FISCAL DECENTRALIZATION IN TANZANIA: ASSESSING THE IMPLEMENTATION OF THE FORMULA-BASED RECURRENT GRANT SYSTEM*

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INTRODUCTION

SINCE 1999, TANZANIA HAS BEEN PURSUING AN active local government reform agenda based on the notion of "decentralization by devolution" (United Republic of Tanzania, 1998). Whereas local governments were assigned the responsibility to provide key public services, such as basic education and health services in the early 1980s, the discretionary and earmarked nature of the intergovernmental transfers system perpetuated a high degree of centralized fiscal control over local public services.

Prior to the introduction of a formula-based grant system in 2004-05, Tanzania relied on a discretionary system of local government allocations, in which local government allocations were determined in an earmarked and ad hoc manner by central government officials. This system was generally perceived to be inefficient, inequitable and non-transparent, and provided little or no fiscal autonomy to the local government level. Indeed, analysis of the transfer system's incidence confirmed that urban local governments and local governments in wealthier regions tended to receive greater financial allocations from the central government budget (Boex, 2003). This finding stood in stark contrast to the government's stated policy goals of providing public services in a pro-poor fashion with an emphasis on development in both urban as well as rural areas (URT, 1999).

Based in part on the finding that the resources allocations provided to the local level were inconsistent with the government's own policy intentions, the Cabinet approved the introduction of a formula-based recurrent grant system in February, 2004. During FY 2004-05, formula-based recurrent sectoral grants were introduced for primary education and local health services, whereas formula-based grants were introduced for the remaining grant-aided sectors at the local level (agriculture extension, road maintenance, and water supply)

in 2005/06.[1] A formula-based recurrent General Purpose Grant (combining the previous local administration grant and the Compensation Grant) was introduced in 2006/07.

The key question addressed in this paper is whether the introduction of a formula-based recurrent grant system indeed has resulted in a more objective, equitable, efficient, and transparent allocation of central-local resources. In short, has the Government of Tanzania adhered to the formula-based approach as it introduced the formula-based recurrent grant system? This question takes on added policy significance since the Government has set itself the medium-term goal, as part of the General Budget Support Performance Assessment Framework, of providing—by 2010—25 percent of the country's public finances to the local government level through formula-based grants that flow directly from the Treasury to Local Government Authorities (LGAs).

Rather than providing a comprehensive assessment of Tanzania's local government finance reform agenda, the scope of the current paper is largely limited to the recurrent grant system, which provides two-thirds of local government finances in Tanzania.[2] In fact, within the recurrent grant system, the current analysis will focus on the two recurrent sectoral grants which were introduced in 2004/05—namely, the primary education block grant and the local health service grant—which together comprise about 80 percent of the recurrent transfer funding made available to the local government level. Given the importance of these two recurrent sectoral grant schemes, we should be able to generalize their experiences and extract lessons for the remainder of the recurrent transfer system.

THE PREVIOUS SYSTEM OF LOCAL GOVERNMENT ALLOCATIONS AND THE DESIGN OF THE FORMULA-BASED RECURRENT BLOCK GRANT SYSTEM

The historical structure of Tanzania's recurrent grant system is straightforward and has not been affected by the recent introduction of allocation formulas: six types of recurrent grants are provided

by the central government to the local government level. Local governments receive separate sectoral grants for each of five key policy areas (including primary education, basic health care, water supply, roads maintenance, and agriculture extension) plus a separate allocation for local administration. Each of these sectoral grants are further broken down into a wage component (referred to as personal emoluments or PE) and a non-wage component (other charges, or OC), which are disbursed separately to the local government level.

While local government allocations prior to 2004 were officially determined in accordance with a series of national minimum standards for local service delivery, in practice these allocations were essentially determined in an ad hoc and incremental manner. As a result, in addition to being non-transparent, significant variations occurred in the per capita allocations between local government districts. While some of the variations in per capita allocations were unsystematic, some clear patterns could be detected as well. For instance, incidence analysis of the transfer allocations revealed that the previous transfer system's incidence was biased in favor of wealthier regions (Boex, 2003). Furthermore, urban local governments were shown to systematically receive greater transfer resources in per capita terms than rural local authorities.

In addition to perpetuating horizontal fiscal imbalances by favoring urban councils and councils in wealthier regions, the previous transfer system also failed to encourage efficient local budget decisions as the PE and OC components of each grant scheme were determined separately by the President's Office—Public Service Management (PO-PSM) and the Ministry of Finance, respectively. This separation meant that local governments did not face a single hard budget constraint and were not required to make direct trade-offs between spending resources either on PE or on OC.

As a result of the weaknesses of the previous approach to allocating intergovernmental fiscal transfers, the Cabinet moved in February 2004 to replace the previous discretionary transfer system with a more equitable, stable, transparent, and efficient formula-based intergovernmental fiscal transfer system.

Instead of opting for an unconditional, cross-sectoral recurrent transfer scheme, such as the *Fund for the Financial Support of the Regions (FFSR)* in Russia, the *Equitable Shares* in South Africa or the *Dana Alokasi Umum (DAU)* in Indonesia,

the Government of Tanzania decided to maintain the sectoral nature of the transfer system since it was felt that key government services delivered at the local government level (including primary education, basic health services, and so on) were not exclusive local government responsibilities. Instead, these functions were seen as concurrent (joint central-local) government functions with strategic importance to the national development process. As such, a conscious choice was made to maintain the sectoral nature of the transfer system and thereby to guarantee minimum levels of sectoral spending for each sector (albeit at the expense of limiting the degree of local prioritization across sectors), while nonetheless allowing greater local discretion over spending within each sector.

In contrast to the previous approach to determining local government allocations, one important feature design of the formula-based recurrent grant system was that a single formula would be applied to all recurrent resources within each sector. During the development of the formula-based grant system, it was agreed that only applying an allocation formula to OC (while having PE continuing to be determined by PO-PSM) would result in a disconnect between the levels of PE and OC in each council. More importantly, excluding the PE component of local government budgets from the formula-based system would fail to address the main cause for the inequitable and inefficient allocations, which were largely caused by the discretionary allocation of local staff postings and PE across LGAs. As a result of applying the allocation formula to both PE and OC resources combined, the formula-based grant would provide a single hard budget constraint for PE and OC in each sector, and would therefore allow LGAs to shift resources between PE and OC as needed to achieve technical efficiency.

In preparation for the formula-based recurrent grant system, allocation formulas for each of the sectoral grant schemes were developed jointly by the Prime Minister's Office - Regional Administration and Local Government (PMO-RALG), the Ministry of Finance, and the respective sector ministries. The primary education grant formula that was agreed upon in 2004, allocated 100 percent of the education grant pool in accordance with the number of school-aged children in each local government authority.[3] The health sector formula agreed upon was slightly more complicated, with 70 percent of resources being allocated in propor-

tion to population, while also taking into account local poverty (10 percent), the geographical service delivery area of the local government (as measured by the length of the DMO's route mileage; 10 percent), and local variations in the burden of disease (estimated based on under-five mortality; 10 percent). Both formulas produced "winners" and "losers" and while neither formula was deemed perfect by all stakeholders, they were universally considered to be a major improvement over the previous discretionary approach to allocating intergovernmental transfers.

One challenge with the implementation of the formula-based grant system was to figure out how the transfer mechanism could be applied to cover both PE and OC, while at the same time ensuring that each council's existing salary commitment (particularly for "losing" councils) could be paid in full. In order to ensure that councils planned for adequate resources for PE, it was agreed that OC would be determined under the formula-based system as a residual between (1) the council's formula-based transfer amount and (2) the council's PE commitment, equal to the existing PE commitment plus the increase in PE due to salary increases, promotions, and new posts. Furthermore, in order to ensure that councils would have adequate resources at all times during budget execution to pay local staff salaries, it was decided that PE would continue to be disbursed separately from OC. In addition, a "hold harmless" provision was put in place as part of the introduction of the formula-based system in order to assure a gradual transition to the formula-based allocations. According to the system's design, each council's "hold-harmless baseline" would be set equal to the council's previous year's allocation, so that those local authorities who received more than their fair (formula-based) share of resources in the past would not face a decline in resources, while winners under the formula-based system would catch up with the councils who previously received "too much." Based on the steady increase in the size of the transfer pool (approximately 10 percent per year), a gradual transition towards the formula-based pattern was expected to take place within a few years.[4]

From an administrative viewpoint, the intergovernmental budget cycle was designed to work as follows: formula-based grants for the next budget year (including the hold-harmless provision) would be calculated by PMO-RALG in December of the prior year, at which point they would be included in the LGA Planning and Budget Guidelines. Local governments would prepare and adopt their budgets in accordance with these ceilings, deciding themselves on the split between PE and OC as part of the local budget formulation process. Scrutinization of local budgets by the Ministry of Finance would subsequently take place to ensure that local governments complied with the conditionalities contained in the budget guidelines, but without altering their formula-based ceilings, so that the budget estimates approved by parliament would reflect the same formula-based grants as contained in the budget guidelines and approved by the local councils. As such, we would be able to confirm whether the formula-based system has been implemented as designed by analyzing the grant allocation patterns at several stages during the budget process and comparing these patterns to the ideal, formula-based allocation pattern.

ANALYZING THE ADHERENCE OF THE FORMULA-BASED RECURRENT BLOCK GRANT SYSTEM

Almost four years after the introduction of a formula-based recurrent grant system, how has the implementation of the formula-based recurrent transfer system fared? Has the central government indeed adhered to the formula-based approach in allocating resources to the local government level? We analyze this question in two different ways. First, we consider the equitability of resource allocations over time in comparison to the formula-based allocations. Second, we analyze at what different stages of the budget process deviations occur from the formula-based allocation pattern.

Adherence to the Formula-Based Approach over Time

Among the policy objectives pursued with the introduction of the formula-based grant system was the desire to achieve a more objective and equitable allocation of resources among local governments. Therefore, our first consideration is whether the introduction of the formula-based recurrent grant system reduced the undesired variations in resource allocations among local governments. As noted earlier, we limit ourselves to the funding mechanisms for primary education and local health services in answering this question.

We analyze the impact of the formula-based grant system by comparing the budgeted allocation of grant resources for each year (from 1999-2000

to 2007-2008) with the "ideal" (objective and equitable) counterfactual, namely the resource allocation pattern that would have resulted if the sectoral allocation formulas for primary education and local health services would have been fully applied in each year since 1999. If the implementation of the formula-based grant system has been successful and the Government now adheres to the formula-based approach, we would expect to see a substantial decrease in the deviations from the strictly formula-based pattern over time.[5]

In order to investigate this question, Table 1 presents the traditional descriptive statistics regarding the allocation of intergovernmental transfers over time. These show a significant increase in the average per capita grant size in each year over the entire period under consideration, as well as significant declines in the variation of per capita resources among local government authorities (as signaled by a gradual decline in the coefficient of variation) for most of the period under consideration.

In addition to the common descriptive statistics, Table 1 also presents a measure of divergence known as the Index of Fit (IOF). The Index of Fit—used earlier by Vaillancourt (2001) and Martinez-Vazquez and Boex (2007)—is defined as one minus half of the sum of absolute deviations for each observation between the actual allocation pattern and the formula-based (counterfactual) allocation, expressed as a share of the total grant pool allocated. As such, the IOF varies in its extremes between one (indicating no divergence from the formula-based pattern—a perfect fit) and zero (indicating complete divergence from the formula-based pattern—no fit). The IOF is easy to interpret, as it indicates one minus the share of the grant pool that would have to be reallocated from one group of local governments to another in order to achieve perfect adherence with the formula-based pattern.

The IOF—which correlates inversely with the respective coefficients of variation—highlights some interesting patterns. First, the trends suggest that a gradual yet substantial improvement in the objectivity and equitability of the grant allocations preceded the introduction of the formula-based grant system in February, 2004. This may have been in part due to increased scrutiny from members of Parliament and a growing awareness by PMO-RALG and Ministry of Finance officials regarding the excessive variations caused by the prior discretionary allocation mechanism.

Table 1
Local Resource Allocation and Correspondence with Formula-Based Allocation Patterns: 1999-2000 to 2007-2008

Year	Education				Health			
	Average Per Cap	CV	IOF	IOF PE	Average Per Cap	CV	IOF	IOF PE
1999/00	3,343.71	0.360	0.834	0.823	676.86	0.695	0.794	0.783
2000/01	4,589.89	0.341	0.868	0.865	1,137.25	0.575	0.848	0.846
2001/02	4,775.78	0.336	0.871	0.865	1,350.65	0.563	0.843	0.837
2002/03	5,620.52	0.305	0.888	0.88	1,614.53	0.574	0.857	0.842
2003/04	6,464.62	0.289	0.892	0.886	1,759.46	0.580	0.858	0.851
2004/05	6,905.51	0.251	0.9	0.875	1,842.50	0.504	0.886	0.849
2005/06	8,385.61	0.202	0.938	0.887	2,121.53	0.488	0.924	0.859
2006/07	11,436.94	0.268	0.91	0.869	3,208.58	0.578	0.892	0.844
2007/08	13,120.88	0.264	0.899	0.875	3,659.58	0.515	0.872	0.834

Second, we observe a sharp improvement in the IOFs in 2005-2006, which was the first year that the formulas for education and health were fully implemented.[6] Finally, we note a worsening of the IOFs during the two most recent years, suggesting worsening adherence to the formula-based allocations.[7]

As such, the trends displayed in Table 1 provide good news as well as bad news. The good news is that the imposition of the formula-based grant system is shown to be capable of improving the objectivity and equitability of intergovernmental allocation if the formula-based system is enforced, as it was during the budget formulation process for FY 2005-2006. The bad news is that there is still a substantial difference between the actual grant allocations and the formula-based allocation pattern, while adherence to the formula-based system in fact has deteriorated markedly since FY 2005-2006.

Adherence to the Formula-Based Approach at Various Stages of the Budget Process

One weakness of the analysis in Table 1 is that it relies on the budgeted allocations to local government authorities as included in the national budget, since data on actual allocations (as executed by the Treasury) are unavailable for most of the period considered. However, detailed data for every stage of the grant allocation process are available for the two most recent years.

As such, Table 2 analyzes the adherence to formula-based allocation patterns at different stages of the budget process for FY 2005-2006 and 2006-2007. It does so by computing the IOF for the four main stages during the budget process. First, the departure point is set by the exact, fully formula-based allocation pattern. The second allocation pattern included in the analysis is the allocation pattern contained in the LGA Budget Guidelines, which are issued at the beginning of the budget formulation cycle (indicated in the table as BG). While these numbers are based on the formula-based allocation computed by PMO-RALG, they also take into account the holding-harmless process. The third pattern captured by the table is the allocation of grants as captured in the national budget document (BD) after budget scrutiny by the Ministry of Finance. Finally, the analysis captures the actual allocation of resources achieved by the Treasury, which may reflect approved changes of the budget plan as well as unapproved deviations during budget execution (BE). Similar in structure to a correlation matrix, each cell in Table 2 reflects the IOF between the respective pairs of allocation patterns. The highlighted cells are of particular relevance, as they indicate the deviation between subsequent steps in the budget process.

What patterns does Table 2 reveal with respect to the Government's adherence to the formula-based recurrent grant system? First, the IOFs reveal that in the years under consideration consistent deviations exist between the ideal formula-based allocation and the ultimate allocation of local resources (i.e., as executed). Starting with the actual allocation of resources, based on IOFs between budget execution and the formula-based counterfactual ranging from 0.89 - 0.93, between 7 - 11 percent of transfer resources would have to be reallocated in order to achieve fair, formula-based allocation patterns. This general conclusion holds true both for the education and health block grants, although the fit is generally somewhat worse for the health block grant than for the education block grant. The main cause for the gap between actual allocations

Table 2
Adherence to Formula-Based Allocation Patterns: Different Stages of the Budget Process

	Education				Health			
2005-2006	*Form.*	*BG*	*BD*	*BE*	*Form.*	*BG*	*BD*	*BE*
Formula	1				1			
B Guide	0.937	1			0.922	1		
B Doc	0.938	0.991	1		0.924	0.983	1	
B Exec	0.928	0.979	0.978	1	0.908	0.970	0.965	1
2006-2007	*Form.*	*BG*	*BD*	*BE*	*Form.*	*BG*	*BD*	*BE*
Formula	1				1			
B Guide	0.946	1			0.943	1		
B Doc	0.910	0.938	1		0.892	0.923	1	
B Exec	0.909	0.945	0.939	1	0.887	0.920	0.934	1

and the fully formula-based allocation patterns is the holding-harmless process (introduced during the formulation of the budget guidelines), which consistently accounts for at least half of the ultimate deviation revealed by the IOF analysis.

However, adherence to the formula-based allocation process is not just a problem caused by the holding-harmless process. The remaining stages of the budget formulation and execution process tend to contribute to further deviations away from the formula-based pattern. In fact, whereas budget scrutinization and budget execution adhered quite closely to the respective previous stages in the budget process in 2005-2006 (with deviations around 1-3 percent), a significant worsening in the deviations was caused by the Ministry of Finance during budget scrutinization and budget implementation for 2006-2007 (consistently in the range from 6-8 percent).

OBSTACLES AND LESSONS FOR IMPLEMENTATION OF THE FORMULA-BASED SYSTEM

The design and implementation of the formula-based recurrent grant system never anticipated an immediate switch from the previous discretionary approach to strict adherence to the formula-based process: a hold-harmless clause was specifically put in place to assure a gradual transition to a formula-based allocation pattern. However, the previous analysis clearly identifies that the formula-based process is not being adhered to as intended. Then, in practice, what explains the growing gap between the formula-based grant system as designed and the actual allocation pattern? Review of the current intergovernmental fiscal processes point at a number of shortcomings in the technical and legal processes surrounding the computation of the recurrent grants. In fact, Table 1 identifies the main reason behind the lack of convergence: whereas the overall IOFs for the recurrent grants show a clear increase over time until FY 2006-2007, when the IOFs are computed exclusively for sectoral PE, these steady increasing trends are altogether absent.

A first deviation from the transfer system's design that took place in the implementation of the formula-based system was (seemingly innocuous, at first) "cheating" with the hold-harmless baseline. While the hold-harmless baseline was designed in order to ensure that those that previously already received too much (compared to the formula-based allocation) would not lose any resources,

the hold-harmless process was modified slightly by not only making sure that nobody would be a loser, but in fact by making everybody a winner vis-à-vis the previous year's allocation. This meant that resources that should have gone to previously under-resourced councils through the formula-based mechanism were now removed from the allocation pool in order to fund the topping-up of already disproportionately advantaged councils under the guise of "holding harmless."

A more significant cause for the lack of adherence to the formula-based allocations results from the fact that separate budget procedures continue to exist for the planning of personal emoluments (PE) on one hand, and other charges (OC) on the other hand. For the determination of local PE, local department heads continue to submit requests for additional staff with the local HR officer, who forward these requests to PO-PSM for approval, whereas OC ceilings are in fact determined in line with the formula-based process as the balance between the formula-based ceiling (or the hold-harmless amount) and the council's PE requirement. Contrary to the intention of the formula-based mechanism that (consistent with the local government reform policy) sought local governments to determine their own balance between PE and OC within the context of the formula-based grant ceiling, PO-PSM failed to realign its mandate over approving local staff postings with the formula-based grant system.

This meant that PO-PSM continued (and continues) to approve additional posts in "hold harmless councils" that had a disproportionately large staff and that are being held harmless, while not necessarily approving sufficient new posts in councils that are receiving large increases in funding as a result of the implementation of the formula-based process.[8] To make matters worse, PO-PSM does not decide on the final approval of new staff posts (which drive local PE requirements) until the end of the budget formulation cycle. This means that in addition to the determination of PE being inconsistent with the formula-based framework, the determination of each council's sectoral OC ceilings cannot be determined in a meaningful way at the beginning of the budget formulation process either, since OC is determined as the difference between the formula-based grant ceilings and the council's PE requirement.

In addition to the additional PE resources that are inappropriately allocated to "hold-harmless

councils" during the budget formulation process, poor budget control during budget execution (or lack of institutional will to enforce budget ceilings for PE) allows PE to creep up even further for many of these councils. This practice contributes to the perpetuation of non-convergences between the hold-harmless baseline and actual allocations, since next year's baseline is based on local governments' actual PE commitments, including those commitments made during the budget year in excess of previous year's budget.

One could consider these obstacles merely as technical issues and seek to address them as such. However, the fact that these issues were allowed to derail the Government's adherence to the formula-based approach (rather than confronting these bottlenecks) may indicate a more serious problem, notably a lack of institutional and political commitment by some (or all) of the key stakeholders to the underlying decentralization process. In fact, no one is without blame in the failure to adhere to the formula-based process: whereas PO-PSM explicitly failed to align its practices with the formula-based approach, the Ministry of Finance encouraged the perpetual modification of the hold-harmless baseline to accommodate further discretionary changes in PE allocations, whereas PMO-RALG and line ministries implicitly allowed the adherence to the formula-based system to gradually deteriorate.

CONCLUSIONS AND LESSONS FOR THE CONSOLIDATION OF A FORMULA-BASED TRANSFER SYSTEM

Interventions are needed at a number of levels in order to assure that the formula-based recurrent grant system is properly adhered to, and that the progress towards instituting a more objective, equitable, efficient, and transparent allocation of central-local resources is consolidated.

A renewed policy commitment is needed. As a first step, the Government of Tanzania should renew, in the most fundamental way possible, its policy commitment to a formula-based transfer system. However, this is unlikely to occur on its own accord because the observed deviations from the formula-based pattern have only been possible because not only the Ministry of Finance and PO-PSM, but also PMO-RALG, chose to prioritize other institutional interests over the Cabinet's decision to implement a formula-based recurrent grant system. The weak institutional commitment

to the formula-based approach is borne out of institutional self-interest: whereas PO-PSM wishes to retain control over local hiring decisions, the Ministry of Finance seems conceptually opposed to reclassifying earmarked allocations to local councils as intergovernmental transfers, fearing that acknowledging the limits of the Public Finance Act would entail loss of control over a significant amount of fiscal space. Similarly, PMO-RALG is torn between its role as a champion of decentralization reform on one hand, and its own, narrower institutional interests on the other hand. As such, the government's international development partners have an obligation to advise the government's political leadership that the narrow interests of various parts of the government are forming an obstacle to the government's broader policy objectives.

Reform of the legal framework and the budget structure. Neither the legal framework surrounding local government finance nor the central government's budget structure have been adjusted over time to reflect the introduction of formula-based recurrent grants as part of the process of "decentralization by devolution." In fact, the budget process still treats local government transfers as earmarked budgetary allocations to LGAs, instead of treating recurrent block grants as budgetary outlays in their own right. Likewise, the budget's vote structure and the presentation of the budget document perpetuates discretionary control by the Ministry of Finance over intergovernmental transfers, as the budget presented to parliament does not contain any language or reference to provide a legal basis to enforce the formula-based allocations. Reform of the legal framework guiding the (recurrent) grant system as well as reform of the manner in which the central government budget treats transfers would be a major step in improving adherence to the formula-based grant system.

Strengthen the institutional framework. Part of the initial success of the formula-based recurrent grant system was the result of improved institutional cooperation and coordination that was achieved at the technical level between the Ministry of Finance, PMO-RALG, and the respective line ministries. During the development and first years of implementation, the interministerial *Coordination Block Grant Implementation Team* provided an effective platform for interministerial coordination and information exchange. The coordinative spirit of this mechanism will have to be rekindled and

ensured through a more permanent institutional structure. One possibility would be the establishment of a Local Government Grants Board to oversee the implementation of the (recurrent and development sides of the) grant system. Not only would such a Board provide an interministerial forum for policy dialogue, but a small dedicated secretariat to such a Board could engage in the analyses necessary to ensure that the formula-based allocations are adhered to by all stakeholders.

Resolving the inequitable allocation of local government staff. At a technical level, the most fundamental obstacle to adherence of the formula-based approach is the unsystematic allocation of local personnel and personal emoluments across different LGAs. Consistent with the government's own Local Government Reform Policy, the harmonization of local payroll expenditures with the formula-based grant system in the long run should be sought by decentralizing human resource management in the context of formula-based grant ceilings, so that LGAs are able (and in fact, required) to plan for their payroll expenditures (PE), other charges (OC), and potentially for their development expenditures in the context of a single hard budget constraint. While this would achieve compliance with the formula-based pattern, this in itself would not resolve the labor supply issues that have resulted in the current horizontal imbalances in local personnel. Therefore, in the short run, a formal reformulation of the hold-harmless approach should be agreed upon by PO-PSM, PMO-RALG, and the Ministry of Finance to assure that any increases in local personal emoluments will take place consistent with the formula-based approach, therefore ensuring that—at the margin—any additional resources for PE are allocated to councils where they are needed the most, rather than posting additional staff to councils that already receive more than their fair share of PE.

Notes

[1] As discussed later, Tanzania relies on a set of sectoral recurrent grants which are earmarked for use within the particular sector. However, in contrast to the international usage of the term, Tanzania's Local Government Finance Act refers to these sectorally earmarked grants as "block grants."

[2] By focusing predominantly on the recurrent grant system, this review does not consider some other key local government finance reforms that have taken place in the past few years. For instance, the introduction of the formula-based Local Government Capital Development Grant (LGCDG), the rollout of integrated financial management systems at the local level, the harmonization and reform of local own source revenues, or the impact of ministerial subventions (funding provided to the local level through ministries, departments, and agencies) are not considered here in detail.

[3] In addition to the formula-based transfer, an earmarked allocation is made to a number of districts that support special schools for the deaf, blind, and nomadic groups.

[4] During the initial years of the transfer system, a phasing-in rule was also applied, which prevented councils from receiving excessively large increases in resources, which was feared to result in absorption problems.

[5] Since phasing-in and holding-harmless provisions adopted in Tanzania allow discrepancies to arise between the formula-based allocations and an absolute application of the formula-based allocation, we do not necessarily expect to see a perfect correspondence between actual allocations and the formula-based allocations.

[6] The LGA Budget Guidelines for FY 2004-2005 had been prepared during the end of 2003 and were issued by PMO-RALG in January, 2004, before the Cabinet adopted the formula-based grant system in February, 2004. Furthermore, coordination problems between PMO-RALG and MOF failed to ensure that the MOF enforced the formula-based allocations during budget scrutiny.

[7] It should be noted that FY 2006-2007 was the first budget of the Fourth Phase Government of President Kikwete, which came into power in December, 2005. The coming into office of the new administration resulted in major delays (and associated difficulties) in the central government's annual budget formulation process for FY 2006-2007.

[8] As an additional negative side effect of this policy inconsistency, although previously under-resourced councils can receive a significant increase in resources, this increase causes a substantial imbalance in favor of OC.

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