and community involvement.
- Where appropriate, supporting the funding of pre-investment costs (related to subproject preparation).
- Establishing, in collaboration with NGOs, a methodology for systematic evaluation of NGO performance and assessing overall NGO performance on an ongoing basis. This information should be shared with NGOs and other stakeholders.
- Recruiting staff who have worked in the NGO sector or who understand and are respected by NGOs, and organizing training for social fund staff on community participation, social mobilization, and working with NGOs.

*Source:* Malena 1996.

4.10 NGO collaboration enables social funds to work in areas previously inaccessible to government line agencies. SFKC was designed primarily as a relief measure after the lengthy conflict in Cambodia. According to its ICR, SFKC worked with 27 international and national NGOs that sponsored 120 subprojects costing US$4.1 million. Generally, collaboration with civil society has enabled SFKC to support better subprojects in areas and sectors that would have been difficult to reach alone. Much of this collaboration was centered on building rural roads, bridges, and culverts to open former Khmer Rouge–controlled areas by linking them to markets and services in the rest of the country.

4.11 On the negative side, collaboration with NGOs often slows implementation, because of the differences in approach to working at the community level. Poor information flows between SFKC and NGOs added to initial mistrust and reduced interest in collaboration. Collaboration was especially difficult where NGOs had worked for a long period, had well-established organizational structures at the local level, and perceived the entry of the SFKC
more as a challenge than as an opportunity. Field visits and regular dialogue helped minimize
mistrust and uncertainties, and the presence of community organizations and structures in the
villages (such as Village Development Committees) helped create a favorable environment
for institutional collaboration and concrete partnerships (World Bank 2001d).

4.12 The benefits of NGOs in subproject implementation are undeniable. But on the flip
side, civil society organization involvement can result in confusion about microproject
ownership and increased dependence on civil society organizations. In the case of Zambia’s
SRP I, the self-confidence and capacity of communities significantly increased when
microproject funds were handed directly over to them. But only 10% of the subprojects
funded under SRP I involved NGOs. During the performance appraisal review of the project
it was evident that lack of familiarity with Microproject Unit (MPU) procedures and the
MPU policy of not funding NGO pre-investment costs (costs incurred in mobilizing
communities) were the main constraints to NGO participation in SRP I.

4.13 Social funds not only enhance the capacity of existing NGOs, they also act as
catalysts for the formation of new ones. The Moldova Social Fund used its capacity-building
component to support creation of new NGOs. By September 2002, 327 new community-
based organizations capable of pursuing local development objectives were created—276 of
them NGOs. Furthermore, a network of community-based organizations was created in the
northern region, and work on creating a network in the south is expected to start shortly.
Community information centers are proposed to disseminate best practices.22

4.14 A close relationship between a social fund and NGOs has positive impacts beyond the
immediate gains in community mobilization and subproject implementation. It is often
suggested that there is a “deep-seated reluctance on the part of NGOs—based on mistrust—
to entering into a relationship with the government” (Van Domelen 1991). There is a school
of thought that asserts that social funds offer an intermediate forum through which civil
society organizations get a better understanding of government by working with a more

22 World Bank staff.
flexible and nonbureaucratic branch of the government. This institutional multiplier effect enhances the ability and confidence of civil society organizations to deal directly with line agencies.

4.15 In Bolivia probably the most significant impact on NGOs of working through the ESF was the maturing of the cooperative relationship with the government. This was most apparent in the health sector, where NGOs signed operational agreements with the government and were ceded entire health districts to operate (Van Domelen 1991). And as Graham (1992) notes, “One of the most cited achievements of the Emergency Social Fund (Bolivia) was the improvement of the relations between NGOs and the state, relations that had traditionally been hostile. Yet it is rarely noted as a contribution to the democratic consolidation process in Bolivia. The role that the ESF played in creating a rapprochement among the state institutions, NGOs and local actors had a positive and a revitalizing effect on local democratic government, albeit one that was not foreseen by the original architects of ESF.”

Institutional Development of Private Sector

4.16 Over the years social funds have developed efficient and transparent systems for engaging the private sector. Primarily focused on procurement and disbursement, these new systems can produce significant benefits. The experience of contractors with efficient systems can motivate the private sector to press government agencies to adopt some of the processes. And as governments align their procurement system with the more efficient systems adopted by the social funds, they can produce huge reductions in transaction costs.

4.17 In an evaluation report the government of Eritrea acknowledged the role of the social fund by stating that, “One great contribution, which was lately realized by the ECDF, was the role it played toward enhancing institutional capacity building of the private sector.” The PPAR done by the Operations Evaluation Department also reiterates this finding by concluding that, “ECDF created demand for and helped expand the private contracting
industry, particularly in the construction, consulting, transport, and other small-scale manufacturing and service sectors” (World Bank 2002c).

4.18 Social funds also contribute to private sector development by enhancing competition in local construction and technical assistance markets. Some social funds, such as those in Honduras and Yemen, are organizing specific training programs for private sector contractors and suppliers. Anecdotal evidence suggests that the presence of a fair and transparent procurement system motivates more suppliers and contractors to participate, leading to obvious efficiency gains for procurement agencies.

4.19 A study of social funds in Europe and Central Asia suggests that funds have played a revitalizing role in some transition countries. Social funds “created opportunities for newly created small and medium-size firms, especially construction and engineering companies that bid on contracts financed by social funds. The competitive culture may also have led to an improvement in overall capacity of the small business sector by emphasizing accountability and discipline in preparation of bids, adherence to designs, technical norms and standards, and abidance with implementation schedules” (Schmidt and Marc 1998).

**Political Economy**

4.20 Critics challenge the claim that social funds are less susceptible to political manipulation because of their autonomous nature. Tendler’s (2000) assertion exemplifies this view: “Autonomy from existing state structures is not synonymous with lesser political interference. The less noted flip side of this autonomy is the social funds’ vulnerability to political manipulation.” Social funds straddle all three levels of government: central, regional, and local. Are they more likely to be subject to pressures than existing government line agencies? An examination of recent PADs suggests that, ex ante, political interference is one of the most important risks.
Box 4.2 Political Determinants of Social Investment Allocations in Bolivia’s Social Investment Fund (1996–98)

Bolivia’s Social Investment Fund (FIS) was an important element in the Bolivian government’s efforts to increase the fiscal autonomy of the country’s newly created municipal governments. Based on an analysis of FIS spending in 296 of 311 municipalities, two features of the country’s political landscape emerged as critical determinants of the allocation of program funds: the partisan leaning of a municipality’s electorate and the stability of the municipal government during the years under analysis.

The single most important predictor of the number of years a municipality received FIS funding was its level of electoral support in the 1995–96 municipal elections. The greater the support for a particular party in the 1996 municipal elections, the less likely it was to receive more than one year of funding from the FIS.

A second finding of the study concerns the determinants of the per capita levels of funding among the 224 municipalities that received at least one year of funding. Among the most important predictors of a municipality’s level of funding, particularly for 1996 and 1997 (the last two years of the Sanchez de Lozada government) were the percent vote received by Sanchez de Lozada’s party, the MNR, in the 1996 municipal elections. After controlling for an array of municipal-level social and economic variables, each 10-point increase in electoral support for the 1996 MNR mayoral candidate translated into an additional 6 bolivianos per capita of FIS funds received by a municipality in 1996 and 1997.

To summarize, the partisan leaning of a municipality appears to have greatly affected the likelihood of a municipality receiving funding from the FIS and, if it did receive money, the amount of funds allocated to it by the program.


4.21 How much evidence is there of partisanship in social fund spending? Findings from Bolivia (see box 4.2) are strikingly similar to other studies of programs like the Social Investment Fund (FIS) that allow for a high level of spending discretion in the name of enhanced targeting capability by program planners. Based on this preliminary analysis, it appears that FIS provides yet another example of the ubiquitous presence of politics in the allocation of public expenditures for programs purportedly designed to help poor people. A study of Peru’s FONCODES program found spending patterns greatly affected by electoral considerations (box 4.3). Several studies of Mexico’s National Solidarity Program of the early 1990s also showed evidence of a link between program spending and electoral patterns. It must be noted, however, that while some earlier social funds did not have transparent allocation formulas, most now have rules for transparency in allocations.
4.22 The evidence from Bolivia and Peru cannot be extrapolated to other social funds because of the specific context of these two countries. Moreover, evidence is available from only those two countries, and no such analysis has been done in Africa or Eastern Europe because elections have not been held on a regular basis there and because there is a lack of reliable data.

**Box 4.3 Political Economy of Expenditures by Peru’s Social Investment Fund**

Using formal econometric modeling and rich, highly disaggregated data, the author analyzed the effect of elections on the timing and distribution of expenditures made by Peru’s National Fund for Compensation and Social Development (FONCODES) between 1991 and 1995. One important advantage of the approach was that it allowed for a separation of the political and technical influences on the fund’s expenditures. The study concludes that expenditures were boosted before national elections and that community-based projects were channeled to provinces where large political returns were expected.

The study shows that FONCODES was responsive to political imperatives, including President Alberto Fujimori’s electoral ambitions. Unlike most programs conducted by line ministries in Peru, FONCODES expenditures were truly discretionary: since 1993 FONCODES has had a backlog of thousands of project proposals that could be funded at opportune times in provinces deemed to be electorally important. Polls suggest that FONCODES projects were closely identified with the presidency and with President Fujimori himself.

But FONCODES also appears to have had an important redistributive function. The study shows that FONCODES funds flowed disproportionately to poor provinces. Household survey data indicate that the infrastructure construction supported by FONCODES reached a larger share of households, especially poor households, than other programs in the Ministry of the Presidency. Such success reaching the poor can be explained in part by the lack of restrictions, paperwork, and inefficiencies that have given the Latin America’s public sector a bad name.

Was FONCODES an effective poverty alleviation program or a brazen attempt to buy votes? There is no simple answer because decisions about funding appear to have been made on the basis of both political and technical criteria. Ironically, the features that enabled FONCODES to reach the poor—including the high degree of flexibility in the allocation, timing, and composition of expenditures—made it particularly vulnerable to political interference.

This tension between effective redistribution and “pork barrel” policies need be no coincidence: some argue that pro-poor programs are much more likely to be implemented when the executive keeps “control over patronage.”

4.23 A study of social funds and public works projects in Sub-Saharan Africa reveals that, “An agency’s independent association status will not prevent government from interfering if it believes that agency leadership is not aligned with government thinking. The distinction between formal autonomy—obtained by giving these agencies independent association status—and a semi-autonomous setup does not produce uniform patterns of results on either side. In addition, the idea that the greatest level of formal autonomy would ensure the best results is debatable” (Frigenti and others 1998).

4.24 If the targeting studies are any indication, there is little evidence to suggest that undue partisan politics affect the allotment of funds. But a detailed followup study is needed to look at the counterfactual—that is, whether investments by government programs are subject to more political influence than social fund investments. Other research could compare the level of political interference at the local and central levels, testing the hypothesis that the very nature of a social fund (its placement in a ministry under the office of a president or prime minister) subjects it to more interference at the national level than at the local level, which would contrast with government programs where the reverse might be expected to be true.

**Corruption**

4.25 One of the largest institutional challenges confronting developing countries is the rapid growth of corruption associated with both political and administrative institutions. Anecdotal evidence suggests that the cost-effectiveness of social fund subprojects comes partially from the reduced transaction costs associated with subproject implementation. Methods used by social funds to minimize leaks include the unit cost method, community participation, and community contracting. Social funds have achieved a high degree of transparency by undergoing frequent audits and by using computerized management information systems and widely distributed operational manuals containing technical criteria.
4.26 Corruption in the context of social funds can be viewed in three dimensions. First, continued investment in an existing corrupt and inefficient delivery system contributes to further deterioration of that system. North (1990) offers a related analogy at the macro level by looking at the “reverse set of incentives” in many developing countries. He refers to countries “that favor activities that promote redistributive rather than productive activity, that create monopolies rather than competitive conditions, and that restrict opportunities rather than expand them. The organizations that develop in this institutional framework will become more efficient—but more efficient at making the society even more unproductive and the basic institutional structure even less conducive to productive activity.”

4.27 A second dimension is the impact of a corrupt system on other delivery systems. Corrupt systems are dubious models. The choice, therefore, is between not funding these institutions or funding them in their existing incompetent forms. A rational public administrator would prefer not funding them to avoid sustaining a weak delivery system. But the need to provide a semblance of service, as well as political economy considerations, could force an administrator to opt for funding them. Evidence needs to be collected about the extent of leaks in social fund projects. The hypothesis could be that social funds have a significantly lower level of corruption compared with mainstream community-level development programs implemented through line agencies or local governments (box 4.4). A deeper analysis could look at comparable local government programs but would require a well-planned and well-executed field survey.
### Box 4.4 Cost Savings in School Construction

While preparing the World Bank–aided Basic Education Expansion Project (BEEP), which was aimed at increasing girls’ enrolment in primary schools, Yemen’s Ministry of Education was confronted with the comparative figures of the unit cost of construction of a classroom.

<table>
<thead>
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<th>Project name (major financier)</th>
<th>Average cost of construction of a classroom (US$)</th>
<th>Average construction period (months)</th>
<th>Community participation and contribution</th>
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<td>High</td>
<td></td>
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<td>Ministry of Education, Governorate</td>
<td>14,109</td>
<td>39,757</td>
<td>24</td>
</tr>
</tbody>
</table>

Though not comparable because of different design features, the cost of the social fund schools was about 70% less than the comparable schools built by the Ministry of Education. Further analysis showed that community participation was the key explanatory variable for the huge difference in the construction costs. Community participation carried with it a huge reduction in corruption usually associated with such construction programs.

The social fund school construction program serves as a benchmark for BEEP. After incorporating some of the salient features of the social fund, construction costs are now almost the same, at US$125 per square meter. The Public Works Project is the third agency entrusted with school construction in Yemen. All three agencies share information during regular coordination meetings to ensure a consistent site selection process and to minimize risks of duplication.

*Source:* World Bank 1998d and personal communication of Mr. Ousmane Diagana, Task Team Leader, BEEP.

4.28 The third dimension of corruption addresses the demand side: given the community’s experience with a less corrupt system of delivery, how do the expectations and attitudes of the community change when interacting with the permanent public agencies? This aspect of capacity-building is often discussed, but rarely rigorously analyzed.
4.29 Social funds confront all three dimensions by offering an alternative that is less corrupt, that does not sustain an existing corrupt system, and that may have other positive externalities in the form of increased pressure for corruption-free services.

4.30 Unlike existing public agencies, social funds are characterized by a high degree of transparency, often as a result of concerted information, education, and communication campaigns. Defining this openness is the availability of project documents in the public domain. In MASAF communities, where elites had been generally unchallenged, free access to information about rights and responsibilities (for example, the role of project subcommittees) gave rise to pointed questions about the use of funds, the quality of materials purchased, the manner in which a contractor is selected, and so on. The information, education, and communications component helped a great deal in moving from an asymmetrical information environment to a symmetrical one. In other words, when all stakeholders have more information, and the information is available more equitably, bargaining positions become clearer and power relationships tend to reformulate themselves (Chibwana 2001).

**Box 4.5 Corruption in the Social Fund of the Kingdom of Cambodia**

Governance was a major issue for the Social Fund of the Kingdom of Cambodia (SFKC). The challenge of preventing corruption in operations was apparent to the World Bank appraisal and supervision teams, given Cambodia’s reputation for misusing public resources. The project design aimed to control unit costs and apply pressure for high technical quality in order to persuade contractors and staff to refrain from rent-seeking. This was combined with a rigorous financial auditing framework.

After some initial problems with appraisal and notification procedures and unit costs, and some indirect evidence of SFKC tampering with applicants’ right to procure, the supervision team imposed a substantial technical and procurement audit and revised cost-appraisal procedures. These steps apparently discouraged abuse. But use of the direct contracting procurement method, while justified on efficiency grounds in a reconstruction situation, was also a persistent risk because it encouraged less transparent procurement. This problem recurred in SFKC II.


4.31 Social fund investments are characterized by very cost-effective outputs. But to attribute their cost-effectiveness in subproject implementation to their success in limiting corruption would be a fallacy since there are so many explanatory variables. The challenge is
to disaggregate these effects in order to identify all the factors and get a reasonable measure of how much is attributable to reduced corruption. Within the Bank, the Public Sector Group has developed toolkits and survey instruments to measure patterns of corruption, incentives faced by public officials, and the delivery and financing of public services. These toolkits and survey instruments need to be extensively applied to support both the design and implementation of social funds.
5. Conclusion and Recommendations

5.1 Social funds have diverse objectives, institutional structures, and operating procedures over time and across countries. An underlying theme of this study is that the nature of the interactions between social funds and the public sector varies according to where a social fund is in its evolution and the characteristics of its country’s public sector. The learning curve of social funds has been steep, and it is important to continually reevaluate their interactions with the public sector. At the same time, this study takes a static view of public sector management. Within the public sector, there is a shift from “best practices” to “good fit.” With the best practices approach, reforms relied on foreign models that may not have fit well with country circumstances and capabilities. By contrast, the good fit approach emphasizes the fit between the institutional prerequisites of each option and the institutional capabilities of individual countries (World Bank 2000). Incorporating this two-dimensional notion of public sector into the study would have been useful, but it would have made the study too complex. Nevertheless, it is useful to keep this point in mind before attempting to validate any of the hypotheses of this study.

5.2 A second important lesson from the study is that most of the highlighted issues are equally relevant to a large body of lending by the World Bank and other donors. Social funds are often a target of criticism that is actually more generic in nature.

5.3 Finally, most of this study’s findings are based on internal self-evaluations by the Bank, which may not entirely reflect the true nature of the outcomes. The recommendations that follow are context-neutral suggestions that apply to a broad spectrum of social funds and other demand-driven programs.23

- An early and systematic analysis of the institutional context into which a social fund is introduced and of the relative roles of the various organizations can help ensure that the fund is designed and implemented in a manner that does not undermine existing

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23 Some of the recommendations have been based on those made in ICRs and PPARs.
institutions, but strengthens them.\(^2^4\) A social fund needs to build effective institutional links both horizontally and vertically to ensure coherence and sustainability. It is important to ensure links not only at the macro level, with sectoral ministries regarding policies and coordination, but also at the local and community levels, to guarantee that projects are consistent with local characteristics. By building on existing community and government structures and processes, social funds can be viewed as integral implementation arms of government at both the central and local levels.

- The balance between greater embeddedness in government structures and autonomy needs to be carefully calibrated. The greater the link with mainstream bureaucracy, the less flexible and agile the social fund is likely to be. A key challenge in designing and operating a social fund is managing administrative autonomy. This usually involves gearing short-term benefits (speed and flexibility of decisionmaking and implementation) toward supporting the long-term goal of reforming existing public sector institutions. Recognizing this role of the social fund facilitates a design that fits with the goal of the social fund and creates positive synergies with the local institutional environment. The design stage of the social fund becomes as crucial, if not more crucial, than the implementation stage. Given the variety of design models used in the past, there is a wide body of experience that can be combined with the results of the institutional analysis to arrive at an appropriate level of autonomy in the design of social funds.

- The need to strike a balance between winning strong political backing for social funds and avoiding undue political interference over them must be addressed systematically. Understanding a country’s political economy can help determine how best to avoid

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\(^2^4\) The proposed Institutional Assessment tool of the Bank can help achieve this objective. It consists of the following steps: (i) identifying actions necessary to successful implementation of the operation and then identifying the key actors who must perform those actions and the institutions that constrain or influence their implementation actions, (ii) considering the capacity of key actors, (iii) considering the sustainability of the project in light of the initial commitment of the actors and the institutional incentives to undertake the necessary actions for implementation, and (iv) assessing the broader impact of the operation on the development and sustainability of public institutions.
partisan or patronage-based political interference. One useful analytical instrument is the Institutional Governance Review (IGR) for individual countries, now being piloted by the Public Sector Board in the Bank. Among other things, it uses empirical methods and diagnostic toolkits to understand political economy issues. Though a full-fledged IGR may not be feasible in all countries that use social funds, some of the individual tools of the IGR can form the basis for a better appreciation of the political economy climate in a country.

- Social fund projects that have long-term service delivery objectives should strive to make investments in economic infrastructure in accordance with norms and rules that reflect evolving sectoral good practice. If national policies in the sector are at odds with the Bank’s good practice guidelines, social fund project investments should still incorporate sectoral good practices so that the investments can positively affect governments. In sectors where this is not possible, it is preferable not to fund investments through a social fund unless the component is extremely small. The bigger the size of overall social fund investment relative to each sector, the more important it is to conform to the sectoral development strategy and to observe evolving sectoral good practices.

- Physical output targets may be emphasized over longer term, less visible objectives such as institutional development and sustainability unless clear mechanisms and incentives are in place. Tradeoffs need to be confronted in the project design stage, and the hierarchy of objectives needs to be defined and established up front. Insofar as sustainability and institutional development impact are important objectives of a project, explicit measures are needed to compensate for the natural bias toward maximizing immediately visible and more easily measurable results. Performance indicators are useful for signaling the outcomes valued by the project.

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25 IGRs are intended to undertake a “broad assessment of the quality of accountability, policymaking, or service delivery institutions in a country and propose a strategy for institutional change.”

26 When looking at the sectoral budget of a line agency or the social fund, it is more instructive to look at the investment portion of the budget after ignoring salaries, administrative expenses, and recurrent costs. This is a more reasonable comparison because the investment portion is usually not more than 20% of the total government budget.
• The most important limitation of social funds is that they are financial intermediaries that can complement and prod fundamental reforms. They are not policymakers. They are not meant to provide a quick fix for poverty or to replace the fundamental fiscal and institutional reforms needed to address poverty systematically. The presence of a social fund should not add to the difficulty of achieving wider public finance or sectoral reforms that need to happen with the social fund project. On the contrary, social funds should be designed to act as catalysts toward more sectoral reforms by grafting their positive features and incentives onto government structures. Thus, instead of allowing governments to forego needed reforms, the new generation of social funds should encourage and support the ongoing process of modernization of the state.

• Social funds should align their objectives and strategies with the decentralization policy environment of their country. When setting goals, a social fund should consider the following key issues:

  o Given the long-term nature of the decentralization process, a social fund should set realistic and modest targets.

  o The final outcome of any decentralization effort is the result of a mix of complex factors. A social fund should continually monitor political commitment to decentralization, while judging the efficacy of its own efforts to support the process.

  o There is a “learning by doing” gain in working collaboratively with local governments in subproject implementation, but greater emphasis should be put on transmitting capacity to the local bodies.

• Auditing by the supreme auditing authority should be mandatory for all social funds. And the annual audit report of the social fund should be presented to the national parliament and be under the purview of the public accounts committee.
• Continuation of a social fund should be considered more objectively than it has been to date. Rather than deciding in advance that a social fund will be discontinued at a certain time in the future, it would be more productive to conduct an intensive cost-benefit analysis when the actual decision has to be made. The calculation should include both the actual financial costs and the potential costs that would arise if the government failed to make the tough decisions to reform mainstream institutions.

5.4 Several questions remain unanswered by this study:

• What do social funds tell us about the broader issue of “autonomization”? It would be futile to try to extrapolate the preliminary findings of this study to other autonomous institutions supported by the World Bank and other donors, but the findings could form the basis of a separate study that reviews all autonomous and semi-autonomous structures supported by the Bank and other donors.

• What is the precise role that a social fund plays in lowering (or raising) the morale of public sector employees? Does resentment arise because of the perceived “higher” salaries social funds pay, or do public sector employees resent the loss of control of investment decisions that are now directly in the hands of the community?

• How do “good practices” within social funds get adopted by public agencies? The special conditions under which funds operate beg the question whether it is difficult to transfer lessons learned and replicate efficient projects in other ministries. This issue becomes more critical because most social funds are progressively moving from being basic infrastructure providers to playing an institutional development and capacity-building role.

• What is the precise nature of the distortions that social funds produce in newly decentralizing countries that are developing intergovernmental fiscal transfer systems? Do social funds hamper or support the establishment of coherent systems? What are the
potential areas for greater coordination between intergovernmental transfer policies and social fund policies? What would be the implications of including social fund investments in local budgets?

- How do the dynamics of corruption play out in a typical social fund? And how can the lessons be transmitted to regular public agencies?

- To assess the issue of political interference and political patronage, it will be necessary to look at the counterfactual: are investments in government programs subject to more political influence than social fund investments? The hypothesis that social funds are subject to more top-level political interference also needs to be examined.

5.5 Government rigidity and poor response time can be crucial contributors to failed development interventions. By contrast, flexibility to respond to changing circumstances is one of the inherent strengths of a social fund intervention. A social fund’s ability to learn and adapt leads to gains that partially compensate for the distortions that may have been created due to the creation of the fund. Reforming public institutions is the first best solution, but in many countries, efforts to reform the public sector have been going on for years with very few visible results. In such countries, social funds have a critical role to play until the public sector develops a greater implementation capacity. The positive evolution of social funds is exemplified by their increasing emphasis on the long-term growth of mainstream public institutions.

5.5 Any evaluation of strengths and weaknesses of social funds needs to take into account the fact that they are often established and functioning in very difficult environments. Since the evidence in this study is rudimentary and potentially biased, it is mainly useful in helping to define the questions, rather than in providing definitive answers. With newer social funds now adopting a more synergy-enhancing (or distortion-mitigating) approach to interventions, it is hoped that further research will help to steer them toward a design that integrates public sector management and institutional issues into all stages of the project cycle.
References

The word “processed” describes informally reproduced works that may not be commonly available through libraries.


## Annex 1 Institutional Matrix

<table>
<thead>
<tr>
<th>Status and institutional setting</th>
<th>Benin Social Fund (AgeFib)</th>
<th>Zambia Social Investment Fund (ZAMSIF)</th>
<th>Ethiopian Social Rehabilitation and Development Fund (ESRDF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elected board of directors,</td>
<td>A not-for-profit association</td>
<td>Managed by a semi-autonomous Project Management Unit</td>
<td>Established by government proclamation. ESRDF Central Office, headed by a general manager, is responsible for planning and managing financial transfers and monitoring and evaluating project implementation.</td>
</tr>
<tr>
<td>composed of two representatives</td>
<td>under the nominal responsibility of the Ministry of Planning, Economic Restructuring, and Employment Promotion. It has the status of a public interest association by decree.</td>
<td>under the Ministry of Finance and Economic Development.</td>
<td>of NGOs, two representatives of potential beneficiaries, a representative of civil society and two representatives of the government.</td>
</tr>
<tr>
<td>of NGOs, two representatives of</td>
<td></td>
<td>National level Steering Committee chaired by the permanent secretary for Budget and Economic Affairs in the Ministry of Finance and Economic Development and includes Permanent Secretaries of different ministries and departments. Meets every six months.</td>
<td>the board is chaired by the prime minister and consists of the head of the Regional Affairs Bureau, the Minister of Finance, and the Minister of Economic Development and Cooperation.</td>
</tr>
<tr>
<td>Project oversight</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Structure of central office</td>
<td>Five units:</td>
<td>Six sections:</td>
<td>Besides having the functional units, there are regional steering committees that approve subprojects from the regional offices.</td>
</tr>
<tr>
<td>Socioeconomic Infrastructure Unit.</td>
<td>Field Operations.</td>
<td>Field Appraisal: Done by the Planning Sub-Committee and might include senior district council and line department staff.</td>
<td></td>
</tr>
<tr>
<td>Income-Generating Activities Unit.</td>
<td>Capacity-Building.</td>
<td>Field Appraisal: The District Planning Officer, district officer in charge of the sector, a technical officer, and a member</td>
<td></td>
</tr>
<tr>
<td>Capacity-Building Unit.</td>
<td>Finance, Administration, and Audit.</td>
<td>Desk Appraisal: Done by the Planning Sub-Committee and might include senior district council and line department staff.</td>
<td></td>
</tr>
<tr>
<td>Monitoring and Evaluation Unit.</td>
<td>Monitoring and Evaluation.</td>
<td>Field Appraisal: The District Planning Officer, district officer in charge of the sector, a technical officer, and a member</td>
<td></td>
</tr>
<tr>
<td>Finance and Accounting Unit.</td>
<td>Poverty Monitoring and Analysis.</td>
<td>Collaborates closely with the central and regional bureaus, but is not a part of either structure.</td>
<td></td>
</tr>
<tr>
<td>Decentralized offices</td>
<td>Four regional offices. Power to approve subprojects up to CFAF20 million.</td>
<td>Network of regional offices existing from the previous Social Recovery Project.</td>
<td>Eleven regional offices.</td>
</tr>
<tr>
<td>Recruitment and salaries</td>
<td>Professional staff selected through a competitive process on the basis of technical expertise, experience, and dynamism. Civil servants are required to leave service before being hired.</td>
<td>The existing Project Management Unit was used and salaries were maintained at competitive levels.</td>
<td>Has its own salary structures designed to attract, motivate, and retain high-caliber staff and special allowances for posts in isolated regions.</td>
</tr>
<tr>
<td>Project coordination with sectoral agencies and local governments.</td>
<td>Operating Manual requires clearance from the relevant ministry for each subproject. Each sectoral ministry has nominated contact people who will be able to provide guidance to staff on matters relating to sectoral policies.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benin Social Fund (AgeFib)</td>
<td>Zambia Social Investment Fund (ZAMSIF)</td>
<td>Ethiopian Social Rehabilitation and Development Fund (ESRDF)</td>
<td></td>
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<tr>
<td>---------------------------</td>
<td>----------------------------------------</td>
<td>-----------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td></td>
<td>of staff from the Regional Planning Section of the Ministry of Local Government and Housing.</td>
<td>regional sector technical standards and plans.</td>
<td></td>
</tr>
<tr>
<td>Accounting, financial and auditing</td>
<td>Special Account denominated in CFAF with an authorized allocation of CFAF500 million. Auditing in accordance with International Standards of Auditing by independent auditors acceptable to IDA.</td>
<td>Special Account in a commercial bank satisfactory to IDA with an authorized allocation of US$5 million. Meets the Ministry of Finance requirements for cash accounting and is audited by independent auditors.</td>
<td></td>
</tr>
<tr>
<td>Procurement (for civil works only)</td>
<td>International competitive bidding for contracts over US$100,000. National competitive bidding for contracts for US$25,000–100,000.</td>
<td>IDA’s prior review required for contracts over US$100,000. National competitive bidding for contracts for US$50,000–100,000. Complies with the provisions and regulations of the Zambia Government Central Tender Board.</td>
<td></td>
</tr>
<tr>
<td>Institutional risks (as identified in the PAD)</td>
<td>• Duplication of activities being undertaken by other ministries or projects. • Fund mechanisms may not be transparent or effective.</td>
<td>• Allocations to social sectors in budget not maintained in real terms and improvements in safety nets not carried out, resulting in limited benefits to community benefits. • Close involvement of government institutions in approval, monitoring, and dissemination may not be forthcoming.</td>
<td>• Limited institutional capacity in some regions where even governmental structures are still in a rudimentary state. Greater pressure on the regional offices to assist communities in preparing proposals. • Decentralized structure of presents challenges in achieving quality standards.</td>
</tr>
<tr>
<td>Status and institutional setting</td>
<td>Eritrea Community Development Fund (ECDF)</td>
<td>Malawi Social Action Fund II (MASAF)</td>
<td>Yemen Second Social Fund for Development (SFD)</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-------------------------------------------</td>
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<td>-----------------------------------------------</td>
</tr>
<tr>
<td>Established by a government directive as an autonomous entity functioning within the Ministry of Local Government. Headed by a general manager appointed by the government.</td>
<td>A quasi-autonomous agency under the Office of the President and the Cabinet, which appoints the executive director, members of the board, and the chairperson of the board.</td>
<td>An independent agency under a board chaired by the prime minister, with executive authority vested in the managing director of the social fund.</td>
<td></td>
</tr>
</tbody>
</table>

| Project oversight | Located in the Ministry of Local Government. | Board consists of a traditional authority, the director for the Center for Social Research, the executive secretary of the Council for NGOs in Malawi, selected secretaries of the government, and two members with skills in urban planning and management, and private sector experience. | The board comprises the minister of planning and development, social affairs, and labor, the minister of finance and local administration, two NGO representatives, two private sector representatives, two members recommended by the prime minister, and one representative from the financial sector. Authorizes projects exceeding US$250,000. |

| Structure of central office | The Management Office is responsible for overall project implementation. It has five functional divisions:  - Engineering.  - Logistics.  - Finance and Accounting.  - Savings and Credit.  - Management Coordination and Administration. | Five divisions:  - Administration.  - Finance.  - Community Subprojects.  - Public Works.  - Sponsored Subprojects.  Four support units:  - Information Technology.  - Communications and Training  - Internal Audit.  - Technical Services.  The National Economic Council, a government agency was responsible for the implementation of the Poverty Monitoring Support Facility. | Seven units  - Community Development Unit.  - Small and Micro-Enterprises Unit.  - Capacity-Building Unit.  - Programming, Institutional Building, and Evaluation Unit.  - Infrastructure and Management Unit.  - Planning and Monitoring Unit.  - Information Technology Unit. |

<p>| Decentralized offices | Six regional branches in each region of the country. The chief executive director of the regional office of the Ministry of Local Government was also designated as a regional subunit. | Sixteen zones headed by project officers. | Six branch offices, with the headquarters supporting five governorates that are not covered by their own branch offices. |</p>
<table>
<thead>
<tr>
<th><strong>Eritrea Community Development Fund (ECDF)</strong></th>
<th><strong>Malawi Social Action Fund II (MASAF)</strong></th>
<th><strong>Yemen Second Social Fund for Development (SFD)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Recruitment and salaries</strong></td>
<td>Has its own salary structure, based on market levels and designed to attract, motivate, and retain high-caliber staff.</td>
<td>Has its own salary structure and is exempt from civil service salary scales.</td>
</tr>
<tr>
<td><strong>Project coordination with sectoral agencies and local governments</strong></td>
<td>All schemes implemented in conformity with ongoing government policy. General manager is also the head of the Ministry of Local Government, which provides enhanced opportunities for learning.</td>
<td>The monitoring unit and its project officers collaborate with: the District Executive Committee, the executive arm of the District Development Committee; NGOs; private contractors; local authorities; and desk officers of various ministries. Desk officers are contact points for sectoral coordination issues, such as sectoral gaps, policies, norms, recurrent budget, and the like.</td>
</tr>
<tr>
<td><strong>Accounting, financial, and auditing</strong></td>
<td>Special Account in a commercial bank acceptable to IDA. Accounts to be maintained in accordance with Generally Accepted Auditing Standard. Auditing in accordance with International Standards of Auditing by independent auditors.</td>
<td>Government maintains a Special Account in a commercial bank to cover part of IDA’s share of eligible expenditures. The annual financial statements to be audited in accordance with International Standards of Auditing. The auditor general also audits the accounts.</td>
</tr>
<tr>
<td><strong>Procurement (for civil works only)</strong></td>
<td>National competitive bidding for contracts for US$75,000–300,000. Limited competition for contracts for US$50,000–75,000. Direct contracting for contracts under US$50,000.</td>
<td>International competitive bidding for contracts over US$100,000. National competitive bidding for contracts for US$30,000–100,000.</td>
</tr>
<tr>
<td><strong>Institutional risks (as identified in the PAD)</strong></td>
<td>• Weakness of local implementation capacity in some of the poorest and isolated regions.</td>
<td>• Donor coordination not proceeding smoothly. • Project management unit remaining efficient over time.</td>
</tr>
<tr>
<td>Status and institutional setting</td>
<td>Pakistan Poverty Alleviation Fund (PPAF)</td>
<td>Thailand Social Investment Project (SIF)</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>-----------------------------------------</td>
<td>-----------------------------------------</td>
</tr>
<tr>
<td>Established in February 1997 as a nonprofit company under the Companies Ordinance, 1984. Has its own Memorandum of Understanding. The General Body provides overall policy guidance and has a membership of up to 50; 12 from the government and 38 from civil society, including 11 from NGOs, 7 from community-based organizations, and 20 from academia.</td>
<td>Implemented by an existing agency, the Government Savings Bank through its subproject agreements with local governments, NGOs and community groups. The Royal Government of Thailand signed a Memorandum of Agreement with the Government Savings Bank outlining mutual responsibilities and obligations.</td>
<td>Operates under a charter enacted by Royal Decree, which gives SFKC considerable autonomy under the authority of its president. Institutional autonomy and freedom from political interference strengthened through the use of a Project Agreement with the Bank.</td>
</tr>
</tbody>
</table>

| Project oversight | The board of directors is a 12-member supervisory body with 3 directors appointed by the government, 8 directors from civil society, and the CEO. Five of these directors form the executive committee. | The Royal Government of Politics shall appoint a broad-based Project Steering Committee to oversee overall SIF policies. | Board of directors and the Ministry of Finance are responsible for project oversight. Members of the board of directors are drawn from the government, private sector, and NGOs. |


| Decentralized offices | Operations implemented through decentralized field offices, with clear allocation of roles and responsibilities between the central and field offices in each province. | Existing structures of Government Savings Bank used. | Three regional offices proposed but only one has been opened (in Battambang province). |

| Recruitment and salaries | The total number of permanent staff is 29, and salary scales are slightly below those of the private sector. | Special recruitment was done, but new staff hired only as consultants. Salary levels on par with NGO or donor agencies, but less than the private sector. | Staff is hired as temporary consultants and not as civil servants. Competitive salaries well above the national norms. |

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27 The matrix only refers to the Social Investment Fund component of the project. Out of a total investment of US$ million 458.0 an amount of 132.8 million (28.7%) is devoted to the social fund. A large proportion of the remaining fund is directly funded to different ministries.
<table>
<thead>
<tr>
<th></th>
<th>Pakistan Poverty Alleviation Fund (PPAF)</th>
<th>Thailand Social Investment Project (SIF)</th>
<th>Cambodia Social Fund II Project (SFKC)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Project coordination with sectoral agencies and local governments.</strong></td>
<td>Almost half (45%) of the funds directed at microcredit activities. Sectoral coordination is not too formidable. Beneficiary communities responsible for all recurrent costs, including operations and maintenance of infrastructure subprojects.</td>
<td>A Project Coordination Unit in the Ministry of Finance carries out the day-to-day coordination with the Project Implementation Units of each ministry and the fund</td>
<td>A Post-Handover and Monitoring Unit visits completed subprojects and will report on maintenance quality, technical quality, and the carrying out of required complementary investments by local governments, cofinanciers, and community groups.</td>
</tr>
<tr>
<td><strong>Accounting, financial, and auditing</strong></td>
<td>Maintains a Special Account and follows International Accounting Standards. A national firm of chartered accountants conducts audit. Statutory Auditors are required to conduct audit of at least 30% of Partner Organizations (POs).</td>
<td>Maintains an independent Special Account, but has to send all its replenishment requests to the Project Coordination Unit. Audited by an independent external auditor.</td>
<td>Maintains a Special Account. Audited by an international auditing firm and by the Ministry of Economy and Finance.</td>
</tr>
<tr>
<td><strong>Procurement (for civil works only)</strong></td>
<td>IDA’s prior review required for contracts over US$100,000. National competitive bidding for contracts for US$50,000–100,000.</td>
<td>International competitive bidding for contracts over US$100,000. National competitive bidding for contracts for US$50,000–100,000. Informal shopping procedures with quotations from at least three qualified contractors. Direct contracting for contracts under US$50,000.</td>
<td>National competitive bidding for contracts for US$100,000–250,000. Procurement of Small Works for contracts for US$50,000–100,000 Direct contracting for contracts under US$50,000.</td>
</tr>
<tr>
<td><strong>Institutional risks (as identified in the PAD)</strong></td>
<td>• Despite autonomous status, government and political interference (substantial risk). • Financial mismanagement by PPAF and partner organizations.</td>
<td>• Civil society groups skeptical of government intentions and capacities. • Lack of locally responsive and sustainable service delivery.</td>
<td>• Political instability disrupting operations and lowering productivity of investments. • Political interference in operations.</td>
</tr>
<tr>
<td>Status and institutional setting</td>
<td>Romania Social Development Fund II (RSDF)</td>
<td>Moldova Social Investment Fund (MSIF)</td>
<td>Armenia Social Investment Fund II (ASIF)</td>
</tr>
<tr>
<td>------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Established in 1998 by Law 1290 as an autonomous public interest institution.</td>
<td>Under the Office of the Vice Prime Minister and serves as an autonomous public organization.</td>
<td>Initially established by government decree as an autonomous organization.</td>
<td></td>
</tr>
<tr>
<td>Initially established by government decree as an autonomous organization.</td>
<td>Since granted a special status as a Closed Joint Stock Company in accordance with Article 123-124 of the Civil Code of the Republic of Armenia. Administers its operations as an autonomous entity governed by its board.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project oversight</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nine-member steering committee nominated by the prime minister and the president and includes a representative of the prime minister, a representative from four ministries, and four representatives from civil society.</td>
<td>National board chaired by the vice prime minister with 10 voting members from government, nongovernment sector, and the donor sector.</td>
<td>National board chaired by the prime minister with representatives of ministries, two departmental heads, the mayor of Ervin, a representative from each NGO involved in the project, and the executive director.</td>
</tr>
</tbody>
</table>

| Structure of central office | Small team of professionals reporting to an executive director who manages the fund’s resources. Special Monitoring and Evaluation Unit set up for the second phase of the project. | Headed by the executive director, with four major departments:  
• Finance and Administration.  
• Promotions and Community Development.  
• Microprojects.  
• Management Information and Monitoring. | Project Implementation Unit headed by an executive director and includes four departments:  
• Finance and Administration.  
• Institutional Support.  
• Microprojects.  
• Procurement and Management Information. |

| Decentralized offices | Two to three decentralized branches to be set up during the second phase of the project. | No regional offices. | Centralized administration in the Project Implementation Unit based on the relatively small size of the country and the desire to minimize the funds to be allocated under the project management component. |

<p>| Recruitment and salaries | Exempt from civil service regulations and pay schedules, which allows competitive wages and recruitment of highly competent employees. The executive director and key staff appointed after their qualifications and terms of reference have been accepted by the Bank. | Competitively recruited staff, with salaries based on standard Project Implementation Unit scale established jointly by the Bank and the Ministry of Finance. Salaries are higher than the salaries of government officials. | Staff selected competitively. Key staff (heads of departments) carried out in collaboration with the Bank. Salaries of technical staff are roughly double those of government officials in similar positions and are comparable to the salaries of local staff working in international agencies. |</p>
<table>
<thead>
<tr>
<th><strong>Project coordination with sectoral agencies and local governments</strong></th>
<th><strong>Romania Social Development Fund II (RSDF)</strong></th>
<th><strong>Moldova Social Investment Fund (MSIF)</strong></th>
<th><strong>Armenia Social Investment Fund II (ASIF)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Members of the steering committee represent various public sectors: public works, labor and social protection, local administration, and finance, which promotes coherent links between the policies that encourage community initiatives and the overall sectoral policies. Emphasis on the role of local authorities in subproject identification and implementation.</td>
<td>National board oversees the quality of project management and ensures consistency with government policies and the Operation Manual.</td>
<td>Improved intersectoral and interagency coordination compared with ASIF I. To be achieved through information, outreach and communications strategy and through regular working contacts among line ministries, NGOs, and donor agencies.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Accounting, financial, and auditing</strong></th>
<th><strong>Romania Social Development Fund II (RSDF)</strong></th>
<th><strong>Moldova Social Investment Fund (MSIF)</strong></th>
<th><strong>Armenia Social Investment Fund II (ASIF)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintains a Special Account and Project Account audited by independent auditors acceptable to the Bank in accordance with auditing standards acceptable to the Bank.</td>
<td>Maintains a Special Account in a commercial bank satisfactory to IDA. Auditing by independent auditors acceptable to IDA in accordance with auditing standards acceptable to the Bank. Government auditors perform periodic reviews to strengthen the internal control mechanism.</td>
<td>Maintains a Special Account in a commercial bank satisfactory to IDA. Auditing by independent auditors acceptable to IDA in accordance with auditing standards acceptable to the Bank.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Procurement (for civil works only)</strong></th>
<th><strong>Romania Social Development Fund II (RSDF)</strong></th>
<th><strong>Moldova Social Investment Fund (MSIF)</strong></th>
<th><strong>Armenia Social Investment Fund II (ASIF)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>International competitive bidding for contracts over US$100,000. Quotes from three qualified domestic contractors in response to a written invitation for contracts for US$50,000–100,000. Competitive selection process for contracts under US$50,000.</td>
<td>National competitive bidding, national shopping, and direct contracting for contracts under US$75,000.</td>
<td>National competitive bidding for contracts for US$30,000–150,000. Minor works procedures awarded on basis of quotes from at least three qualified contractors for contracts under US$30,000.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Institutional risks (as identified in the PAD)</strong></th>
<th><strong>Romania Social Development Fund II (RSDF)</strong></th>
<th><strong>Moldova Social Investment Fund (MSIF)</strong></th>
<th><strong>Armenia Social Investment Fund II (ASIF)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Management assuming the authority and responsibility for every aspect of the project, thereby exposing it to possible risks of collusion and corruption. • Local authorities not interested in establishing partnerships with community-based organizations and NGOs</td>
<td>• Professional capacity not adequate to serve demand and ensure quality. • Inability to maintain full consistency between social sector reform policies and plans and microproject investments</td>
<td>• Interference of the government in the daily operation, compromising autonomy, effectiveness, and credibility. • Government unable to provide counterpart funding.</td>
<td></td>
</tr>
<tr>
<td><strong>Honduras Social Investment Fund V (FHIS)</strong></td>
<td><strong>Nicaragua Social Investment Fund III (FISE)</strong></td>
<td><strong>Peru FONCODES II</strong></td>
<td></td>
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<tr>
<td>---------------------------------------------</td>
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<td></td>
</tr>
<tr>
<td><strong>Status and institutional setting</strong></td>
<td><strong>Operates relatively freely from political interference and is exempt from normal government budgeting, procurement, and disbursement regulations.</strong></td>
<td><strong>Set up as a temporary agency in 1990 and extended twice until 2002. Presidential decree permits it to operate relatively freely from political interference and is exempt from standard government budget, procurement, and recruitment regulations.</strong></td>
<td><strong>Established in 1991 (without World Bank or other international funding). Has legal, technical, administrative, and financial autonomy. The first loan by the Bank was approved in December 1993.</strong></td>
</tr>
<tr>
<td><strong>Project oversight</strong></td>
<td><strong>Board of directors chaired by the president and includes top government and congressional officials and representatives of the private sector, cooperatives, and NGOs.</strong></td>
<td><strong>Oversight provided by a board of directors, with four members appointed by the president.</strong></td>
<td><strong>The president appoints a five-member board of directors, chaired by the minister of the presidency.</strong></td>
</tr>
<tr>
<td><strong>Structure of central office</strong></td>
<td><strong>The executive director has the rank of minister and is a member of the cabinet. There are two vice ministers under the executive director, one for financial and administrative matters and the other for project management. Six directors for:</strong></td>
<td><strong>Headed by the Executive Director. Recently reorganized by region for much of the project cycle. Contracting, administration, and finance are still centralized.</strong></td>
<td><strong>Executive director responsible for operations and the central office, with seven units:</strong></td>
</tr>
<tr>
<td></td>
<td>- Projects.</td>
<td>- Projects.</td>
<td>- Projects.</td>
</tr>
<tr>
<td></td>
<td>- Legal Advisories.</td>
<td>- Legal Affairs.</td>
<td>- Legal Affairs.</td>
</tr>
<tr>
<td></td>
<td>- Monitoring.</td>
<td>- Public Relations.</td>
<td>- Public Relations.</td>
</tr>
<tr>
<td></td>
<td>- Financial Management.</td>
<td>- Internal Control.</td>
<td>- Internal Control.</td>
</tr>
<tr>
<td></td>
<td>- Information Management.</td>
<td>- Planning.</td>
<td>- Planning.</td>
</tr>
<tr>
<td></td>
<td><strong>Six directors for:</strong></td>
<td>- Management Information Systems.</td>
<td>- Management Information Systems.</td>
</tr>
<tr>
<td></td>
<td>• Projects.</td>
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<tr>
<td></td>
<td>• Procurement.</td>
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<tr>
<td></td>
<td>• Legal Advisories.</td>
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<tr>
<td></td>
<td>• Monitoring.</td>
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</tr>
<tr>
<td></td>
<td>• Financial Management.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Information Management.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Decentralized offices</strong></td>
<td><strong>No decentralized offices. Under a pilot program, in 10% of the municipalities, most of the functions are delegated directly to municipalities.</strong></td>
<td><strong>Two regional offices, one in the North Atlantic Coast region and one in the South Atlantic Coast region. Remaining work is carried out from Managua. The entire project cycle is managed in 20 municipalities by local governments.</strong></td>
<td><strong>23 regional offices. Larger offices delegated some project evaluation and approval authority.</strong></td>
</tr>
<tr>
<td><strong>Recruitment and salaries</strong></td>
<td><strong>Competitive salaries were initially offered in line with private sector salaries. But no adjustments have been made for in the last three years, eroding real values of salaries.</strong></td>
<td><strong>Competitive salaries go up to US$6,000 a month for top managers.</strong></td>
<td><strong>Salaries are reviewed on a regular basis to ensure that they are competitive with the private sector.</strong></td>
</tr>
<tr>
<td>Project coordination with sectoral agencies and local governments</td>
<td>Honduras Social Investment Fund V (FHIS)</td>
<td>Nicaragua Social Investment Fund III (FISE)</td>
<td>Peru FONCODES II</td>
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<tr>
<td>To ensure that activities are consistent with the policies and development strategies of line agencies and other relevant stakeholders, updates framework agreements were established with the Ministry of Education; the Ministry of Health, Culture, Arts, and Sports; the Ministry of the Environment; the Honduras Institute for Child and Family Welfare; and the Association of Honduras Municipalities. Also has a Local Institutional Strengthening Component for training municipal staff.</td>
<td>Works closely with the National Water Institute, the Ministry of Health, and the Ministry of Education. Works on municipal and community strengthening and decentralization of resources to the local level in close cooperation with the Nicaraguan Institute for Municipal Development and the association of municipalities. Preventive Maintenance Fund (with equal contributions from the central government ministries, beneficiaries and donors) set up in municipalities for the maintenance of schools and health centers.</td>
<td>Formal agreements, <em>convenios</em>, signed with the Ministry of the Presidency, the Ministry of Health, the Ministry of Education, the Ministry of Agriculture, and the Ministry of Energy and Mines, as well as local authorities. The agreements stipulate that FONCODES will not, for example, initiate the construction of school or health post unless the line ministry in question agrees to staff it and meet all additional recurrent costs in terms of personnel, supplies and maintenance.</td>
<td></td>
</tr>
</tbody>
</table>

| Accounting, financial, and auditing | Credit proceeds deposited in a Special Account at the Central Bank. Funds channeled through a bank account of the Ministry of Finance. Auditing by independent auditors acceptable to IDA. Audit reports include the results of operational audits, including review of subprojects both in execution and completed, covering both their processing and implementation. | Maintains a Special Account in a commercial bank satisfactory to IDA. Auditing by independent auditors acceptable to IDA in accordance with auditing standards acceptable to the Bank. | Maintains a Special Account in a commercial bank satisfactory to IDA. Auditing in accordance with auditing standards acceptable to the Bank, by independent auditors acceptable to IDA |

| Procurement (for civil works only) | National competitive bidding for contracts over US$75,000. Quotes from three qualified domestic contractors in response to a written invitation required for contracts for US$50,000–75,000. Direct contracting where competitive proposals cannot be obtained for contracts under US$50,000. | National competitive bidding for contracts over US$150,000. Quotes from three qualified domestic contractors in response to a written invitation required for contracts for US$50,000–150,000. Direct contracting where competitive proposals cannot be obtained for contracts under 50,000. | Lump sum fixed price contracts on the basis of three quotations for contracts for US$60,000–250,000. Direct contracting for contracts under US$60,000. |

| Institutional risks (as identified in the PAD) | • Failure to attract and retain competent staff. • Government maintaining policy directions conducive to FHIS effectiveness. • Social Assistance Board not functioning effectively. | • Demand for investments exceeding capacity and affecting quality of output. • Weak municipal capacity. | • Discontinuity and weakened management. • Political interference and excessive bureaucratization. • Lack of coherence and coordination with other organizations including the line ministries and local governments. |
Annex 2 Task Managers and Other Bank Staff Interviewed

1. Wim Alberts
2. Yisgedullish Amde
3. Anush Bezhayan
4. Hans Binswagner
5. Soniya Carvalho
6. Samantha de Silva
7. John Elder
8. Laura Frigenti
9. Yasser el-Gammal
10. Gita Gopal
11. Qaiser Khan
12. P.C. Mohan
13. Norbert Mugwagwa
14. Nadine Poupart
15. Randa –al-Rashidi
16. Maryam Salim
17. Rodrigo Serrano
18. Parmesh Shah
19. Lynne Sherburne-Benz
20. Mike Stevens
21. K. Subbarao
22. Maurizia Tovo
23. David Warren
Annex 3 Institutional Links in a Social Fund

Figure 1 is a very simplified version of the institutional structure and links of a social fund. The figure shows how social funds provide support for local organizations in a more flexible and transparent manner than line ministries do. In some ways social funds are an apex institution intermediating among government, donors, and such implementation agencies as local governments, NGOs, and small enterprises.²⁸ For simplicity neither all the institutions nor all the links are depicted. For example, regional governments are not shown, and in many cases the community²⁹ receives the money directly from the social fund (link E) and therefore the community becomes both the implementing agency and the beneficiary. The elected local governments and the local offices of line agencies are shown separately. In an ideal decentralized setting the local offices of line agencies would be under the administrative control of the local governments and thus not shown separately. The political and administrative arm of a truly decentralized body would be the same.

The multiple alternative channels of service delivery can be explained by combining some of the links in figure 1:

- **Deconcentration: K-I.** Deconcentration is the dispersal of agents from higher levels of government into lower level arenas. A government delivers services through local line agencies, usually a very top-down, supply-driven approach.

- **Decentralization: J-G.** Here the central authorities devolve the service delivery responsibilities to the elected local governments. For the sake of convenience decentralization here would subsume an appropriate mix of all the three types of decentralization: democratic, fiscal, and administrative. This is often referred to as democratic decentralization or devolution.

²⁸ Marc, A. 1995, p.10
²⁹ For the purpose of this study no distinction will be made between community and community-based organizations.
• **Privatization or Contracting: M-D.** This would be the contracting out of a service delivery task to a private firm on the basis of an explicit contract with the central government.

**Figure 1: Institutional Links in a Typical Social Fund**

(Source: Author’s compilation)
Although a link has not been shown on the figure, central governments can also work through civil society organizations. Even without the social fund, several options are available to central authorities to attract investment, but at the same time there is little scope and opportunity for central governments to directly work with communities. The presence of a social fund adds to the options available to a government. The social fund also operates through most of the other implementing agencies that central governments work with, but with one important difference: there is a greater role played by communities in subproject implementation (shown by the link E). This framework suggests that social funds facilitate an approach in which the comparative advantage skills of different implementing agencies can be capitalized on.

To further study the service delivery options, the notation $| |$ will denote the strength of a link. For example, $|B|$ denotes the strength of the link between the CSO and the community.30

All things being equal, the efficiency of the investment will depend on the strength of the institutional link between the central government and the provider and on the strength of the link between the provider and the client. For example the efficiency of a deconcentrated mode of investment will be proportional to $|K| \cdot |I|$

**Decisions based purely on efficiency (economic and social) grounds**

For the purpose of this thought experiment let us assume a single development investment. The choice between the different options will be made on pure efficiency grounds.31

---

30 The strength of the link will also depend on the nature of the service being delivered. Take the case of a permanent public agency like the office of the district engineer in the context of education:

$|I_1|$: ability of the district engineer to build a primary school for the community.

$|I_2|$: ability of the district engineer to improve the functioning of the PTA of the primary school.

It is obvious that $|I_1| > |I_2|$ because the core competency of the district engineer is centered on technical solutions as opposed to community capacity building.

31 It would also include redistributive efficiency.
**Case 1: Prefer decentralization over deconcentration**

\(|J| \cdot |G| > |K| \cdot |I|\)

If the elected local governments are more efficient at using development funds than the local line agencies, decentralization is the preferred mode.

There could be two reasons for weak implementation capacity of the line agencies.

*If \(|K|\) is weak.* In situations of conflict, war, or natural calamity the central government may have very little authority over its jurisdiction. Countries experiencing civil or political strife or in post-conflict situations would fall in this category.

*If \(|I|\) is weak.* The local officials of the permanent public agencies may not have a functional relationship with the community, therefore restricting their ability to deliver investments. Issues such as corruption, incompetent officials and a lackadaisical approach to public service could be contributing factors.

Similarly, deconcentration could be preferable to decentralization.

**Case 2: Prefer social funds over decentralization and deconcentration**

\(|L| \cdot |A| \cdot |B| \text{ or } |L| \cdot |C| \cdot |D| \text{ or } |L| \cdot |E| > |J| \cdot |G| \text{ and } |K| \cdot |I|\)

There could be three situations in which the decentralized agencies fail to properly utilize an investment.

*If \(|J|\) is weak.* In other words, the country has a very poor decentralization framework and very little commitment from the central authorities, often because of poor fiscal decentralization.
If $|G|$ is weak. Even if devolution of powers to the local governments has progressed well, the bond between the local government and the community may be weak. Funds channeled through the local government will result in poor service delivery. Some of the underlying reasons could be vested interests in the local government, corruption, or sheer incompetence. The disconnect between the local government and the community may be greater than what is generally acknowledged in the development literature.

Both $|J|$ and $|G|$ are weak.

Similarly, the social fund may be more efficient than deconcentrated agencies.

Case 3: Social funds become a vehicle for decentralization


This situation could arise in a country where decentralization is taking roots and the social fund channels a significant portion of its funds through the local government.

There can be many more such combinations where investments are channeled by all the three agencies depending on their capabilities.
The “efficiency” argument can use a basic matrix for reference:

**Figure 2: Mechanisms for Making a Development Investment**
(Source: Author’s own compilation)

<table>
<thead>
<tr>
<th></th>
<th>Weak</th>
<th>Strong</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elected Local</td>
<td>Social funds, Contracting out</td>
<td>Deconcentration</td>
</tr>
<tr>
<td>Governments</td>
<td>Decentralization</td>
<td>Multiple options with decentralization as the preferred mode</td>
</tr>
</tbody>
</table>

Strength and weakness are in the context of “ability to efficiently utilize the development investment.” Undoubtedly decentralization is the preferred mode, but the challenge will be to ensure that redirection of fiscal and administrative responsibility does not simply result in a transfer of patronage and corruption from one (centralized) locus of control to another (local) one (World Bank 2000).

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32 Includes situations in which elected local governments do not exist
Annex 4 The Development Equation

Any development investment has three outcomes or impacts, with the net return given by:

\[
\text{NPV (development investment)} = \text{NPV (economic and social gains)} + \text{NPV (community capacity-building gains)} + \text{NPV (institutional development gains)} - \text{initial investment}
\]

Where \( j = 1, 2, \ldots, n \), \( E_i \) is the net present value of the economic and social gains\(^{33}\) in year \( i \). (This term also captures the distributive gains associated with efficient targeting.) \( C_i \) is the net present value of the community capacity-building gains in year \( i \). (This term includes all the social capital and empowerment gains associated with active community participation in a development initiative and the “multiplier effect” that goes with increased social capital and empowerment.) \( I_{ij} \) is the net present value of the institutional gain in year \( i \) for institution \( j \), where \( j = 1, 2, 3, 4, 5, 6 \) for a typical social fund. The entire equation will be called the development equation. It is only a conceptual framework, and no attempt will be made to assign values to each term.

The above framework accounts for all the future gains and losses that may accrue from a development investment. The impact of a development investment often cannot be neatly categorized into economic and social or community capacity-building, and the distinction may not be very clear. But the crucial point is that impacts should not be double-counted. With an intertemporal framework, such critical issues as sustainability are automatically captured by the development equation. This framework is also useful for addressing the tradeoffs that accompany a development initiative. For instance, it may be more useful to

\(^{33}\) For simplicity the word “gain” is used. If there is a loss, this term will have a negative value.
channel funds through existing line agencies to strengthen the agencies, but this would be at the expense of quality basic services that maybe urgently required in the community.

There is general consensus that $\sum_{i=1}^{x} E_i$ and $\sum_{i=1}^{x} C_i$ are positive for social funds. In other words, there is a positive economic and social gain from social fund investment and community capacity-building is an important outcome of social fund investment. But there is a vibrant debate about the institutional impact of a social fund. The component $\sum_{i=1}^{x} I_j$ can be further divided on the basis of the institutions impacted by the investment. In a social fund context, they would be:

- $j=1$ the social fund as an autonomous institution by itself
- $j=2$ the elected local government
- $j=3$ the public sector and in particular sectoral line agencies
- $j=4$ NGOs and other members of civil society
- $j=5$ the private sector
- $j=6$ donor agencies

In other words, $I_{i2}$ will be the net present value of the institutional gain or loss for the elected local government in year $i$ and so on.

$I_{i1}$: A significant portion of the institutional development component of a social fund is directed at the institutional development of the implementing agency and there is general consensus that a positive sign can be assigned to it. But since social funds are viewed as stopgap measures, the wisdom of investing too much into the institutional development of the social fund agency is often questioned.

$I_{i2}$: There is considerable debate about the effect that social funds have on local governments and it is difficult to assign a sign. But early social funds gave very little attention to local governments, so for some early social funds a negative sign might be appropriate.
A lot of criticism is directed at the distortionary effect of social funds on the existing public sector framework of a country. A large part of this study centers on identifying all these institutional effects.

Development practitioners would generally assign a positive sign to institutional impact of social funds on civil society and the private sector.

The intertemporal framework of the development equation is also useful because it takes into account the time dependent impact of a development investment. For example, in a social fund in the first few years of the social fund there may be very little positive impact on the local government. But once the social fund establishes procedures and processes, it will begin to focus on the institutional growth of local governments. So the absolute value of $I_{12}$ will be significantly smaller than the absolute value of $I_{62}$, or the institutional gain for an elected local government will be higher in the sixth year of the social fund compared with the first year. Similarly, in communities with poor service delivery by the public sector hierarchies it maybe preferable to effectively bypass such institutions by using a social fund. But this can have adverse effects on the longer term development of local institutional capacity. In this case the positive value of $E_1$ will be offset by the negative value of $I_{13}$.
Annex 5 Results of Task Manager Survey

Members of the social funds thematic group and the public sector management anchor began discussing how social funds fit in the institutional framework of a given country. Both sides recognized that there was a great deal of speculation, but little compiled information on the general characteristics of the Bank’s social fund portfolio.

At the same time, as part of its evaluation of social funds, the Operations Evaluation Department sent a questionnaire to social fund task teams, inquiring on public sector management aspects of social funds. As a basis for further discussions, the Operations Evaluation Department graciously provided copies of the completed questionnaires. In several cases, multiple questionnaires were submitted for the same social fund, for example Honduras I, II, and III. Where there were no differences in the answers to the institutional results, only one questionnaire per fund was used to avoid double counting and skewing the results. Where there was substantial institutional change between one phase of a social fund and the other, such as Bolivia’s ESF and SIF, both questionnaires were included. Because the questionnaires were already completed, there was no way to add or alter questions.

The responses reflect the institutional structure in 29 of 56 social funds. This does not count the many social fund-like projects like the rural funds, indigenous funds, and the like.

The countries with social funds included in the review are:

<table>
<thead>
<tr>
<th>Country</th>
<th>Country</th>
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</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Guatemala (SIF and FONEPAZ)</td>
</tr>
<tr>
<td>Algeria</td>
<td>Honduras</td>
</tr>
<tr>
<td>Argentina (Trabajar)</td>
<td>Malawi</td>
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<tr>
<td>Belize</td>
<td>Moldova</td>
</tr>
<tr>
<td>Benin</td>
<td>Nicaragua</td>
</tr>
<tr>
<td>Bolivia (ESF and SIF)</td>
<td>Pakistan</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>Panama</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Peru</td>
</tr>
</tbody>
</table>

34 Julie Van Domelen, Senior Economist, AFTR, provided this writeup and analysis, on the basis of completed questionnaires provided by the Operations Evaluation Department of the World Bank.
Cambodia | Romania  
---|---
Ecuador | Thailand  
Egypt, Arab Rep. | Togo  
Eritrea | Yemen, Rep.  
Ethiopia | Zambia  

The countries with social funds that did not complete questionnaires are:

| Argentina (FOPAR) | Madagascar  
| Armenia | Mali  
| Angola | Nigeria  
| Comoros | Philippines  
| El Salvador | São Tomé and Príncipe  
| Georgia | Sri Lanka  
| Ghana | Saint Lucia  
| Guinea | Tajikistan  
| Guyana | Tanzania  
| Haiti | Turkey  
| Jamaica | Ukraine  
| Kosovo | Uzbekistan  
| Lao PDR | West Bank and Gaza  
| Lesotho | Zimbabwe  

The surveys contained 20 questions on institutional aspects of social funds organized along three broad areas: institutional structure, operating procedures, and integration with budget and government accountability.

**Status and Institutional Setting**

There was a fair variety in where social funds are located within the government. The most common arrangement was as an independent agency under the president or prime minister, but this only applied in 41% of the cases. Other common arrangements were under sectoral ministries, as a government foundation, or as a fully autonomous body.
In most cases (76%), the social fund was overseen by a board of directors comprising government officials, NGOs, private sector, and in some cases donor agencies. In 14% of social funds, there was a board of directors comprising only government officials. The few cases where there was no oversight board were all under line ministries. When asked to whom the social fund is accountable, 62% responded the prime minister or president, far greater than the share that are actually under the prime minister or president’s office. Some 21% responded that they were responsible to one of the core ministries, either finance or planning, also greater than the 7% that actually located under these ministries.

The expected lifespan of the social fund varied quite a bit. One of five social funds is considered permanent. Two of five could be considered “semi-permanent” in that they had a lifespan of more than four years, which was renewable. Only 10% were considered “nonrenewable.” About half of the social funds surveyed had had their lifespan extended at least once. The legal basis of the social funds is usually by decree (46%) or law (36%). Of those created by ministerial resolution, none of them are under line ministries. The social funds under line ministries were created by decree or proclamation. In three-quarters of the cases, the social fund was created to be independent of line ministries.
Operating Procedures

Social funds are known for their operational and managerial autonomy, and this came out in the survey. Social funds were most autonomous in terms of staffing policies. In almost all cases (93%) they had the freedom to hire staff and in 88%, the terms and conditions of employment were different from the civil service. Of the three cases where the terms and conditions were the same as the civil service, none was in social funds under sectoral or core ministries. In these three cases, two were under government foundations (Guatemala SIF and Guatemala FONAPAZ) and one under the president (Panama).

Procurement was the next most frequent area of social fund operational autonomy. Three-quarters of the social funds were exempt from public procurement systems. Of the six that do follow national rules, two are under the president’s office, two are government foundations, one is under a line ministry, and one is an NGO. Of the six funds under ministries, only one follows public procurement systems (Argentina’s Trabajar). One response said that only World Bank financing is not subject to national procurement systems, while government financing is. Since in all World Bank–financed projects, Bank guidelines supersede national procurement laws, it is not clear the extent to which the question was able to distinguish whether the social fund was exempt due to the World Bank Loan Agreement or due to the law or decree creating the social fund. The same interpretation problem applies to the question of whether the social fund is exempt from public disbursement procedures. Some 63% responded yes, but it is impossible to tell whether this is because of the World Bank Special Account arrangement. In a similar vein, only about 40% of social funds are exempt from tax law, but one respondent clarified that this was due to the World Bank exemption from VAT.

Integration with Budget and Government Accountability

Social funds are often perceived as somehow being extrabudgetary, operating outside of the government financial and auditing systems. In fact, social funds are included in the
government budget in 86% of the cases. There was no information on whether, when external financing was not included, this was specific to the social fund or represented national budgeting norms. In more than half the cases, recurrent costs relating to social fund investment were budgeted in central budgets. There was no question on how recurrent costs were financed for those that responded in the negative (12 cases). In some of these cases, communities or local governments may be directly responsible for operations and maintenance, but this was not queried.

In the vast majority of cases, social funds were audited by national auditors, often supplemented by international firms as well. In 71% of cases, the social fund is covered in the auditor general’s report to parliament; in 13% of cases the social fund is not included; and in 17% of cases, no auditor general’s report exists. Similarly, there was a high likelihood of scrutiny by the Public Accounts Committee (79%), and almost all social funds responding had an accounting officer responsible for answering to parliament on the proper use of funds.