Summary of research in financing of social services in Ukraine

Background note for developing a Reform Concept Communication to the Government of Ukraine

This report is a deliverable within a consultancy contract with UNICEF Ukraine. It is part of technical support which FISCO id (www.fisco-id.com) is providing to UNICEF in the area of public finance in 2012 to facilitate more effective redistribution of resources to enhance children's wellbeing and protect their rights. The views expressed are those of the authors and do not necessarily reflect the policies or views of the UNICEF.

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Content

Introduction

Background and purpose of the study: UNICEF Ukraine intends to cooperate with the Government of Ukraine to utilise the political momentum to consolidate technical analysis created through the decades of reform effort to start practical implementation of key recommendations for improved planning, financing, and administration of social services for vulnerable population groups, including children and families. This desk study was commissioned as the first step to take stock of the research undertaken in this area so far. Findings from this analysis will be used as a basis for: (a) development of a general concept memo for Government Stakeholders to initiate further co-operation; and (b) main phase of the UNICEF Ukraine work on developing and communicating evidence-based reform recommendations during 2012-2013.

Scope: The review is focused on public financing of social services for vulnerable population groups, including, but not limited to, children and families. It builds on a series of previous wider analysis led by the UNICEF Ukraine in 2010-2011; in particular, it utilizes a systemic review of donor recommendations in the area of Public Financial Management and a similar review for recommendations in the area of Social Security budgeting in Ukraine.

Structure: The paper briefly describes the evolution of development initiatives in the area of social service financing during the last decade (key players, approaches and factors which influenced the speed of reforms), major themes in the previous research, key lessons and recommendations, as well as major barriers and bottlenecks which have to be taken into account in taking forward the unfinished business from previous reform initiatives. The paper concludes with an outline of proposed next steps, including practical proposals for data analysis, outline of key stakeholders to be involved, and technical requirements to necessary data and their sources.

Development initiatives in social services finance in 2001-2011

Fiscal and political environment which shaped the trajectory of reforms

The years of economic growth

Since 2000 and until the 2008 global crisis, Ukraine achieved substantial progress in macro-economic stabilisation, with real GDP growing on average at 7.5% a year and moderate inflation. During these years, budget revenues expanded, easing borrowing requirements and reducing the country's debt-to-GDP level to less than 15% (FISCO id, 2010). This created, for the first time since independence, a fiscal and political space for a range of reforms with crucial implication to social service funding:

- Acknowledgment of social security agenda: On the one hand, in 2000, the Government has, for the first time, acknowledged the existence of increasing poverty and defined poverty reduction as a top policy priority. It requested assistance from the WB and other donors to join forces in addressing social security issues, including support to reforms in health, education, social assistance and social service delivery. In the area of social services in particular, the donors characterised systems existing at the time as highly exclusive and generally dysfunctional (DFID Ukraine, 2003).
- Decentralisation of service provision: On the other hand, political turbulence of 2000-2001 overlapped with the growing enthusiasm for decentralisation at the municipal level, creating unique circumstances which resulted in fundamental budget reforms and massive fiscal decentralisation in key social sectors, including social services (Dzhygyr, September 2008). Principles introduced by that reform, as well as it loopholes and omissions, have defined the trajectory of further reforms in social service sector for the next decade and continue to influence it to this day.

Global economic crisis and its impact on Ukraine's reform and research agenda

The economic crisis of 2008-2009 highlighted fundamental weaknesses in Ukraine's overall policy environment and shifted the focus of research and reform recommendations to institutional and governance issues, in all areas – including social service funding. Even during years of growth, donors pointed at a number of weaknesses in Ukraine's policy framework, which would represent risks in less favourable years. Already during those affluent periods, domestic and international observers noted the underlying economic growth was achieved primarily as a result of favourable terms of international trade which helped to Ukraine to expand its exports of metals and chemicals. This meant that although Ukrainian economy was growing, it was highly vulnerable to the possibility of external economic shocks.

Respectively, as the crisis unfolded, macro-fiscal concerns materialised into growing public arrears on financial liabilities, soaring public debt, rapid contraction of the private sector, and extreme inflation rates which were highest in the world, following only Venezuela (IMF, April 2009). For social services, this meant that from 2008 onward, the fiscal space available for reforms has rapidly shrunk. Moreover, growing fiscal pressures brought to light the inefficiencies of the previously implemented solutions which were no longer affordable (such as inconsistencies in decentralisation arrangements, expensive and inefficient residential services, and lack of fiscal autonomy at the local level to implement new models of social service funding). The focus of the research in social services area in this latest period has shifted towards institutional barriers to implementation of the previously designed technical reform recommendations.

These developments have driven a range of policy research partnerships between the international development community, the Government, and Ukraine's non-state agents, described below.

Decentralised financing of social services

Development of initial reforms in 2000-2001 (USAID, DFID, WB)

Major fiscal decentralisation reforms in 2000-2001, including the country's first Budget Code introduced in 2001, were designed and implemented with significant support from the international development community (in particular, the World Bank research initiatives, the USAID-funded Fiscal Reform Project, and the DFID Local and Regional Government Institutional Strengthening (LARGIS I) programme (Davey, 2000) (Thirsk, 1998) (Fiscal Analysis Office, 1999) (Fiscal Analysis Office, 1999). This initial research was focused on introduction of basic principles of decentralised funding of public services.

The new rules were designed to serve as a fiscal platform for a system where major functions in healthcare, education and social care would be delegated to local authorities. This platform included explicit legal and procedural distinction between state and local budgets, disjunction between general and earmarked transfers, introduction of an equalisation formula, and anchoring of this formula to variables of relative expenditure needs of communities compared to national average, rather than their absolute needs compared to national standards. This latter decision assumed that allocation of transfer funds based on relative needs would equalise opportunities between regions, leaving it to the local authorities to take these opportunities forward.

World Bank Public Finance Review (2006-2008)

The World Bank was among the first international observers to note significant loopholes and mismatches which remained in Ukraine's system of decentralised service funding after 2000-2001 reforms. The second phase of the WB Public Finance Review (PFR), completed in 2008, was devoted to intergovernmental finance system and outlined the key imbalances in this system which were creating growing risks for provision of services (as described in detail in the next section) (World Bank, February 2008). The conclusions were formulated generally for all types of decentralised services, with direct relevance to social care (although the report focused in particular detail on healthcare and education).

DFID Sustainable Financing to Territorial-Administrative Reform (SUFTAR) project (2005-2006)

In parallel and in partnership with the WB, continued problems in decentralised funding of public services were addressed by the DFID within the SUFTAR project. The project was designed to assist the Government in developing budgeting changes needed to implement administrative-territorial reform (SUFTAR, 2006). By definition, this also included analysis of the inefficiencies which existed in the intergovernmental budgeting system at that moment, including an inventory of problems in implementing the country's Budget Code since 2001 (SUFTAR, 2006).

LGI/OSI/CoE analysis of impact of economic crisis on social service provision at the local level

During 2009-2011, following the outset of the 2008 crisis, the LGI/OSI with support from Council of Europe (CoE), conduced annual assessments of the impact of the turbulence on public service provision at the local level (with focus on social services for the elderly) (Council of Europe, 2010). This research aimed to assess the feasibility of the policy options for addressing the crisis including: improvements in efficiency of services; rationalisation of social expenditures to concentrate on support to low income households; cuts in the cost of territorial fragmentation through municipal consolidation or greater inter-municipal co-operation; relaxation of unsustainable service standards and expenditure norms.

Social service commissioning and transfer of funds to community-based care

The Ukraine Social Investment Fund (USIF)

In 2000, responding to the new Government poverty reduction agenda, the WB has initiated assistance to establish Ukraine Social Investment Fund (USIF). The goal of this initiative was to improve coverage and targeting of social and community services for the poor in Ukraine.

<u>2001: Pilot phase: mitigating shortcomings of SIFs</u>

The pilot stage of the USIF loan (2001-2003, USD 30 million, Khmelnytska oblast) was implemented in close partnership with DFID, which provided technical assistance (total DFID input 750,000 GBP) to test the Fund's targeting methodology, to understand the demand for micro project typology, and to develop institutional arrangements for the USIF (DFID Ukraine, 2003). Importantly, apart from institutional support to USIF, the DFID funds were used in particular for implementation of the several pilot micro-projects for community based and innovative social services (GBP 500,000).

This work was commenced with acknowledgment of a number of shortcomings in the design and development of newer Social Funds in Central and Eastern Europe (Tendler, 2000). The DFID policy in that work was to help the WB mitigate these shortcomings by: improving the pro-poor focus, strengthen capacity building at local level and foster partnership between SIFs and all levels of Government (Barret, 2004).

<u>2003: A hope for a SIF of "new generation"</u>

Building on pilot results, USIF implementation stage was viewed by the WB and DFID as "a signal of a new stage in the evolution of the SIF model" (DFID, 2003). The novelty was in the attempt to combine the usual SIF task of delivering quick and tangible benefits to the poorest communities with a more strategic ambition to assist the Government with a national reform in social protection and to build local capacity for service delivery at all levels.

To achieve this, the Ukrainian SIF included an additional component to fund community-based micro-projects for development of innovative social services and a separate budget for policy development and capacity budget. The DFID approved a new project (Facilitating Reforms in Social Services in Ukraine, FRSSU, described below), whose role was to strengthen the policy capacity building component of this work.

For the benefit of policy development to introduce innovative social services, the USIF was working with the Ukrainian Government (mainly with the Ministry of Labour and Social Policy, MoLSP) on respective legislative changes and reform initiatives.

2005-2008: Restructuring of co-operation with DFID and revision of USIF loan

Joint assessment of the USIF initiative by the DFID and the WB concluded that, despite the unorthodox structure of the Ukrainian SIF project, the initiative was associated with a range of bottlenecks, requiring a changed approach. These bottlenecks included technical weaknesses of the USIF as an organisation (including on issues related to service costing in the decentralised service delivery set-up), institutional weaknesses (which made it impossible and undesirable for the USIF to act as a Government's policy unit), as well as methodological weaknesses (including misguided vision of community development (Fox, 2003)).

The latter were especially problematic since USIF approach to development of innovative social services was assessed as such which was limited to developing new services for vulnerable groups, rather than achieving a shift at the local level towards new models of *decision making*, which should lead, among other things, to pluralisation of the services menu available for the population (Maynzyuk, 2008). DFID project promoted a more complex approach to working with local community, which included an introduction of a full model of responsible and accountable service delivery, including more empowered dialogue with the central government with regard to administrative and financial responsibilities in social care.

The assessment found that development of alternative services at local level with the methodology of USIF type was identical to the practice of unfunded expenditure mandates popular in centralised fiscal systems. The methodology implied that new services were initially funded with the earmarked central transfers with the idea that the funding would be picked up by the local budgets. In a situation where local budgets had very limited own revenue base (they were not able to raise additional local taxes by increasing rates), this meant that the new services would have to be squeezed into the current fiscal envelopes funded from the central budgets (DFID Ukraine, 2005).

As a result, by joint decision of the DFID, WB and the MoLSP, further approach was re-designed away from focusing on supporting USIF towards direct support to Ukraine's Government as the key stakeholder in the country's policy process.

DFID Facilitation of Reforms in Social Services (FRSSU) Project

This project, originally designed to support the WB USIF and alter re-structured to work directly with the Government, aimed to work in parallel at local, regional and national level to achieve a systemic impact on the policy-making in social service provision.

- At the local level, the project administered four pilot social service commissioning schemes[1], which generated palpable evidence for further promotion at regional and national level. Each pilot was built as a full-fledged purchaser-provider arrangement organised to establish additional innovative community-based services for vulnerable groups. In particular:

[1] A city and a rayon from two pilot oblasts (Khmelnitska and Kharkivska): (1) a city of Kamyanets-Podilsky and (2) Krasylivskyi rayon of Khmelnitska oblast, and (3) a city of Kharkiv and (4) Dergachivskyi rayon of Kharkivska oblast.

> The project helped to establish an operational cross-cutting group of stakeholders acting as a purchaser of new services ("Policy and Practice Development Group/PPDG"). The group included representatives of authorities of all relevant departments plus key non-state stakeholders. The project helped to set up the group, provide basic training and support the operation during the first service contracting rounds.

> The project allocated USD 505 thousand Micro-Grand scheme to fund two rounds of pilot service commissioning.

> The project helped the PPDGs to outsource an independent community-needs assessment to formulate criteria for commissioning innovative social services. The task was outsourced through a tender to local analytical centres (who were then coached additionally with project's help).

> Based on the detected needs specific to each of the four communities, the project helped each PPDG to run a competition of proposals for service providers to suggest innovative and cost-effective services for relevant vulnerable groups.

> The project coached selected providers and the PPDG throughout implementation and assessment of the micro-projects[2].

> The micro-projects introduced innovative cost-effective services which were taken on board by local budgets. In some cases they seemed to have even caused a minor outflow of clients from residential institutions. In such cases, local authorities complained that this might cause a decrease in equalisation grants[3] but were still prepared to provide local funding given the obvious link to local needs.

- At the oblast level, the project helped to establish Regional Advisory Expert Groups (RAEGs) in the two pilot oblasts, which co-ordinated regional policies related to social services to vulnerable population groups. Among other things, the RAEGs coordinated development of local social services policies, established regular communication with non-state providers and client representatives, and helped to submit proposals for central-level changes required to support local pilots.
- At the national level , the project worked with the Ministry of Labour and Social Policy (MoLSP) and the Ministry of Finance (MoF) to facilitate systemic reform in support of social service commissioning. All work at the national level had mixed success: on most issues, the project helped to significantly expand relevant capacities but realised that palpable change in the way policy is made requires a longer change horizon and a flatter learning curve. The work included:

> Helping to build capacity of an "Inter-Departmental Working Group on Implementing the Law on Social Services" (WGILSS). This group was led by MoLSP and was supposed to drive all major policy initiatives in the area. Project tried, among other things, to strengthen the engagement of the MoF to achieve consensus on service financing reforms.

> Technical support to the Ministry to understand the current weaknesses of the policy process as such (legalistic tradition, lack of orientation on results, partnerships and consultations etc) and of possible drivers of change in this area related to the Europeanisation agenda.

> Coordinating a comprehensive review of Public Expenditure Management for Social Service provision and promoting resulting recommendations to key ministires. This included

[2] Eighty two applications for MGP funding were received, 40 MGPs were contracted, with a further 2 MGP applications subsequently contracted as "Development Projects" and 41 of these projects successfully completed.

[3] The current formula allocates transfers for funding social services based on the number of clients registered in existing institutions. The formula is therefore not neutral to the type of service provision: it reinforces provision of care in residential institutions and discourages local initiatives for alternative community-based services.

recommendations of change in the transfer formula to eliminate current incentives for residential service provision;

> Helping the ministries to analyse legal and financial obstacles (including taxation) for engaging NGO sector into provision of social services in Ukraine (with recommendations for change);

> Strengthening the capacity of MoLSP for analysis of long-term impact of demographic trends on demand for and financing of social services (with a view of improving the technical merit of the ministry's approach to budget negotiations in annual and mid-term cycles);

> Coordinating a comprehensive review of current approaches to service quality management, including an analysis of the role of the Accounting Chamber, awareness raising about methodologies of statistical process control and Six Sigma tools.

Overall, the restructured FRSSU project was successful in implementing operational pilots of social commissioning despite existing systemic obstacles. It was also able to detect the fundamental challenges for sustainable nation-wide transition to strategic policy planning in the area and to introduction of purchaser-provider service funding. It demonstrated that wide-scale pluralisation of service menu in Ukraine will not be possible without removal of central level barriers such as lack of marginal revenue flexibility at local level (as will be described in detail in the next section of this paper). The project also concluded that communicating these ideas and achieving actual policy change requires longer-term influencing and dialogue, combined with continued work at the level of individual communities.

EU Project "Development of Integrated Social Services for Exposed Children and Families"

An important set of analytical recommendations with direct implications for social services funding was developed during 2006-2007 by an EU TACIS project which co-operated with the State Social Service for Children, Family and Youth to develop Integrated Social Services for Exposed Families and Children. The direct goal of this project was to reduce the number of children in residential care, but given the central-level barriers to de-institutionalisation of child care in Ukraine, the project engaged into strategic analysis of such barriers and recommendations for long-term change. In particular, project used the result of its pilots in Kyiv oblast to understand:

- Problems in assessing and using information about unit costs of social services in Ukraine;
- Lessons from the attempts to implement in Ukraine the "Money follows the child" principle;
- Financial implications for local budgets and intergovernmental finance system of the projects which attempt to reform and increase the amount of social services at the local level.

Key themes, issues and recommendations

Fiscal incentives for residential provision and against service commissioning

Most of the spending on social services in Ukraine is delegated to sub-national budgets. This means that all respective services are financed by a local administration, but the central government compensates some of these costs with a financial transfer. Unlike social assistance (whose expenditures are "deconcentrated"), "delegated" funding assumes that local governments have some flexibility in utilising central funds provided for delegated programmes, in order to make sure that services are provided in ways which are most suitable for local conditions and are therefore most cost-efficient. In principle, the way it is achieved is through dividing a pool of funds across sub-national units based on objective criteria of their relative expenditure need (such as share of population residing on their territory), and providing local governments with sufficient administrative and regulatory autonomy to organise service provision in ways which utilises available funding in an optimal way.

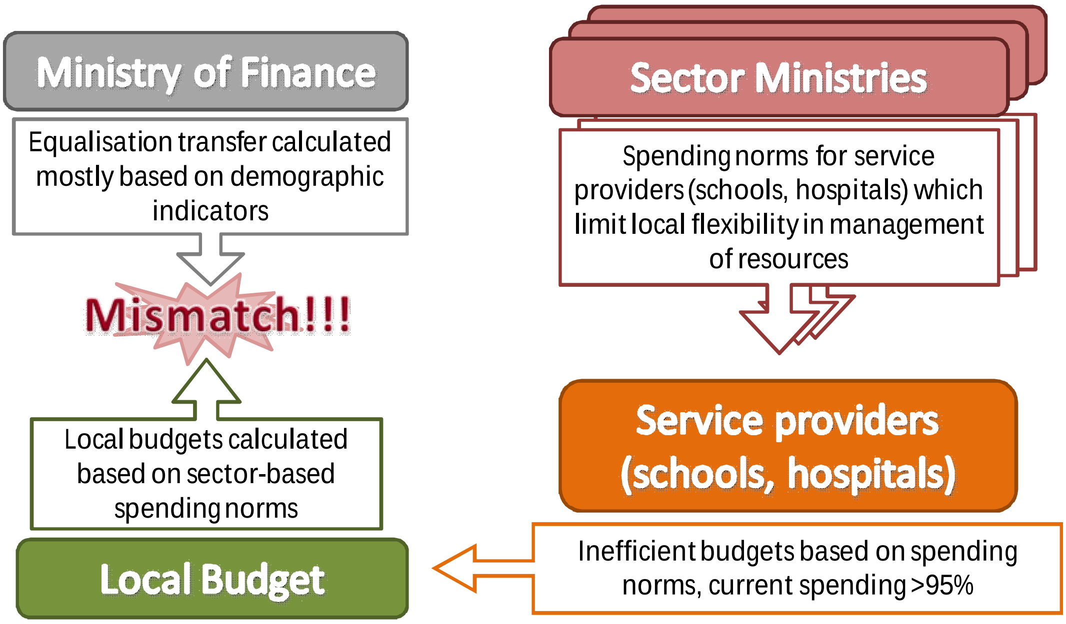
The key spending units who administer the bulk of social service expenditures are local administrations (not line ministries). According to Ukraine's Budget Code, this "delegated" arrangement is used for most expenditures in Education, Healthcare, Culture, Sports and Social Services to vulnerable groups: in 2008, combined spending on these functions was around 85% of local budget expenditures (World Bank February 2008). In Healthcare only, local expenditures in the 2010 budget represent 80% of total consolidated healthcare spending. One implication from this arrangement is that key spending units responsible for these programmes are respective sub-national administrations (rather than line ministries), and <u>ministry-level spending statistics available at the central level is not suitable to assess local expenditures by type of services or institutions</u>. While central ministries (who are themselves key spending units) do provide some services directly (via some central programmes), these expenditures are insignificant. For example, in the latest assessment conducted in 2005, the MoLSP spent most of its budget on social assistance programmes (around 93% in 2005), another 6% on Research and Regulatory Activities, and only slightly less than 1% - on direct funding for two institutions and several national level service-providing NGOs (Joshua 2006).

Delegated expenditures are covered by unconditional transfer of funds from the central budget. According to a "delegated" principle, the central government estimates the amount of funds it is prepared to allocate to these combined delegated programmes, which is allocated to sub-national governments through a combination of shared revenues and an equalisation grant scheme. Equalisation transfers are unconditional: theoretically, they can be utilised for any of the delegated sub-programme (although there are numerous practical barriers to this rule).

In reality, the current equalisation system creates strong barriers against service commissioning, promotes residential forms of care, and increases regional inequalities in access to services:

- It makes it extremely difficult for local authorities to re-allocate funds between programmes. In reality, there is a fundamental mismatch between financial and administrative responsibilities for social services delegated to local authorities, and resulting unfunded mandates on local budgets. Local governments have very low discretion in allocating funds and administering respective programmes. Administrative decision-making (including facility-level budgeting) is subject to a rigid vertical structure of input norms, dictated by central line ministries (see FIGURE 1). One consequence is imposition on local governments of vertically protected recurrent spending, including half of the total public wages.

FIGURE 1. THE MISMATCH BETWEEN FINANCIAL AND ADMINISTRATIVE RESPONSIBILITIES AT THE LOCAL LEVEL



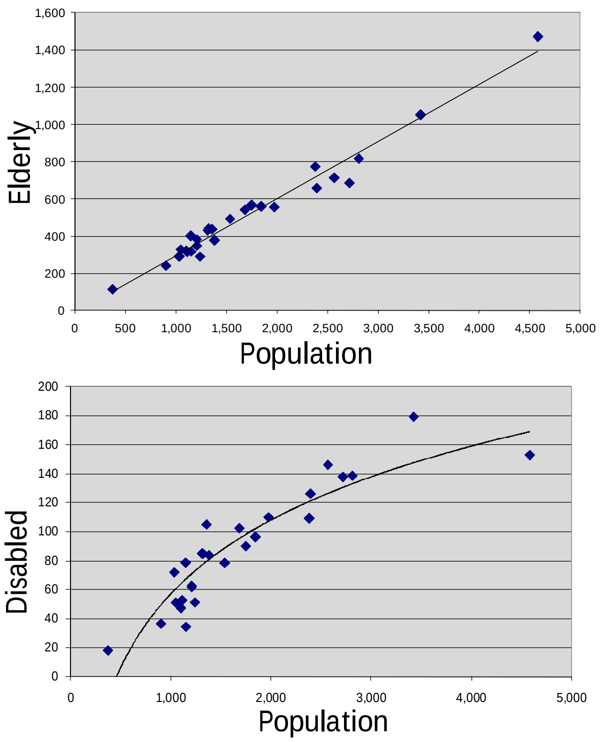
- It creates financial incentives to residential provision of social services. Some decisions on local approaches to service provision are also stimulated by incentives built in the transfer formula: although most variables in the formula are linked to demographic variables, some other variables still allocate funding based on existing infrastructure of service providers. In particular, the formula allocates funds for social care based on the number of clients registered with particular residential institutions, reinforcing their domination, because stimulates local governments to continue funding traditional residential providers, since re-allocating resources to alternative services would decrease respective equalisation transfer to such local budget.

- It stimulates not only domination of residential institutions as service providers, but also creates considerable disproportions in service funding across regions. Allocating funds based not on objective demographic indicators but based on already existing infrastructure (represented by the number of registered clients) means that the regions receive funding which is proportional to their existing network of institutions, rather than objective demand.

  This problem is illustrated in FIGURE 2 for social services for elderly and disabled: but entirely the same situation is observed in social for children since they are funded based on the same principle. The issue in this example is illustrated for disparities at the oblast level, but the issue of similar negative incentives remains valid also for rayons and cities of oblast significance. The left side of the Figure shows that, on the one hand, proportion of elderly and disabled population is approximately the same in all oblasts. Each point on these two graphs on the left side represents the share of respective categories in overall population in each oblast. However, as illustrated by the table in right side of the Figure, oblasts with almost identical population sizes can receive very different amount of funding for social services for elderly and disabled (territorial centres and internats).

- It fundamentally discredits the idea of "purchaser-provider" split, since spending agents are stimulated to allocate funds only among existing providers. Given the input-oriented funding system, most expenditures on social service provision are administered via sub-national administrations based on the existing network of service-providers. This arrangement is fundamentally different from an alternative financing principle, when the state acts as a service purchaser representing best interest of the vulnerable client, assessing the client's needs, and commissioning required services on competitive basis. Such "purchaser-provider" financing model is strongly recommended to increase allocative and financial efficiency of service provision.

FIGURE 2. DISPROPORTIONS IN SOCIAL SERVICE FINANCING ACROSS OBLASTS



Oblasts, paired based on similar population size	Population (2007)	Estimated expenditures for 2007, defined based on the number of registered clients	
		Territorial Centres	Inernats
Dnipropetrovska	3,447	35,972	51,741
Kharkivska	2,829	48,716	48,053
Lvivska	2,577	46,634	26,811
Luganska	2,409	27,335	49,918
AR Crimea	1,984	36,930	26,831
Zaporizka	1,861	21,420	33,769
Iv.-Frankivska	1,389	18,104	15,546
Khmelnytska	1,373	34,055	25,178
Cherkaska	1,342	29,948	32,158
Zhytomyrska	1,330	15,086	39,873
Sumska	1,226	18,816	26,139
Chernigivska	1,168	34,334	28,371
Khersonska	1,127	15,512	23,087
Volunska	1,040	31,854	11,077

Problems with consolidation of fiscal data

One complication resulting from the fragmented responsibility for social services is the difficulty to assess overall expenditures on this sector. Since spending on the various institutions providing social services are reported under separate functional lines (Healthcare, Education etc) and since publicly available budget execution data by functions is not disaggregated by types of institutions / services, collecting data on these costs requires a specific effort and access to respective data sources.

Although some pilot-level data exists for social services, extrapolating it to receive nation-wide estimates is not possible. In 2004-2008, an attempt to collect expenditure data to assess the overall volume of spending on social services was undertaken by the DFID at the level of two oblast-level pilots (in Kharkivska and Khmelnytska oblast). A sample of resulting information is provided in for 2002-2005 is available for Khmelnytska oblast. It shows that in this oblast, overall expenditures for social services varied very considerably during 2002-2005 as a % of consolidated oblast expenditures (the latest figure, for 2005, was 12.8% of consolidated oblast spending). However, extrapolating this share to assess overall spending on social services at the national level is not possible given the highly disproportionate allocation of respective infrastructure. The pilot data also help to see that at least in the example of Khmelnytska oblast, residential institutions were highly dominant (taking up about 80% of all spending), although the share of expenditures on community-based services did gradually increase.

Need for an integrated model of service commissioning

Lack of joint vision of the service procurement model

Financial and institutional barriers to social commissioning, described above, explain at least to some extent why only a negligible and episodic fraction of public funds is currently spent from the local budgets to procure social services through competitive tenders in response to the needs of the clients. As was demonstrated by the projects reviewed by this study, essentially, the only possibility for this type of procurement at the local level is available through a highly cumbersome procedure of case-by-case approval of respective projects as local strategic development initiatives to be funded from local development budgets. This unnatural budgeting channel implies disproportionately high administrative costs and, at the same time, very low financial envelope available for funding such projects, which cannot be used as a sustainable source of regular funding for alternative types of care.

However, apart from financial incentives, introduction of full-fledged social commissioning model is hampered by lack of joint vision at all levels of the key principles which define competitive procurement of services on behalf of the clients, and the institutional nature of the purchaser-provider split. For convenience, the detailed description of this model with reference to Ukrainian context, as well as the key steps needed to implement it, is provided in Annex 1 on page 22). Moreover, without such joint vision of the key principles of social service commissioning, several initiatives in this direction in the recent years were assessed as seriously misguided. These problematic initiatives are briefly discussed in the two subsequent sections.

Conclusions from the hands-on work along with research conducted by the projects in relation to introduction of full-scale social service commissioning, reviewed for this paper, is summarised below:

- Integration with reforms to remove barriers at the central level. Attempts to introduce social service commissioning should be closely integrated with the policy reforms at the central level to remove systemic barriers such as wrong fiscal incentives in intergovernmental formula and rigid input-based spending norms.
- Institutional changes to ensure genuine purchaser-provider split. Introduction of commissioning requires appropriate arrangements (legal, institutional, informational) for the state authorities to act as service purchasers (including clearly defined responsibility and incentives to defend interests of the children, not care providers). These arrangements – and the role of a "service purchaser" should include sufficient flexibility to choose between different options of care, and capacity to assess and compare their costs and benefits.
- Building capacities of purchasers, including through conditional grant schemes. To introduce full-fledged commissioning of socials services with the view to promote innovative service options for the clients, it is imperative to design and introduce appropriate toolkit of funding mechanisms and budget procedures for service commissioning at all levels as well as other necessary tools for the authority and providers to engage in "purchaser-provider" relations, including:
    - Assessing the needs of clients (individual and by categories of vulnerable population groups). Initial methodologies for such assessment were developed and tested in two pilot regions (Khmelnytska and Kharkivska oblast).
    - Mapping and forecasting future demand for services. To allocate sufficient funds for services in response to identified community needs, local (as well as central) authorities need skills to transform information about the needs of clients into projections of service demand, in short- as well as long-run perspective. Methodologies to design scenarios of changes in service demand have been also developed in co-operation with the Ministry of Labour and Social Policy in 2004-2007 (Facilitating Reforms in Social Services in Ukraine Project (DFID), 2007).
    - Selecting appropriate service plans. Current regulations provide no guidance to designing appropriate outsourcing plans for social services, which requires further work on developing and promoting respective methodologies.
    - Estimating unit costs and pricing the services. As will be discussed in detail in the next sections, stakeholders at all tiers generally lack coherent vision about how estimate the

costs of service provision as well as, critically, about why this information is needed and how it should (and should not) be used.

  - Control the quality of service provision. One barrier to social commissioning in Ukraine is lack of mechanisms for quality control, including effective licensing and standardisation approaches. Moreover, unclear division of roles in service provision between tiers of government is reflected in the lack of effective financial oversight over the efficiency of public spending at the sub-national level.

- Expanding the supply of alternative service provision. Previous research has identified legal barriers for non-state providers to enter the market for social services, which have not yet been alleviated. Introduction of social service commissioning should be accompanied with efforts to reform existing providers and to create conditions for new providers (including non-state) of non-residential care compete for public contracts in the area of social care.

Misunderstandings regarding purchaser-provider split: "Money follows the child" initiative in Ukraine

In 2006, Ukraine introduced a new benefit scheme for family-type orphanages and fostering, which was named as "Money Follows the Child" financing programme. The programme was designed as a set of cash transfers to respective service providers (family-type orphanages and foster families), calculated on per child basis. In 2007, this programme was extended on an experimental pilot-basis (in Kyivska oblast) to include children without parental care place in the regular orphanages in this oblast. Overall size of the programme continuously increased over 2004-2012, both in absolute terms and as a percent of total social assistance related cash transfers (see TABLE 1).

TABLE 1. EARMARKED TRANSFER FROM THE STATE BUDGET TO LOCAL BUDGETS ON ON CASH BENEFITS BASED ON "MONEY FOLLOWS THE CHILD" (MFC) PROGRAMME IN 2004-2012 (UAH MLN)

	2004	2005	2006	2007	2008	2009	2010	2011	2012 Plan
Cash transfers based on "MFC" scheme (national programme)	n/a	n/a	6,122	56,961	109,112	156,048	237,590	283,204	381,806
Cash transfers based on "MFC" scheme (Kyivska oblast pilot)			n/a	10,681	17,276	n/a	n/a	n/a	n/a
Cash transfers based on "MFC" scheme total (as % of total cash transfers)	n/a	n/a	0.1%	0.4%	0.7%	0.7%	0.8%	0.8%	0.9%

Source: State Treasury of Ukraine

Ukraine's "Money follows the child" programme represents a regular categorical social assistance benefit and is not based on "money follows the client" funding principle. In terms of its impact on social service funding system, it is structured as a classical "Money follows the provider" principle, since the money is allocated based on the type of provider (in this case, foster families and family-type orphanages), rather than through a competitive process of selection of an optimal type of care and most cost-efficient provider for a child (again, the details about the difference between the two principles are provided in Annex 1 on page 22.)

Misunderstandings regarding the role of economic assessment of service unit costs

Most initiatives in the area of social funding in Ukraine have tried to address the issue of calculation and application of data on unit costs of services. Within the recent research on social service reforms, the need in unit cost assessment is usually mentioned in connection with the following challenges: introducing social service commissioning and contracting, diversifying social services network, increasing the role of alternative and community-based services, and improving budgeting techniques at all levels.

Analysis of various initiatives related to unit costs shows that key stakeholder lack a common vision for the role of this instrument (why it is needed and how to apply it). Recommendations on the necessity of applying this instrument usually focus on methodological details of procedures for unit cost assessment. At the same time, explanations on why unit costs should be calculated are usually rather generalised. Most materials that are currently available in Ukraine dwell on the importance of systems of unit cost assessment for all aspects of the reform process. However no practical guidelines are given as to how this information should be applied at specific stages of policy-making process and implementation of the service delivery policy. Consequently, the stakeholders in the reform process lack a common vision of the instrument, and, hence, of the steps that have to be made to introduce it and the optimal distribution of responsibilities between various government levels and agencies. As one side effect, this ambiguity makes it difficult to agree and approve terms of reference for donor initiatives and projects in this field.

In discussions during the recent decade, opinions clashed on a number of critical issues. Some issues regarding unit cost assessment for social services are not only open but have become stumbling blocks to further discussion. Namely, controversial questions include:

- The role of unit cost indicators in defining the size of intergovernmental transfers – what should it be and should the indicators be used at all at this stage?
- Scope and regularity of unit cost assessment: what is the role of pilot and sampled studies of unit costs; how regularly and under which principles they should be conducted; what should be the scope and the system for data collection; and how to organise it?
- More technically, how should the unit costs be assessed and what are the actual costs of some of the key types of services and their financial implications for the budgets of various level?

The main purpose of unit cost indicators is to inform decision making in social policy, and costing should be done in a way which corresponds to the type of the decision in question. Reflecting the differences in the type of decisions at hand, approaches to collection and analysis of data on unit costs to inform these decisions should also vary. Moreover, while unit costs play a decisive role in making some decisions, other processes may use such information only as secondary or additional. Detailed analysis of the problem of costing social services in Ukraine is provided in Annex 4, while this section contains only a summary of key conclusions.

For practical understanding on how costing could be applied best, it is convenient to define three broad kinds of decisions requiring unit cost analysis:

1. To assess a particular service.

This is the simplest of all situations, where the service provider or policy maker needs to understand how much it costs to provide one concrete service. Respectively, it represents a relatively simple accounting task. Methodologies for such cost accounting are the basic tools needed at the local level to start contracting the services out.

2. To assess and compare alternative services

This class of tasks requires comparative analysis of different types of services. There are several types of economic assessment of alternative ways of funds utilisation. All of them use information on costs associated with service delivery but compare this information with different indicators of achieved results (as described in more detail in Annex 4):

- Cost minimisation analysis;
- Cost-effectiveness analysis;
- Cost utility analysis;

- Cost consequence analysis;
- Cost benefit analysis.

3. To assess policy initiatives

This most difficult class of tasks implies much more complex decisions (policies), such as introducing or supporting innovations and new services, extending policies to cover new clients or priorities etc.

- Often applicable to make decisions in decentralisation, especially when services are delegated to local governments.

- Could include overall costing of a policy, or comparative analysis of various policies. In such case, it relies on sampled studies.

- Could be sequenced as “top-down” and “bottom-up” approaches. Top down – quick but less precise. Bottom up – more accurate and complete, but tends to overestimate the costs.

Importantly, there is a critical difference between the way unit costs should be used by sub-national authorities for the purposes of local procurement and policy-making and, on the other hand, central authorities when they divide funds between the regions. An important corollary from this typology of various applications of unit costs is that while costing of particular services should play a critical role in local procurement, they should be applied in a very different way at the central level at the stage of allocating funds for decentralised provision of services across regions. In this latter case, the way unit costs are applied depends on the degree of autonomy which sub-national authorities enjoy in delivery and financing of the services. The higher is the autonomy, the less central government should rely on unit costs as criteria for allocating funds. Again, a detailed explanation of this differences is described in Annex 4.

To summarise, the major recommendations on the role of unit cost indicators in the current research include:

The format of collecting and using data on the unit cost of services should differ. It directly and essentially depends on the specific application in social policy that it is intended to be used for.

- It is not possible to develop a system for unit cost analysis without a clear vision of the final goal for the calculations.
- In the majority of cases, other data, namely service effectiveness indicators, should complement unit costs information.
- The central government should draw on the unit cost information as on an ancillary instrument in the form of separate targeted research for analysing strategic objectives of social policy (i.e. for initiating reform, justifying distribution of resources between public sectors, defining the system of power distribution between levels of government, developing service standards, etc.).
- Local governments should make active and regular use of the unit cost data for making direct procurements (for identifying the most effective service packages and providers and for concluding corresponding agreements).

Proposed next steps

Sequencing

- Introductory communication to the Government (Concept Memo). This initial desk-research will become a basis for drafting a brief Concept Memo to be used for initial consultations with the Government counterparts regarding proposed reform process. This Concept Memo will outline: our understanding of the background to the current reform agenda (including generally formulated basic technical research findings and recommendations), our vision of goals and objectives of potential changes, outline of additional technical analysis which needs to be conducted (and reasons for such analysis), as well as an outline of key data which would be needed.

- Inclusive work with the Government counterparts on evidence-based development of reform options. Based on the obtained data, our team will undertake a range of technical analysis, described below. Throughout this work, we will maintain consultations with Government counterparts (as discussed below) through individual meetings, presentations and, if needed, working groups.

- Evidence-based Reform Concept Paper communicated to the Government. Statistical and legislative analysis will become a basis for the extensive report which could be used as a draft "White Paper" for changes needed in the area of social services financing. This Paper will include:

  - Specification of required reforms and technical argument for these changes based on revised and up-to-date statistics;
  - Scenarios of possible changes in the intergovernmental transfer formula based on factor analysis of social vulnerability data, which would help to link allocation of funds to neutral variables which correlate with distribution of social risks rather than with input-based variables which promote residential care and other inefficiencies;
  - Options for transition mechanisms to avoid sharp negative financial impacts on individual local budgets from implementation of the reform. These would be based on statistical simulations of such potential financial impact by individual communities and based on up-to-date budget statistics.

- Communications as an integral part of policy influencing. Throughout this work, the ideas behind technical analysis, and its result, should be pro-actively communicated to the Government, as discussed below.

Outline of proposed technical analysis

As outlined above, the following additional analysis would be of critical help to implementation of reforms described in this paper:

- Assessment of current trends in financial allocations for social services. As was discussed on page 11, fragmentation of responsibilities in social services makes it nearly impossible to estimate exact amounts of budget funds spent in this area; respectively, even remote estimates of such expenditures for Ukraine do not exist. There are several reasons why such estimates are needed, and several options for how to compile and analyse relevant statistics:

  - To estimate overall amounts of spending on social services (and services for children in particular). This task is highly complex because requires collecting data from a range of central ministries on financing of particular types of services. At the very least, this should include the Ministries of Social Policy; Education; Healthcare and Justice. To this date, no such analytical effort was attempted in the area of social services, or in particular types of services such as services for children and family. If successful, the estimate would allow to see, for the first time, how much Ukraine spends on social services in comparison to other sectors; what is the share of this budget which is focused on children; and what is the composition of this spending in terms of various forms of care.

Importantly, even in the best case scenario, this work is unlikely to produce a total estimate of spending which would include all local programmes of outsourcing services to non-state providers. This is because, as was described earlier, current legal framework requires local authorities to account such initiatives as local development projects, which makes them invisible in the central level statistics. However, approximate size of such initiatives could be deduced from analysis of the total volumes of local development budgets.

- To understand what share of total budget is spent based infrastructure-based criteria which promotes residential care and hampers innovation and personalisation of services. This is a highly practical task on the way to change the current financing arrangement and to redirect resources into an alternative scheme which would be based on objective criteria, giving the green light for the local authorities to use their budgets for alternative care options. For such purposes, accurate assessment of exact amounts spent on each types of service is not necessary. A sufficient proxy would be the information on the estimated (not actual) local expenditures on socials services which is generated by the Ministry of Finance in the process of calculating the annual amounts of intergovernmental transfers for each local budget.

- Analysis of spatial distribution of available official statistics on key vulnerable groups of recipients of social services (e.g. elderly, children, disabled). To design and simulate various scenarios of reformed financial flows, it will be important to incorporate information on the demographic structure of communities across Ukraine, and to assess whether certain life-time risks (related to young or old age) or certain disabilities are distributed disproportionately across the regions.
- Assessment of spatial distribution of social vulnerability (proxy measure of relative demand for social services) among cities and rayons (oblasts) on the basis of independent surveys (e.g. HBS). Similarly to the analysis of population statistics, data on social risks is another proxy measure of the distribution of social risks across the regions and identification of any current disparities.
- Factor analysis of vulnerability data, identification of neutral demographical variables (e.g. population, age / gender structure etc.) which correlate with distribution of vulnerability. The reason for this analysis and the proposed plan of statistical simulation is described below:
    - Ideally, allocation of resources across the regions to fund decentralised services needs to rely on policy-neutral indicators. In defining criteria for dividing resources across sub-national budgets for delivery of decentralised programmes, it is critical to base allocation decisions on variables which are “local policy neutral”, so that the resource allocation process does not create financial incentives for the local authorities to increase their allocated share by influencing respective variables (Schroeder, 2003). For example, if funds for long-term care for the elderly were divided based on the amounts of residents of elderly homes in each region, this would create an incentive for each region to increase the share of people receiving such residential services (which is not always efficient and not always brings best value to people) rather than try to redirect resources into alternative forms of long-term care (e.g. community based care). In this example, if funds were allocated based on population numbers, it would have been more difficult for regional authorities to influence the allocation. However, variables such as population – which are the easiest to use – are not always accurately capturing

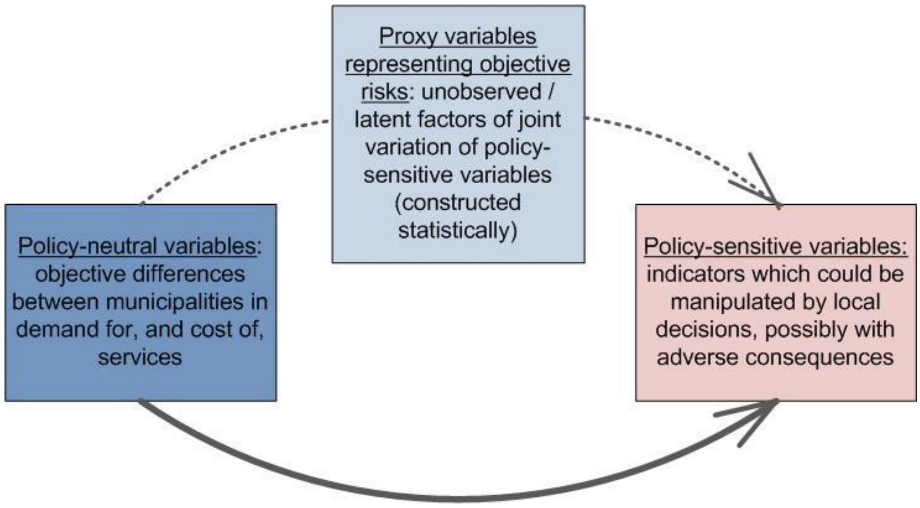
objective differences between the regions in the cost of providing services and in the objective barriers to inclusion and thus disparities in the demand for services.

- Most of the direct social vulnerability indicators are not neutral to local policy decisions. It is clear that individual indicators such as family breakdown and amounts of violent deaths are only the outcomes of social risks dispersed unevenly across communities, and that many other factors – some of which we have listed in earlier sections – are the primary barriers to inclusion which cause these unfortunate trends. From social policy perspective, such the indicators might be viewed as "ex post" variables in that they represent the result of policy action and reflect its current ability to prevent and protect people from social risks. And clearly these indicators as such are not appropriate to use as direct criteria for resource allocation, even though they represent useful information to monitor the distribution of vulnerability and/or the impact of policy decisions.

- Variables in the formula must be not only policy-neutral, but they must also reflect spatial distribution of social risks. A range of possible policy-neutral variables could be considered as candidates to participate as criteria in the formula for allocation of funds (population figures, demographic statistics, levels of urbanisation, etc). However, to consider such variable choices, the Government must first empirically test that they are indeed linked to social vulnerability outcomes at the local level (see Figure 3).

- Selecting appropriate variables for the formula therefore requires statistical analysis of the correlation between potential policy-neutral criteria and actual spatial allocation of social risks. There is a range of statistical methods which could be used for this task. One possibility is to analyse in general terms the unobserved objective variables which dictate the behaviour of available indicators of social vulnerability, in order to illustrate their distribution across municipalities and assist the search for respective statistics (see Figure 3). This is achieved with the help of Principal Components Factor Analysis – a statistical methodology which helps to describe variability among a number of variables with a smaller number of unobserved factors. This procedure identifies joint variations in the known variables in response to some other latent factors and helps to present these latent factors as new variables available for further analysis. At this point of formula design and given the lack of data, factor analysis of social vulnerability may help us to produce a string of new indicators for each of the local budgets which would implicitly measure the unobserved objective social risk and could be mapped geographically and against population.

Figure 3. Types of variables in the formula design



- Development of several options for reform. The analysis outlined above will help to develop several scenarios for modifications in the intergovernmental formula and the respective changes in the financial flows to the local budgets.
- Assessment of distributive consequences of reform options. As was discussed in this paper, political feasibility of reform depends on the assessed financial impact of changes in the breakdown by individual communities. With access to fiscal data in sub-national breakdown for the recent years, we will simulate such potential impact for each of the proposed scenarios and propose transition mechanisms to cushion the losses of transition.

Data requirements

Below is a brief list of data which will be needed and their basic potential sources. Detailed draft description of this data is provided in Annex 5. This list is preliminary and will be updated in the process of research.

Source of data	Type of data
State Statistics Committee	Social vulnerability data in sub-national breakdown; Micro-data from household suveys;
Ministry of Social Policy	Data on numbers of service clients (by types and by regions); Data on service financing;
Ministry of Finance	Estimated expenditures used in the calculations of transfer grant amounts for social services, with detailed breakdown of expenditures in the area of education and social protection;
Ministry of Health	A range of healthcare indicators (morbidity, mortality, general health); Data on financing of selected types of facilities.

Disclaimer on anonymity and generalised use of data. It is critical for the formula simulations to obtain data for the indicators listed in Annex 5 *broken down by individual oblasts, rayons, and cities of oblast significance*. In other words, each of the specified variables (indicator or survey question) would need to be provided for each of the individual unit of local administration (oblast, rayon or city). However, it is expected that all this data will be provided in generalized form and *will not be broken down by individual households or other survey respondents, and will not help to identify these respondents.* Therefore, statistical simulations under this project will not under any circumstances jeopardize anonymity and confidentiality of data collected by the Government of Ukraine. Moreover, it also means that concerns over personal information privacy could not in any way constitute a barrier to obtaining necessary statistics and conducting the technical analysis proposed in this paper.

Policy dialogue and communications

Approach:

- The three key stakeholders for this work include:
  - The Ministry of Social Policy;
  - The Ministry of Finance;
  - The Economic Reform Committee.
- Key milestones and key deliverables should be communicated, for information, to the Deputy Ministers.
- The key counterparts for this work will be heads of departments, based on the draft list below.

Preliminary list of stakeholders to be involved in communications throughout this work includes:

- Ministry of Social Policy: Department of Social Services;
- Ministry of Finance: Department for Local Budgets and Investment; Department for Finances of Social Sphere.

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Annex 1. Input-based versus output-based financing in social services for children[4]

What is input-based financing, how it relates to "money follows the provider" principle, and why it is bad for children?

Input-based allocation of funds in social services for children is rather typical for the region and is known as a principle of "money follows service provider"[5]. The essence of this terminological label is that the state agency, which acts simultaneously as a purchaser of services for the child and as a representative of the system of service provision, allocates available funds among already existing providers. In that sense, money is "following" these providers: allocation is based on already existing providers or already existing types of services. In other words, it is also "input-based", since the government allocates funds between already known set of possible "inputs". This approach to funding public services is simple and convenient, and was used in Western countries for a long time (Dzhygyr, 2006) (Dzhygyr, 2007).

However, despite its simplicity and convenience, this approach also has a number of considerable downsides for the children:

- When money follows providers, it does not leave an incentive for those who provide services to accurately evaluate current needs for services, and to search for the most effective and efficient way of providing them and of satisfying these needs. For any provider – not only residential – this approach does not create incentives to care for children better and more efficiently.
- When budgeting is based on inputs in relations between a funding agency and a service providing facility (for example, a residential care institution), it usually allocates resources based on expenditure norms for one client. This approach stimulates organisations to extend their client base or stops them from helping children to leave residential care for more flexible types of care.

It is important to note that input-based budgeting maintains its benefits and downsides at any stage of resource allocation. In other words, input-based budgeting happens just as well when central government allocates funds for child care across local budgeting based on existing infrastructure for service provision as when a state agency pays an orphanage in proportion to the number of "beds", "buildings" or "staff of defined categories".

What is the essence of the alternative funding mechanism, where "money follows the client"?

An opposite approach to the currently prevalent input-based budgeting through arrangement where "money follows providers" is a funding mechanism where "money follows the client", or, in a narrower case, the child. Again, the fundamental difference between the two systems is in the sequence of decision making and in the roles played in the relations between the participants of the market for social service provision; that is, in the scenarios against which these relations unfold (described by the label of "routes" which money "follow").

The essence of funding principle where money follows the client is in dividing the two key roles – the role of a purchaser and the role of the provider, leaving the role of "purchaser" to a government (funding) authority, and fully transferring the role of service provision to other organisations, which should compete with each other to receive a contract for service provision. Such scheme creates a clear link of market relations between purchaser and provider. Moreover, the state authority, as a

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[4] Based on (FISCO id, 2010)

[5] Alternatively, this model is sometimes called "money follows the supplier" (see (Fox 2003)).

"purchaser", acts fully in the interest of the client (the child), and not in the interest of any provider. This state "purchaser" evaluates the needs of the child, investigates the best service options (e.g. care options) and purchases them on the market. This is why this mechanism is known as "money following the client", or, because of the clear distinction between the two roles, as a more commonly known "purchaser-provider" or "social commissioning" model.

In other words, a purchaser-provider institutional arrangement is one of the dimensions of the transition to results-based financing; it is the institutional essence of how, practically, it could be possible to allocate resources based on expected outputs (not inputs). A purchaser-provider setting helps to allocate resources to providers (or, indeed, to entire government tiers) not based on automatic financing of their declared needs (within limited budget envelopes), but based on agreed performance and results indicators. Such agreements (or contracts) can go into details about concrete line items of future expenses only in case, and only in size, in which this helps to achieve and control the result. Rigid line-item budgeting gives space to flexibility of using funds towards best results – at any level.

This division gives space to resolving the problem of excessive residential care provision, which is to a large extent motivated by financial incentives to such providers to keep children in residential care. When state representative acts as a care purchaser on behalf of the children, it opens possibilities for providing funds to residential institutions in sizes defined by entirely new principles. In the interest of the client, the state purchaser can set financing volumes for each provider not so much based on the arguments of what funds are needed to maintain this institution (including calculations based on the number of children served). Rather, such ceilings could be determined by the expected results for these children and the effectiveness of care of each provider (Dzhygyr, 2006) (Dzhygyr, 2007).

What is the essence of reforms to introduce a new funding mechanism so that resources could follow the needs of the child, not residential providers?

The essence of reforms which aim to achieve sustainable – not short-term and cosmetic – change in the provision of child care is to create an institutional setting which gives the state authority a role of service purchaser and which clearly distinguishes this role from the role of service provision. In other words, introducing a funding mechanism where "money follows the child" implies primarily a structural change in the role of existing agents – rather than one-off reallocation of funds. Such structural changes should include, among other things, creating legal and operational basis for the existing authorities to take new roles, including clear statement of powers and responsibilities, clear instructions and help to engage in the new type of relations.

Simply paying for some new family-based services does not bring sustainable change, or reform, for children, and could be very much input-based and systemically inefficient. The fact that the input-based "money follows providers" model is usually oriented towards state-owned residential institutions does not at all exclude the fact, that the same model is often used to fund (rather automatically and inefficiently) some alternative care services, including private providers such as foster families or family-type orphanages. This means that creation or support of family-type care providers – or any other alternative non-residential providers – as such – does not yet imply a change from input-based towards result-based budgeting, and introducing a model where "money" genuinely follows the child, and not care providers.

On the other hand, purchaser-provider, or output-based budgeting, when the state pays for results, not infrastructure, helps to make all kinds of services more efficient, including residential. Very often, especially at the initial stages of such reforms, state-owned residential providers continue, for some time, to dominate on the "market" of care services for children. However, in the "purchaser-provider" setting, they do not receive their financing directly and automatically. Instead, they are forced to compete for funds, and, respectively, to "sell" their services to the state "purchaser", who in turn can chose the best and most efficient service for the client within the available funds.

What are practical stages for introducing a new approach?

Introducing service commissioning requires the government to solve four major tasks:

- To design and introduce appropriate arrangements (legal, institutional, informational) for the state authorities to act as service purchasers (including clearly defined responsibility and incentives to defend interests of the children, not care providers). These arrangements – and the role of a "service purchaser" should include sufficient flexibility to choose between different options of care, and capacity to assess and compare their costs and benefits.
- To design and introduce funding tools and budget procedures for service commissioning at all levels;
- To design and introduce other necessary tools for the authority and providers to engage in "purchaser-provider" relations (contracts, pricing, tender procedures etc);
- To reform existing providers and to create conditions for new providers (including non-state) of non-residential care to enter the market.

Alternative forms of care as communicating vessels (and why flexibility of choice is the key tool in results-based budgeting for children).

The key aspect of acting as service purchaser is to be able to analyse relative benefits and costs of every type of care for the children (with varying needs!), and use this information as key guidance in decisions on how much to spend on every type of care. Respectively, to engage in such role, the purchasing agency should not only be able to conduct such analysis, but also to be flexible in using alternative forms of care as communicating vessels: being capable to influence the sizes of all types of care, reducing or extending their shares through respective commissioning decisions, as needed.

In the practice of more advanced European systems of care provision, this flexibility is known as a "balance of service provision" model and has remained a leading concept in social care reforms in recent decades. The idea of this concept is to help the agency responsible for service provision to qualitatively define a balanced and most efficient composition of various services which should be available to clients, depending on what are the needs of these clients (what sub-groups with what vulnerabilities are present among those who need care).

Annex 2. “Balance of Service Provision” Model for Child Care

A balance of service provision is a menu of alternative forms of care for every vulnerable categories of children. The financing agency defines the share of every form of care based on specific analysis of the current needs of children matched to the comparative costs of needed forms of care to the budget.

Obviously, for any kind of vulnerability – including absence of parental care – children greatly differ in terms of the level of their dependency on social care. Although the benefits of growing up in a family are well known, some of the children, for example, might require more professional or additional care (e.g. medical assistance related to certain health-related problems), which could be more conveniently or effectively provided in a residential setting.

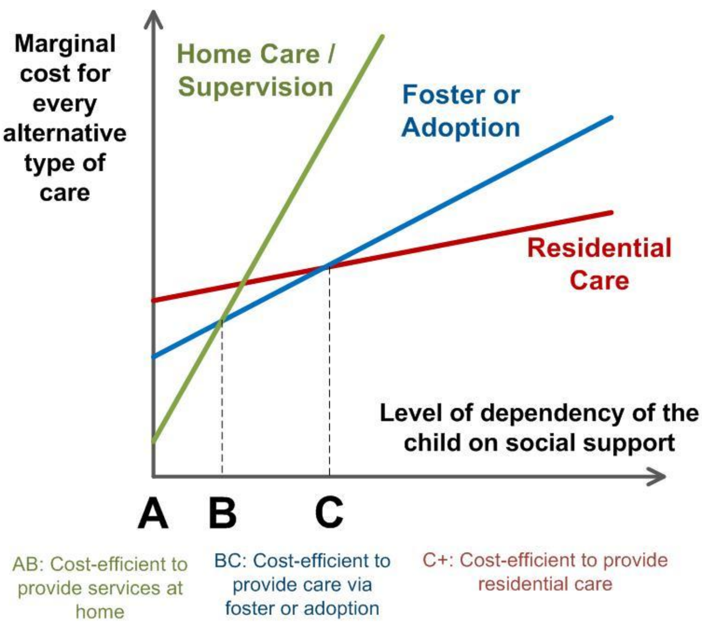
On the other hand, there could be a whole range of alternative forms of care with varying depth of proposed support, including elements of residential support. Respectively, services differ in their cost. The task of the government as purchaser is to define which groups of vulnerable children it has to support, and to find for each of these groups a form of care which represents the best combination of a needed amount of services and their cost.

This Annex explains the principle of such analysis and calculations, for an example of social services for children without parental care.

- Horizontal axis measures the level of dependency of a child (or group of children) on additional help: this dependency can be measured in various units reflecting the amount of additional help needed (from periodic consultations to continuous professional or medical support).

- Vertical axis measures marginal unit costs of each form of services: how much does it cost to the budget to provide needed level of support using this particular form of care? For example, providing additional medical help to a child with a disability is more expensive when provided at home compared to the same level of medical support in a residential home or specialised boarding school.

An example of defining optimal forms of services for children Based on the “Balance of service provision” model



- After defining these indicators, the agency which defines the policy and financing decisions for the given category of vulnerable children on a given territory can select, for any of sub-categories of such children, a type of care which would bring those children biggest benefits at the lowest cost (for each value of X this means selecting a service represented by the lowest curve). For example, for children who need support at the level in the interval AB (quite low) it is preferable to provide services at home, etc. Further on, depending on the composition of sub-groups, the policy-maker can identify and finance an optimal overall balance of service provision.

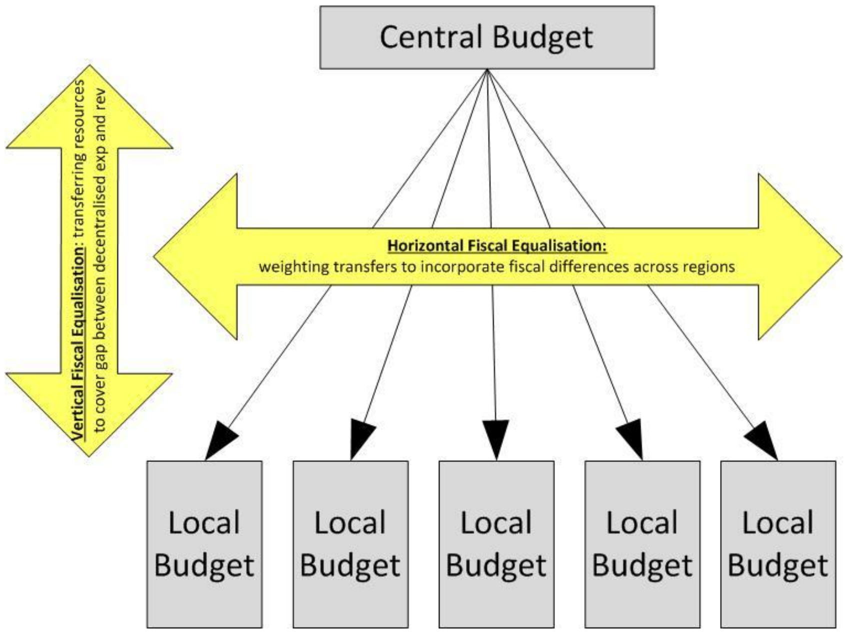
Annex 3. Formula as a mechanism for covering horizontal and vertical gaps

All budget equalization systems are created to help the central national government to address two main tasks (see Figure 4):

- On the one hand, decentralisation of functions means that local governments incur certain additional cost liabilities and thereby create a certain *vertical gap* - that is a gap between expenditure liabilities and local financial capacities. The central government needs to find a way to breach the gap. Possible solutions include transferring tax collection to the local level altogether, sharing the taxes and/or introducing a range of different transfer systems.

- The other task of the central government is to develop a position regarding regional differences in their ability to finance the services. The discrepancies between budgets of the same level in this case are named a *horizontal gap*. Usually governments use certain equalisation mechanisms between the budgets, at least regarding the services which the central governments are obliged to deliver to certain categories of people in accordance with the laws. Countries devise different systems for breaching vertical and horizontal budget gaps that differ vastly and are conditioned by numerous factors, including peculiarities of the political system, national concept of the distribution of responsibilities between government levels, preferences of the voters as to the optimal degree of equalisation between the regions, etc.

Figure 4. Vertical and horizontal fiscal equalisation



Ukraine's approach to fiscal equalisation is not unique and has elements which are frequently used in other countries. It was constructed to use one formula (and hence one set of transfers) for *two parallel tasks*: firstly, to level horizontal imbalance between budgets of one level and equalise the difference between them, and, secondly, to breach the vertical gap between the delegated expenditure liabilities, transferred to the local level in accordance with the Budget Code and the sources of revenue the local budgets have at their disposal.

This attempt to address two tasks is reflected in the twofold principle of the formula of transfer calculation:

- Revenue part of the formula calculates estimated volume of the revenue-earning capacity of each budget in two steps. First, the coefficient of the relative tax collection capacity of the budget, which compares its revenue positions against the national average (the average value is taken as one and the budget coefficient has a value below one if its capacity is below average and above one if it is higher than average). Secondly, the coefficient received is multiplied by the average projected volume of collected delegated revenues for the coming year and thereby a UAH estimate of its projected relative revenue capacity is generated for each budget. Thereby the received volume of relative revenues contains information on the relative rating of this budget against other budgets in the country and a projection of its revenues in the absolute value.

- Expenditure part of the formula for each expenditure function uses a set of indicators of the relative demand in corresponding services (i.e. population or number of school students), which is multiplied by the projected level of average corresponding costs in the country per unit. Certainly, the notion of "*projected level of average costs calculated per unit of need indicator"* sounds cumbersome and calls for detailed clarifications. However in spite of its drawbacks this terms more accurately reflects the nature of this variable than its commonly (and legally) accepted name of *financial normative of the budget sufficiency*.

  This inappropriate term contributed to the sharp conflicts and misunderstandings continuing over the expenditure side of the formula. This is due to the fact that the *financial normative of the budget sufficiency* is actively associated with the notion of *normative,* as a certain standard of expenses, which have to be made by local government and *budget sufficiency* can justifiably be interpreted as volume of funding sufficient to cover certain budget needs.

  But in reality none of these interpretations reflects the approach which was adopted for the formula that is currently used. In the revenue part, the *financial normative of budget sufficiency* is only a mechanistic indicator generated by dividing projected scope of delegated expenses in a certain field by the number of its potential recipients (i.e. population of Ukraine or national total of students of a certain category). To estimate the projected scope of expenses of a specific local budget this total national average per capita *projection* is multiplied by the number of potential recipients residing on the given territory. In other words, as in the revenue part the calculation is twofold: (1) estimation of the total national average projection, and (2) application of this projection to each city and rayon based on their relative rating against others in the country.

  Considerations as to why complications arose with the introduction of the twofold idea formula in Ukraine are outlined in the annex.

Annex 4. Assessing the costs of service provision: key concepts and controversies

The main purpose of unit cost indicators is to inform decision making in social policy. Information about how much it costs to provide a certain service can play a deciding role at various stages of decision-making by officials of all levels of government. However, it is clear that stakeholders should make the whole range of various decisions in the process of policy design and implementation. This variety is illustrated by the list of the following diverse decisions that should be considered:

- What are reform goals?
- What are long term challenges? (e.g. demographic change?)
- What should be the balance between different types of services?
- What obstacles will appear on the path of reform and how to overcome them?
- How spending on social services should compare on spending in other sectors?
- How to divide responsibilities for services between levels of government?
- How to define the size of transfers to local governments to fund social services?
- What is the realistic minimum of guaranteed services?
- What should be standards of their delivery?
- How to select the most effective providers of social services?
- How to control effectiveness of spending by the selected providers?

This Annex describes two of the key most technical dimensions of applying unit cost analysis in social services. One such dimension is the need to select an appropriate type of analysis in the situation when a policy maker needs to assess and compare alternative services. The second dimension is the need to differentiate between the type of cost assessment that should be done at the local level (at the point of selecting the best providers or service plans for the clients or entire communities) and, on the other hand, at the central level at the stage of policy design and in allocation of funds between the regions for decentralised service provision. These two dimensions are covered in turn by the sections below.

Assessing and comparing alternative services: key approaches

Often in social policy at local and central level, policy-makers need to compare different types of services in terms of their economic implications. There are several types of economic assessment of alternative ways of funds utilisation. All of them use information on costs associated with service delivery but compare this information with different indicators of achieved results:

- Cost minimisation analysis. This is the simplest type of economic assessment, which considers only cost indicators and does not take into consideration the indicators of the expected results of the funds utilisation. This analysis can serve the only purpose of identifying the cheapest alternative. Accordingly, its use is limited to the cases when the analyst is prepared to make an assumption that all alternatives in the analysis are equally effective. For example, a policy maker can use this analysis to identify what is the cheaper way of providing care for a child without parents: in a residential home or in a foster family.

- Cost-effectiveness analysis. Calculations measure benefits in so-called *natural units* - i.e. years of life gained, number of disability free days, depression level, etc. In case of social services the improvements in family relations, ability of elderly people to be selfsustainable or ability of disabled people to perform certain functions could be taken as units. Then, it is possible to define for each alternative project (i.e. Alternative types of services or providers) a measure of proposed costs per one *natural unit of outcome gained*. Priority is given to the projects with the lowest value of costs per unit of outcome. For example, a policy maker can use this analysis to identify which type of care for a child is most effective in ensuring some of the child's future life-time indicators (e.g. looking at expected additional years education achieved by each alternative type of care per dollar spent, or, in another way, how much does it cost with each type of care to ensure the same expected amount of education years for the child).

- Cost utility analysis. In essence, this is special case of cost-effectiveness analysis, which measures outcomes specifically as "utility" or improvement in quality of life. Quite often 'Quality Adjusted Live Years' or now commonly accepted abbreviation QALY are used as utility indicator. To estimate this indicator, life years are adjusted with a number of coefficients according to the impact of various health conditions on the quality of life. This analysis is more widely used in health care and not commonly used for social services. However, in principle, it could also be applied: for example, to compare types of childcare in terms of what comparative professional utility they bring in future life per dollar spent (i.e. not just years of education, but also professional achievements measured in some quantifiable way).

- Cost consequence analysis. As in the simple cost-effectiveness analysis, this approach estimates project costs per certain *natural unit*; however, it assumes that the same activities may simultaneously have several different effects. This analysis is based on the fact that for many services it is impossible to measure effectiveness with just a single unit. In the example we are using for child care, comparing residential care with family-based care is impossible with only one indicator like additional education. Usually, it is important to simultaneously analyse effectiveness of each type in terms of a range of indicators such as, for example, health and mental health outcomes, social outcomes, criminal vulnerabilities, etc.

- Cost benefit analysis. This approach measures project costs and outputs in monetary terms. Thereby it becomes possible to directly compare the cost and benefits of the proposed steps. Certainly it is difficult to use this method if it is hard to estimate the results of some events in monetary value. In such cases it is recommended to distinguish monetary and non-monetary dimensions on the output which in fact approximates this method to the cost-consequence analysis. So, the benefit for the child in our example would be a complex indicator of various results achieved by alternative care types, including educational, health, social, criminal and other dimensions.

The difference between costing of services by central and sub-national authorities in a decentralised system

Funding social policy can be imagined as a multi-stage process of procurement of social services using public funds with, trying to maximise their effectiveness. The process is "multi-stage" due to the organisational complexity of service delivery system, including the need to decentralise their delivery. In other words, the central government, which is responsible to the people for practising human rights and implementing national programmatic documents, usually funds respective programmes through a number of 'intermediaries', which are granted the funds and endowed with responsibility to make further procurements. The 'intermediaries' in question include local governments, which actually finance social programmes from their budgets. What are the various links and stages in this process, and what are the roles of all counterparts, depends on the state structure and the model of decentralised distribution of state functions, specific to each country.

Every stage of this complex process may apply different approaches to allocate funds and monitor their effectiveness, depending on the nature of the "agreement" used at this stage between the source of funding and the stakeholder taking over further steps related to the service. The nature of the agreements may vary vastly. In particular, approaches and information the central government needs to use in assigning funds for implementation of the delegated liabilities between local budgets will essentially differ from approaches and information which is used by local governments for identifying a specific range of services and specific service providers.

- The last link in the procurement process - the choice of concrete service for each client and selection of an appropriate provider stands out due to the choice of alternative options (services and providers)[6] and needs to actively use unit cost data on a regular basis. At this stage, the main decision of the *source of funding* (specifically local government) – is a decision about the balance between various types of services to be procured and the choice of providers based on the number of economic and social criteria. Decision-makers at this point need to make of range of numerical projections. There is a wide range of different research data that can be used for choosing between alternative options and service packages and their providers. It is at this stage that there is an immediate need in collecting and actively applying various types of information about the unit cost of service delivery. Moreover, to make these assessments properly, the information of the costs of service delivery should be complemented by quantitative indicators of service effectiveness. In addition, at this stage, the data on unit costs of services is of critical importance for the effective organisation of financial relations with service providers (for designing appropriate contracts and control terms).
- On the other hand, when the central government allocates funds for delegated functions among local budgets, this decision assumes a principally different type of "agreement". It also requires fundamentally different information on the cost of services. At this stage, the nature of the "agreement" is a joint decision to decentralise public functions. The degree and the nature of decentralisation may vary. In traditional classification, there are three degrees of decentralisation: the most powerful, *devolution* (when all decisions on the implementation of the corresponding functions are made locally), moderate - *delegation* (when the local level is empowered to make decisions which are to some degree controlled by the centre) and the weakest – *deconcentration* (when local level only implement certain tasks of the central government).
  - The weaker is the degree of autonomy granted to the local level, the stronger the role of the central government resembles direct service procurement.
  - When a country opts for the model which gives more autonomy to local government (e.g. when delegating takes place), the role of the central government is different. The central level typically retains control over certain aspects of services delivery (i.e. their quality and accessibility). However, the central government performs these functions not through direct influence over the range of services procured and over selection of providers. Rather, it exhorts influence through a system of reasonable, realistic and controlled effectiveness standards of service delivery to ensure that its requirements are met.

    The central government also remains responsible for assessing social expectations regarding guaranteed rights for social services. Accordingly, the central government is responsible for macroeconomic decisions about the optimal size of public sector and the need to augment it or redistribute among the main social functions. Although many factors are taken into consideration for making decisions of this nature, they should necessarily include objective calculations as to how realistic are the declared civil rights. Such calculations should incorporate information on unit costs of service provision. However, approaches to using such indicators in strategic decisions for social policy design should be different from approaches to using them for direct procurement. In strategic planning at policy level, data should be collected based on representative samples; analysis should be performed in cases where it has to inform specific strategic tasks (not as a routine procedure) and should not be related to the tactical decisions about allocation of funds to specific budgets and providers.

[6] Evidently, this is the case only if the institutional and statutory regulations allow such freedom of choice (*de jure* and *de facto*).

Relations between governmental levels in Ukraine are still evolving, but – as discussed earlier – its fiscal decentralisation model is strategically focused on delegation, rather than deconcentration of social services function. Strategic role of the central government in a delegating system implies that unit costs of services should not directly affect the size of the *normatives of budget sufficiency* in the formula for allocation of intergovernmental equalisation transfers. As described in Annex 3, the existing formula was developed to simultaneously address two tasks: inter-regional budget equalisation and covering the gap between delegated responsibilities and locally available financial resources. The variable called *normative of budget sufficiency* in the formula is purely mechanistic and is obtained by dividing the projected volume of delegated spending in a certain sector by the overall projected number of potential recipients. This variable only shows what overall scope of funding was allocated to a specific sector throughout the year - that is the scope of the generally accessible resources in the field. The decision about the scope of funding is made (and should be made) prior to the application of the formula based on a completely different set of procedures. The formula is intended to only distribute the resource among the territories based on objective differences between them (of demographic and geographical nature).

Meanwhile, the government should use sampled targeted studies of the cost of services as an important tool to support policy-making. As has been noted, such decisions include fundamental issues of social policy that affect the overall scope of the allocated resource, distribution of powers between government levels and agencies, as well as introduction of the respective quality standards. Deliberation and discussion of these decisions can be made more effective if based on objective analysis of the projected budget implications of the decisions. For instance, when a regulatory body is developing new standards or requirements for the service it should make an objective analysis of the projected outcomes of the decisions: from the point of view of their benefits and cost to the budget. A similar analysis can be made for projecting budget implications of demographic changes and reflecting this in policymaking.

One way to use the instrument for analysing unit cost of services at the central level could be to create a reference database on the approximate costs of specific types of services. According to the Terms of Reference considered by the World Bank and DFID for the costing study in Ukraine in 2008, mentioned earlier, the first step to introducing the instrument for analysing unit cost could be a sample study of the approximate current costs of the main types of services delivered in Ukraine at present. The data base with the indicators in question could serve as a source of reference information for all stakeholders of the social policy and especially for people involved in defining standards of service delivery.

Annex 5. Draft wish-list of required data

Source of data	Type of data
State Statistics Committee	Social vulnerability data disaggregated by oblast, rayons and cities of oblast significance; including but not limited to: ▪ Natural changes in population (births, deaths, marriages, divorces); ▪ Economic activity of the population; ▪ Morbidity and other health statistics; ▪ Criminal statistics; ▪ Demographic statistics; ▪ Labour market statistics; ▪ Education levels statstics. Generalised micro-data from household surveys, including but not necessarily limited to the ▪ Household living conditions survey; ▪ Population census.
Ministry of Social Policy	Data on numbers of service clients ("contingent") (by all types of facilities) disaggregated by oblasts, rayons and cities of oblast significance; Data on actual levels of financing of all types of facilities disaggregated by oblasts, rayons and cities of oblast significance;
Ministry of Finance	Estimated expenditures used in the calculations of transfer grant amounts for social services, with detailed breakdown of expenditures in the area of education and social protection: Education: ▪ Special boarding schools for children with mental disabilities; ▪ General secondary schools for orphans and children without parental care; ▪ Vocational schools for for orphans and children without parental care; Social Protection and Social Care: ▪ Boarding schools for elderly and disabled; boarding schools for disabled children; education and professional orientation of people with disabilities; ▪ Facilities providing aid to children in difficult life situations; ▪ Territorial centres of social services; ▪ Programmes for children, youth and women; ▪ Social support to those providing care to disabled (1 and 2 group) with mental disabilities (including numbers of such people); ▪ Financial compensation to physical persons providing social services to elderly, disabled, disabled children, people whose health requires external help (including number of such people); ▪ Care to persons with limited physical abilities provided in the centres for professional rehabilitation of disabled and disabled children (including the number of disabled).
Ministry of Health	A range of healthcare indicators (morbidity, mortality, general health); Data on financing of selected types of facilities.