

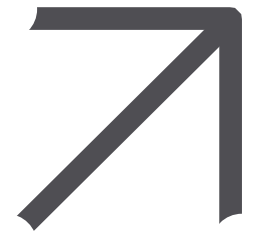


Subnational competitiveness grants *guidebook*

A tool to promote jobs and economic transformation in cities and regions through performance-based financing

Jade Salhab
Diana Hristova
Sohaib Athar
Ayah Mahgoub





Finance, Competitiveness,
and Innovation Global Practice
Urban, Disaster Risk Management,
Resilience and Land Global Practice

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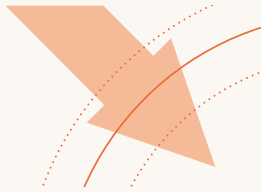


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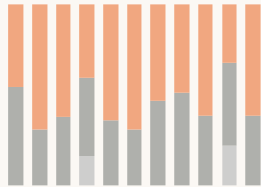


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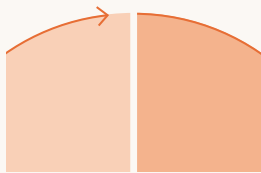


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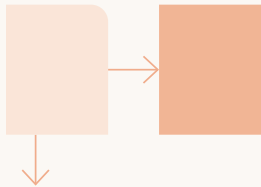
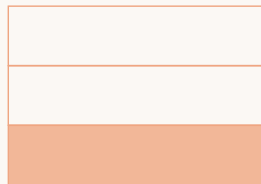


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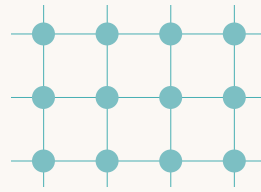


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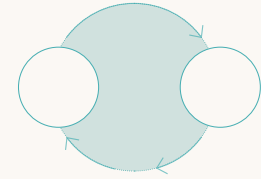


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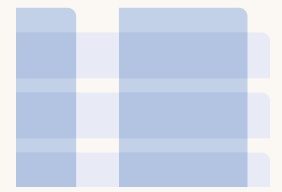


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Acknowledgements

About the Finance, Competitiveness & Innovation (FCI) Global Practice

The Global Practice combines expertise in the financial sector with expertise in private sector development to foster private-sector led growth and help create markets in client countries. Through this work, it strengthens the World Bank Group's evolving approach to development finance: to maximize finance for development and to leverage private sector investments for sustainable and inclusive growth.

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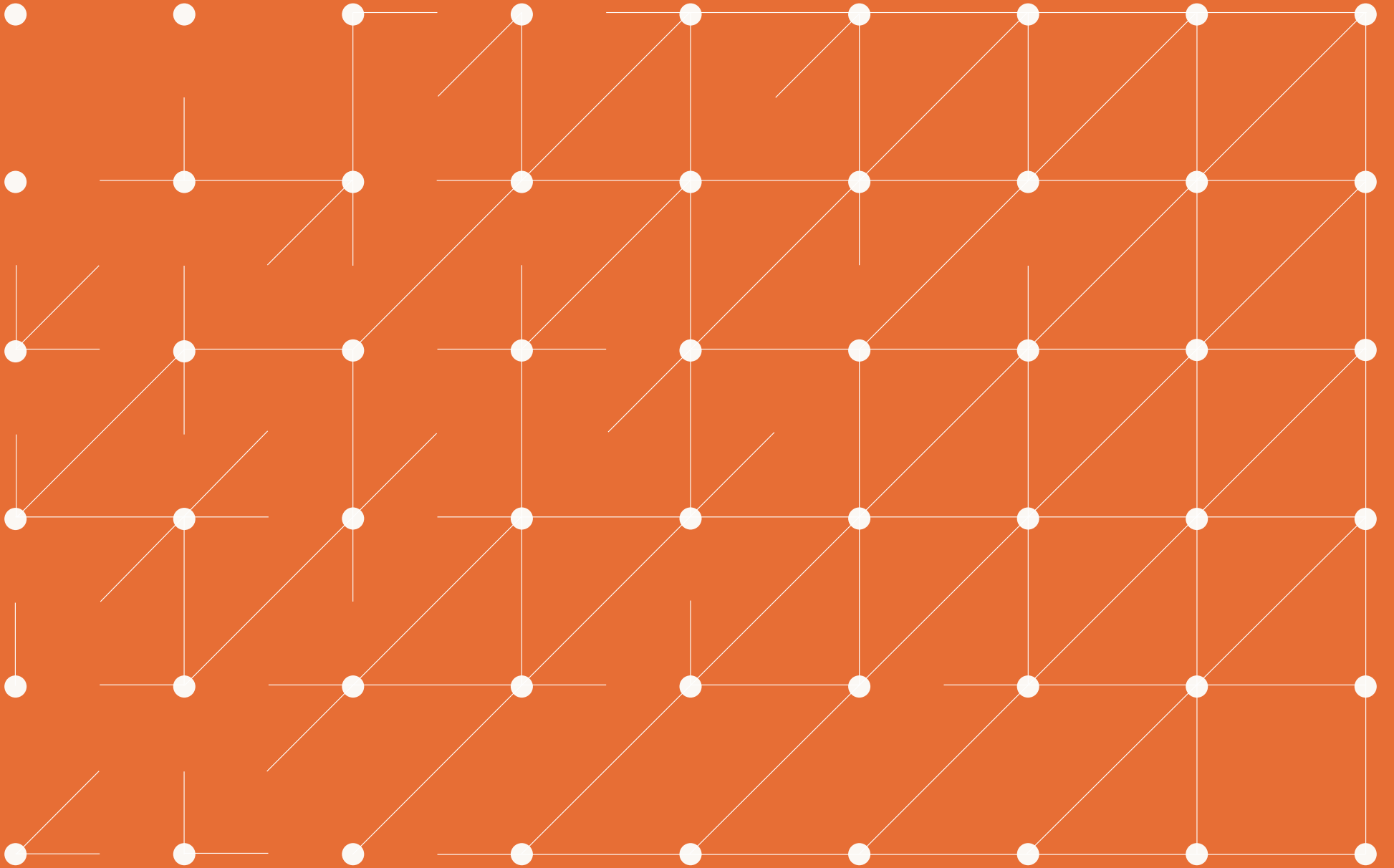
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Acronyms

APA	Annual Performance Assessment	R&D	Research and Development
ASA	Advisory Services and Analytics	SCG	Subnational Competitiveness Grant
BDS	Business Development System	SMART	Specific, Measurable, Achievable, Relevant, and Timebound
CAP	Cluster Action Plan	SMES	Small and Medium Enterprises
CCI	Cluster Competitiveness Initiatives	TA	Technical Assistance
CIIP	Competitive Industries and Innovation Program	TOC	Theory of Change
CPSD	Country Private Sector Diagnostic	TOR	Terms of Reference
CRI	Competitiveness Reinforcement Initiative	UELDP	Upper Egypt Local Development Program
DPL	Development Policy Lending	WBG	World Bank Group
DSC	District Service Center		
EU	European Union		
FCI	Finance, Competitiveness, and Innovation		
FDI	Foreign Direct Investment		
G2B	Government-to-Business		
GDP	Gross Domestic Product		
GP	Global Practice		
IGFT	Intergovernmental Fiscal Transfer		
IT	Information Technology		
IVA	Independent Verification Agency		
IZUP	Industrial Zone Upgrading Plan		
JET	Jobs and Economic Transformation		
MAC	Minimum Access Criteria		
MOF	Minister of Finance		
MOIC	Minister of International Cooperation		
MOLD	Minister of Local Development		
MTI	Minister of Trade and Industry		
NCC	National Competition Council		
NCP	National Competition Policy		
PBG	Performance-Based Grant		
PM	Performance Metric		
POM	Program Operations Manual		
PPD	Public-Private Dialogue		
PPP	Public-Private Partnership		



Part A

*Rationale and contextual
fit for subnational
competitiveness*



1

Introduction

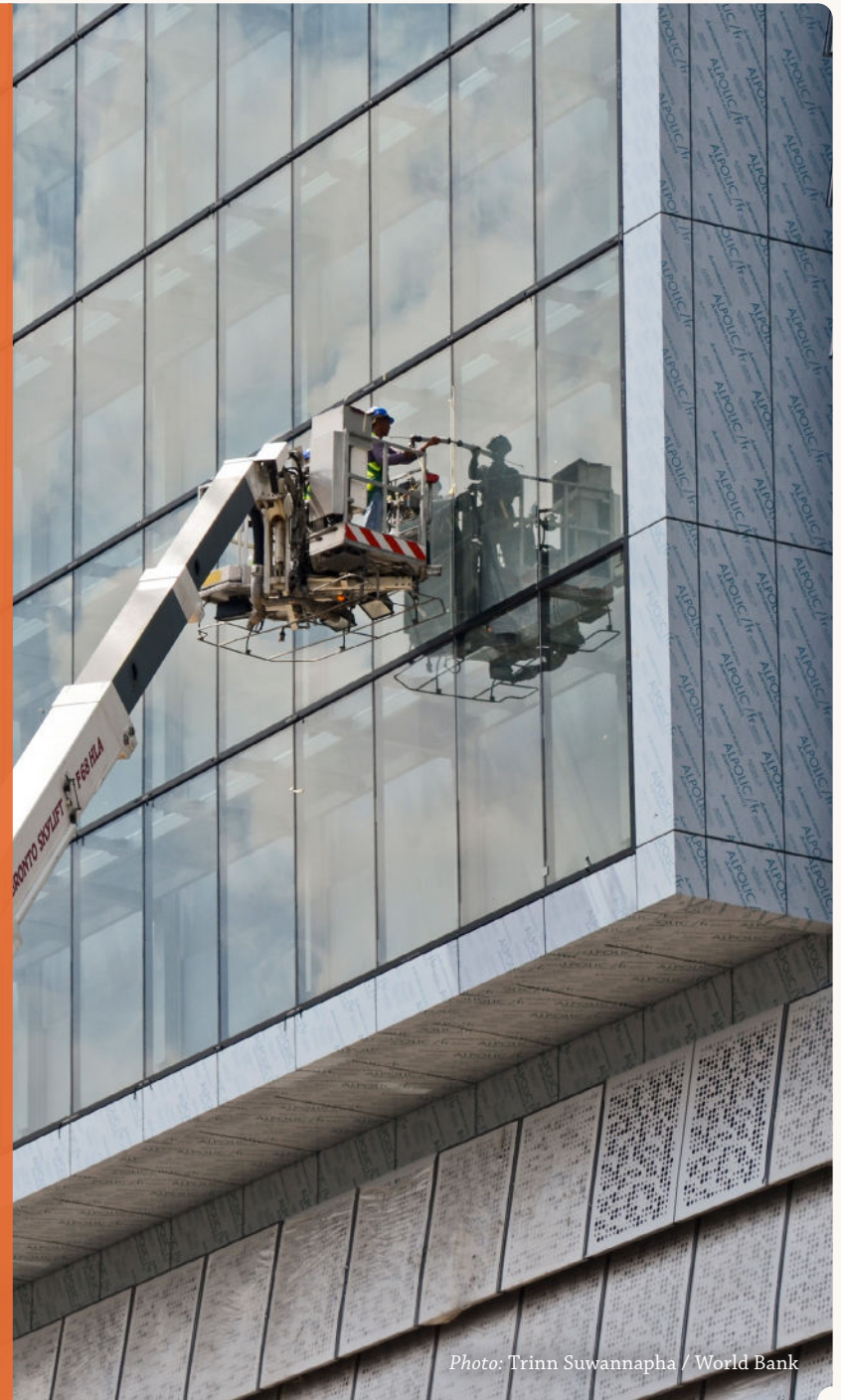



Photo: Trinn Suwannapha / World Bank


The World Bank Group (WBG) published the *Competitive Cities for Jobs and Growth report*¹ in 2015 which developed a conceptual framework that analyzes what makes cities and subnational regions competitive and provided policy recommendations on how these places can create economic growth and quality jobs. Since the report came out, WBG staff have worked on operationalizing this framework through country-level analytical and financing engagements. The Subnational Competitiveness Grant (SCG) is an approach which contributes to this effort, by proposing a novel way in which well-tested tools for competitiveness policy and subnational performance can be combined to advance the jobs and economic transformation (JET) agenda in cities and lagging regions. It builds on experience and lessons from within and outside the WBG by aiming to leverage subnational governance and decentralization processes to promote economic competitiveness at a subnational level.


The objective of this guidebook is to offer practical advice to stakeholders on assessing the relevance of an SCG to particular contexts and designing and implementing an SCG program to maximize impact and minimize risks. The targeted stakeholders include, but are not limited to, national and subnational governments, program designers, development practitioners and others working on topics of subnational and city competitiveness. The SCG tool is a good fit for a wide range of places that would benefit from and could engage in creating a better enabling environment for competitiveness and economic transformation. An SCG offers a means for incentivizing a better understanding of what is needed to enable private sector agents to thrive and create jobs for inclusive growth in specific places; over time, helping identify changes in mandates needed to appropriately empower subnational governments to achieve these objectives; and better tailoring capacity enhancement support to subnational governments and other critical actors. In that sense, the SCG is a complement to existing tools that may have wider applications, such as existing frameworks for competitiveness and local/subnational institutional performance improvement.


1. World Bank Group. 2015. *Competitive Cities for Jobs and Growth: What, Who and How*.


The rest of this guidebook is structured as follows:


- 
Section 2 shows the relevance of subnational governments in enhancing competitiveness and economic transformation and argues that expanding the remit of cities and subnational regions to improve competitiveness is a key area of engagement for JET. It shows that in certain circumstances, SCGs could be a useful tool in incentivizing and capacitating subnational governments to support local private sector development.

- 
Section 3 highlights the potential of subnational performance-based financing to support competitiveness/JET and provides guidance on how to assess whether, and in what circumstances, an SCG is the right fit in a particular context. It describes how performance-based grants (PBGs) — a specific type of intergovernmental fiscal transfer mechanism for subnational governments — have been used to support improvements in subnational institutional performance, and how such mechanisms have been leveraged to enhance subnational competitiveness performance in certain cases. It then provides a framework for assessing the fit for an SCG in a particular context. Guiding questions and a decision tool are provided to help assess whether the identified barriers to competitiveness can be addressed through an SCG, and whether an SCG is the right fit to address the identified market failures at the subnational level. It also identifies situations when the SCG tool may not be right based on contextual factors.

 **Section 4** provides guidance on how to conduct rigorous diagnostics of subnational governments' incentives, capacity, and mandates and local private sector needs to define the entry point for an SCG. It provides examples from several countries and contexts of how competitiveness-related policy actions have been aligned with subnational government mandates. This is followed by a description of likely critical risks that SCGs will face and need to mitigate. The section concludes by providing a summary of key lessons for program designers, organized around the following guiding questions: When is there a rationale for subnational engagement to promote competitiveness/JET? When is the proposed SCG mechanism relevant to consider (i.e., a conditional fiscal transfer mechanism focused on competitiveness/JET)? When should alternative tools and instruments be used instead of an SCG? And what are critical risks that SCG programs need to mitigate, and how?

 **Section 5** provides an overview of how to develop an SCG program, and introduces its various phases, components, and key design considerations. It describes the concept and planning phase, where the program objectives and theory of change of a SCG program is developed, informed by diagnostics and prioritization exercise. It then introduces the various aspects of designing an SCG mechanism, such as eligibility criteria; performance metrics; measurement, assessment, and reporting; the financial allocation structure for program financing; and the SCG funds disbursement timeline.

 **Section 6** delves deeper into the nuts and bolts of an SCG program design and operations. It provides guidance on eligibility criteria for subnational governments to participate in the program and receive funding; selection of thematic metrics on which the performance of subnational governments on improving competitiveness will be assessed; factors to consider when selecting appropriate indicators based on assessments of local context; and various aspects of results/performance measurement, assessment, quality assurance and reporting; and the roles of various entities.

 **Section 7** compiles additional key considerations for program operationalization and implementation, including defining what participating subnational governments can use the SCG funds for, identifying capacity-building needs, defining the SCG allocation structure, and establishing the SCG funds disbursement timeline.

2

What is *the* role of subnational governments in enhancing competitiveness for firms?

This section shows the relevance of subnational governments in enhancing competitiveness and economic transformation and argues that expanding the remit of cities and subnational regions to improve competitiveness is a key area of engagement for JET. It shows that in some cases subnational governments have a competitive advantage in addressing subnational challenges to competitiveness, relative to higher tiers of government. In certain circumstances, SCGs could be a useful tool in incentivizing and capacitating subnational governments to support local private sector development.

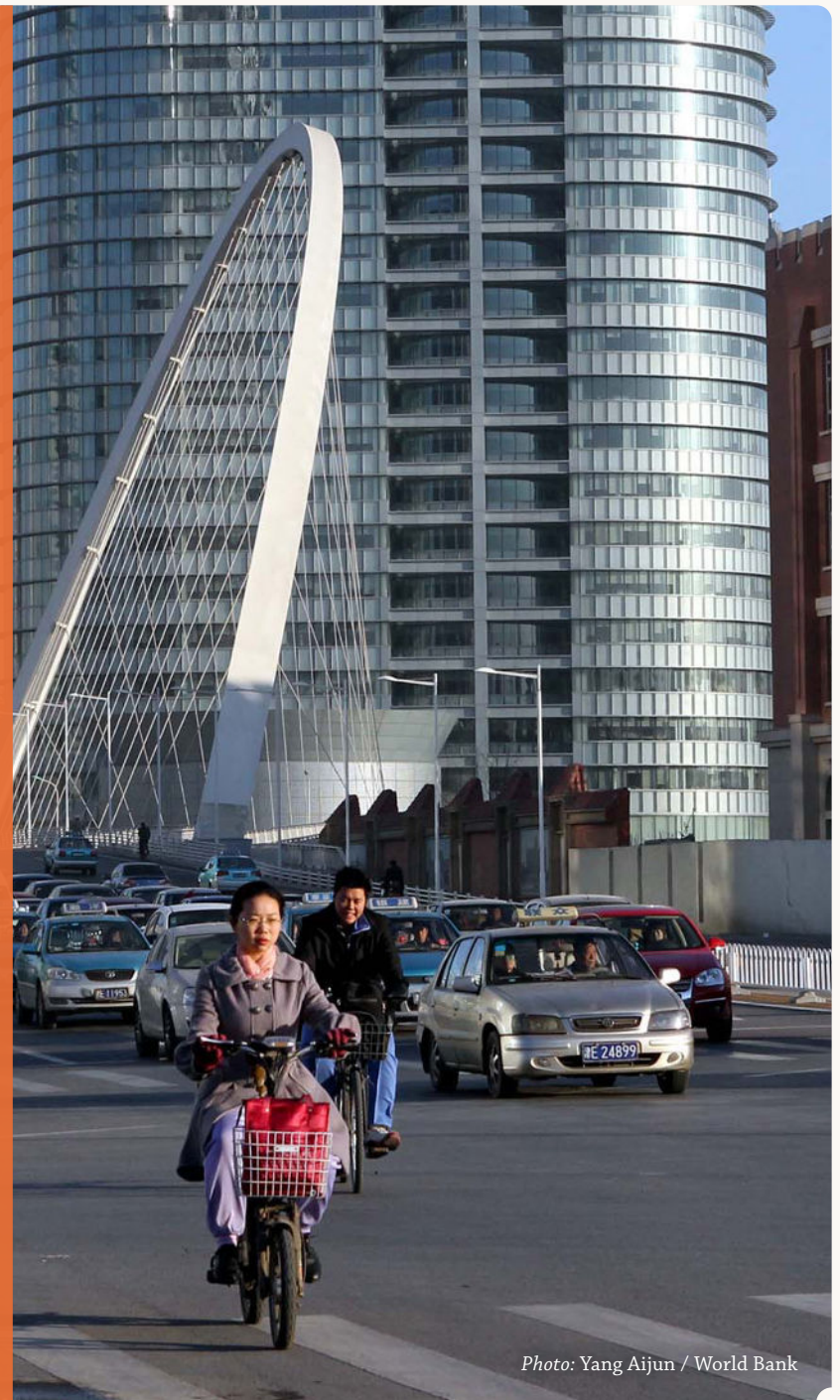


Photo: Yang Aijun / World Bank

2.1 Importance of subnational governments to the competitiveness agenda

2.1.1 The subnational dimension is important to the competitiveness/JET agenda

Competitive cities and subnational regions are those places that—over time—successfully facilitate their firms and industries to create jobs, raise productivity, and increase the incomes of citizens.² Cities and subnational regions across all income levels and diverse economic structures and governance models have managed to achieve economic growth by leveraging agglomeration economies to strengthen the competitiveness of their firms, especially in tradable sectors. For example, between 2005 and 2012, employment in tradeable sectors in the fastest-growing cities (the top 10 percent in gross domestic product [GDP] per capita growth) grew 2.5 percentage points faster every year (on average) than employment in non-tradable sectors.³ Growth in tradable sectors could also ignite job creation in non-tradable sectors in these cities: cities in which tradable sector employment grew fastest recorded 6.6 percent job growth in non-tradable industries, compared to less competitive cities where both tradables and non-tradables both grew around 2 percent annually over the same period.

The factors that help attract, retain, and expand the private sector are central to what makes a city or region competitive. The subnational dimension is critical for the competitiveness/JET agenda because many of these factors manifest at the subnational level and the critical barriers

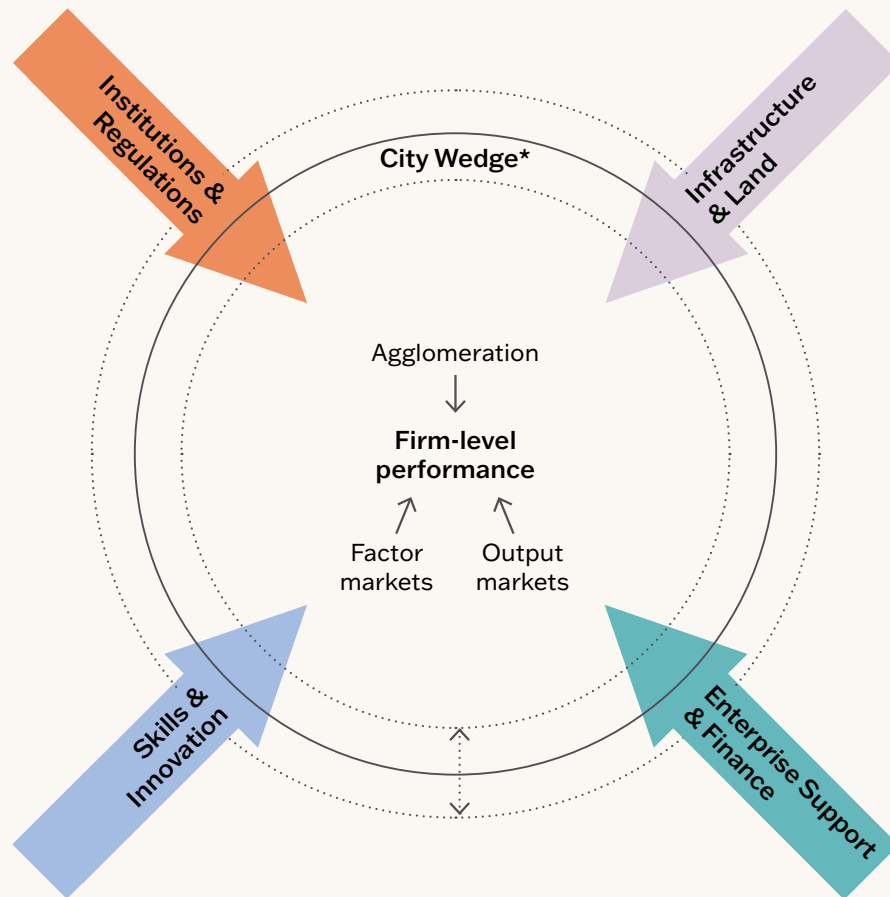
to competitiveness/JET can be unique to a city or region. Examples of subnational barriers include deficient local infrastructure, low access to connected or serviced land, local red tape, coordination issues along local value chains, negative externalities (insecurities, pest disease, environmental issues), or lack of positive externalities, such as economies of agglomeration or specialization. There are potentially four policy levers or types of interventions available to cities and subnational regions to improve competitiveness, as outlined in the Competitive Cities report framework (*Figure 1*):

1. **Institutions and regulations** (for example, taxes, licenses, duties, legal regulation, promotion, and branding)
2. **Infrastructure and land** (for example, roads, public spaces, markets, transportation, communications, land [including colocation arrangements for similar firms in dedicated zones and/or office space], electricity, water, and sanitation)
3. **Skills and innovation** (for example, education, vocational training and workforce development, and innovation networks)
4. **Enterprise support and finance** (for example, access to capital, export assistance, investment promotion and support, incentives, and business development services).

2. World Bank Group. 2015. *Competitive Cities for Jobs and Growth: What, Who and How*.

3. Ibid.

Figure 1 Competitive Cities framework: Four policy levers to improve competitiveness



Source: Adapted from World Bank Group (2015)

2.1.2 Subnational governments have a competitive advantage in addressing subnational challenges

While subnational barriers to competitiveness can be resolved directly by national governments or through the leadership of the local private sector, subnational and local/city governments can be more efficient and effective in addressing subnational challenges.

Governments of cities and subnational regions play a key role in driving competitiveness where firms are located. The key constraints to private sector investment, entrepreneurship, and growth are often partly under the control of cities and subnational regions as local regulations and capital investments affect the business environment under which firms access output/input markets, serviced land, government-to-business (G2B) services, and skills. More generally, subnational governments can facilitate or stifle the generation of economies of agglomeration/specialization (that is, clustering effects), which is instrumental for firms' competitiveness in global markets and trade. For example, depending on the extent of devolved powers, cities and regions are empowered (or not) to support industry and private sector development by reducing administrative burdens in licensing and permitting, improving access to serviced land and property registration (which has direct impacts on access to finance for small and medium enterprises [SMEs]) or connectivity. Other elements of competitiveness and economic transformation might not be under the direct control of subnational government institutions (decentralized or deconcentrated) but might depend on their ability to enforce central policies.

Subnational governments also possess context-specific knowledge of the challenges facing the private sector within their jurisdictions and can be instrumental in designing the most relevant solutions. Literature points to decentralization as a helpful factor in driving successful

improvement in competitiveness because solutions require local contextualization to address the needs of those meant to be served.⁴ For instance, subnational governments have been at the forefront of managing the COVID-19 crisis: cities around the world have responded with measures such as basic support on health, hygiene, sanitation, and nutrition; information sharing and communications campaigns; support for vulnerable populations; financial support and safety nets for firms and citizens; enhancement of public spaces for outdoor recreation and business activity; and a range of measures to support businesses, including consulting services and digital tools to assist remote working.⁵

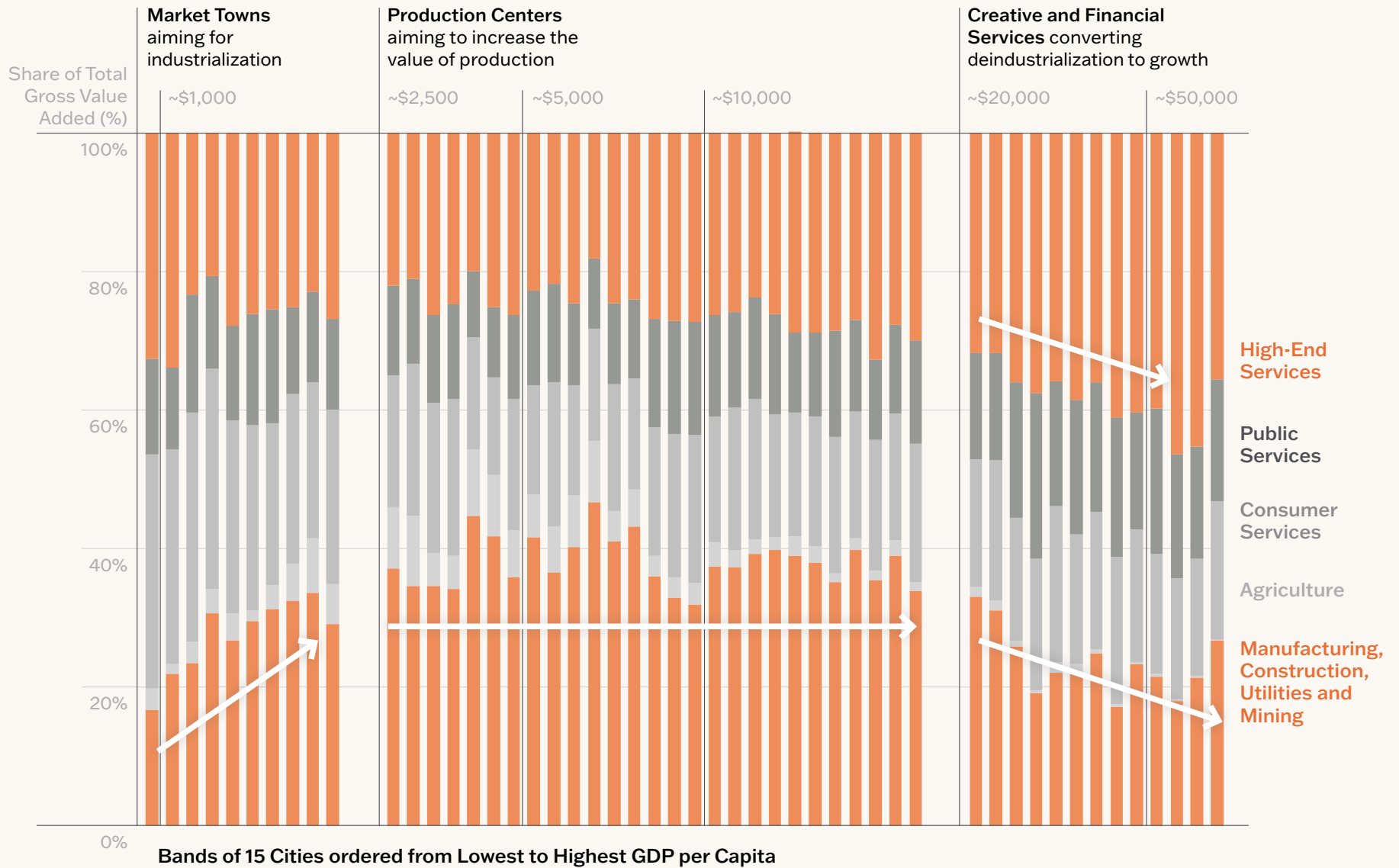
Cities and regions need to customize a set of interventions within these levers that fit local circumstances, political economy, economic opportunities, and the needs of local firms. As noted in the Competitive Cities framework, “institutions, regulations, and basic infrastructure tend to be crucial drivers of competitiveness at lower income levels, whereas human capital, advanced infrastructure, and innovation systems become crucial for sustained economic growth and job creation at medium and higher income levels”⁶ (*Figure 2*). Targeted interventions are more effective when informed by a diagnostic of the local business environment and analysis of constraints and opportunities for relevant sectors and economic clusters—as described in subsequent sections of this guidebook.

4. Ibid. For example, “decentralization through city proclamation (a sudden broadening of the mayor’s wedge...) resulted in better implementation of existing national level tax policies, leading to better economic outcomes.” And “the larger the mayor’s wedge the higher the potential for competitiveness outcomes.”

5. OECD. 2020. *OECD Policy Responses to Coronavirus (COVID-19): Cities Policy Responses*. July 2020.

6. World Bank Group. 2015.

Figure 2 Cities' and regions' levels of development



Source: Adapted from World Bank Group (2015)

2.2 Challenges and opportunities for subnational governments in enhancing competitiveness

Economic development is uneven across places, even within the same country, and a key challenge for policy makers is to create economic opportunities and raise living standards for all. The most competitive places have facilitated their local economies to create jobs, raise productivity, and increase the incomes of citizens, while other places have fostered decline and discontent. If more cities and subnational regions in each country performed at the level of their most competitive peers, they could create millions of additional jobs every year,⁷ particularly in traded sectors. The Competitive Cities report highlighted multiple cases where such places (for example, Gaziantep, Bucaramanga, and Changsa) were able to have transformative impact on competitiveness, growth, and investment.⁸

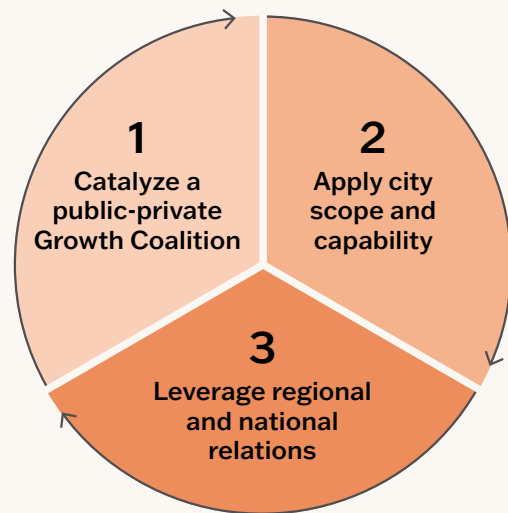
Subnational governments have widely varying functional roles and prerogatives to affect the four policy levers that drive competitiveness and support economic transformation. Since the drivers of competitiveness are distributed among different levels of government and various entities, local and subnational governments can enhance their own scope and capacity by leveraging ‘growth coalitions’ through partnerships with local stakeholders—including the private sector and civil society—as well as intergovernmental coalitions with other jurisdictions and layers of government. The Competitive Cities framework presents this functional role of subnational governments across three levels (*Figure 3*):

1. **Governor’s or mayor’s wedge.** The internal scope and capacity of the subnational government/administration (that is, city, district, governorate, region, province, state, and so on) compared with other tiers of government⁹.
2. **Growth coalitions wedge.** Partnerships with other city/local stakeholders (especially private sector and civil society).
3. **Intergovernmental relations wedge.** External leverage with neighboring jurisdictions and other (vertical) tiers of government.

7. World Bank Group. 2015.

8. Ibid.

9. The terms ‘governor’ and ‘mayor’ are used to represent the position with the political and executive authority in each respective subnational government. These exact terms may not apply to each context, depending on the specific political and administrative factors. They can be used interchangeably with, for example, ‘city manager’, ‘secretary’, and ‘administrator’, especially in cases where executive authority rests with unelected positions appointed by higher levels of government.

Figure 3 Competitive Cities framework: How

Source: Adapted from World Bank Group (2015)

Mandates, incentives, and capabilities differ widely across and within geographies, and the lack thereof often presents the biggest hurdle for cities and subnational regions in leveraging their existing endowments or assets to improve competitiveness and drive economic transformation:

1. Mandates: Subnational governments might have a limited mandate to act on the four policy levers reflecting the varying levels of decentralization in a country or region. They might not have the mandate or power to affect identified market, coordination, or government failures, such as modernizing or improving regulations and business services that are not yet decentralized (for example, SME registration and land use) and upgrading needed but mismanaged economic infrastructure or services that fall under centralized authority (for example, industrial zones, regional roads and ports, sanitation services, and labor force training).

2. Incentives: Their incentives to pursue competitiveness interventions might also be constrained by limited accountability or lack of financial reward. Mid- to long-term gains may be dependent on short-term pains and losses of fiscal revenue. Subnational governments might also benefit from revenue or capture associated with local red tape, imperfect land markets, and so on. Personal incentives of local decision-makers, such as promotion, might not be aligned with incentives to pursue competitiveness outcomes. There might also be no structured or transparent accountability to private sector actors and no clear vision or understanding of role or potential impact.

3. Capacity: Finally, their capacity could also be a constraint as the technical ability to design and implement a competitiveness program and the requisite human resources might be limited within city and regional administrations. Capacity might be limited in procurement or financial management as well as in the ability to spend money well by identifying binding constraints to competitiveness/JET through market-oriented public-private dialogues (PPDs), writing terms of reference (TORs), supervising works and services needed to address coordination failures in clusters, or providing new economic infrastructure, such as industrial zones or intermodal hubs. Where subnational governments lack the adequate powers or capacity to enable competitiveness, “national and provincial governments may need to invest in a sound decentralization, including by building the capacity of local governments to act effectively.”¹⁰

Understanding and enhancing the mandates, incentives, and capabilities of subnational governments to implement the four policy levers that drive the competitiveness of their regions is recommended to be a key component of programs to improve subnational competitiveness.

10. World Bank 2015.

3

When is an SCG the *right tool* to enhance competitiveness?

This section provides guidance to program designers on assessing whether, and in what circumstances, an SCG is a relevant tool in specific contexts. It starts by describing how performance-based grants (PBGs) — a specific type of intergovernmental fiscal transfer mechanism for local and subnational governments — have been used over the past several decades to support improvements in subnational institutional performance. This mechanism has been widely used by the Bank and other development partners to support the subnational governance agenda in a variety of countries. The section then describes how mechanisms such as PBGs can be, and have been, leveraged to enhance subnational competitiveness performance. This is an introduction to the concept of a subnational competitiveness grant. It then provides a framework for assessing the fit for an SCG in a particular context based on understanding that local context. Some guiding questions are provided to help program designers assess whether the identified barriers to competitiveness can be addressed through an SCG — that is, whether an SCG is a good fit. A decision tool is proposed as a simplified guide to determining whether the SCG is the right fit to address identified market failures at the subnational level. The section concludes by identifying situations when the SCG tool may not be right based on contextual factors.



Photo: Gerardo Pesantez / World Bank

3.1 Role of performance-based grants in enhancing subnational institutional performance

PBGs are a specific type of financing mechanism for local/subnational governments where financing is provided to incentivize performance improvements by linking local and/or subnational government(s)' performance in pre-determined areas with access to funds. They are typically designed to improve institutional and service delivery performance of targeted subnational/local governments through a set of financial incentives, often in support of decentralization objectives of national governments across countries, but may be focused on a wider range of performance areas. Such PBG financing programs are generally integrated into countries' intergovernmental fiscal transfer (IGFT) systems, where fiscal transfers from a higher level of government (e.g. central government) to subnational/local governments (e.g. provinces, states, governorates, counties, districts, and city/local governments) are conditioned on performance.¹¹

Over the past several decades, the World Bank has established an extensive portfolio of PBG financing programs supporting governments across several regions and especially in low- and lower-middle income countries. These programs are generally characterized by a design which focuses on improving the institutional and infrastructure service delivery performance of targeted (grant-receiving) local/subnational governments through a set of financial incentives. This approach has allowed them to be successful in expanding the incentives and capacities of subnational governments in a wide variety of countries to improve service delivery for citizens and enabling environments for firms. In some cases, they have been introduced in contexts in which national governments expand the mandates of local governments.

11. For a detailed review of PBGs, see: World Bank. 2022. *Performance-based financing for institutional and service delivery outcomes in local governments*.

PBG programs aim to strengthen subnational government capability and reduce risks associated with fiscal decentralization. Since the 1990s, the World Bank has introduced PBG programs in over 30 countries to improve local management, infrastructure and service delivery and, in several cases, to help implement governments' decentralization and devolution programs.¹² Prominent examples include Uganda and Kenya: in the former, the central government piloted the first PBG program in the 1990s and currently conditions fiscal transfers to all subnational governments on institutional improvement (in areas such as capital investment planning, budgeting, financial management, accountability etc.); and in the latter case, the World Bank has supported the central government's devolution agenda through a series of PBG programs supporting county governments following constitutional reforms.¹³ The Program-for-Results financing instrument has been increasingly used by the World Bank to support such programs, where World Bank funds are disbursed to the central government based on verified performance of all participating subnational governments, which in turn receive funds from central government.

12. World Bank. 2008. *Fiscal Incentives and Local Government Performance: A Literature Review*.

13. For a detailed review, see: 1) UNCDF. 2010. *Performance-Based Grant Systems: Concept and International Experience*; and 2) World Bank. 2022.

PBG programs have generally improved subnational government performance in several areas, including:¹⁴

- Supporting core administrative functions and compliance with basic statutory requirements;
- Catalyzing public investment management and public financial management by subnational governments (for example, quality planning processes, compliance with procurement regulations, timely accounting, audit processes, outcomes, and responses);
- Enhancing subnational government transparency and accountability, including downward accountability (interface between subnational governments, citizens, and firms), upward accountability (incentives for subnational governments to comply with national laws and regulations), and horizontal accountability (between local civil servants and elected officials);
- Improving local infrastructure service delivery performance and expanding the stock of municipal infrastructure;
- Spotlighting cross-cutting issues, such as gender, social inclusion, poverty targeting, and the environment. Such issues have often been embedded in the performance indicators used by PBGs.

14. Ibid.

3.2 Leveraging PBG programs to enhance subnational competitiveness performance: the SCG

The PBG modality can be used in certain circumstances to support subnational governments to pursue competitiveness. While PBG programs have historically focused on improving service delivery for citizens by incentivizing better public investment management, institutional capability, and transparency and accountability, there is growing demand to support subnational governments in areas beyond core service delivery. The capabilities of subnational governments to support private sector-led job creation and competitiveness often lag those in infrastructure provision, investment planning, or accountability. Economic development tends to be a less familiar area of responsibility for subnational governments. It requires a suite of new capabilities—in economic analysis, strategy, investment promotion, financial instruments, or SME services in incumbent or emerging sectors—which are often lacking at the subnational level.

Examples where performance-based financial mechanisms were used in promoting competitiveness and economic transformation can mostly be found outside the World Bank financing portfolio. Three relevant examples are Australia, the European Union (EU), and China. In Australia, PBGs financed by the federal level provided an incentive to subnational governments to implement pro-competitive economic reforms from 1995 to 2005. In the EU, all regional development investments must be aligned with policy objectives defined at the EU and national levels, and the achievement of targets is incentivized through a performance reserve equivalent to 6 percent of the budget. In China, subnational governments compete to achieve national planning priorities, which creates a strong incentive to increase business activity and the value of land in their area. Promotion of local government leaders is also linked to their performance on

economic outcomes. However, some pilots within the World Bank, which have focused on reforms in the local business environment, have informed this guidebook.¹⁵ In one prominent example in Egypt, the World Bank is supporting the government to pilot an SCG to promote competitiveness policies and investment in the lagging region of Upper Egypt by focusing on local government capacity for market-oriented PPD, improved G2B services, and industry- and sector-specific capital investments (*see Example 1*).

The proposed SCG tool utilizes the proven effectiveness of PBG programs to incentivize and manage subnational government performance and leverage it to strengthen competitiveness of private sector firms and industries within their jurisdictions. A SCG program can support a continuum between national and local business environments and the implementation of pro-competitiveness policies at a subnational scale that avoid blind spots and resolve government coordination failures. This tool can also help align objectives across levels of government and increase their complementarity. For subnational governments, SCGs can present an opportunity for advocacy toward higher levels of government for local prerogatives, leverage local knowledge to strengthen local economic competitiveness and development, and improve institutional capacities for competitiveness interventions. For national governments, SCGs can present an opportunity to promote good practices and incentivize and finance economic initiatives at the subnational level.

15. See for example, Pakistan: Competitive and Livable City of Karachi project (P161402); Morocco: Casablanca Municipal Support Program (P149995), and two subnational economic transformation projects in Nigeria (P164031 and P161998).

Considering the drivers of impact of PBG programs described above, utilizing SCGs can help improve competitiveness through the following channels:

1. **SCGs build upon the existing knowledge on the determinants of competitiveness and economic transformation and aim to shift the focus of subnational governments on these determinants.** The World Bank has strong analytical frameworks¹⁶ on identifying policies that enhance the ability of firms in cities and subnational regions to be more competitive, including identifying the differentiated needs of firms in traded, enabling, and domestic sectors. Interventions identified by these frameworks may require coordination action by different levels of government, with local/subnational governments typically having a range of tools to implement these but with varying levels of influence. The SCG is a tool that can incentivize lower levels of government to focus on competitiveness results informed by these frameworks.
2. **SCGs can create an incentive to focus on localized needs of private firms, including tradable sectors.** Competitiveness literature stresses the importance of contextualizing solutions to local needs and objectives.¹⁷ Accordingly, localized focus is needed (for example, diagnostic and prioritization approaches; *see Section 4*) if competitiveness-related programs are to be successful. In SCGs, through the PM selection process (*see Section 6*), subnational governments may, for example, be tasked to deliver on improving the local business environment. Consider how this incentivizes them to engage the local private sector to better understand what will deliver this result.

16. These include the *Country Private Sector Diagnostic* (CPSD) approach, the Competitiveness Enhancement Initiatives, and *Competitive Cities Growth Pathways methodology*.

17. For instance, consider World Bank (2015), which highlights the importance of local contextualization: “customized its choices and interventions within each area to its local circumstances, political economy, and economic opportunities...” and “the core objective of a competitive cities approach is to understand and engage coherently with the local economy.”

Local conditions that constrain their ability to effectively compete in markets (foreign and domestic), and the corresponding effective policy actions, would differ depending on the sectors and markets local firms are active in.

3. **SCGs can enhance competitiveness at the country level by increasing capacity, mandate, and incentives of subnational governments to affect relevant policy levers.** SCGs focus on competitiveness, a policy area that tends to be partly outside the mandate of subnational governments, even though they do have a critical role in improving the competitiveness of firms in cities and subnational regions and private sector-led job creation. A recent SCG pilot in Egypt has shown that the SCG—focused solely on promoting competitiveness at the subnational level—can improve subnational governments’ awareness of the ways they can contribute to local private sector development and competitiveness and thus increase their interest in pursuing the necessary capacity, mandate, and resources.
 - **Capacity:** SCGs can increase the capacity of subnational governments to affect subnational competitiveness policy levers by improving absorption capacity of financial transfers; improving technical, planning, and governance capacity through improved diagnostic, training, technical assistance (TA), and dialogue with the private sector; and improving local reform teams’ ability to advocate national government or agencies.
 - **Mandate:** SCGs can temporarily or marginally expand mandates through pilots that can demonstrate the effects of decentralization. Through an SCG, subnational governments can proactively mobilize or lobby other levels of government that have relevant mandates (for example, interagency agreements in Upper Egypt).
 - **Incentives:** An SCG can show what is feasible and create a horizon of ambition through preliminary diagnostics. SCGs can also increase incentives by offering financial rewards to safeguard against vested interests. Financial

incentives alone are often not enough, but in combination with other incentives, they can mitigate short-term losses for midterm gains. SCGs can make subnational governments more accountable to local populations and the private sector through dialogue, reporting, and rigorous monitoring.

- 4. SCGs can empower subnational governments while making them more responsive to the private sector and less vulnerable to political capture.** Policy is more likely to improve the competitiveness of local firms when it is informed by analytically underpinned dialogue and engagement with the private sector, with a strong focus on market demand and trends. This can be reinforced with incentives tied to transparency of results and/or metrics that involve inputs from beneficiaries. For example, adding incentives tied to publishing the results of the subnational government in the SCG program or survey responses of assessed effectiveness of local government administration by firms can strengthen the accountability of the subnational government to the private sector and its citizens. Thus, SCGs are also a strong complement to other fiscal transfer programs to support decentralization and local/subnational performance improvement, such as PBGs, and can be incorporated within existing PBG frameworks and designs based on the institutional context in each specific case—as shown in subsequent sections.

3.3 Assessing the fit for an SCG based on understanding the local context: possible scenarios

Before diving into the design of an SCG, it is necessary to determine its fit for addressing barriers to competitiveness and economic transformation in each context. This mechanism can only deliver benefits when it offers the right response to the right problems, with the necessary conditions in place, and when tailored to the context-specific constraints and considerations. Accordingly, stakeholders interested in utilizing SCGs to improve competitiveness or JET-related programs can conduct the following assessment to determine the value add of SCGs: program designers can start by identifying existing barriers to competitiveness and assessing whether these barriers can be addressed by any of the four drivers of impact.

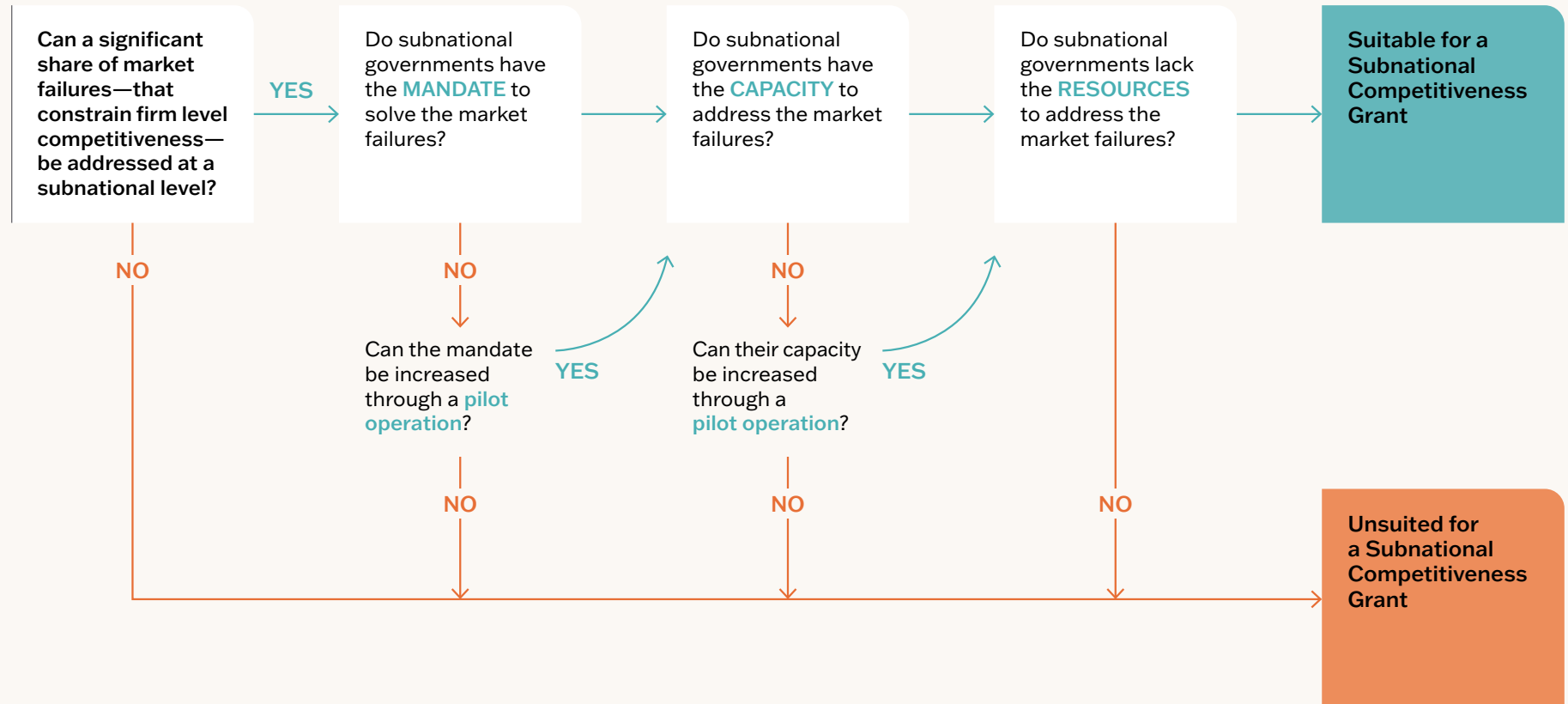
Three guiding questions are provided below to help program designers assess whether the identified barriers can be addressed through an SCG. These questions are based on the drivers of impact presented earlier:¹⁸

1. Is the political economy context open or supportive of increased mandates, incentives, and capacity of subnational governments? Can the central government rigorously enforce performance-based fiscal transfer programs (either as part of their ongoing fiscal transfer system or as a stand-alone program) even when faced with political pressures to ease conditionalities? Enabling subnational governments and holding them accountable to implement competitiveness reforms is key for the successful implementation of an SCG program.
2. Can a SCG empower and enable subnational governments to alleviate the critical barriers to competitiveness? That is,
 - **Strengthened capacity:** Could greater capacity strengthening of subnational governments on competitiveness policy areas drive improved results in firm-level competitiveness?
 - **Enhanced mandate and/or influence:** Could greater attention by subnational governments to firm-level competitiveness drive improved results? Do the existing mandates of subnational governments allow them to contribute meaningfully to improve competitiveness? Or, alternatively, can their mandate be strengthened (including through pilot measures) to contribute to this area?
 - **Increased incentives:** Could better (fiscal or other) incentives to subnational governments to focus on firm-level competitiveness drive improved results in terms of business and investment climate?

A decision tree is proposed as a high-level simplified guide to determining whether the SCG is the right fit to address identified market failures at the subnational level (Figure 4). If identified critical failures that prevent private sector growth and job creation are subnational in nature, and other relevant stakeholders are less able or less effective in addressing them, there could be an economic rationale for supporting subnational governments to pursue competitiveness and JET objectives. If subnational government mandate, capacity, or incentives are critical barriers for subnational government support to competitiveness, an SCG could be considered as a tool to expand and align them to address the identified failures.

18. These are adapted and modified from Instiglio. 2018. *A Guide for Effective Results-Based Financing Strategies: The Global Partnership on Output-Based Aid*. World Bank.

Figure 4 Decision tree to determine fit of SCGs

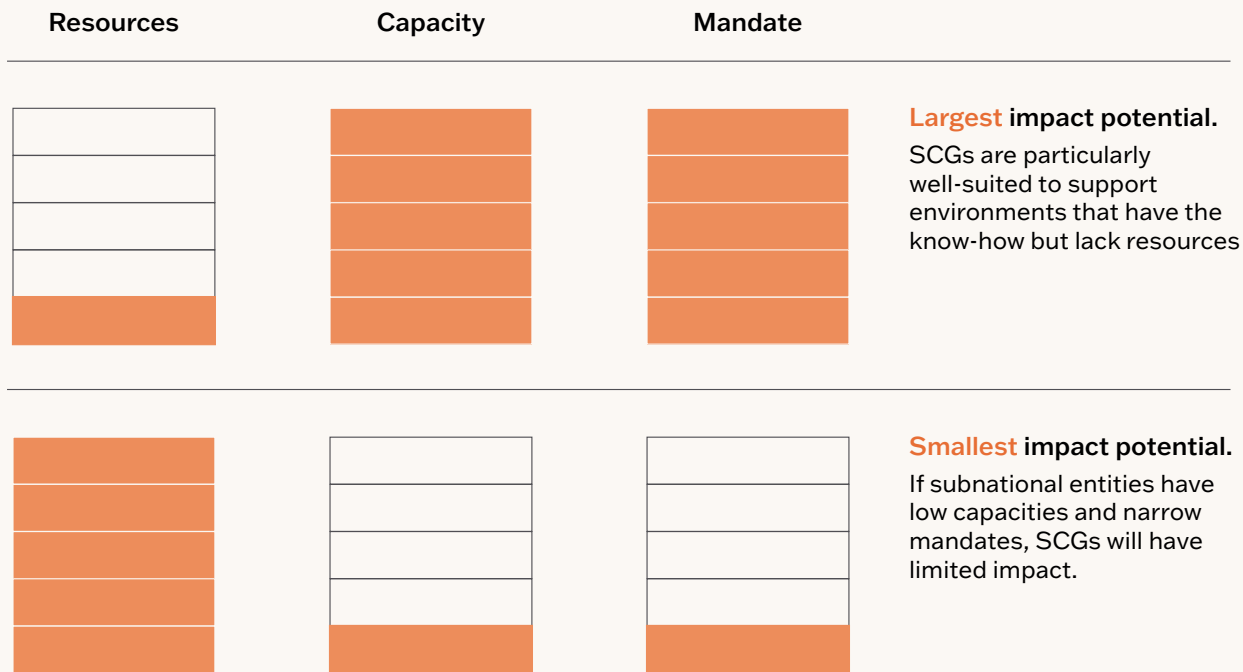


3. What other changes or complementary reforms (especially at the national level) are required to address barriers and improve results? Can these be implemented through the duration of the SCG? If not, how can these constraints be accommodated through the SCG design?

There are a set of scenarios for how well suited an SCG may be for a local context, depending on the prevailing institutional context for subnational governments. A rigorous diagnostic of subnational governments’ resources, mandates,

and capacity (*section 4.1.1*) can inform these scenarios and determine the optimal entry point (if any) for an SCG. The potential impact of an SCG will vary based on the level of resources, mandates, and capacity for subnational governments in a particular context, with the strongest impact likely in contexts where subnational governments have relatively better mandates and capacity but lack resources, while the weakest impact likely in contexts where they have weak mandates and capacity (*see Figure 5 and Box 1*). It must be noted that specific examples are indicative and by no means exhaustive.

Figure 5 Relative impact of an SCG given level of resources, capacity, and mandate



Box 1 Indicative set of scenarios for suitability of SCG in various institutional contexts**→ Scenario 1: Low Resources, High Capacity, High Mandate**

Since the financial incentive is at the core of a PBG, an SCG would have the highest potential impact in subnational jurisdictions with high capacity and high/relevant mandate but with insufficient financial resources - at least on the shorter term - to address the identified barriers to private sector growth. In Australia, for example, the National Competition Policy pursued competition policy reforms that were already within the mandate and capacity of States and Territories, but it was the competition payments that underpinned the program that provided the critical incentive for States to implement the reforms because the fiscal payout compensated States for short term losses incurred because of the reforms. In this scenario the priority focus of an SCG would be on calibrating the right level of fiscal incentive.

→ Scenario 2: Low Resources, Low (but expandable) Capacity, Low (but expandable) Mandate

For the SCG to have the most impact, the capacity of the supported subnational governments would need to be high, and the mandate would need to be relevant to the identified private sector needs. In certain contexts, and if necessary, the specific design of the SCG program could be leveraged to expand both the capacity and mandate. Capacity building in technical and policy skills that are relevant to the design and implementation of competitiveness interventions could be built into the minimum access criteria of the SCG to ensure that the needed level of capacity is reached before the funding is accessed. The mandate could also be partially expanded through the SCG, where local governments can leverage the proceeds of the SCG to sign interagency agreements with other levels of government that have the relevant mandates (e.g., Upper Egypt's MOUs between governorates and central agencies on loan proceeds). As such, the SCG's support of the expansion of local mandates and/or strengthening of their capacity could serve as a pilot for a wider decentralization and institutional reform.

→ Scenario 3: High Resources, Low (and not expandable) Capacity, Low (and not expandable) Mandate

If capacities or mandates are not adequate for subnational governments to pursue competitiveness reforms, and those capacities and mandates are also not expandable because of political economy considerations pertaining to the intergovernmental framework, the SCG would also have very limited impact. Alternative instruments would be more effective, particularly if resources are not a constraint to implementation.

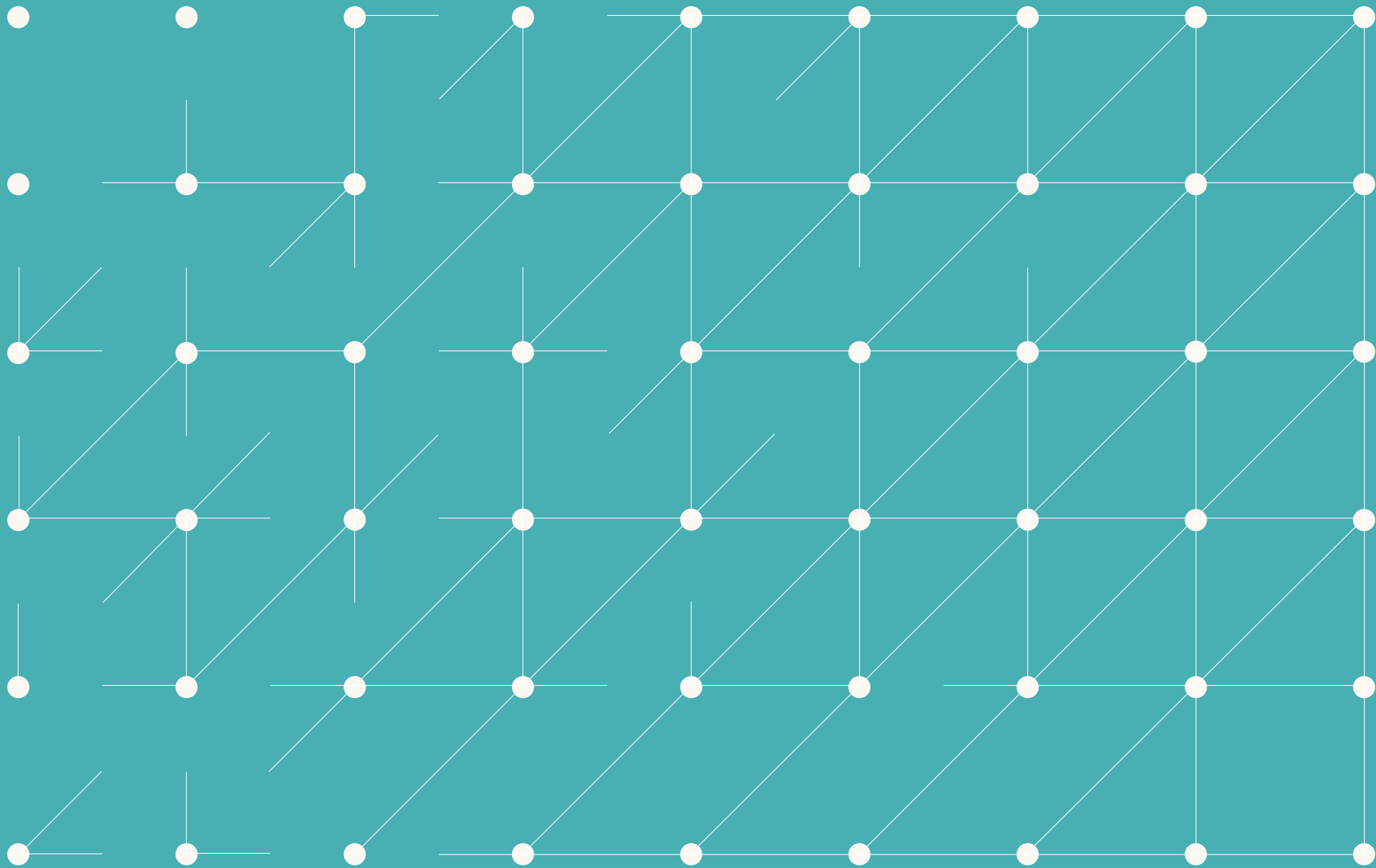
3.4 When the fit may not be right for an SCG based on contextual factors

There are circumstances when even though the identified market and government failures are at subnational level, the SCG may not be the right fit to address them. Those include, but are not limited to the following:

- **When financial rewards cannot incentivize performance.** In some cases, the relative ranking of the subnational government is a stronger performance motivator than funding and the incentive to compare it to others is greater than a targeted local incentive, such as extra funding or increased capacity. This could be true in cases where it makes a difference to the city or region to be visible to others while attempting to attract foreign direct investment (FDI). Subnational indexes or rankings might be more appropriate alternative tools than an SCG.
- **When there are political barriers to decentralization.** This is relevant in cases where subnational politicians have deep-seated incentives to preserve centralized authority over fiscal policy, such as preempting the growth in power of regional political rivals, claiming political credit for subnational developments, and so on. Under such circumstances, a national-level private sector development program might be an alternative instrument to the SCG.
- **When the administrative/governance map is substantially divorced from the economic map.** This is relevant in cases where political governance units (for example, municipalities) are not aligned with economic reality (for example, when most clusters and value chains span multiple municipalities/targeted local governments, making the adequate unit of economic analysis and intervention pertain to a higher level of government).

In such cases, subnational governments might be unable to control or influence the relevant policy levers that are needed to support the private sector and a more relevant alternative tool might be a national-level private sector development program.

- **When the critical issues at the subnational level are overwhelmingly related to good governance and bureaucracy or corruption.** This is relevant in cases where the subnational governance capacity is too low (or governance challenges too high) to be able to effectively work on private sector issues, so before a SCG can be considered, a traditional PBG to improve institutional performance of subnational governments is a more appropriate modality.



Part B

*How to design and
use Subnational
Competitiveness Grants*



4

How to use diagnostic and prioritization exercises to define the *entry point* for an SCG

This section first shows how SCGs aim to align subnational government mandates with identified private sector needs, in order to address constraints to competitiveness. It describes how an assessment and diagnostic of the institutional framework of subnational governments in a prevailing context can be conducted, to understand their incentives, mandate, and capacities. It then describes various tools available to assess and diagnose private sector needs and constraints in a particular policy. It then provides examples from several countries and contexts of how competitiveness-related policy actions have been aligned with subnational government mandates. This is followed by a description of likely critical risks that SCGs will face and need to mitigate.

Finally, the section concludes by providing a comprehensive summary of key lessons until this part of the guidebook, organized around the following questions for program designers:

1. When is there a rationale for subnational engagement to promote competitiveness/JET?
2. When is the proposed SCG mechanism relevant to consider (i.e., a conditional fiscal transfer mechanism focused on competitiveness/JET)?
3. When should alternative tools and instruments be used instead of an SCG?
4. What are critical risks that SCG programs need to mitigate, and how?



4.1 SCGs aim to align subnational government mandates with identified private sector needs

If program designers conclude that the SCG could be an appropriate instrument to pursue competitiveness objectives at a subnational level, the next step is to conduct a rigorous diagnostic and prioritization exercise that simultaneously aims to identify the specific needs of the private sector (traded, enabling, and/or domestic sectors¹⁹) and the prerogatives that targeted subnational governments have in influencing the four policy levers of competitiveness.

It is equally important to know what the needs of the private sector are before applying public policy and investment tools to address them, as it is to know what the mandates, incentives, and capacities of the public sector are to meet those needs and whether there is room to expand them to match the scope of needed policy intervention. *Table 1* shows a grid intersecting examples of private sector needs with typical subnational government prerogatives (though these prerogatives can vary widely from one context to the other). Conducting rigorous diagnostics and prioritization along both axes of the framework is critical to informing the design of the SCG, including specific performance conditions or capacity-building activities. The SCG can achieve maximum impact by understanding what serves competitiveness at the firm level locally and empowering subnational governments to pursue relevant interventions within their control or scope of influence. Subnational governments

can also proactively mobilize other levels of government that have mandates relevant to the identified challenges (for example, through interagency agreements, as was the case in Egypt) or form partnerships with the private sector that can yield results (for example, Gaziantep [Turkey], Bucaramanga [Colombia], or Sialkot [Pakistan]).

19. The CSPD Methodology Note defines tradable sectors as mining, agribusiness (including food and beverages), resource-based manufacturing, light manufacturing, complex manufacturing, tourism, and digital services; enabling sectors as digital infrastructure, water, power, transport and logistics, finance and insurance, business services, education, and health; and domestic sectors as construction (including residential and commercial), retail and wholesale trade, and personal services.

Table 1 Competitive Cities framework: Subnational government roles across the four policy levers to improve competitiveness

INSTITUTIONS AND REGULATIONS	INFRASTRUCTURE AND LAND	SKILLS AND INNOVATION	ENTERPRISE SUPPORT AND FINANCE
National government			
<ul style="list-style-type: none"> • Macroeconomic management • National investment and trade policy • Legal framework around property protection • Industry-specific taxes and regulations 	<ul style="list-style-type: none"> • Highways, roads, airports, ports • Power grid • Regulations for infrastructure provision, such as public-private partnership (PPP) laws 	<ul style="list-style-type: none"> • Public education system • Immigration policies to attract talent • Research and development (R&D) funding, support schemes • Health care 	<ul style="list-style-type: none"> • Export and trade facilitation • Access to finance support schemes • Facilitation of seed, catalyst, and risk capital
Governor's or Mayor's wedge Subnational government			
<ul style="list-style-type: none"> • Municipal taxes and incentives • Zoning and land use policies • Construction permits, business licenses • Public safety and law enforcement • Subnational sector and market-specific regulations 	<ul style="list-style-type: none"> • City roads and public transport • Water, sanitation, waste management • Public safety • Public spaces, neighborhood, and slum upgrading • Housing 	<ul style="list-style-type: none"> • Talent attraction programs • Cluster development support • Linking firms with academia 	<ul style="list-style-type: none"> • Business support services (including business improvement districts) • Investment policies, promotion, and aftercare
Private sector			
<ul style="list-style-type: none"> • Standards and certification associations 	<ul style="list-style-type: none"> • Additional infrastructure and shared services 	<ul style="list-style-type: none"> • Vocational training programs • R&D 	<ul style="list-style-type: none"> • Business associations and support networks • Market intelligence and business information • Equity and debt finance

Source: Adapted from World Bank Group (2015)

4.1.1 Assessment and diagnostic of subnational government incentives, mandate, and capacities

Table 1 highlights some of the common areas within subnational governments' remit to influence the four policy levers of competitiveness and support economic transformation. Before designing an SCG, it is critical to accurately assess the resources and authorities of subnational governments to affect competitiveness variables within each of the four policy levers. This is helpful to identify not only limitations or constraints on policy action but also areas where the design of the SCG could help increase their incentives, mandate, and/or capacity to a meaningful level (including in the context of demonstrative pilots which may be possible). Understanding subnational governments' practical policy remit is a critical starting point in the design of SCGs and optimizing it can be one of the biggest impacts of the SCG. This is usually done through an institutional and fiscal diagnostic/assessment of subnational governments which covers these aspects.

Incentives: Local economic diagnostics conducted to inform the design of the SCG can be used to enhance the incentives of subnational governments to pursue competitiveness and economic transformation by creating a horizon of ambition and showing what subnational governments can do to create local jobs and growth. Incentives can also be enhanced with fiscal flows that aim to compensate subnational governments for short-term losses brought on by reforms or strengthen the subnational governments' resolve against vested interests (see Section 4.2 on Australia's productivity commission). A fiscal assessment of subnational governments is critical to establish the budget realities of these governments and determine the optimal fiscal size of the performance grant, relative to their existing revenues. This is important to ensure a sufficient financial incentive relative to existing resources (an incentive too small might not work) and absorptive capacities of the local/subnational government. The increased account-

tability of subnational governments in the implementation of an SCG (for example, through structured PPDs) could also sustain and fuel reforms provided the adequate approaches are used to mitigate capture risks and ensure alignment with market dynamics (*see Section 4.1.2*).

Mandates: It is important to assess and utilize the available mandate of subnational governments for actions which may impact competitiveness of firms. Many successful cities and regions have enhanced growth and competitiveness by maximizing performance within available mandates as well as by creatively exploiting the different levels of de jure and de facto authority to affect the identified competitiveness policy areas. When possible, the SCG can help temporarily and/or marginally expand the existing mandate within the context of operations, including through pilot measures that can be institutionalized subsequently if successful. In areas where mandates cannot be stretched, subnational governments can still play a key role in lobbying other layers of government regarding pro-competitiveness policy actions that are particularly important to firms in their jurisdiction, advocating on behalf of the private sector, facilitating policy dialogue between relevant public agencies and the private sector, or even, when possible, acting directly in partnership with the private sector. For instance, subnational governments can have influence over policy levers not within their control and can still achieve their goal by knowing who to lobby (for example, Bucaramanga in Colombia).

Capacity: Each subnational government has unique and varied capacity levels across different areas. Some key capacity areas for subnational governments include implementation/delivery capacity, technical capacity, and results and risk management²⁰. A diagnosis of subnational government capacity in terms of competitiveness and JET policies is critical to (a) understand the ability of the SCG to address these constraints and exploit these opportunities, which can help set the parameters of the SCG design, and (b) inform the level and types of

capacity building needed to support SCGs in addressing competitiveness and economic transformation/JET policies. For successful implementation of an SCG, it is particularly important for subnational governments to have or build adequate capacity to perform critical planning and governance prerogatives related to competitiveness policy (let alone planning and governance capacity at large, including on public service delivery); engage in processes of economic diagnostics and prioritization of binding constraints and opportunities; facilitate productive dialogue with the private sector²¹ around critical factors for competitiveness and economic transformation/JET; and advocate and cooperate with higher or horizontal levels of government on JET-related policies. Capacity-building needs should define certain design elements of the SCG. For instance, capacity assessment can determine priority areas that subnational governments are required develop before receiving any grant and that could potentially be included as minimum conditions for which partial payments could be made (*see Section 6.1* on eligibility criteria). In view of the traditional gaps in capacity on this topic in subnational governments, capacity-building needs may require additional time and costs which can be incorporated into the program budget and timeline.

20. Instiglio 2018.

21. Sivaev, Dmitry, Benjamin Herzberg, and Sumit Manchanda. 2015. *Public-Private Dialogue for City Competitiveness*.

4.1.2 Assessment & diagnostic of private sector needs and constraints

Addressing key barriers to competitiveness and JET, setting priorities and translating them into actions can be enhanced when informed by a market-oriented analytical process and proactive consultation with the private sector. In contexts of limited public resources and low institutional capabilities, it is imperative for subnational governments to channel development efforts toward those interventions that are most likely to improve productivity and facilitate economic transformation in a city, region, or state. The screening, identification, and prioritization of policy interventions increases in relevance when grounded in (a) an assessment of the current sector mix and development stage of the local economy, (b) analyses on the various markets of the business fabric with a deliberate attention to mitigating risks of capture by incumbents and promoting economic transformation, and (c) a shared long-term vision oriented toward growth on national and global markets, in view of the high impact tradable sectors have on employment and economic growth in cities and regions.²²

Program designers can use an array of tested private sector diagnostic tools and analytical methodologies. In some cases, diagnostics are conducted through a top-down approach in which prioritization is led primarily by the national government, which establishes the key policy areas for subnational government focus. The CPSD framework can be particularly useful—adapted to the subnational level—for a top-down diagnostic approach, and its private sector-led growth framework aligns almost exactly with the Competitive Cities framework and its companion papers on the topic (*Figure 6*). The growth enablers in the CPSD approach correspond to the four policy levers—with the nuance that access to output and input markets is analyzed separately from access to finance (in the

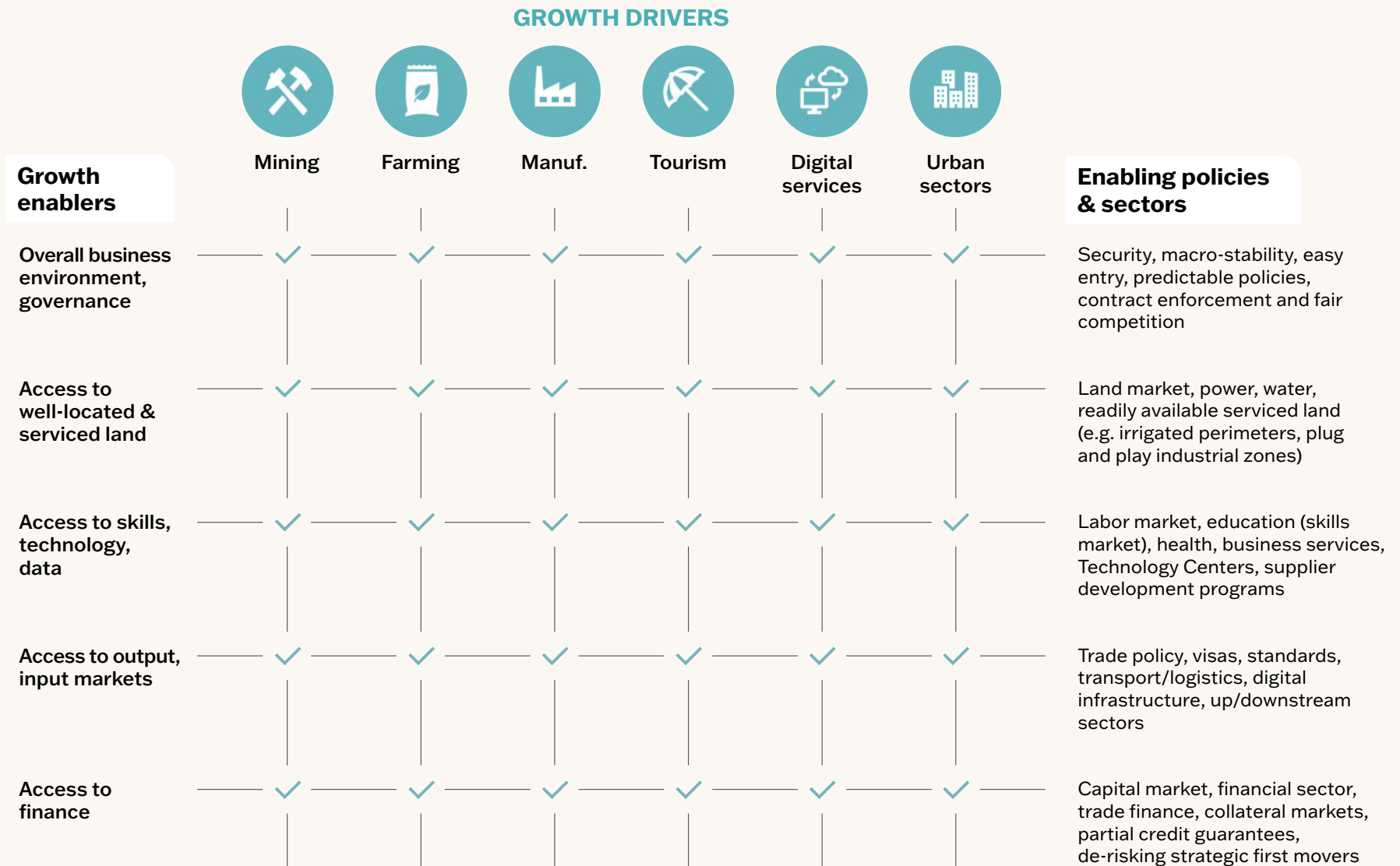
22. World Bank (2015). See also *Figure 1*, which shows that growth in jobs in the top 10 percent of successful cities is primarily generated by tradable sectors rather than non-tradable sectors.

Competitive Cities framework the two are combined under ‘SME support and access to finance’). As a pilot, the CPSD framework was slightly adapted for subnational-level analysis in the Upper Egypt context. The 10 guiding questions of the CPSD (*Box 2*), applied at the subnational level, can be a useful starting point in orienting the scope of the private sector diagnostic. It must be noted that a CPSD approach can be implemented in three to six months, adjusting to the level of detail needed for project preparation and/or implementation.

Such a top-down approach is improved when complemented by a bottom-up approach that allows a more granular understanding of private sector needs and a more continuous feedback loop as sectors evolve. Decisions on what incentives, services, infrastructure, and regulations could then be pursued in a specific city or region based on inclusive and analytically underpinned PPDs at the cluster level. An engaged private sector—individual firms and cluster/sector agents—can contribute value during the design stages and increase participation during implementation (as SCG beneficiaries). The Competitiveness Reinforcement Initiative (CRI) approach is particularly useful to structure such a bottom-up diagnostic and advise the private sector on strategic markets; advise policy makers on relevant interventions; build the capacity of subnational governments to conduct and sustain the facilitation of these periodic PPDs and diagnostics over the years of implementation and beyond,²³ with replicability across all clusters, allowing a continuous feedback loop for policy makers; and avoid capture by incumbents and vested interests.

23. Capacity for such an approach cannot be built at every level of government. Building capacity in every municipality and town, for example, might not meet the minimum conditions to achieve impact and sustainability. A critical scale is important to ensure that the geographic scope of engagement by trained units (to facilitate CRIs) reasonably correlates to the economic geography, whether it is cities, metropolises, regions, or economic corridors.

Figure 6 County Private Sector Diagnostic: Growth enablers and growth drivers



Source: Adapted from World Bank (2021)

Box 2 Country Private Sector Diagnostic - Snapshot of methodology

Answering these questions will help capture the context, the most pressing development challenges, and the role the private sector plays or could play to address these in the near term.

→ Contextual questions:

1. What are the city or region's main development challenges that the private sector can help address in the near term?
2. What is the state of the private sector, what are its main characteristics, and what role does it play in the city or region's development?

→ Analytical questions:

3. Which policy issues are major cross-cutting constraints to private sector-led growth?
4. Which enabling sector issues are major constraints to the private sector?
5. In which enabling sectors can the private sector contribute as an innovator, operator, or financier? Which actions can be taken to facilitate more private sector engagement and investment?
6. In which tradeable sectors can the private sector drive growth and the creation of more and better jobs? Which actions can be taken to better support private sector growth and investment?
7. In which domestic sectors can the private sector drive growth and the creation of more and better jobs? Which actions can be taken to better support private sector growth and investment?

→ Synthesis questions:

8. Where are the most important and feasible opportunities for private investment to transform or create markets in the near term?
9. Which actions (cross-cutting, sector specific) could have the greatest impact on unleashing private sector growth? How can these be prioritized based on impact, urgency, and feasibility?
10. How to get started with implementation and how could the WBG help?

As firms are proactively consulted and encouraged to follow up the analysis-to-action process, they gradually take ownership of the diagnostic which may result in increased awareness and interest by policy makers and a higher incentive to follow through on implementation (*see Annex 2* for more details on this approach).

Other relevant tools that could be utilized include the *Competitive Cities growth pathways tool* developed by The World Bank Group, the *Growth Diagnostics methodology*, and most recently, the *Metroverse tool* developed by Harvard University. When choosing the most appropriate diagnostic and prioritization tool, the appropriate unit of analysis which is most relevant to inform SCG design within the local context needs to be determined. Different tools are more appropriate to different phases (design phase or implementation phase—as part of the rollout). *Annex 1* includes a comparison table of distinctive attributes to consider when choosing and implementing diagnostic and prioritization tools, while *Section 4.2* provides global examples of how some of these types of analyses have been used to inform private sector-oriented performance-based programs at the subnational level.

Irrespective of the tools used, the SCG aims to promote a built-in capacity in local governments so that the diagnostic and prioritization become iterative processes that are periodically repeated to adapt to evolving circumstances, refine interventions, learn from implementation, and ensure that investment and reform planning cycles are informed by dialogue with the private sector. Subnational governments could become the custodians of a continuous and circular process of analysis, design, implementation, impact evaluation, learning, and redesign. If there is critical mass in diversity and size of economic activity, local governments could build these diagnostic and prioritization skills internally through dedicated staff. Alternatively, this capacity could be brought in by hiring, supervising, and facilitating bottom-up diagnostic and prioritization implemented through third parties (private sector consultants or dedicated development agencies).

4.2 Examples of aligning competitiveness policy action with subnational government mandates

4.2.1 Subnational state level

In Australia, the National Competition Policy (NCP) was anchored in a diagnostic and prioritization exercise that created consensus on the substance of reforms that subnational states had to pursue and an alignment across levels of government for their implementation. The Hilmer Report was grounded in empirical analysis of existing challenges and opportunities facing the private sector and found that while initial reforms were largely within the purview of the Commonwealth (that is, federal) government, subsequent areas of structural policy reform increasingly fell within the control of state and territory governments. The national analysis was deeply informed by the nature of the respective markets in each jurisdiction, and even though the constraints to growth were identified at the national level, the benefits of their removal were quantified at the state level to get state buy-in. The overall reform agenda of the NCP was nationally agreed, but it was negotiated through a consultative process and largely initiated by the states. Lower levels of government had flexibility in setting their approach to achieving the reform outcomes. Reforms were set in terms of principles rather than outputs, so states could set their own implementation approach that fit the principles of the NCP and select the appropriate metrics to assess implementation. PBGs were utilized to incentivize states to implement the reform agenda and to support states in resisting political economy opposition to reform by sharing the fiscal benefits of reform. The NCP, with the Hilmer Report as its blueprint, successfully aligned policy priorities with jurisdictional incentives and mandates through a mechanism for national reform coordination that utilized fiscal and institutional arrangements to prioritize and coordinate pro-competition reforms across all jurisdictions.

Since the official conclusion of the NCP (which was implemented from 1995 to 2005) there have been very few, if any, reversals of specific reforms. A 2015 Competition Policy Review provided a comprehensive assessment of the competition framework in Australia and made 56 recommendations to further enhance competition policy at both State and Commonwealth level, reshape competition institutions, and modernize and simplify competition law. Many of the recommendations outlined in the review have already been implemented, while others are still ongoing.

In Mexico, a national productivity program, led by the National Productivity Commission, established State Productivity Commissions aimed at increasing productivity at the subnational state level through public-private collaboration. The initiatives were underpinned by a diagnostic of the drivers of productivity growth and performance at the state and sector levels, which used the *growth diagnostic methodology* that builds on the link between aggregate private investment and economic growth. The diagnostic used data from the *Atlas of Economic Complexity of Mexico*, which utilized the economic complexity methodology to showcase the current economic structure, product space, and potential growth opportunities in each state. The program funded 16 subnational economic complexity studies based on the same data, which were intended to inform the state-level productivity plans and thus serve as a frame of reference for decision-making to firms, investors, and state governments and to contribute to increases in productivity in their respective environments. Policy recommendations and targets in the state productivity plans focused on entrepreneurship, skills,

investment attraction, innovation, and business environment (informality, labor legislation, and regulatory issues). Although the State Productivity Commissions were meant to identify the most impactful policy priorities and reflect them in the respective state productivity plans, the commissions had very little power to influence the actual policy decision-making process, and state governments had no incentive to heed their recommendations and stopped participating due to lack of budget, absence of technical capacity support, and competing interventions that were conducted simultaneously.

4.2.2 Provincial level

In Egypt, the World Bank-supported Upper Egypt Local Development Program (UELDP) aims to directly empower governorates (that is, provinces) to improve the local business environment and enhance firm competitiveness. The diagnostic and prioritization exercise that underpins the design of the competitiveness grant in Egypt is entirely driven and implemented at the governorate level. The governorates conducted a series of CRIs (*see Annex 2*), which intertwine industry analysis with inclusive PPDs to inform policy definition and prioritize public-private interventions, thereby increasing the incentive and accountability to perform on this agenda. The importance of defining the local conditions of firms and sectors and designing relevant and effective interventions is embedded in the design of the SCG through performance metrics (PMs), the achievement of which is linked to funding. An essential aspect of the CRI approach and a special emphasis of the program is to build the local administrations' capacity to facilitate this process as an iterative feedback loop used to identify, prioritize, and address sector-specific and economywide constraints continuously over time. The minimum access criteria (MAC) for this grant contribute to the capacity-building objective by requiring governorates to commit to developing these capacities as an eligibility criterion to participate in the grant. Since CRIs can only be conducted during implementation (with the necessary staff, resources and time), a subnational application of the WBG's CPSD was also piloted in the Upper Egypt region to identify preliminary cross-cutting constraints and enablers in additional governorates during a short program expansion phase. This 'subnational CPSD' helped inform the definition of the first round of PMs. The subsequent rollout of the CRIs would then help refine the identification of constraints and solutions, ensure strong buy-in by the private sector, and initiate the iterative feedback loop.

The SCG in this program also expanded the governorates' mandate to implement competitiveness policies. This policy area tends to be outside the mandates of governorates in Egypt despite their critical role in the outcome, but the program, after making governorates more cognizant of their potential influence on competitiveness and more invested in developing the relevant skills to pursue it (in part through the CRIs), also provided them with tools that could increase their ability to act through PPPs. The additional funds received through the grants are discretionary, so governorates have the flexibility to decide how to use these resources and can prioritize capital investments which are deemed important for local development. The SCG allowed governorates to sign interagency agreements, which allowed them to leverage the flexibility of grant use to contract out services and hold other delivering agencies—including central and deconcentrated ones, with larger or complementary mandates—accountable for achieving a certain level of performance. This allows governorates to take on responsibilities that are typically outside of their legal prerogative and expand what is within their manageable control. Through this innovative combination of tools and analytical approaches, this program aims to increase the incentive, capacity, and mandate of governorates to affect competitiveness.

4.2.3 City level

The city of Sialkot, Pakistan, is a unique example in the country of how competitiveness enhancing measures can potentially be pursued by local governments through a partnership with the private sector. In fact, the private sector of Sialkot was the driving force behind the diagnostic and prioritization of competitiveness-driven reforms and investments as well as the leader in successful coalitions with various levels of government and primary investor in critical infrastructure supporting local clusters and industries. The city is an export hub and home to a century-old light manufacturing cluster holding the dominant global market share in soccer balls and surgical instruments manufacturing. The cluster has benefitted from the co-location of leading firms and suppliers, specialized labor pooling, knowledge diffusion, and so on. The private sector has driven local economic development through capable and cohesive interventions. Despite the limited formal power of the local government, the cluster has worked with the local, provincial, and federal governments to develop the region through the financing of an international airport and exhibition center, which have provided direct access and a one-stop shop for international buyers. Support from various levels of government has included land for the airport, authorization for direct international flights, especially to Dubai and Qatar, preferential visa treatment for buyers and investors, a new motorway, and an entrepreneurial support fund operated by the Sialkot Chamber of Commerce and Industry. Other examples have been documented in the Competitive Cities report where various towns (for example, Gaziantep, Turkey) and regions (for example, Bucaramanga, Colombia) with limited powers proactively identified the most relevant policy interventions to improve the competitiveness of their local firms and the transformation of their economy and took the leadership in partnering with multiple layers of governments and the private sector to achieve greater impact.

4.3 Critical risks that SCGs need to mitigate

The following are some of the most critical risks that SCGs would need to mitigate to maximize their development impact:

- **Capture.** When conducting PPDs, there is a risk that the process includes only actors that already benefit from the status quo and reduces competition from incoming actors. The risk can be mitigated through CRIs or similar bottom up PPD approaches that could ensure inclusive representation and focus the analysis on opportunities beyond the status quo. For example, In Upper Egypt, conducting CRIs is a PM for the competitiveness grant. Sectors for the cluster initiatives were identified by the governorates through participatory PPD processes, and broad participation of local firms was a safeguard against capture.
- **A theory of change (TOC) that is too prescriptive.** Outlining specific and rigid outputs, outcomes, and impacts to be achieved can fail to adequately capture and reward progress. The risk can be mitigated by allowing a flexible TOC that can be adapted to fit local context or changing circumstances. For example, in the Australian NCP, the goals were formulated as general principles and states were given implementation flexibility to choose the most efficient and effective path to achieve the broad reform goals. This gave implementing agencies the ability to experiment and be agile.
- **Inadequacy of PMs.** The chosen PMs and eligibility criteria might not be aligned with the targeted impact or fit to subnational government capacity or remit. The risk can be mitigated by designing the SCG based on diagnostics that aim to calibrate the performance scale to be ambitious without being out of reach. For example, in the EU, metrics were too low in the TOC. The focus on activities and outputs left no way to measure the impact that Cohesion Policy funds might have had on firm-level performance. This can also incentivize governments to showcase effort (number of incubators built) versus results (number of startups launched). The metrics could also be too high and unachievable (or outside the scope of subnational governments), which could exclude some governments with lower capacity that could nonetheless benefit from a tailored intervention.
- **Faulty or complicated operational arrangements.** Implementation or verification mechanisms could be burdensome or unclear. This risk could be mitigated by ensuring that implementation arrangements are informed by stakeholder mapping and clearly spell out roles to avoid overlap, conflict, or gaps. For example, in Mexico, the State Productivity Commissions were meant to identify the most impactful policy priorities and reflect them in the respective state productivity plans, but the commissions had very little power to influence the actual policy decision-making process, and state governments had no incentive to heed their recommendations.
- **Low institutional sustainability.** SCGs might promote arrangements and solutions that are too alien to national fiscal and regulatory systems. This risk is best mitigated if grant mechanisms rely on existing fiscal transfer mechanisms to the extent possible and align with existing planning and budgeting cycles. Utilizing native institutional arrangements (and incrementally improving them during implementation as needed) can greatly facilitate the take-up and sustainability of the program beyond the life of the project.

4.4 Frequently Asked Questions and Answers on the rationale and relevance of SCGs

This section provides a comprehensive summary of key lessons until this part of the guidebook, organized around the following questions for program designers:

When is there a rationale for subnational engagement to promote competitiveness/JET?

*When is the proposed SCG mechanism relevant to consider?
(i.e., a conditional fiscal transfer mechanism focused on competitiveness / JET)*

When should alternative tools and instruments be used instead of an SCG?

What are critical risks that SCG programs need to mitigate, and how?

When is there a rationale for subnational engagement to promote competitiveness/JET?



When identified critical failures which prevent private sector growth and job creation are largely subnational in nature, and national/central governments are less effective in addressing them

Many market & government failures impeding competitiveness are subnational in nature

EXAMPLES

- Deficient local infrastructure & services
- Lack of local positive externalities (e.g., economies of agglomeration, specialization) due to coordination failures at cluster level (e.g., Peru and Upper Egypt)
- Local red tape or barriers to competition (e.g., Mexico, Peru, and Russia)
- Low access to connected, serviced or secure land (e.g., Pakistan)
- Presence of local negative externalities (e.g., insecurity, environmental issues)



Diagnostics tools (see Section 4.1.2) can help identify barriers to competitiveness and determine the relevance of subnational engagement

Various stakeholders and levels of governments have a role in resolving subnational market & government failures

EXAMPLES

National government

National governments often resolve local market & government failures (e.g. **Chile**), but experience shows subnational governments can be more effective in some cases

Subnational government

In **Australia**, the NCP was successfully implemented with active initiative & participation of states and territories since the principles of competition policy reforms were within their functional role

In **Bucaramanga (Columbia)**, the subnational government identified the region's key economic development priorities and led the creation of a Regional Competitiveness Commission that coordinated implementation

Local private sector

In **Sialkot (Pakistan)**, the local business association lobbied the government to build an international airport (co-financed by the private sector) to resolve local market failures and facilitate exports



Diagnostics of subnational governments (see Section 4.1.1) can define their functional remit in affecting competitiveness relative to other levels of government, advise whether subnational engagement is feasible, and in which policy areas partnerships are necessary to achieve impact

When is the proposed SCG mechanism relevant to consider? (i.e., a conditional fiscal transfer mechanism focused on competitiveness / JET)



When limited capacities, mandates, and/or incentives are critical barriers for subnational government to increase competitiveness

What prevents subnational governments from resolving subnational competitiveness issues?

Limited capacity

- Lack of institutional capacity to efficiently spend available resources (e.g., weak planning, procurement, financial management)
- Lack of technical capacity to identify critical constraints to competitiveness through market oriented PPDs, engage relevant expertise, or design & supervise services to address coordination failures in clusters or inadequate economic infrastructure

Limited mandate

Limited (but expandable) institutional authority to affect identified market, coordination, or government failures, such as improving centralized regulations and business services (e.g. SME registration and land use, upgrading of local economic infrastructure or centralized services such as industrial zones, regional roads, sanitation services, labor force training etc.)

Limited incentive

- Lack of financial resources to invest in competitiveness given other competing needs
- Personal incentives of local decision makers not aligned with incentives to pursue competitiveness
- No structured and transparent accountability to private sector actors
- No clear vision/understanding of role and impact



Section 2 expands on the functional roles of subnational governments

How can SCGs support subnational governments to resolve competitiveness constraints?

By increasing capacity

- Improve technical & institutional capacity for private sector development diagnostics and PPDs through improved training and technical assistance
- Improve absorption capacity of financial transfers
- Improve local governments' ability to advocate to higher levels of government and mobilize partners such as the private sector

By increasing mandate

- Temporarily or marginally expand mandates through pilots that can demonstrate effects of decentralization (e.g., Upper Egypt's MOUs between local government and central agencies on loan proceeds)
- Proactively mobilize other levels of government that have relevant mandates through Disbursement Linked Indicators at the appropriate government level

By increasing incentive

- Make subnational governments more accountable to private sector through dialogue & transparency
- Show what is feasible and create horizon of ambition through preliminary diagnostics
- Provide fiscal transfer as financial incentive — it can be a sufficient incentive in combination with other measures



Section 3 expands on the value add of PBGs to address competitiveness

When should alternative tools and instruments be used instead of an SCG?



**When the administrative/
governance map is substantially
divorced from the economic map**

National-level private sector development programs/projects

Relevant when most policy levers to support subnational competitiveness are influenced at the national level, or when subnational administrative units are not aligned with economic geography (e.g., when firm clusters cross multiple jurisdictions)



**When political
economy barriers to
decentralization exist**

National-level private sector development and competitiveness programs/projects

Relevant when higher levels of government have strong incentives to retain centralized control over policies, spending etc.



**When financial rewards
cannot incentivize
performance**

Subnational indexes and rankings of relative performance (e.g., City Competitiveness Index)

Relevant when subnational governments have funding but no capacity or mandate to implement reforms (e.g., some mining regions in Peru). Relative ranking of subnational performance on business environment indices can be sufficient reform incentive when visibility is important for attracting FDI (e.g., Pakistan, Indonesia)



**When critical issues at subnational
level are mostly related to
governance & institutional
weaknesses**

Traditional PBG programs to improve subnational institutional performance or other similar tools

Relevant when subnational governance capacity is too low (or governance challenges too high) to be able to effectively work on private sector issues, and needs to be improved before SCG can be viable



Section 3.4 shows circumstances when SCG is not the right fit

What are critical risks that SCG programs needs to mitigate, and how?

<p>Weak contestability in the private sector</p> <p>PPD includes only actors that already benefit from the status quo and reduces competition from incoming actors</p>	<p>Theory of change that is too prescriptive</p> <p>Outlining specific and rigid outputs, outcomes, and impacts to be achieved</p>	<p>Inadequacy of performance metrics</p> <p>Selected metrics are not aligned with the targeted impact, subnational government capacity or remit</p>	<p>Faulty or complicated operational arrangements</p> <p>Implementation or verification mechanisms are burdensome, unclear or with diffused responsibility</p>	<p>Institutional sustainability</p> <p>Promoting arrangements that are too alien to national intergovernmental and regulatory systems</p>
MITIGATION				
<p>Ensuring inclusive representation and focusing analysis on opportunities beyond the status quo</p>	<p>Allowing a flexible theory of change adaptable to local context or changing circumstances</p>	<p>Designing SCG based on diagnostics to calibrate performance scale to be ambitious but not out of reach</p>	<p>Implementation arrangements be informed by stakeholder mapping and spell out roles to avoid overlap, conflict, or gaps</p>	<p>Designing SCG by relying on existing intergovernmental fiscal & institutional systems to the extent possible</p>
EXAMPLES				
<p>In Upper Egypt, conducting CRIs was a metric for the SCG. Sectors for cluster initiatives were identified by subnational governments through participatory PPD processes. Participation of local firms mitigated against capture</p>	<p>In the Australia NCP, goals were formulated as general principles and states were given implementation flexibility to choose the most effective path to achieve them</p>	<p>In EU Cohesion Fund program, metrics were too low with focus on activities and outputs. Impact of funds on firm-level performance was not measured directly. This can also incentivize grant recipients to showcase effort (number of incubators built) versus results (number of startups launched)</p>	<p>In Mexico, State Productivity Commissions were meant to identify impactful policy priorities in the state productivity plans, but had little power to influence decision-making, so state governments had no incentive to heed their recommendations</p>	<p>Utilizing existing institutional arrangements (and incrementally improving them during implementation) can greatly facilitate program sustainability</p>



Section 4.3 highlights the critical risks that SCGs need to mitigate to ensure success

5

How to *develop* an SCG program: Phases, components, and key design considerations

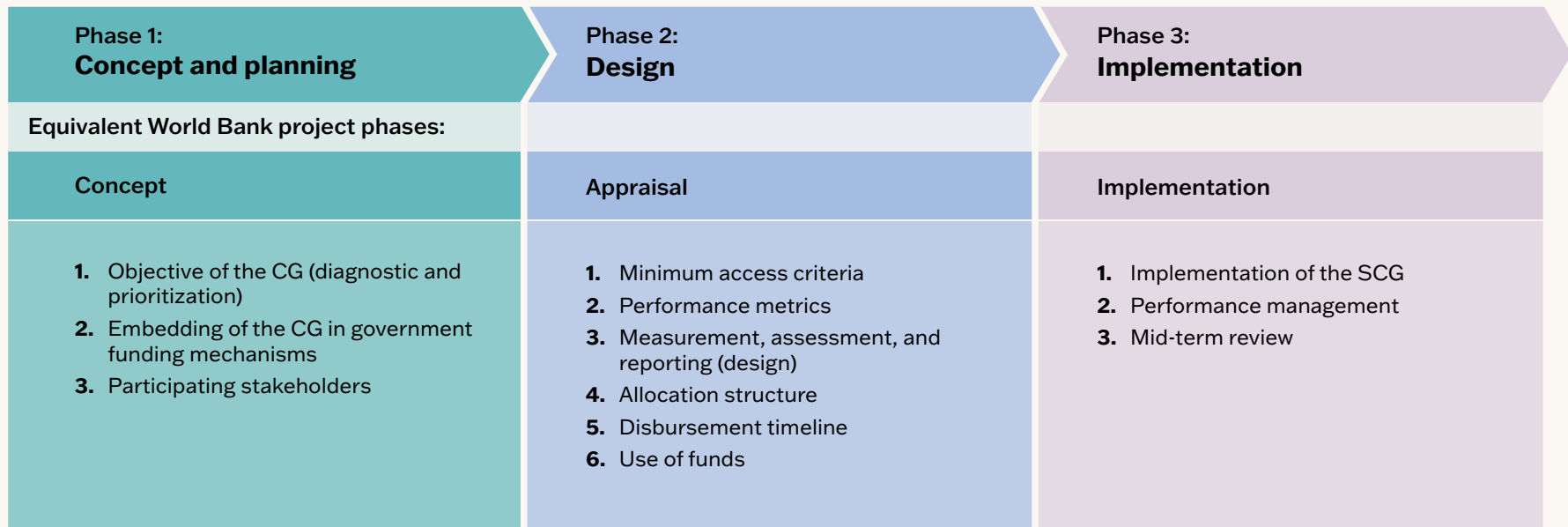
This section introduces the basic components of conceptualizing, designing, and implementing an SCG, by providing a simplified view of the SCG process and its basic building blocks. It first describes the concept and planning phase, where the program objectives and theory of change of a SCG program is developed, informed by diagnostics and prioritization exercise. It introduces the importance of ensuring that the SCG program is embedded into the existing intergovernmental fiscal transfer framework of a country/context. It then introduces the various aspects of designing an SCG mechanism, including key concepts such as eligibility criteria; performance metrics; measurement, assessment, and reporting; the financial allocation structure for program financing; and the SCG funds disbursement timeline. It concludes by introducing the various aspects of program implementation.



Photo: Simone D. McCourtie / World Bank

The basic components of an SCG—across the three phases of concept and planning, design, and implementation—are outlined in *Figure 7*. These three phases—and specific activities therein—are not necessarily sequenced linearly in practice but are often done through an iterative process, as noted in *Section 4*.

Figure 7 Simplified approach to the SCG process



Note: CG = Competitiveness grant.

5.1 Phase 1: Concept and planning

The concept and planning phase of an SCG program is fundamental to define its objective and high-level parameters. This phase draws substantially on the various diagnostics conducted to inform this activity.

5.1.1 Objectives and Theory of Change of a SCG program, informed by diagnostics and prioritization exercise

The findings of the diagnostic and prioritization analyses that are conducted during the concept and design stages are fundamental to the SCG process since they define the specific competitiveness and JET policy areas on which the SCG could focus and the incentives, mandate, and capacity of the subnational government to influence them. The specific policy areas define the SCG PMs, which subnational governments would aim to achieve and to which they would be held accountable. For example, some contexts are rife with horizontal barriers (for example, bureaucratic burdens) while other contexts face vertical barriers to a sector or group of sectors (for example, trade-related connectivity/infrastructure) or factor-level barriers (for example, access to land or qualified labor in the city or lagging region).

In this phase, program designers may use the relevant diagnostic and prioritization tools to explore the following fundamental question: *What is the ultimate outcome or impact we intend to achieve with this specific SCG, and how does this respond to the reform agenda?* The development objective of the SCG would need to be contextualized to the needs of the region/city and focused on policy areas where its incentive scheme adds most value to local firm-level competitiveness and economic transformation/JET.

Once the objective and prioritized policy areas of the SCG have been defined, and the subnational policy mandate to influence competitiveness and JET has been optimized, the preliminary diagnostics and prioritization can be used to build a TOC that serves as the thematic backbone of the SCG incentives design. A TOC is a thorough map of the intervention that illustrates the causal pathway of the program. Constructing the TOC starts with defining the goal of the intervention. Then, a chain of results (that is, pathway) is articulated, mapping how the activities and inputs translate into outputs and, consequently, how outputs deliver outcomes, impact, and the long-term desired goal. Thus, the TOC is used as a methodological tool from which SCG designers can identify the potential PMs for the SCG's incentive structure.

A strong TOC generally reflects the priority policy areas and major constraints identified during the diagnostic and prioritization process. For instance, if G2B services are identified as a priority policy area for the context in which a particular SCG is expected to be implemented, the TOC can be structured to display related activities (e.g., digitalization of business licensing services), outputs (for example, business licensing processes more streamlined), outcomes (e.g., increased formalization of firms), and impact (e.g., increased competitiveness via increased formal employment) in a causal pathway.

Example 1 Objective of the UELDP

The UELDP's objective is to improve the business environment for private sector development and strengthen local government capacity for quality infrastructure and service delivery in select governorates the lagging region of Upper Egypt. It comprises two subprograms: Subprogram 1 aims to improve business environment and competitiveness in these governorates through a competitiveness grant and Subprogram 2 aims to improve local capacity and access to quality infrastructure and services for citizens through a PBG. Since July 2020, both grants are based on a PBG approach aligned with the government's planning, budgeting and financing cycle, and are implemented in synergy - making Subprogram 1 the first SCG supported by the World Bank.

The UELDP SCG focuses on three constraints that were considered binding to the competitiveness of firms: efficient G2B services (in addition to citizen services more broadly), adequate PPD facilitation capacity to help inform local capital investment plans, and adequately serviced land for industrial activities. The PPD aspect is, by the same token, a way to ensure that targeted subnational governments acquired the capacity to periodically update the diagnostic as well as gradually refine it based on the specific needs of the clusters in targeted territory.

The program uses existing IGFT mechanisms. Upon achievement of annual performance indicators, the Ministry of Finance transfers program funds to the subnational governments commensurate with their performance, and is monitored by the Ministry using official budgeting rules.

5.1.2 Embedment of the SCG program in intergovernmental fiscal transfer framework

All PBG programs, as well as a SCG program, will perform best if they are embedded within into existing national intergovernmental fiscal frameworks systems for fiscal transfers, program oversight and accountability.²⁴ This often entails providing direct transfers of funds from a central agency, like the Ministry of Finance to the local or subnational government. In addition, since the SCG program is embedded within an IGFT mechanism, oversight of the system is typically entrusted to a national/provincial government ministry or department in charge of finance, subnational governments, planning, or competitiveness matters. An inter-ministerial/inter-agency Steering Committee can also be established to jointly oversee the process. Utilizing IGFT mechanisms also avoids incurring additional transaction costs associated with the development and operation of parallel systems, and increases the likelihood of stronger coordination in the fiscal transfer timeline and, consequently, of timely funds to subnational governments. It also contributes toward the sustainability of the program and increases subnational governments' accountability to higher levels of government.²⁵ An SCG program embedded in IGFTs can leverage existing sources of funds for subnational governments intended for competitiveness policies, adapting them to the SCG program design.

24. See World Bank 2022 and UNCDF 2010.

25. See World Bank (2022) and UNCDF (2010).

5.1.3 Participating stakeholders: Incentivized agents (subnational governments) and higher tiers of government

The set of participating subnational governments can range from nationwide to a more targeted or differentiated approach where one or multiple subnational governments are selected as SCG participants. From a technical perspective, the selection of the number of participating entities can be guided by multiple factors, including financial considerations. If resources are limited, it may be recommended to limit the number of participating subnational governments to allow for sufficient financial incentives for each.²⁶

Example 2 Number of participating subnational government in similar programs

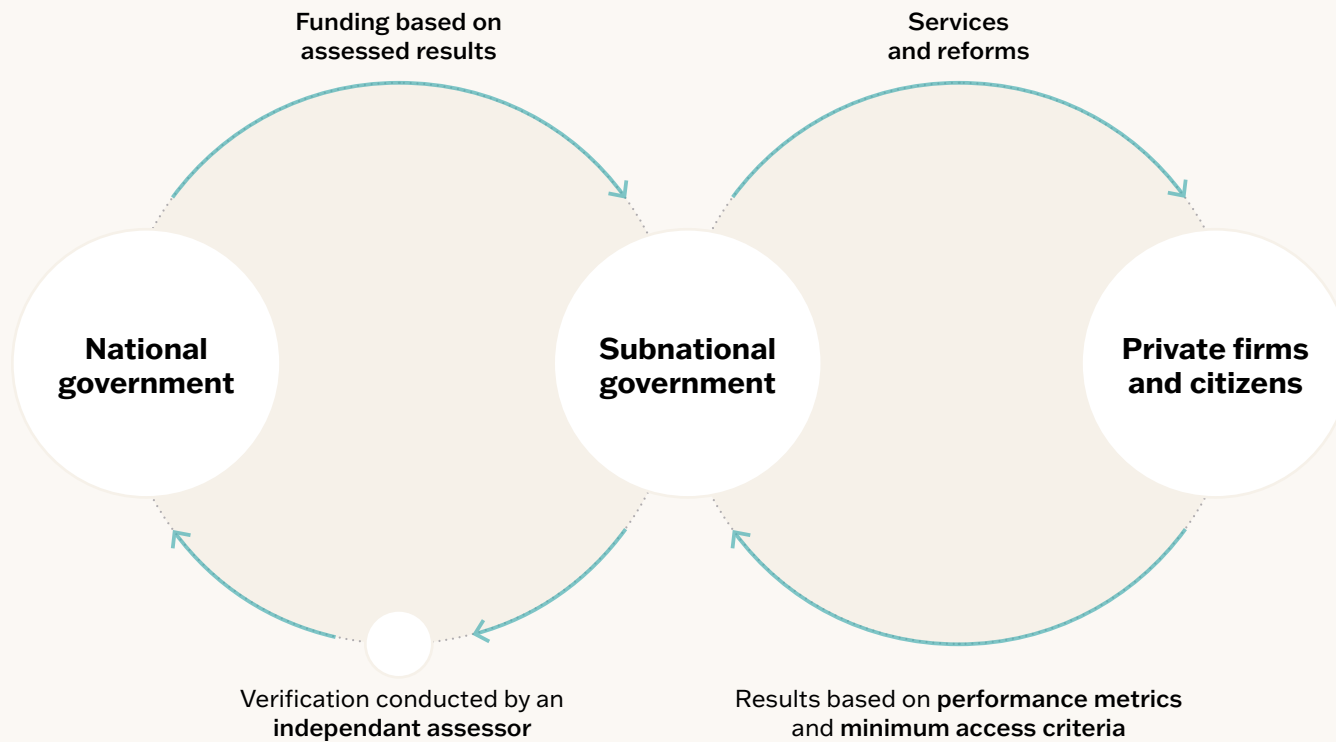
Existing subnational competitiveness programs have incentivized different varieties of subnational governments. In UELDP the SCG program includes four governorates while the Australian NCP included all its eight states and territories, and Mexico's subnational State Productivity Commissions included all 32 states in partnership with States and Governors and the National Council for Regulatory Improvement (CONAMER). On the other hand, China's Torch program, the indigenous innovation in renewable energy, and the industrial upgrading initiatives, incentivize subnational governments and park/zone authorities both at the institutional level and at the level of individual career officials.

26. See Instiglio (2018) for discussion on incentives under results-based financing programs.

5.2 Phase 2: Design of the SCG mechanism

The design elements of the SCG are informed by the concept stage and associated diagnostics. The core design elements are introduced below and detailed in the subsequent sections. *Figure 8* presents a generic design of an SCG.

Figure 8 Illustrative example of an SCG (and PBG) program implementation structure



Minimum access criteria (MAC), also known as eligibility criteria,²⁷ represent a set of conditions that are basic requirements that all subnational governments (program participants) need to comply with to access funding allocated to the PMs. Satisfaction of these criteria is often binary (that is, a yes/no trigger), and when subnational governments demonstrate compliance with MAC, they become eligible to receive the payment tied to the achievement of PMs. The MAC comprise criteria distinct from the selected PMs and, if tied to funding, are separate from the funds allocated specifically for PMs. An SCG design might not include MAC if the subnational government is already compliant with these basic requirements, thus making MAC an optional component.

Performance metrics represent the specific results the subnational governments need to achieve to receive payments. Thus, PMs define what success of the SCG means. It is recommended that the PMs be linked to market and coordination failures that constrain competitiveness or economic transformation in the subnational jurisdiction, and that they target the intended focus areas identified in the diagnostic.

Measurement, assessment, and reporting are the processes of collecting and reporting accurate data on the results of a subnational government against established targets or milestones. Assessment is a key element to guarantee that what is paid for is valid and objective. Designed and defined well, an assessment mechanism reduces the risk of disagreement over the level of results achieved.

Financial allocation structure defines the level of program financing commensurate with the achieved results. The allocation structure often includes (a) target setting: the expected level of performance for each PM that will trigger grant disbursement to the subnational governments; (b) relative weights across metrics: the relative portion of the total financing that will go into each indicator, and between MAC and

PMs; (c) allocation function: exact amount of financing, in monetary terms, for each unit of result achieved; (d) the over-performance gap: any extensions to the disbursement cap to reward extraordinary performance, and (e) the relative share of funds for participating subnational governments — how the total program funding pool is to be allocated across all participating subnational governments. Determining the appropriate level of financing for a subnational competitiveness grant is a delicate balancing act, since the grant amount needs to provide a sufficient financial incentive to subnational governments to expend the effort required to meet program conditions to access funding, while also covering the cost of implementing the interventions, while without exceeding the participating entities' absorptive capacity. Implementation experience from PBG programs supported by The World Bank points to the importance of strong incentives and facilitating the implementation of meaningful actions for improved local competitiveness outcomes. The share of SCG funds, relative to other funding streams and budgetary resources of subnational governments, needs to be substantial enough to provide a sufficient incentive. The grant allocation function also contributes to establishing this incentive structure: an improvement in performance by a subnational government should lead to a corresponding increase in access to funding, or else the incentive and impact of the SCG will be diluted.²⁸

Since many interventions that support local private sector growth will be defined through a discovery process, the determination of financial allocations, targets, and relative weights could also follow a flexible approach and anticipate the likelihood that such allocations could be changed or re-allocated between components during implementation. The size of the initial grant allocation could be determined based on what is already known about basic or cross-cutting private sector needs. As stakeholder buy-in increases and the diagnostics become more precise, policy interventions and investments will be defined and costed increasingly more clearly and thus

27. Also referred to as minimum criteria, minimum conditions, and minimum mandatory conditions in the context of PBGs.

28. See World Bank (2022) for lessons and good practices on key design factors for financial allocation structure for PBGs.

a regular and iterative revision of budgets and targets could be built into the grant design (though not very frequently, *see section 5.3* for risks of frequent design updates). In such cases, if it is seen that the initial allocations for SCG funding will likely be insufficient to fully execute planned/budgeted expenditures, such a financing gap may be absorbed and filled by other sources of revenue or financing available to these entities, such as other fiscal transfers, own-source revenues, prior unspent funds, etc. However, if the funding gap persists and other revenue/financing sources are not sufficient, period reviews of the SCG program (*see section 5.3*) present an opportunity for more substantial rebalancing between milestones and expenditures and determining the size and timing of the flow of funds.

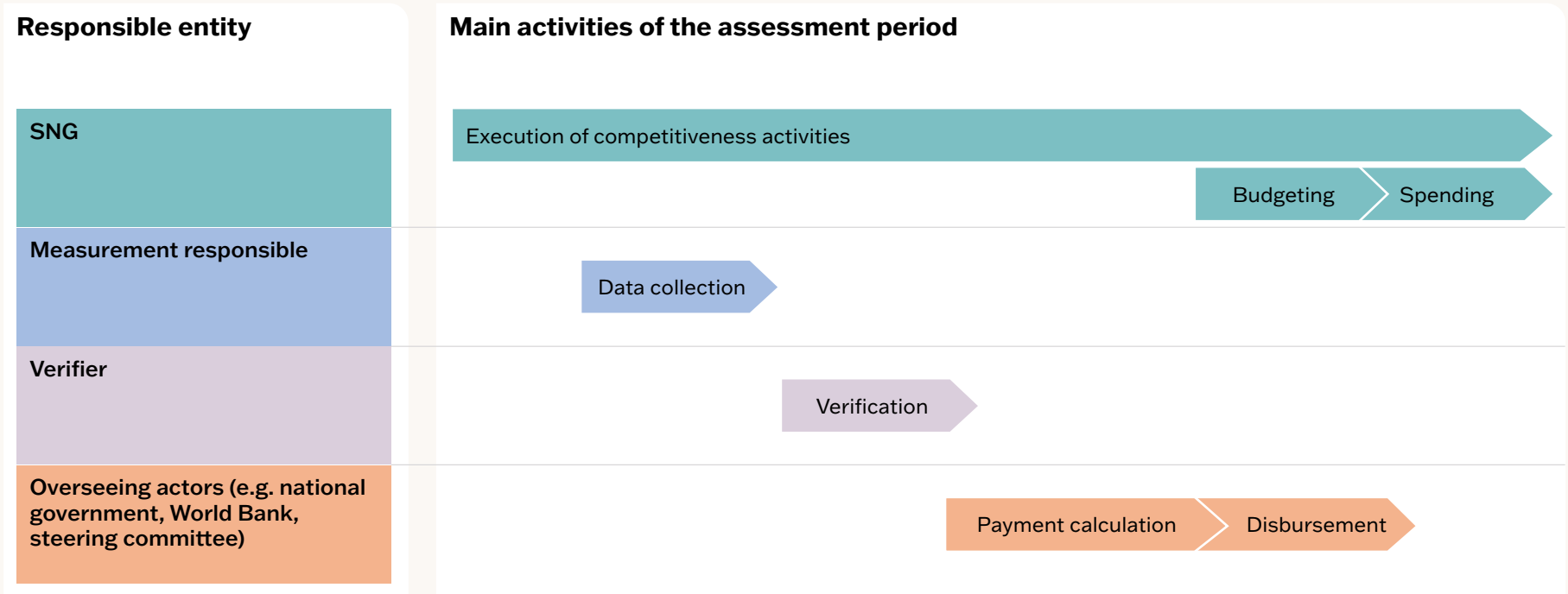
Grant funds disbursement timeline is the process through which financial disbursements are made. A stable and reliable timeline and flow of funds are key to providing strong incentives to the subnational government, allowing it to properly plan and spend the funds. This can contribute toward its performance in the subsequent assessment period, which can generate a virtuous cycle of planning, investment, performance, and received disbursements. The key aspect here is that funds flow be tied as closely as possible to the intergovernmental budgetary and financial management cycle. World Bank operational experience shows that this factor can be a substantial constraint on the overall functioning of the entire subnational fiscal transfer system, including such grants. *Figure 9* shows how the timeline is linked to the other components of the program.

Use of funds defines what can the subnational governments use the SCG funds for. Funds transferred through SCGs to subnational governments (resultant of achieved performance) are invested into the city or region. The use of funds in SCGs can be divided into two categories: (a) conditional, or restricted, use of funds and (b) unconditional, or unrestricted, use of funds. Unconditional grants are not tied to a specific expenditure type if it is within the mandate of subnational governments. Conditional grants are 'earmarked' for a specified list or type of expenditure that is defined by an

investment menu. Lessons from implementation experience suggest that how SCG funds are to be used should be defined during the program design phase, as it informs and affects the investment plan of the subnational government and determines whether an investment menu (that is, a comprehensive list of permitted expenditures for SCG resources, determined by the SCG designers, from which the subnational government can choose how to expend SCG funds) or negative list for the use of funds (that is, specific expenditures not permitted with SCG funds) needs to be developed.

It is important to note that making design decisions across these elements will require balancing trade-offs between the pursuit of impact on the one hand with practicality and feasibility on the other.

Figure 9 Disbursement timeline component coordination



5.3 Phase 3: Implementation

During implementation, the SCG requires regular attention to monitor progress and its impact on improving the identified competitiveness focus areas. Building systems for monitoring and adaptation that can support the national/provincial department managing the system and allow participating actors to respond to emerging issues is critical to the success of the SCG.

Performance management is critical throughout SCG implementation to ensure that the subnational government is aware of and responsive to its performance. This can be accomplished through performance management tools to help manage performance based on relevant and timely performance data. Incorporating performance management systems could facilitate data-driven decision-making to course-correct and adapt. Regular performance evaluations can also help subnational governments tailor the needed capacity-building support to ensure that it responds to identified gaps and challenges that may be hindering their ability to achieve results.

Systematic reviews of the program are an opportunity to review and adjust program design if needed to improve its effectiveness. The iterative diagnostic and prioritization exercise that subnational governments would perform (as noted in [Section 4](#)) can be used to inform these adjustments. By doing so, the revised program can reflect updated priorities and incorporate changes in the local context.

While it is ideal to conduct a thorough diagnostic and prioritization exercise during the design phase to ensure that all inputs are available up front, it is also important for competitiveness diagnostic and prioritization exercises to be periodically conducted throughout implementation. Such diagnostic exercises provide inputs to inform periodic (albeit not too frequent) updates to the design of the SCG, to

better reflect implementation experience. Newly identified priorities, identified from diagnostic and prioritization exercises, can be reflected in the SCG redesign. For example, a new sector may demonstrate its competitive advantage during implementation. If this was not anticipated during project preparation, it would make sense for the SCG to incentivize the development of the sector rather than focus only on the limited priorities identified during the preparation phase.

Therefore, the combined top-down (design phase) and bottom up (iterative) SCG design approach proposed in [Section 4.1.2](#) is recommended for SCGs. First, the program designer may establish preliminary design components during the SCG preparation phase. At this stage, ‘no regret’ policy areas are targeted based on the initial diagnostic conducted at the operation preparation phase. Second, the design may be adjusted based on the subsequent diagnostic and prioritization exercises. The midterm review can be leveraged to perform this redesign/updating process as it (a) represents the midpoint of the lifetime of the SCG and (b) coincides with the cycle of periodical assessments mandated by specific diagnostic and prioritization tools, such as the CRIs ([see Annex 1](#) for more information about these methodologies).

However, there are risks of SCG design updates during project implementation. These risks and potential mitigation measures are as follows:

1. Performing frequent diagnostic and redesign implies additional costs for all stakeholders involved, especially the subnational governments. It is recommended that SCG calibration happen only at limited periodic intervals.
2. As the initial design would not be fully based on a comprehensive/JET analysis of the subnational government context, the selected 'no regret' design elements might end up being 'regret' elements at some point. For example, city officials may believe that developing trade-oriented infrastructure is a priority for boosting competitiveness and incentivize this as a 'no regret' SCG element. However, following the diagnostic phase, the subnational government might realize that infrastructure is not the optimal solution to local barriers to competitiveness and economic transformation. Hence, it is recommended that the selection of initial design elements (based on the first prioritization exercise) focus on low-risk areas and the selection of areas be supported by sufficient analysis and evidence.

6

The *nuts and bolts* of an SCG program: Eligibility criteria, performance metrics, results assessment

This section delves deeper into the nuts and bolts of an SCG program design and operations. It first provides detailed guidance on eligibility criteria for subnational governments to participate in the program and receive funding, followed by a discussion on thematic metrics on which the performance of subnational governments on improving competitiveness will be assessed. It provides detailed guidance on factors to consider when selecting appropriate indicators based on assessments of local context. Finally, it provides guidance and best practice on various aspects of results/performance measurement, assessment, quality assurance and reporting — which is the process by which the achievement of subnational governments in improving competitiveness is assessed and certified, and they become eligible to receive SCG funding through the country's budgetary process. Guidance is provided on the main features of the measurement process and roles of various entities.



6.1 Minimum access criteria (eligibility criteria): Concept, rationale, and challenges

The MAC are a set of metrics that represent basic requirements that subnational governments must comply with to be considered able to engage meaningfully in an SCG. Therefore, if the participating subnational government already has these conditions in place, the inclusion of MAC in the design is not necessary. The MAC can respond to two main rationales: generic and thematic MAC. Generic MAC focus on generic areas of subnational government performance. They ensure that subnational governments have the minimum absorptive capacity and performance level (for example, planning, financial management, and administration) to handle additional funds. They represent the minimum conditions needed to ensure subnational government capacity to manage funds, reduce fiduciary risks, and comply with legal and statutory requirements.

Thematic MAC are focused on key conditions for developing and implementing competitiveness and JET reforms. Improved competitiveness is heavily dependent upon local conditions of firms, their sectors, competitive advantages, and numerous contextual and economic factors. Thematic MAC focus on promoting the minimum conditions that allow subnational governments to successfully plan, prioritize, and implement competitiveness/JET policies that respond to these contextual factors and the needs of their firms.

Example 3 Examples of common MAC in most PBG programs

- Audit report of governorate final accounts from the previous fiscal year publicly accessible
- No adverse audit report or all serious audit queries settled
- Final accounts produced on time
- Cash books and bank reconciliations kept and up-to-date
- Investment plan approved on time
- Core subnational government staff positions and decision-making committees in place (for example, staffing of an internal audit unit)
- Procurement entity in place and functional
- Capacity-building plan in place
- Bank reconciliation statements on time

Thematic MAC for competitiveness/JET reforms will generally include the following which can be used for an SCG program:

1. **Have capable and dedicated personnel.** This allows the subnational government to ensure effective program delivery at the technical and administrative levels and appropriately engage with the private sector and other key stakeholders.
2. **Manage adequate and relevant data and data systems on businesses and clusters.** Subnational governments need data on firms and stakeholders to understand who to engage and how to identify policy actions and priorities in the most effective and inclusive manner. This involves subnational governments having data and data systems to identify public and private stakeholders that need to be engaged in local economic development and competitiveness-related policy design and to conduct analysis based on market analytics.
3. **Adopting a methodology for engaging stakeholders.** Engaging public and private stakeholders is essential for defining, prioritizing, and implementing competitiveness and economic transformation reforms. To do so effectively, subnational governments can adopt existing methodologies (for example, manuals of engagement written with TA).
4. **Understand the local context and economy.** In competitiveness/JET reforms, it is critical that the subnational government understands the constraints faced to improve competitiveness (for example, private sector diagnosis), to prioritize addressing those constraints, and to define how to implement effective solutions. Performing frequent diagnostic and prioritization exercises can facilitate updating the SCG design to reflect changing contexts and priorities. By including this as an MAC, it is possible to assess the quality of the output of the diagnostic and prioritization processes. In addition, it promotes the sustainability of reforms by ensuring that the subnational government builds the required capacity to repeat this in the future.

Typically, though not always, MAC are ‘yes/no’ conditions that determine if subnational governments can access payments for achieving PMs. In addition, MAC themselves can either be tied to funding or not.

Challenges: How to best use MAC

MAC can define the subnational government’s access to significant portions of funding. In consequence, it is key to consider the following considerations when designing MAC:

1. **Type of indicators.** The MAC are generally used to incentivize performance in basic areas to safeguard the proper utilization of funds and facilitate competitiveness/JET reform. Implementation experience shows that indicators should cover those functions or activities which are primarily under the control of the subnational government, as it can only be held accountable, or assessed, for factors which it can reasonably control or influence.
2. **Number of MAC.** It is recommended that MAC consist of a small number of simple indicators to focus the government’s attention on addressing the most pressing bottlenecks. It is recommended that this list be small enough to avoid diverting the government’s attention, effort, and time away from the achievement of PMs, which is generally the core of the SCG program. Additionally, too many MACs might restrict flexibility by becoming prescriptive. Once potential MAC are identified, it is recommended to rank them according to their relative priority and select only a small number.
3. **Funding tied to MAC.** It is recommended that funding tied to MAC be less than that for PMs. Conditioning too much funding on MAC may be detrimental to unlocking the intended development objectives because (a) MAC are generally inputs and activities, which, by definition, are not closely related to the program’s impact (like traditional financing models) and (b) it can weaken the relative strength of the incentives provided by results-oriented PMs. This would also divert the government’s effort and attention away from key results.

Example 4 Thematic MAC in the UELDP Competitiveness Grant

The UELDP SCG program included five MAC which reflect the basic conditions that would allow a governorate to effectively engage in the planning, prioritization, and implementation of competitiveness-focused policy actions and be able to appropriately handle the funds. These included the following :

- Technical and functional expertise in place to ensure effective program delivery based on best practice procurement, safeguard, and financial management standards
- Dedicated staff for conducting PPDs on competitiveness policy and cluster development established
- Operations manual for analytically underpinned PPDs (adopting the CRI approach) adopted
- A detailed database on SMEs and clusters of economic activities in the governorate created and maintained
- A strategic study of the local economy of the governorate prepared/ reviewed in each governorate

Source: UELDP program documents.

6.2 Performance metrics: Definition, rationale, and challenges

PMs represent the policy areas where the subnational government need to achieve results to enhance the competitiveness of firms in its territory and, therefore, receive SCG funds. It is recommended that the PMs be linked to market and coordination failures that constrain competitiveness of firms and economic transformation in the identified subnational geography.

Main characteristics

Each PM represents a specific result where subnational government performance will be measured and compared against predefined targets. A combination of outputs and outcomes as PMs is recommended to preserve a focus on results and flexibility and secure appropriate cash flows for governments. In addition, a pathway to success can be more clearly defined by including some outputs in the PM mix, measurement can be easier, and it would allow to secure small wins over time as they learn to iterate and adapt to achieve outcomes (*see Table 2*).

Challenges

Poorly chosen PMs may generate risks for the SCG. For instance, a PM that seeks to incentivize reductions in the tax burden of firms might lead the subnational government to increase the tax burden of citizens to compensate lower taxes for businesses. In addition, if PMs focus too much on results that the subnational government cannot affect, the PMs may generate disproportionate performance risk. Lastly, they can also fail to focus subnational government efforts on the desired results. To avoid these challenges, the following section presents some criteria to select PMs.

Table 2 Benefits of output and outcome PMs

OUTCOMES	OUTPUTS
<ul style="list-style-type: none"> • Motivate greater focus on results • Help guarantee that resources are used in a cost-effective manner • Provide subnational governments with flexibility to explore different approaches 	<ul style="list-style-type: none"> • Can provide subnational governments with a roadmap to achieving the desired impact • Can be easier to measure • Generate lower delivery risk, making it easier for subnational governments to secure a portion of the funds

Example 5 Focus of incentives in competitiveness programs

Programs that incentivized policies and reforms in competitiveness have focused on different points along the activity-impact spectrum, as shown below.



The EU Cohesion Policy funds provided governments with funding tied to detailed seven-year plans, implying a focus on activities and outputs. While this has led to support for firms, infrastructure development, and innovation systems financing, the outcomes of these interventions have not been tracked. Further, enforcement is difficult if output targets are missed.

The UELD DP SCG and the Australian NCP, in turn, both focus on output-level incentives. The UELD DP SCG's PM design focuses on outputs that serve as gradual steps to the desired outcomes. For example, under theme 1 (infrastructure and land), the PM structure guides governorates from allocating and promoting the occupation of industrial zones to committing and implementing works under the industrial zone upgrade plan. This can guide low-capacity governorates to achieve outcomes but risks limiting their flexibility to achieve them.

The NCP approach implemented competition payments to states tied to the achievement of broader reform goals. While the goals were defined in the NCP agreements, states had flexibility to decide how to implement the reforms. This allowed states to experiment and learn which approaches were more appropriate for their context.

Lastly, China's Torch program, indigenous innovation in renewable energy, and industrial upgrading initiatives incentivize subnational governments and park/zone authorities to achieve outcome- and impact-level results. These include domestic R&D, SME formation, entrepreneurship and automation, and GDP growth. This granted subnational governments regulatory autonomy and the possibility to quickly adapt to incorporate new knowledge. China's approach to competitiveness reform helped generate positive results in high-tech and renewable energy industry creation, entrepreneurship, automation, and wages. However, greater flexibility also led to uneven development and investments in overcapacity in certain sectors, like the renewable energy industry.

6.3 Selecting appropriate MAC and PMs based on assessments of local context

The TOC can serve as the basis to identify potential PMs because it reflects the priority policy areas and major constraints identified during the various diagnostics. Each element of the TOC constitutes a potential PM. This section provides criteria for assessing potential PMs and MAC and the overall set of metrics.

6.3.1 Assessing and selecting individual metrics

For an optimal technical selection of MAC and PMs, their assessment involves assessing them against four key criteria. The score for each metric against the criteria will be based on context-specific conditions. Recommended criteria include the following:

1. The metric is closely related to the intended impact of the program

Choosing PMs that are closer to the intended impact or goal has three main benefits. First, it puts a greater focus on results (as opposed to a focus on activities). Second, paying for results further down the results chain of the intervention allows for greater flexibility in program implementation. That is, the subnational government is not subject to executing a prescriptive list of activities to receive payment but instead can course-correct, innovate, and decide for itself what action to take to achieve results. Third, it helps guarantee that resources are used in a more cost-effective manner than traditional activity-based funding, as outcome payments (grant funds in this case)

reward results that are closely related to the desired impact. *For example, business licensing is often included in measures of the local business environment, which can initially make it an attractive PM. However, if the business licensing processes managed by the subnational government are not a strong barrier to competitiveness for firms (for example, the licensing process does not meet international quality benchmarks, but this does not affect the firm's capacity to operate), it may not be suitable as a PM.*

2. The metric is objective and easy to measure

Selecting clear and easy to measure PMs is essential to ensure there is no ambiguity in what is going to be paid for and that the incentives are strong enough to drive better performance. First, all stakeholders need to have a clear understanding of the PMs selected as well as how PMs are to be measured and monitored over time to ensure that stakeholders understand what they are expected to achieve. Second, both the data and the method used to measure the PMs need to be objective and reliable to guarantee accurate measurement. Third, measurement for each PM should be possible within reasonable cost and time. *For example, PMs measured through complex technical methodologies can be difficult to understand by nontechnical stakeholders. When not defined well, PMs that measure quality can appear subjective to the subnational government.*

3. The metric is within the manageable control and mandate of the subnational government

Metrics need to be within the manageable control and legal mandate of the subnational government. Manageable

control is the ability of the subnational government to affect its performance on the metric within a reasonable time frame; the subnational government's mandate often defines what is within its manageable control.²⁹ Paying for results that are as close as possible to the desired impact is desirable; however, this may increase performance risk, as they are more susceptible to the effects of external factors, which are outside of subnational government control. Therefore, selected PMs need to be as close to the intended impact as possible while also being within the manageable control of the subnational government. *For example, improvements in business regulation designed at the national level would be outside of the subnational government's manageable control.*

However, it is important to consider that SCGs aim to deliver transformational competitiveness reforms, which are unlikely to be fully within the manageable control of the subnational government. Consequently, it may be required to incentivize subnational governments to explore methods to influence results beyond subnational government limitations and manageable control. Competitive cities and regions, for instance, build and use growth coalitions and intergovernmental relations to do so.³⁰ **Box 3** explores how SCGs can introduce approaches that help subnational governments overcome the manageable control and mandate limitations to achieve transformational competitiveness results.

29. For instance, reforms to policy areas within the subnational government's mandate might be vulnerable to external factors outside of its control or might require resources and capacities not available to it.

30. World Bank (2015).

Box 3 Overcoming manageable control and mandate limitations in SCGs

SCGs aim to deliver transformational competitiveness reforms, which may not likely be fully within the manageable control or mandate of the subnational government. The following two methods can help overcome this limitation:

1. The SCG can incentivize and support subnational governments to expand its de facto manageable control and influence results beyond it. For instance, building the capacity to use growth coalitions and intergovernmental relations can help subnational governments to do so.³¹ Similarly, the SCG can provide subnational governments the resources and tools to 'outsource' implementation through interagency agreements.
2. Alternatively, the SCG can directly incentivize other actors or levels of government that do have the power and manageable control to influence said results (for example, provincial governments).

31. Ibid.

4. The metric should aim to reduce potential perverse incentives and gaming

Tying funding to results may generate perverse incentives or gaming. For instance, a common risk is that the selected PMs lead the participating subnational government to shift their efforts to improve the metric with no, or little, impact on the goal. Or, in some cases, the subnational government may focus on a subgroup of the population that is most likely to achieve the greatest results in the absence of the program (that is, ‘cream skimming’) while ignoring other populations in need. Accordingly, the selection of PMs should aim to minimize such undesirable effects. *For example, a PM that incentivizes a lower tax burden for firms might lead the subnational government to increase taxes for individuals to compensate lower tax revenue from businesses.*

Example 6 PM assessment example

The Pakistan Competitive Cities Index aims at measuring the competitiveness of mid-size cities in Pakistan, providing cities a roadmap to improve competitiveness, and incentivizing them to improve performance through healthy rivalry. While the index does not include payments tied to city performance, the provided PM assessment approach was used to generate incentives to cities to improve their competitiveness. This assessment corresponds to potential PMs for the ‘institutions and regulations’ policy lever.

→ PM selection example

POTENTIAL PM	CLOSELY RELATED TO THE PROGRAM INTENDED IMPACT	WITHIN THE MANAGEABLE CONTROL OF SUBNATIONAL GOVT	OBJECTIVE AND EASY TO MEASURE	SELECTED?
Construction permitting process streamlined	Medium-high	High	Medium-low	YES. While it is challenging to measure, this was identified as a barrier to local business environment and is strongly within the control of cities.
Increased own-source revenue	High	Medium-low	High	YES. Increased revenue is key for implementing important competitiveness reforms and can be easily measured. This compensates the relative lack of manageable control that cities currently have over this.
Business licensing process streamlined	Medium-low	Medium-high	Medium-low	NO. Business licensing processes managed by cities are not a strong barrier to competitiveness for Pakistani firms, and assessing this PM is complex in the Pakistani context.

6.3.2 Assessing and prioritizing the full set of metrics

Incentives introduced by an SCG depend on each individual metric as well as how metrics interact with one another. Accordingly, attention must be given to the collective set of metrics, considering the following:

1. **Total number of metrics.** The greater the number of metrics, the weaker the incentives provided by each will be and the greater the chance the participating subnational government may get distracted from the PMs that matter the most. On the other hand, having too few metrics risks overlooking important areas of focus. Additionally, the total number of metrics will affect the assessment cost (that is, more metrics to measure and assess usually equals more time and costs). *For example, having 50 indicators would not provide sufficient clarity or focus regarding what matters. On the other hand, using two indicators could leave important competitiveness areas outside the scope of the SCG.*
2. **Avoid duplication.** It is recommended that the selected metrics not duplicate or overlap along the chain of results. Tying payments to closely related outputs and/or outcomes can limit flexibility as it defines a specific approach to be prioritized to reach the desired result. In addition, duplication increases subnational government focus on a specific area, potentially drawing their attention from other key results areas. For example, if an SCG incentivizes “improving the local business environment” (an outcome) as well as “digitization of government-to-business services” (an output), the subnational government could prioritize the latter as a method to achieve the former and fail to explore other alternative approaches, which may ultimately be better.
3. **Mitigate weaknesses of other metrics.** Some metrics might mitigate the weaknesses identified for other selected ones. *For example, including a PM on the time*

required to obtain a business license can lead subnational governments to prioritize the speed at which business licenses are provided, while sacrificing the quality. Including a PM on the quality of the service can mitigate this weakness.

Table 3 presents examples of potential generic PMs within each of the four policy levers of the Competitive Cities framework. This list is not exhaustive and only represents potential inputs as a starting point for designing PMs for an SCG. Potential PMs and additional options may be assessed using the frameworks recommended throughout this section, considering the relevant context-specific characteristics and the TOC.

Table 3 Indicative list of potential performance metrics for an SCG, across the four policy levers of subnational competitiveness

POLICY LEVER	PM EXAMPLES
Institutions and regulations	<ul style="list-style-type: none"> • Subnational business environment indicators • Performance of G2B services • Compliance cost for business licenses and inspections • Updating of physical/territorial plans • Business promotion/local economic development department performance • Updated regulations to guide public investment allocations to be consistent with physical/territorial plans • Management of industrial zones
Infrastructure and land	<ul style="list-style-type: none"> • Improved market spaces • Transit times and congestion • Public and soft transport use and access • Data speed • Quality of key infrastructure and services (for example, electrical supply, water supply, and logistics services) • Green spaces, playgrounds, and public amenities (as proxy for talent attraction) • Increase in available area of serviced industrial land or office space • Creation and occupancy rates of industrial zones
Skills and innovation	<ul style="list-style-type: none"> • Up-to-date skills databases • Job placement services • Access to, completion of, and relevance of education (primary, secondary, tertiary, and vocational) • Performance of universities in job placement • Attraction and retention of skilled workers
Enterprise support and finance	<ul style="list-style-type: none"> • SME support/BDS system in place • Total number of agreements in effect using available SME matching grant • Responsiveness to firm and citizen feedback systems • Services to reinforce backward and forward links between firms at the local level (clustering or value chain development) • Productive PPD facilitation to prioritize policy reforms and public investments that best address market and coordination failures • Private sector satisfaction with PPD • PPP projects in place • Cooperative initiatives by/through PPD

6.4 Measurement, Assessment, Quality Assurance and Reporting of results

Measurement is the process of collecting data to assess the level of performance of a subnational government against established targets or milestones. Assessment is the process conducted to ensure that reported results of MAC and PMs are accurate. In an SCG, financial rewards are tied to measured results, and thus, it is essential to avoid misreporting and guarantee that what is paid for is valid. Without a well-defined assessment process, there is greater risk of dispute over what has been achieved, and the incentive structure may be compromised. Reporting refers to the process of certifying and communicating performance results. Generally, an adequate and effective reporting scheme involves (a) defining a process by which parties can attest results, (b) publicly sharing results, and (c) ensuring timely/prompt processes for results sharing and dispute resolution.

Measurement and assessment of results is recommended to be rigorous, credible, objective and transparent. This is important to ensure stakeholders, particularly subnational governments, trust that results are accurately assessed and rewarded. This helps create the necessary incentive to deliver on results. Additionally, rigorous measurement assessment systems can provide useful insights and learnings for subnational governments and for the program more widely. At the same time, it is important to account for cost-effectiveness of the measurement and assessment, which is important when aiming to facilitate program scale-up by governments. Measurement and assessment costs can add to the administrative cost of the program.

Box 4 World Bank assessment protocol

Commonly used World Bank performance assessment protocols in PBG programs are described in general as follows: The achievement of MAC and PMs is determined annually by an Annual Performance Assessment (APA) conducted by an independent third party, who shares the findings of the APA with the central/higher tiers of government responsible for managing the PBG program. The APA forms the basis of resultant allocation of grant funds to local/subnational governments, as the performance of these governments (grant recipients) in the APAs determines the size of performance-based fiscal transfers to be disbursed. Each APA examines the performance of these grant recipients at the end of the previous fiscal year or at the time of assessment for each MAC/PM (if different) and is completed within a fiscal year. The APA cycle is synchronized with the intergovernmental annual budget planning cycle to ensure that allocations are reflected in governments' annual budgets on time.

See World Bank (2022) for a more detailed discussion on lessons and good practices on the performance assessment process for PBG programs.

6.4.1 Main features of the measurement process

The measurement process defines how a specific indicator will be measured. The measurement process will vary according to each MAC or PM and will be based on context-specific factors that enable or constrain potential measurement processes. Below is a list of key features of the measurement process, which, however, could vary depending on the specific indicator.

- **Data collection method:** The method used to collect the data (for example, surveys, interviews, focus groups, and direct observation).
- **Source of data:** Where collected data come from. This can be divided into primary data (firsthand evidence from the subjects of study) and secondary data (data collected by a third party).
- **Data collection frequency:** Frequency at which data are collected. This may be different from the reporting frequency explained earlier.
- **Recall period:** The time frame respondents are asked to consider in responding to a question (for example, in the last year, how many times the respondent used G2B services).
- **Responsible for data collection:** Person or entity responsible for data collection. Potential actors involved in this process include the subnational governments, other levels of government, the World Bank, and other third-party actors, such as think tanks or the private sector.
- **Sample size:** The number of observations for which information is collected.
- **Sampling method:** The method used to determine the sample (for example, random selection of observations and nonrandom selection).

Example 7 Indicator example - Measurement process

Below is an example of an indicator for the PM: “Improvement of industrial zone occupancy rate.”

Data type: Primary data

Frequency: Measured and calculated yearly

Sources:

- Master plan layout for each industrial zone issued by the relevant agency,
- Land allocation register for industrial zones,
- Statements received from investors & random interviews of investors.

Procedure:

The performance assessor will verify occupancy rates based on the:

- Master plan layout for each industrial zone issued by the implementing agency,
- Land allocation register/records (log) for each industrial zone,
- Thorough data check for randomly selected handing over files to ensure the compliance with the log handing over statements received from investors, and
- Field verification through random interviews of investors to confirm that they received the land on the date registered in the log and have original signed copy of the land handing over document.

6.4.2 Who is responsible for assessing results?

Implementation experience from The World Bank's support for PBG programs shows that the assessment process is best conducted by a credible entity which is in some ways external to the functioning of the program. This approach has tended to reduce conflicts of interest and increase the quality of the assessment. The key aspect is to try to keep the assessment process separate from the rest of the grant administration machinery.

One approach that has worked successfully in several cases is to contract an independent external party. Such a party is usually hired and paid for by the national ministry/agency managing the SCG program. Such an independent assessor can also ensure a division of responsibilities such that the assessor is not the same as the stakeholder involved in the process of deciding the allocation of SCG funds. It also ensures a standardized and professional approach to the assessment and provides incentives to conduct it timely and efficiently.³² The benefits of a robust and independent assessment process outweigh its costs: the cost of managing and implementing such a process has generally been less than 2 percent of the total program cost for a set of PBG programs, even though such processes are generally thought to be costly.³³

Other alternatives have also been used for results-based financing and PBG programs in several cases, but with somewhat mixed results. While less costly, some of these have faced inherent conflicts of interest. Such approaches can be considered in more sophisticated institutional contexts, and are best accompanied by adequate measures for quality assurance and reducing conflict of interest in these contexts. In such cases, it is recommended that an independent

external party still be contracted to perform quality assurance checks/audits of the assessment, possible on a sample basis. These alternatives include the following:

- **Assessment conducted by a national government entity.** A dedicated government entity can conduct the assessment. This approach can contribute to strengthening the performance management system of the government entity involved in the process, which can promote long-term adoption of such systems. This approach has worked successfully in Tunisia as part of a World Bank-supported flagship program to support all local governments in the country.³⁴ However, in other cases, programs where government agencies conducted assessments (for example, Uganda and Tanzania) faced challenges such as limited checks and balances and lack of standardization³⁵ which led to the deterioration in quality for these assessment systems. It is possible that such entities can be subject to political incentives that reward the disbursement of grant funds, which can dilute the overall reliability of the assessment process.
- **Self-assessment conducted by grant recipients (subnational government entities):** If the SCG is expected to be implemented across many subnational governments, there is a potential risk that the assessment process would not be uniform or standardized—a risk that is particularly salient if subnational governments differ in their capacities to conduct the process. Further, this approach can present a significant conflict of interest and pose a challenge to the objectivity of the assessment. There are also capacity constraints. This approach is not recommended without parallel safeguards that can ensure objectivity.

32. UNCDF (2010).

33. See World Bank (2022) for lessons and good practices on having a credible, transparent, and independent assessment process for PBGs.

34. See World Bank (2022) for a review of the Tunisia experience.

35. UNCDF 2010.

Box 5 Building capacities of the subnational government to measure performance

In addition to common World Bank practices, when defining the responsible for data collection, a key consideration could be if the SCG aims to build monitoring and performance management capacities of the subnational government. Making subnational governments responsible for monitoring indicators can improve their performance in the SCG as well as their data-driven decision-making. It can also contribute to government adoption and sustainability of the SCG program. However, additional expectation and responsibility placed on subnational government in this realm can impose additional (often short-run) costs, as the subnational government must adapt to this new system. Successful monitoring by the subnational government may require capacity building to generate the necessary data. If subnational governments are responsible for data collection, complementary measures may be needed to avoid misreporting of results. For example, a sample of results can be validated through quality assurance reviews.

Example 8 Assessment processes in the Australian NCP

The monitoring and evaluation process of the Australian NCP is an example of assessment performed by a government entity. It was led by the National Competition Council (NCC), an independent body tasked with promoting competition policy, assessing compliance with NCP agreements, monitoring progress in the implementation of reforms, and providing regulation recommendations. The NCC's members were appointed by the federal and state governments, with a focus on making appointees seem independent, rather than representatives of any state. The NCC assessed progress reports submitted by each state government and the federal government. Based on what aimed to be an evidence-based assessment, it made a recommendation on the disbursement (partial or total) of competition payments to each state.

The NCC's role as independent assessor was perceived by several participants as key to the effectiveness of the NCP owing to the accountability framework that it fostered. In addition, the collection and dissemination of information of the reform processes contributed to improvements in the NCP's implementation across participating jurisdictions. However, the NCC's hybrid functions of assessing progress and promoting and recommending policies partially undermined its legitimacy, as it was perceived as seeking to impose its own outcome preferences.³⁶ This led to the implementation of an amendment to the Competition Principles Agreement in 2000, which introduced a list of characteristics to be identified in the reform reports with the objective of strengthening the NCC's legitimacy and the transparency of the assessment process.³⁷

36. Productivity Commission. 2005. *Review of National Competition Policy Reforms*.

37. Banks, Gary. 2005. *Structural Reform Australian-Style: Lessons for Others?*

6.4.3 Quality assurance and review of the assessment

Implementation experience from PBG programs financed and supported by The World Bank has also shown the importance of putting in place a quality assurance and review system for verifying the accuracy of the assessment results submitted by the government agency managing the SCG program. Since the program rests on the independent and credible conduct of a performance assessment of the participating subnational governments—usually done by a contract third party—World Bank teams supporting the implementation of these programs have often undertaken a quality assurance review of the assessment on a sample basis. Any discrepancies identified from this review are generally discussed and resolved with the government agency before the assessment is finalized and forms the basis of results achievement and SCG fiscal allocations. This additional layer of quality assurance and review has tended to provide all stakeholders with a high degree of confidence in the reported results achieved.

6.4.4 Certifying and reporting results

It is recommended to have a process by which the results from subnational governments' performance will be certified and reported by the higher tier of government running the SCG program. In most PBG programs, assessment results are certified by the central/higher government, usually by the ministry in charge of disbursing or overseeing resources to subnational governments or the Program Steering Committee (when applicable). To promote transparency and participation, recommended best practices and considerations include the following:

- **Define a process by which parties can attest results.** Despite having a robust, objective, and neutral assessment process, it is important to provide stakeholders (especially Subnational Governments) with the opportunity to dispute or question results if they consider that their performance has been incorrectly assessed (for example, mistakes in the assessment process).
- **Publicly share results.** This promotes transparency, builds credibility in the system, and allows subnational governments to compare their performance with peers and share best practices for improvement. This is a good practice to bolster accountability between firms and citizens.
- **Ensure timely/prompt processes for results sharing and dispute resolution.** This allows the program to comply with established schedules, which is key for subnational governments to properly plan and execute allocations. Ensuring a swift process for solving disputes and establishing deadlines also deters stakeholders from questioning results (therefore delaying the disbursement timelines) for prolonged periods.

The certification and reporting of results lead to the disbursement of funds. Once results are certified, resources are allocated to the subnational governments using the mechanism's allocation structure (*see Section 7.1.2*) and allocation is communicated to the subnational governments. This allows them to plan appropriately for receiving and managing the funds (*see Section 7.1.3*).

7

Key considerations for Program operationalization and implementation

This section presents an overview of additional recommendations for the operationalization and implementation of SCGs beyond the core elements already presented. This includes defining what participating subnational governments can use the SCG funds for, identifying capacity-building needs, defining the SCG allocation structure, and establishing the SCG funds disbursement timeline.



Photo: Dominic Chavez / World Bank

7.1.1 Use of funds

The design phase of an SCG program will generally determine what subnational governments can (or cannot) use the grant funds for. The use of funds in SCGs can be divided into two categories: (a) conditional, or restricted, use of funds and (b) unconditional, or unrestricted, use of funds. Unconditional grants are not tied to a specific expenditure type, as long as it is within the mandate of subnational governments. Conditional grants are earmarked for a specified list or type of expenditure that is defined by an investment menu. How SCG funds are to be used informs and affects the investment plan of the subnational government and determines whether an investment menu (that is, a comprehensive list of permitted expenditures for SCG resources from which the subnational government can choose how to expend SCG funds) or negative list for the use of funds (that is, specific expenditures not permitted with SCG funds) needs to be developed.

In PBG programs generally, unconditional or unrestricted funds are more widely used as they provide greater autonomy to the subnational governments to invest funds as they think best address their specific needs and priorities.³⁸ Thus, unrestricted funds are recommended as a general rule of thumb to offer greater flexibility and autonomy to the subnational governments to spend funds as they see best meet their needs and priorities. By providing flexibility on use of funds, subnational governments can better maneuver to select and change activities to pursue the delivery of results more effectively, using SCG funds to finance such activities. In turn, this promotes innovation, experimentation, learning, and growth.

Unrestricted funds can also be an effective tool to strengthen the incentive structure of an SCG. The strength of incentives generated through the SCG will generally depend on (a) the amount of funding and (b) the use the subnational

government can make of those resources. Consequently, unrestricted use of funds can strengthen the overall incentives. While generally applicable, this is especially relevant in contexts where financial resources are limited. In many cases, even a small amount of resources can be attractive to subnational governments if they can use those resources for priority investments. However, while offering flexibility is desirable, the program can establish basic guidelines regarding the use of funds to ensure budgetary or legal compliance on the part of subnational governments.

38. UNCDF 2010.

7.1.2 Funds Allocation structure to subnational government

The allocation structure of funds to subnational governments determines the size of SCG grant commensurate with achieved results. The allocation structure may be designed after defining MAC and PMs and often includes the following elements:³⁹

Target setting

Targets constitute the expected performance for each MAC and PM. As a general principle, targets that provide adequate incentives to subnational governments are recommended to meet the following criteria:

1. **Targets be ambitious but realistic.** Targets that are set too low may not incentivize subnational governments to increase their effort, since they are likely to see low targets as ones that are expected or easy to achieve. Consequently, subnational governments will not see the cost of SCG design and implementation compensated by increased performance. Targets set too high, on the other hand, may (a) discourage local governments and negatively affect their efforts, (b) encourage local governments to cream-skim or conduct other perverse behaviors that improve the indicator but have little or no effect on the intended impact, or (c) force the funder to reduce targets, which may undermine the credibility of the SCG.

2. **Targets may be incremental instead of binary.** Incremental targets allow for proportional compensation (for example, 60 percent achievement compensated by 60 percent payout), while binary (“all-or-nothing”) targets increase the risk that outcome payments (SCG funds in this case) are not disbursed.

Weights

Weights determine the relative portion of the total payments that will go into each MAC and PM. Weights strongly influence the overall incentive scheme and largely determine which results the local government will prioritize: the larger the weight of a metric, the greater the incentives for the local government to focus its efforts on achieving said metric. Weights can be defined using the following considerations:

1. **Assign a greater weight to MAC and PMs when:**
 - The MAC/PM is closely related to the goal of the program,
 - There is a relatively greater certainty that the subnational government will achieve the targets based on its manageable control over the MAC/PM,
 - There is a relatively greater certainty that the subnational government will achieve the targets based on the certainty that the targets are ambitious but realistic based on the context and data of past performance, and
 - The MAC/PM minimizes perverse incentives and gaming.
2. **Weights for each metric should be determined such potential outcome payments** (i.e. SCG funds for each participating subnational government) are at least enough to cover the costs of implementing activities required to achieve results.

39. All of the elements described in this section are relevant for PMs. However, given that MAC have a binary logic (“all or nothing”), only target setting, relative weights, and allocation of funds among participating subnational governments are applicable for that type of incentive and only if funding is tied to it.

Funding allocation formula

The allocation function determines the exact amount of payment for each unit of result achieved. This is usually defined as a ‘price per unit of outcome’. Generally, a linear allocation function is the simplest way to define allocations for each unit of results. Each PM can have a different allocation function, but it is recommended to keep each allocation function and the overall set of allocation functions as simple as possible. This will make it is easy to understand for all stakeholders, especially for the subnational government, allowing them to properly react to the allocation structure incentives.

The allocation function may also include a minimum threshold and a maximum disbursement. A minimum threshold is the minimum level of results that a subnational government needs to achieve before any allocation is made. Funders may want this feature to avoid spending money on a program that does not achieve a minimum level of impact. An overall maximum allocation, in turn, protects the funder against unlimited expenditure.

Overperformance gap

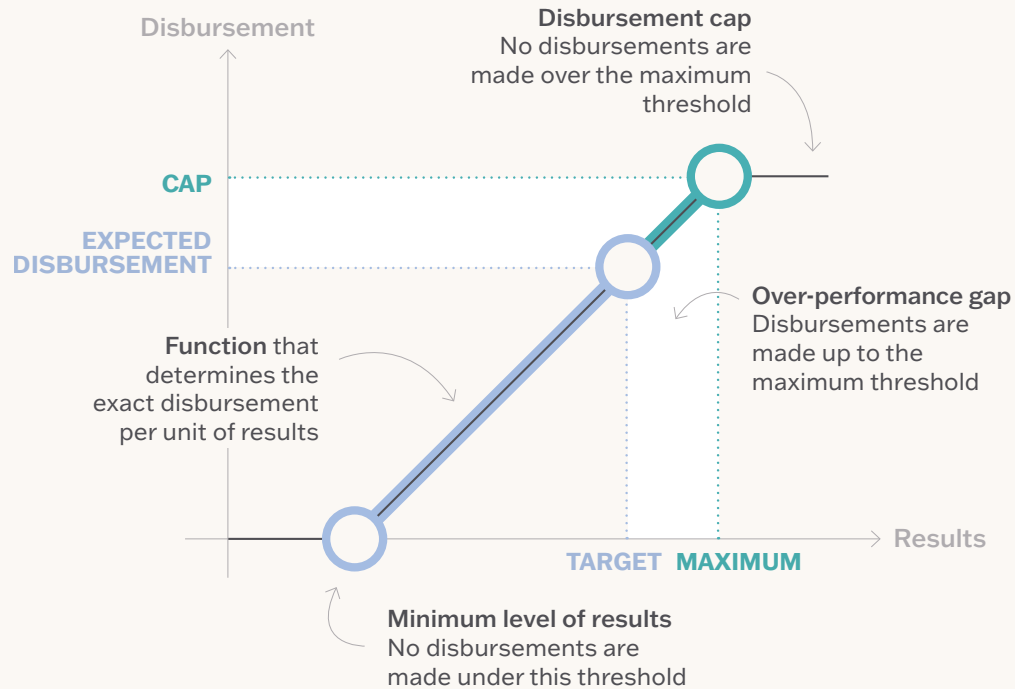
An overperformance gap extends the disbursement cap above the expected level of results to reward extraordinary performance. Allowing the subnational government to earn additional transfers for performance above the expected targets can strengthen the incentives of the SCG. In addition, overperformance gaps allow the subnational government to compensate low performance in a specific PM with overperformance in another. This reduces performance and non-disbursement risk by providing the subnational government with a higher probability of obtaining all potential disbursements. Including overperformance gaps is feasible when the following conditions are met: i) the PM is not binary (that is, ‘all or nothing’ PM); and ii) targets for the PM are set at the expected performance, not at the maximum level of performance.

The inclusion of overperformance gaps requires establishing disbursement caps per PM. A disbursement cap per PM is a threshold of results over which disbursements are no longer made, leaving limited room for compensating overperformance. This is necessary as it is not desirable that the subnational government obtains the maximum amount of total disbursement by simply overperforming in a single PM while underperforming in the other PMs. *Figure 10* illustrates the idea of overperformance gaps.

Distribution of funds among participating subnational governments

When there are multiple participating subnational governments, the allocation structure will need to define how the total pool of potential disbursements will be allocated across subnational governments. Consider two main approaches to this component:

1. **Basic allocation proportional to specific factors:** Each subnational government is assigned a portion of the total pool of potential payments. The pool can be divided equally across each subnational government (for example, each of two subnational governments can receive an amount equal to 50 percent of the total pool) or distributed according to the characteristics of subnational governments (for example, population: the subnational government representing 80 percent of the total population across the two subnational governments can receive up to 80 percent of the total funding pool and the subnational government representing 20 percent of the total population can receive up to 20 percent of the total funding pool). Then, subnational governments receive disbursements according to those established potential allotments in proportion to their individual performance. Consequently, performance transfers only depend on the performance of each subnational government. However, this presents a risk that some funds are not disbursed at the end of the implementation if subnational governments underperform, which is not always a desired outcome.

Figure 10 Overperformance gap

2. **“Competitive” allocation:** Under this approach, each subnational government receives disbursements proportional to its relative performance. Thus, participating subnational governments compete with one another for the total pool of funding. The size of potential disbursements depends partially on the other subnational governments’ performance, as high performers can claim most of the available funds before other subnational governments have the opportunity to do so. This introduces a factor outside of the subnational governments’ manageable control into the allocation structure. While this is conducive to ensuring that all SCG funds are disbursed for performance, it may disadvantage low-capacity subnational governments which cannot compete with higher-performing subnational governments. Hence, it might be pertinent to define subgroups of subnational governments with more homogeneous characteristics, rather than having all subnational governments compete, when the heterogeneity of the entire subnational governments group is high.

SCGs can also follow a hybrid allocation. For instance, subnational governments can receive disbursements proportional to their own performance and, if some subnational governments underperform, others can access their undisbursed funds through overperformance at the end of the assessment period or the program.

Example 9 UELDP allocation structure

The allocation structure of the UELDP SCG integrates the elements described above in a scoring system where transfers are proportional to the total score earned by each governorate. Governorates receive points for their performance in each PM, up to a total of 50 points per governorate over the lifetime of the program and 100 points for the overall SCG. The number of points received is defined on a PM-by-PM basis, depending on the targeted performance and the PM design. In general, points are awarded using thresholds to ensure a minimum level of performance and are proportional to performance improvements above that threshold.

This combination of minimum thresholds and proportional compensation rewards governorates for the results they achieve. For example, in PM 1.2: “Implementation of IZ upgrading plan (IZUP),” there is a threshold where at least 50 percent of works under the zone’s IZUP must be implemented to score points. In addition, for each 5-percentage point increase above 50 percent of work implementation, 0.25 points will be assigned until 80 percent of works are implemented, which is the target for the PM.

The portion of the total disbursements assigned to each PM is defined through weights. Given that the total amount of points that governorates can earn is 100, each weight can be translated into a maximum number of points that can be earned per PM. For example, if “improvement in government-to-business services” has a weight of 20 percent, then the maximum score in this PM is 20 in total. This is then split in half to define the maximum score per governorate. In this SCG, the rationale for the weights is based on the proportion of money that was left from previous assessments and the allocation system of the program’s previous design. The rationales for weights recommended in this section can strengthen the technical design of such approaches.

Governorates can aim to obtain as many points as possible in the first assessment period to maximize the funding they receive, since there is no cap on the points governorates can achieve per assessment period, only per PM. Therefore, this design aspect incentivizes governorates to work faster to get closer to the results that promote competitiveness quickly.

Regarding the allocation of funds among governorates, the UELDP case followed a hybrid allocation. Subnational governments received payments proportional to their own performance and, if some subnational governments underperformed, others can access their undisbursed funds through overperformance at the end of the assessment period or the program. This method allows governorates to compete for undisbursed funds.

7.1.3 Timeline of disbursement of SCG fiscal transfers

A stable and reliable flow of funds is key to providing strong incentives to the subnational government, and the SCG funds disbursement timeline is the defined process through which funds are transferred. A reliable disbursement of grant funds allows the subnational government to plan and spend the funds, potentially contributing toward its performance in the subsequent assessment period, which can generate a virtuous cycle of planning, investment, and performance. However, if the flow of expected funds is not coordinated well, it can lead to rushed, delayed, or overall inefficient planning and spending. Under PBG programs generally, the scheduled annual assessments and funds flows based on achievement of results are designed to follow the governments' annual budget cycle. This allows subnational governments to budget and plan for their annual capital investments and expenditures. The timing of the results assessment and disbursement of funds allows these governments to anticipate how much money they will receive.

The disbursement timeline can benefit from integration into existing budget cycles and transfers. Examples have shown that the necessary coordination between the national government, the subnational government, and other actors involved in this type of transfer improves during implementation. However, it is possible to improve the likelihood of success by planning for potential inefficiencies beforehand or even to postpone the introduction of this system so that it can fit into the budget cycle and existing transfer systems from Year 1.⁴⁰

The timing of fiscal transfers will also need to consider the subnational government's capacity to pay for expenditures up front. If the participating subnational government has limited financial capacity to pay for expenditures up front, it

might be discouraged to take the risk of expending resources on investments that might not generate expected results. The fiscal transfers timeline will need to consider these limitations and may have to include early disbursements when necessary. These can be linked to performance indicators or be independent of subnational government performance.

40. UNCDF 2010.

Annexes



Annex 1 Comparison table of diagnostic and prioritization approaches

	GROWTH DIAGNOSTICS	CRI	CPSD	GROWTH PATHWAYS
Outputs and outcomes				
Scope of recommendations and action plan	Select reforms to remove or minimize the effect of a binding constraint	Includes recommendations for action initiatives tailored to the strategic needs and barriers to growth in a given cluster: <ul style="list-style-type: none"> • Delivery of a report containing a Value Chain Investment Plan • Delivery of a report containing Policy Reforms Proposals The final project findings and recommendations are presented through a conference with sector stakeholders. Economywide reforms may be identified by aggregating CRI action plans.	Economywide recommendations and opportunities for private investment in 3 prioritized sectors	A diagnostic methodology that evaluates how competitive a city's economy is (benchmarked against neighbors, competitors, and global leaders), identifies what its competitive advantages are, and highlights the key barriers that businesses in the city are facing.
Knowledge-based deliverables		Phase 1 <ul style="list-style-type: none"> • Database of industry agents • Report on Assessment of Cluster Status • Report on Global Industry Phase 2 <ul style="list-style-type: none"> • Report on Cluster Potential and Strategies These reports are prepared and validated through process-based activities (for example, stakeholder workshops and a reference trip to benchmark cluster).		<ul style="list-style-type: none"> • Competitive city snapshot: Overview of city economy and benchmarking on key indicators and drivers of growth • Deep dives: Analysis of potential of sectors or types of businesses and constraints • Constraints diagnostic: Detailed analysis of cross-cutting drivers
Potential for sector mobilization (private sector, government, and/or donor stakeholders)	<ul style="list-style-type: none"> • Firms and other private sector stakeholders are consulted for analytical purposes only. • Stand-alone piece of action-oriented research 	Improved PPD. Private sector buy-in is a key success factor in this methodology as the sustainability of clustering efforts primarily depends on the ability and willingness of firms to take ownership of the process.	<ul style="list-style-type: none"> • Goal is to align WBG efforts and inform the dialogue with government clients as to how the private sector can support the development of the country, binding constraints, and possible solutions. • Firms and other private sector stakeholders are consulted for analytical purposes but not actively involved until and optional implementation stage including follow-up activities. 	

	GROWTH DIAGNOSTICS	CRI	CPSD	GROWTH PATHWAYS
Operational and implementation considerations				
Implementation time frame and alignment with the WBG project cycle	Well suited for Advisory Services and Analytics (ASA) and preparation stages in a lending operation	5–6 months A CRI is best suited to be incorporated in implementation and a way to create a granular and continuous feedback loop on private sector priorities and needs/constraints.	<ul style="list-style-type: none"> • CPSD preparation stage: 3 months • Analysis stage: 6 months Well suited for ASA and preparation stages in a lending operation.	
Required institutional capacity	Cost/human resources...	A CRI is typically implemented by a <i>local team</i> (comprising government officials or similar local organizations) with the proactive coaching and support of a <i>contractor</i> who ensures the quality and transfer of knowledge. When the implementation agency cannot dedicate or train ⁴¹ staff to conduct full CRIs, the contractor could deliver pilot CRIs while public officials provide ad hoc support and supervision and facilitate the alignment between the government's SME support schemes and the resulting action plan.		The growth pathways diagnostic is delivered by World Bank staff as an analytical product and the different exercises in the methodology can be fitted into a larger engagement with city clients.
Flexibility/rigidity of the model			It takes into account relevant factors of their country's economic, political, and social context.	Very flexible and adaptable and uses a wide range of tools to account for diversity in city circumstances
Risks during implementation	Coordination mechanisms	Methodological complexity... Perception that the model picks winners (strategies or firms)...		Given the complexity of cities, diagnostic tools may need to be technical and customized.

41. The European Foundation for Cluster Excellence as the de facto 'university' cluster managers.

Annex 2 What are Competitiveness Reinforcement Initiatives

CRI fundamentals

A CRI typically intertwines *industry analysis* with an inclusive PPD approach, which specifically entails the following:

- **Industry analysis.** A CRI's analytical workstream entails an examination of the evolution of industry structure in the identified sectors. The analysis makes use of Porter's 5 Forces⁴² to identify new strategic segments⁴³ in which a country's firms could maintain or develop a competitive advantage and successfully compete in regional or global markets.
- **Inclusive PPD.** A CRI's activities aim to facilitate an inclusive interaction between the public and private sectors. The CRI team takes initiative to identify and invite all relevant actors in the cluster (that is, the regional industry). The dialogue mechanism leverages various channels—including workshops and working groups—to make sure that the industrial analysis is both informed and properly debated among local actors.⁴⁴

A CRI is typically implemented by a *local team* (comprising government officials or similar local organizations, which are the recipients of the training) with the proactive coaching and support of a contractor who ensures the quality and transfer of knowledge. If the local team that will be trained through the project does not have sufficient staff to conduct a full 'CRI', the selected contractor can implement four 'pilot' or practice CRIs, which entail less intensive stakeholder enga-

42. Porter, M. 1998. *Competitive Strategy*. New York: Free Press.

43. Strategic segments understood as combinations of product/services and markets/users that have five different forces and will require different value chains to be served. Ibid, pp. 235

44. In this role, the CRI should utilize management techniques to avoid capture by any group or constituency.

gement through the PPD and more limited engagement with private sector firms operating in the sectors. In a pilot CRI, the contractor will be ultimately responsible for delivering the analysis and organizing the stakeholder workshops. The local team participants may be available for ad hoc support if their employing agencies allow.

Objectives of a CRI and a 'pilot CRI'

The objectives of a CRI are twofold:

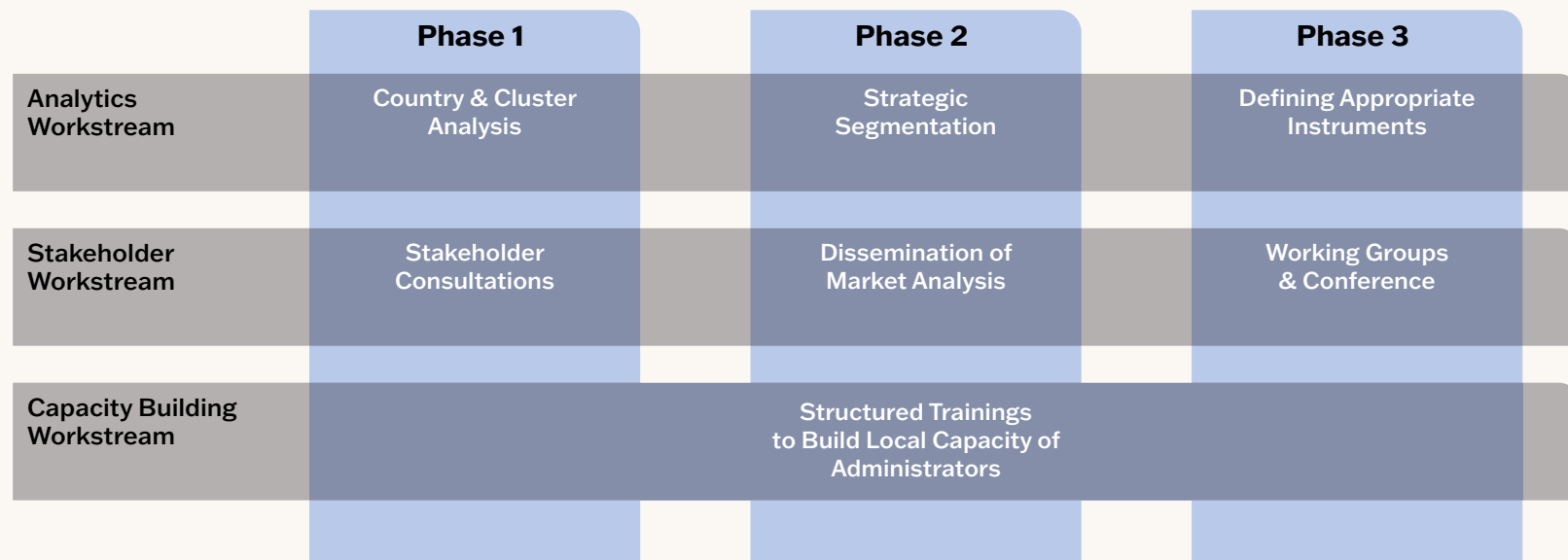
- For the participating **private sector firms**, to move to more attractive markets, developing the new skills and activities needed to compete;
- For the **public sector**, identifying the necessary government reforms and potential market failures that constrain the private sector's competitiveness and evolution.

When several CRIs are conducted in parallel (or in a recurrent way), they can help refine and better target cross-cutting national-level policies for private sector development (for example, skills and infrastructure).

The 'pilot CRIs' can develop the analysis for the private and public sectors but can limit the initial stakeholder consultations to the public sector. Once the local teams have been trained and the TA has been delivered, the Ministry of Economy (or relevant host agency) could independently start a full set of CRI projects. However, it would be important to conduct full CRIs only when significant resources are made available to finance the actions that would be identified by the private sector participants in the CRI.

CRI involves three different workstreams: (a) an **analytical** workstream, (b) a **stakeholder** workstream, and (c) a **capacity-building** workstream. Analytical deliverables produced in the first workstream are delivered and disseminated in a set of corollary workshops in the stakeholder workstream. Local counterparts nominate up to 40 individuals to be the recipients of the training under the capacity-building workstream. Local team participants are expected to be employed in various public sector agencies and potentially from related cluster organizations or industrial parks.

Figure 11 CRI Workstreams and phases



CRI implementation methodology

→ Phase 1. Cluster Selection (1–2 months)

Objective: The goal of this preparatory phase is to identify the sectors of importance and clusters which could be the target of a CRI.

Outcome: Key activities of Phase 1 include

- Rapid assessment and cluster prioritization and
- Cluster selection meeting.

Relevant training: Local team members carrying out this phase should have been trained in Module 1.

→ Phase 2. Data Collection and Assessment of the Cluster (2–3 months)

Objective: The goal of this phase is to motivate firms within the cluster to participate in the CRI.

Outcome: The outcome expected from Phase 2 is (1) establishing a rapport with the cluster stakeholders and (2) developing a basic understanding of (a) the characteristics and performance of the cluster and (b) the market opportunities it potentially could tap into. Key activities of Phase 2 include

- Fieldwork to map clusters and
- Desk work to analyze the sector, and
- First PPD meeting.

Relevant training: Local team members working on Phase 2 should have completed Module 2 of the CRI training.

→ Phase 3. Cluster and Market Segmentation Analysis (2–3 months)

Objective: The goal of this phase is to derive a forward-looking strategy for the cluster based on market segmentation analysis and feasibility analysis.

Outcome: The outcome expected from Phase 3 is that cluster participants obtain an enhanced understanding of market opportunities and threats as well as the strengths and weaknesses of the cluster, such that feasible market segments can be identified. Key activities of phase 3 include

- Market segmentation analysis,
- Feasibility analysis, and
- Second PPD meeting.

Relevant training: Local team members working on Phase 3 should have completed Module 3 of the CRI training.

→ Phase 4. Cluster Action Plans (1–2 months)

Objective: The goal of this phase is to generate a detailed CAP corresponding to (a) the forward-looking market segmentation strategy for the clusters and (b) the market failures identified. Typically, the CAPs will include actions in the following categories: (1) regulatory reform, (2) infrastructure investments, (3) firm-level assistance (financial and nonfinancial), (4) skills and human capital development, or (5) informational assistance (data or analytical).

Outcome: The outcome expected from Phase 4 is a CAP that is approved by the client. Key activities of Phase 4 include

- Identification of market failures
- Articulation of the CAPs
- Third PPD meeting

Relevant training: Local team members working on Phase 4 should ideally have completed Module 4 of the CRI training.

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