

## Paper Summary

# Do Formula-Based Mechanisms Eliminate Politically Motivated Targeting of Public Resources?

## Evidence from Ghana's District Assembly Common Fund

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In Ghana as well as in many other countries, local governments receive a major share of the resources they can spend to provide public services and infrastructure from the central government. Making sure that these transfers from the central to local governments are allocated in a way that contributes most to development is a major challenge. Central governments inevitably face incentives to distribute resources according to political goals, which do not necessarily correspond to the development needs and opportunities. In 1994, Ghana instituted a pioneering mechanism that aims to tackle this problem: a formula-based system of resource allocation through the District Assemblies Common Fund (DACF).

### Intergovernmental transfers in Africa

By "bringing government closer to the people", decentralization has the potential to improve the allocation of public resources, especially if local government are able to raise their own resources. However, in many developing countries, local governments continue to depend on transfers of resources from the central government. In the young democracies in Africa, there is a belief that these resource transfers are strongly influenced by the nature of the political relationship the receiving group has with higher tiers of government. This belief is influenced by a history of overt political patronage that preceded decentralization and democratization on the continent. Where data is available, the salience of political considerations in government transfers on the continent is evident. Barkan and Chege (1989) found that in Kenya in the 1980s, budget allocations for construction of new roads and health facilities in President Arap Moi's political strongholds of the Rift Valley and Western provinces were disproportionately high. From 1984 to 1988, between 57% and 68% of the road budget each year went to these areas which held only 33% of the country's population. Miguel and Zaidi (2003) showed that in Ghana, annual central government per student expenditure on education in 1998 was 27% higher in districts that had voted overwhelmingly for the ruling party in parliamentary elections than in other districts.

### Institutions that aim to mitigate political manipulation of transfers

One strategy to address this problem has been to delegate the mandate for distributing national resources to independent agencies. There is evidence that the Finance Commission in India, for instance, was successful in removing the political bias in the resources it allocates.<sup>1</sup> Another strategy has been the use of formulas to determine resource allocations. This strategy has gained prominence in the developing world after the wave of decentralization in the last two decades. In 1994, Ghana created a pioneering formula-based system of resource allocation through the District Assemblies Common Fund (DACF) that provides the financial sustenance for the local governments of the country. In India, the largest rural development expenditure program, the Sampoorna Grameen Rozgar Yojana (SGRY) launched in 2001, and the 2005 National Rural Employment Guarantee Act (NREGA) that superseded it, are required to devolve resources by means of a formula. South Africa's Local Government Equitable Share established in 1997, Kenya's Local Authority Transfer Fund established in 1999 and Nigeria's Federation Account created in 1999 also use formulas to allocate resources.

## How well do formulas work?

The promise of distributing resources by a formula based on economic and welfare variables, is that it can suspend the discretion that allows politically motivated targeting. However, whether this promise is realized in practice is not clear. This study analyzes whether resource allocation is still influenced by the political characteristics of districts, in spite of a formula-based sharing mechanism by studying a concrete case: the transfers of the central government to districts in Ghana under the DACF over the period from 1994 to 2005. Since the DACF constitutes the major funding source of districts in Ghana, transfers are an important medium through which voters perceive the benefits of having a particular political party in office at the central level. This creates incentives for politicians to manipulate districts' allocations. Examining the influence of politics on DACF transfers can, therefore, provide important insights into the scope of political considerations in allocations that result from other formula-based programs.

There is a debate in the theoretical literature about the direction in which transfers will be affected based on the political characteristics of the recipient groups. In one school of thought, transfers will be targeted to districts with relatively more 'swing voters'.<sup>ii</sup> The main assumption is that voters are willing to compromise their political party preferences if presented with sufficient economic benefits from another party. In contrast, another school of thought argues that voters respond more strongly to economic incentives provided by the political party they prefer.<sup>iii</sup> The prediction under this 'core supporter' model is that politicians, are risk-averse, and, will target more resources to areas where they have concentrated political support to assure the best return in terms of votes.

The empirical evidence of which political characteristics are most salient, and in which direction intergovernmental transfers have been affected, are also varied. Case (2001) found that block grants to districts in Albania increased with the president's vote share in the previous election. On the other hand, Cole (2009) finds that Indian state governments supplied more subsidized

agricultural loans in election years to districts in which they had a narrow margin of victory or loss suggesting that swing voters were targeted. Dahlberg and Johansson (2002) determine that municipalities with swing voters were favored in the award of temporary grants in Sweden.

## Findings from Ghana

Due to its pioneering nature, Ghana's DACF constitutes a unique opportunity to examine the question whether a formula-based allocation of transfers from central to local governments can indeed limit political motivations of public resource allocation. The analysis conducted for this study is based on DACF data and election results data for the extensive period from 1994 to 2005. Interview information from key persons involved in decisions about the DACF contributed to the interpretation of the results of the statistical analysis.

Statutorily, the DACF formula is chosen by a Fund Administrator and voted into law by parliament. Since the administrator is appointed by the president, one may assume that his/her incentives are aligned with that of the president. Through the Administrator, the president has informal "agenda-setting powers" over the formula recommended to the parliament. Moreover, due to the presidential nature of Ghana's political regime, one can assume that he will be able to reward or punish parliamentarians based on their votes regarding the DACF formula. Within this structure, the president can advance a formula that produces allocations that are in line with his targeting goals.

In agreement with the prediction of the 'swing voter' models, the analysis showed that districts with lower vote margins between the two dominant political parties in the previous presidential election receive higher DACF allocations and disbursements. This suggests that the DACF transfers were targeted to swing voters. The analysis did not provide evidence that DACF transfers are targeted to the incumbent's core supporters.

The DACF formula was changed in each of the years under study except in 1995 and there is evidence that the formula itself is manipulated to achieve the politically desired allocations. For each year, the formula from the previous year was used to calculate counterfactual allocations, that is

the allocation of funds to the districts in the case that the formula not been changed. This figure was compared with actual allocations under the changed formula. The analysis showed that the formula changes tended to benefit districts that had lower vote margins in the previous elections suggesting that the formula changes are indeed influenced by political considerations.

## Conclusions

The study indicates that the central government was able to achieve some degree of sophisticated political targeting even within the confines of the sharing rules of the DACF. This indicates that resource allocation by means of a uniformly applied formula grounded in economic variables has a considerable potential, but it does not, in itself, fully prevent politically motivated targeting. The study indicates that who determines the formula, and how and when the formula can be altered, are important determinants of how well it works to prevent political manipulation.

These findings have important policy implications regarding the goal to limit political influence on resource transfers from central to local governments. It shows that to increase the effectiveness of the formula-based mechanism, the independence of the administration of the fund must be strengthened. One might consider measures such as the appointment of the Fund

Administrator by an inter-party Parliamentary Committee.

One has to keep in mind that in a strong presidential system, which is typical not only for Ghana, but also for many other African countries, creating autonomous institutions is challenging, since informal mechanisms may override formal provisions. Therefore, it might be useful to consider mechanisms that increase transparency about resource allocation. For example, making data about resource allocation and disbursement, available through public media would help citizens to hold their governments accountable for any political bias in public resource allocation.

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<sup>i</sup> Khemani, S., 2007. Does delegation of fiscal policy to an independent agency make a difference? Evidence from intergovernmental transfers in India. *Journal of Development Economics* 82, 464–484.

<sup>ii</sup> Lindbeck, A. and Weibull, J., 1993. A Model of Political Equilibrium in a Representative Democracy. *Journal of Public Economics* 51 (2), 195-209.

, Dixit, A. and Londregan, J., 1998. Ideology, Tactics, and Efficiency in Redistributive Politics. *Quarterly Journal of Economics* 113 (1), 497-529.

<sup>iii</sup> Cox, G., and McCubbins, M., 1986. Electoral Politics as a Redistributive Game. *Journal of Politics* 48 (2), 370-389.

The Ghana Strategy Support Program (GSSP) is a research, communication, and capacity-strengthening program to build the capabilities of researchers, administrators, policymakers, and members of civil society in Ghana to develop and implement agricultural and rural development strategies. With core funding from the U.S. Agency for International Development (USAID)/Ghana and a mandate to develop a multi-donor-funded program, IFPRI launched GSSP as a partnership between Ghana and its development partners. Any opinions stated in this note are those of the author(s) and do not necessarily reflect the policies or opinions of IFPRI.

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