



Per Capita **Financing of Education:** **Experience and Issues**

The findings and conclusions presented in this report do not necessarily represent the position of the World Bank or of its member governments or share holders. The World Bank does not guarantee the accuracy of the data included in this publication and accepts no responsibility for any consequence of their use.

ISBN 83-88911-04-X

© The World Bank Russia Country Office

Edition I, Moscow 2004

Publisher

World Bank Russian Country Office
The World Bank (IBRD)
Bolshaya Molchanovka 36-1
121069 Moscow, Russian Federation
tel: +7 (095) 745-70-00
fax: +7 (095) 745-70-02
www.worldbank.org.ru
moscow@worldbank.org

Published by

Protea-Taff Studio DTP
01-067 Warszawa, ul. Piaskowa 3
tel./fax (48 22) 636 80 92/3/4
e-mail: studiodtp@protea-taff.pl

Report No. 29943

Russian Federation

Per Capita Financing of Education: Experience and Issues

Policy Note
September, 2004

This policy note was prepared by Martin Godfrey (Education Economist, Consultant) with input from Natalia Tipenko (Education Economist, Consultant), Mary Canning and Isak Froumin (ECA Human Development Sector Unit). Reviewers were Deborah Wetzel, Stepan Titov (PREM) and Peter Moock (Consultant).

Executive Summary

This brief policy note reviews experience so far with the implementation of a new financing scheme for general education (based on the principle of ‘money follows the student’) in the Russian Federation. The policy note, which also briefly discusses the lessons of international experience in the field, may be relevant to other countries that are in the process of moving to a system of *per capita* financing of education services.

Of the four major issues facing the education sector in Russia – resource mobilization and efficiency, quality and output measurement, market linkages and equity and access – the first is central: other reforms will be difficult to implement without an improvement in mobilization and allocation of resources. The traditional budget allocation process is at the root of these problems: non-transparent, unpredictable, cumbersome and short-term, it results in an inflexible and inefficient use of scarce resources. The July 2003 law on subventions, which defines minimum educational standards that the state is expected to meet free of charge, and the division of responsibility between the different levels of the state in providing the finance to meet these minimum standards, is an important step towards improving the situation. It is backed up by the development of an alternative, transparent budget allocation mechanism based on the *per capita* principle of ‘money follows the student’. An essential element of this mechanism is the decentralization of budget management to the school director, who should be able to receive a block grant, open and operate a bank account for the school, and flexibly manage a school budget (including funds obtained from non-state sources) without rigid budget headings. In all this, the school director would be accountable to a Board of Trustees at school level, and there would be similar Boards at municipal and republican levels.

The pioneers in the introduction of the new scheme are the Samara and Yaroslavl Regions and the Chuvash Republic. Their experience so far suggests that it takes some time for the efficiency benefits of the system to be felt. Only in Samara Oblast has experience with the scheme been long enough for some evidence of positive impact to emerge. In particular, the number of schools and classes has fallen in line with the number of pupils, and pupil/ teacher and pupil/ non-teacher ratios have increased significantly. At school level, there are also examples of an increase in development expenditure and of increased ability to obtain non-budget funding. However, there is no evidence of a dramatic impact on salaries, which have fallen in real terms since 1997. Even before the impact of the new scheme can be properly measured, it has run into trouble from another source. The introduction of Treasury control of regional budget seems to threaten the possibility of schools achieving financial autonomy (because of the excessive number of line items and the apparent need to get Treasury approval of budgets in advance and permission to reallocate funds). International experience shows that there is no necessary conflict between centralized treasury control of expenditure and school autonomy (including their own bank accounts).

The policy implications of experience in implementing the *per capita* financing schemes so far are as follows:

1. Experience underlines the importance of the new law guaranteeing sufficient state expenditure, through subventions from the federal to local budgets if necessary, in support of min-

imum standards. The *per capita* financing system cannot achieve efficiency and quality improvements if the total amount made available for education is inadequate. This is one of the lessons of what has happened to teachers' real wages in Samara. The new law on subventions needs to be implemented and carefully monitored. After more than a decade of financial crisis, the funds needed for renovation of schools, as well as for other quality-boosting purposes, are substantial. The number of school-age children is falling and prospects for GDP growth are good but, even so, it will be important to achieve the State Council's target of increasing public expenditure on education as a proportion of GDP from 3 per cent in 2000 to 4.5 per cent by 2006.

2. 'Quasi-markets' in state-provided education can be dangerous without an adequate regulatory framework. A national curriculum and testing system, combined with national publication of test and examination results and regular inspection of schools and publication of inspectors' reports, is needed to stimulate autonomous schools to improve their efficiency and the quality of the education that they provide. Exit, entry and school size also cannot be left entirely to the market: the location of the decisions about these things and the criteria to be used have to be clear. With autonomous schools, financial audit becomes even more important and systems for this have to be developed. Some regulations need to be abolished, however – for instance, limitations on class size – to allow the flexibility that the system needs. And the precise extent of local flexibility on teachers' pay and conditions needs to be defined.

3. The institutions needed to make the *per capita* financing system operational, particularly the school-level Boards of Trustees and the mechanisms to strengthen the role of parents and to ensure school accountability, have to be created and/ or strengthened. The stakeholders to whom decision-making is decentralized under the PCF system also need to be trained. All three regions report a lack of budget-planning skills among school directors and accountants. Members of Boards of Trustees and local authority staff need similar training, and parents need to be aware of how the new system works. Particularly in the case of vocational schools, links with the local business community need to be built up.

4. There are local variations in the formulae being used for allocation of funds. As long as they are consistent with the 'money follows the student' logic of the new system (and with the equity objective) it may not matter much. In England, for instance, different local authorities use different formulae. But some federal overview may be needed here.

5. The experience of the pilot regions to date demonstrates that, although education resources are decentralized to the municipalities, adjustment coefficients are not working well. Consequently, school budgets continue to be based on a formula which, if used strictly, does not cover basic educational services in some schools. Therefore, *per capita* financing systems are still implemented only on the municipal level.

As far as the problems arising from the Treasury system and the Budget Code are concerned, in general, the extent to which Treasury systems have been compatible with school autonomy in the regions that are implementing *per capita* financing depends mainly on the flexibility with which treasuries have approached their role. In the Chuvash Republic and (after some initial difficulties) Yaroslavl, treasuries seem to have accepted that they have a technical and not a policy-making role and the system is working reasonably well, but in Samara there are many issues still to be resolved.

There are **three possibilities** to be considered for policy in this area. **One** is that of a series of local compromises – ‘deals’ at the regional level between the Education Department and the Finance Department/ Treasury, along the lines of those already struck in the Chuvash Republic and Yaroslavl. This is useful in the short run, but does not provide a long-run solution for the Federation as a whole. It would be an extremely wasteful path to follow, diverting the efforts of busy education professionals from increasing efficiency and quality towards lengthy and often frustrating negotiations with their counterparts.

A **second possibility** is to move towards a change in the status of schools (and other public social-service institutions). Such institutions would become a new type of legal entity – eligible to receive budget financing allocated on the basis of capitation or a fee for services, to provide additional services for private fees and to enjoy some operational autonomy. This might be similar to the English school-based management model (within a careful regulatory framework) described in the report.

The **third possibility** is to develop national guidelines for regional Treasury control practices. A streamlining of budget classifications, planned in Russia for 2005, will be helpful to this process. Whatever progress is made with other reforms, the development of such national guidelines should be an urgent priority. Without them, it will be much more difficult for the new *per capita* financing schemes to get off the ground.

Table of Contents

Executive Summary	III
Introduction	1
Background	1
The Key Issue: Resource Mobilization and Efficiency	2
Advantages of a <i>Per Capita</i> Financing Scheme	2
Experience to date with the Introduction of <i>Per Capita</i> Financing in Russia	3
Implications of the Budget Code and Treasury System for the Financing of Education	5
The Role of Minimum Standards and Budget Norms in Education Financing Mechanisms	8
Lessons of International Experience	10
Outstanding Issues	13
I. Implementation of the <i>Per Capita</i> Financing scheme to date:	13
II. The Treasury system and the Budget Code	14
Promising Policy Options	15
I. Develop implementation plans to ensure the smooth introduction of the <i>per capita</i> implementation scheme in the Russia Federation	15
II. Harmonize the operation of the <i>per capita</i> financing and school autonomy policies with the Federal and Regional Treasury systems	17
References	19
Annex A: The Impact of the Per Capita Financing Scheme	20
Annex B: The Treasury System, the Budget Code and the PCF Scheme: Regional Experience	22

Per capita Financing of Education in the Russian Federation:

Experience and Issues

Introduction

1. This brief policy note reviews experience so far with the implementation of a new financing scheme for general education (based on the principle of ‘money follows the student’) in the Russian Federation, and makes some recommendations for further development of policies to ensure the efficient and equitable allocation of budgetary resources for general education in the Russian Federation.

Background

2. The World Bank review of the education sector in Russia (Canning et al. 1999) identified four major issues: (i) resource mobilization and efficiency, (ii) quality and output measurement, (iii) market linkages, and (iv) equity and access. In 2004, all four remain matters for concern. A disappointing performance in the 2001 OECD PISA tests (of the ability of fifteen-year-olds to use knowledge and skills acquired in schools to meet real-life challenges) has raised more questions about quality of education and excessive reliance on memorization (OECD 2001). The crisis in initial vocational schools continues to be related partly to their lack of linkages to labor markets in an economy in rapid transition. And problems of access and equity have increased – as evidenced by growing inequalities between regions, disproportionate dropout from schools by children from poorer families, a widening gap in access to, and quality of, schools between the more prosperous urban centers and poorer urban and remote rural areas, and the rapid growth of secondary-level enrolment in private schools and selective grammar schools and lycea for high-ability pupils.

3. The reasons for these problems are many and complex, but one thing is certain. The educational reforms needed to solve them will be difficult to implement without an improvement in mobilization and allocation of resources – the first of the issues identified by the 1999 sector review. In relation to education financing, the review drew attention to the fall in federal transfers to regional compulsory education systems, inefficient use of resources within schools (exemplified by a fall in student/ teacher ratios, to extremely low levels of resources in some rural schools, and by a high proportion of non-teaching staff), lack of accountability of school administrators for private funds that are mobilized, lack of capacity of sub-national governments to direct their own expenditures and, most serious, a crisis in teachers’ pay (low salaries frequently paid in arrears). The review recommended, inter alia, the introduction of *per-capita* financing schemes, based on the principle of “money following the student” as a means of ensuring optimum use of education budgets by ensuring that pupil demand would be the determining factor in the reallocation of resources.

The Key Issue: Resource Mobilization and Efficiency

4. Persistent resource problems in Russian education are a reflection of the substantial fall in real GDP over the past decade, combined with a fall in public expenditure on education as a proportion of GDP – to three per cent in 2000, compared with more than five per cent in Poland and Hungary and more than six per cent in the Baltic states. These problems also reflect the traditional process of budget allocation to schools, whereby each school formulates its budget estimate by using norms based on inputs (such as the number of classes, the number of teaching hours, the number of square meters, previous years' budget allocations) rather than on outputs. The school then submits its estimate to the municipal administration where proposals are reviewed against actual resource availability. Usually the actual budget received is much less than the demands estimated by the schools. Schools receive their allotment on a monthly basis, by line item. There is no provision for any kind of monitoring, evaluation and feedback.

5. This line-item budgeting procedure limits school directors' autonomy in making allocative choices. There is no incentive for schools to economize on particular areas of spending, since the school is unlikely to benefit from the savings. School budgets are sometimes cut by the amount saved during the previous year. Indeed, there is an incentive for schools to inflate their 'needs', for instance a school could create classes with low number of students, in order to increase artificially the relative number of teachers. In short, this budget allocation process, which involves bargaining and 'discretion', is non-transparent, unpredictable, cumbersome and unrelated to long-term strategic issues. It results in an inflexible and inefficient use of scarce resources.

6. The government's response to this has been to work towards a definition of: (i) minimum standards, in terms of subjects and hours of teaching; and (ii) the division of responsibility between the different federal and regional levels for the provision of resources to meet these minimum standards.

7. An important step for the whole Russian Federation was taken on 7 July 2003, when the President signed the law on the amendments to federal legal acts regarding general education funding. This law affirms the right of Russian citizens to widely accessible and free primary, basic and secondary (complete) general education in general education institutions. Together with the amended law on local self-government, it guarantees that the regional government will make financial provision in support of this right, through subventions to local administrations aimed at the achievement of the national standard of general education. These subventions should cover the salaries of school staff, the cost of textbooks, teaching/learning equipment and materials and consumables. Local administrations are responsible for financing maintenance of school buildings and utilities.

Advantages of a *Per Capita* Financing Scheme

8. At the same time, among other government initiatives, work has been proceeding on the development and implementation of an alternative, transparent budget allocation mechanism based on the *per capita* principle of 'money follows the student'. The choice of this alternative mechanism is based on the following expectations:

- it would increase transparency, objectivity and predictability in the budget allocation process, and reduce the time spent on bargaining;

- it would no longer be input-based;
- at the municipal level, it would lead to better allocative choices, drawing attention to ‘non-viable’ schools, within a plan to restructure the network of schools to reflect the fall in the school-age population;
- at the school level, it would increase incentives to use resources efficiently (to the benefit of quality) and increase accountability to parents and a Board of Trustees.

9. In its simplest form, under this system, the allocation of a given amount of budgetary resources between schools depends only on the number of students enrolled: each school gets an equal amount per student. In practice, the formula is usually adjusted for a few factors, reflecting the location and type of school. In Russia there is no unified approach to what coefficients are to be applied and to how many of those should be available to serve the range of possible needs for adjustment. Nevertheless coefficients reflecting the following factors are used most often in the regions:

- differences in location (urban or rural);
- differences in school size;
- differences in type of education (vocational, general etc.);
- provision of specialized education for mentally retarded children;
- provision of home education for children with health problems;
- provision of enhanced education in specific subjects; and
- provision of ‘family education’.

10. Thus, although, the amount that any school is allocated would depend on a number of factors other than the number of pupils it is able to attract, it would receive a block grant, the size of which would be objectively and transparently determined.

11. An important feature of the Russian version of this alternative allocation scheme is that budget management is decentralized to the school director, who should be able to receive a block grant, open and operate a bank account for the school, and flexibly manage a school budget (including funds obtained from non-state sources). In all this, the school director would be accountable to a Board of Trustees at school level, and there would be similar Boards at municipal and republican levels. Such decentralization can be expected to have a positive effect: the OECD PISA study found that mean performance of students varied directly with the degree of school autonomy in budget allocation (OECD 2001:Table 7.11).

Experience to date with the Introduction of *Per Capita* Financing in Russia

12. The pioneers in the introduction of the new *per capita* financing scheme in the Russian Federation have been Samara and Yaroslavl *Oblasts* and the Chuvash Republic. Transition to *per capita* financing of pre-schools and general and initial vocational schools began in Samara in January 1998. As the scheme has operated so far, the regional budget for educational districts provides each school with a formula-based block grant, which is not divided into line items. This grant is confined to salaries, operational expenses and minor repairs, and (for initial vocational schools)

social payments to pupils; however, the purchase of equipment and payments for utilities and renovation of buildings are funded from municipal budgets, outside the per-capita financing framework. Schools have their own accounting offices and bank accounts. The main determinants of the budget allocation to a school are the number of pupils, the location of the school and the number of complete classes (of 25 students in a town and 15 in a village) that it has.

13. One of *Samara Oblast's* distinctive features is its division into educational districts subordinated to the regional Education Department. Based on this governance structure, funds are allocated to finance salaries and training-related expenses in district schools, and strategic control is ensured. The regional school bus program is managed at the district level as well. The school buildings remain municipal property and their maintenance is financed from municipal budgets. The regional Education Department has taken pains to mitigate any negative effects of the new financing system (e.g., by financing redundant teachers' moves to schools in neighboring districts). The current educational district structure is unique inasmuch as it is in many respects at odds with existing legislative norms regulating the delineation of budgeting powers. At the same time, the Educational Subventions Law No. 123, which provides for the financing of the educational process from the regional budgets, actually incorporates Samara's practice of allocating regional budgetary funds to finance part of the overall costs of general education.

14. Samara's school directors have a high degree of independence: they draw up a budget which is then approved by the relevant local authority. They are able to redistribute expenditures between line items, and can use non-budget funds for any purpose including bonuses for teachers. Only 30 per cent of general schools have their own Boards of Trustees, while 50 per cent work with district-level Boards: such Boards are responsible (together with school directors) for school management, including the planning and monitoring of expenditures. One of the constraints on efficient implementation of *per capita* financing in Samara is a lack of the necessary budget-planning skills among local authority staff, school directors and accountants, and Board members.

15. Since 2001, general schools in the Chuvash Republic have also been funded through a *per capita* financing scheme. In 2002 these numbered 643, including 49 primary schools, 170 basic schools (including those for students with special needs) and 424 secondary schools (including four lycea and *gymnasia*). The particular feature of the Chuvash Republic model is that budget allocation to any school covers two types of expenditure – for teaching and maintenance. The allocation for teaching depends on: the total number of students; the number receiving special or remedial education, home education for children with health problems, enhanced education in specific subjects or 'family education'; and the size, type and location of the school. The allocation for maintenance depends only on the number of students and the size of the school.

16. From 2001 to 2003, funds for schools were channeled through local authority budgets, but from 2004 only utility costs will be financed in this way: educational expenses, such as salaries and costs of textbooks, technical aids and materials, will be financed from the regional budget (education subventions). Municipalities and district authorities are formally responsible for decisions on closure of non-viable schools, but in practice the regional Department of Education, which also operates a school bus program, takes the strategic decisions. School directors are free to use extra-budgetary funds in any way that they like, and have a lot of flexibility in their use of budgetary funds. So far, in contrast to Samara, only a minority of schools are legal entities.

17. Yaroslavl has been implementing *per capita* financing of general schools since January 2003, when, following some years of testing, an innovatory regional administration resolution “On the transition to normative budgetary funding of general education in the region”, was launched. Under this arrangement, funds for salaries and current expenses are transferred from the regional budget to municipalities while durables, maintenance and utilities are funded from municipal budgets.

18. The formula uses five adjustment coefficients to modify the per student allocation, as follows:

- low-enrolment rural schools;
- provision of advanced educational programs (in *lycea, gymnasia*);
- provision of pre-school programs;
- adult evening classes; and
- provision of remedial programs for disabled students.

19. All schools in the *Oblast* are legal entities, receiving regional funds in the form of block grants, which school directors are responsible for. Larger schools have their own accounting offices. Shortage of budget-planning and accounting skills is a problem, but a team has been touring districts for three months, training school directors and chief accountants.

20. So far evidence on the impact of the *per capita* financing scheme (reviewed in Annex A) is mixed. Only in Samara Oblast has experience with the scheme been long enough for some evidence of positive impact to emerge. In particular, the number of schools and classes has fallen in line with the number of pupils, and pupil/teacher and pupil/non-teacher ratios have increased significantly. At school level, there are also examples of an increase in development expenditure and of increased ability to obtain non-budget funding. However, there is no evidence of a dramatic impact on salaries, which have fallen in real terms since 1997.

Implications of the Budget Code and Treasury System for the Financing of Education

21. Most OECD countries rely on Treasury systems¹, operated by their Ministries of Finance, to manage their government finances. Such systems (often centralized) process payments and provide comprehensive accounting, fiscal reporting, and financial management services for central governments. In advanced economies networked computer systems integrate all these functions for the finance and line ministries, and may include modules for budget preparation, debt management, extrabudgetary funds, local governments, etc. Moreover, almost all the former republics of the Soviet Union have introduced Treasury systems, and most have made some progress in setting up Treasury payment systems and basic Treasury single accounts.

22. Russia’s shift to Treasury control over budget execution is designed to establish operational control over the targeted use of budgetary funds and budget execution procedures, make budg-

¹ See Potter and Diamond (2000) for further discussion of the issues involved in building Treasury systems in economies in transition.

et-planning practices more accurate, create additional opportunities for budget liquidity regulation, and slash the need for short-term borrowings. In line with Articles 215 and 216 of the RF Budget Code, Treasury control over budget execution will be based on the “cash unity” principle. This principle is designed to ensure that all budgetary funds are concentrated in a single budget account which will govern all financial transactions.

23. In Russia, the basic principles of the Budget Code and of the Treasury system, which began operation for Federal education expenditures in 1998, include the following:

- Operation of a single budget account;
- Payments to providers of goods and services can only be made from one single budget account which is under tight Treasury control to ensure strict observance of the rules for budget limits and expenditures;
- Closure of budget users’ current accounts and a (step-by-step) shift to a system of financing based on personal accounts.

24. There are several models of Treasury operation at the sub-national level. Under the first (already applying to Rostov oblast and Taymir Autonomous Okrug), the Federal Treasury performs some or all Treasury functions for sub-national governments. Under the second, some sub-national governments (including the Chuvash Republic), have established their own Treasury system at the regional level with the coverage of both regional and municipal budgets. A third approach envisages creation of independent regional and municipal treasuries.

25. From 2001, the possibility that the introduction of Treasury control of regional budgets might threaten the principle of financial autonomy for schools has been widely discussed in Russia. In line with the provisions of Article 43 of the RF Education Law, educational establishments shall conduct independent financial and economic operations, have separate balance sheets, and open settlement accounts with banking or other lending institutions. However, pursuant to Article 161(6) of the Budget Code, while executing its income and expenditure plan, a budget-financed institution shall only be independent in expending the funds it has received from extra-budgetary sources.

26. The provisions of the Education Law regulating the financing of budget-financed institutions are deemed to be inferior to those of financial and budget legislation, in particular the Budget Code. The educational institutions’ right to open settlement accounts with banks, which is guaranteed under the law, is at odds with the general principles of Treasury-controlled budget execution. The freedom of budget-financed institutions to expend funds from extra-budgetary sources as they see fit is restricted by the requirement for any such funds to be reflected in the single budget account under the system of Treasury-controlled budget execution. In line with Articles 155 and 156 of the Budget Code, budget accounts shall be serviced by the Bank of Russia, which is an additional restriction on budgets and budget-financed organizations.

27. At the moment, with tax and budget legislation undergoing a drastic revision, the financing practices and rights of budget-financed institutions differ considerably in various regions and municipalities. In some cities, municipal educational institutions are entitled to open settlement accounts with commercial banks to accumulate and independently expend revenues from the provi-

sion of paid services. At the same time, revenues from the lease of premises to budget-financed organizations are transferred to the Treasury account for centralized distribution. Elsewhere, revenues from the provision of paid services by budget-financed organizations are reflected in a single Treasury account, which notably restricts educational institutions' independence.

28. With the system of Treasury-controlled budget execution in effect, budget-financed organizations attach major significance to opportunities for prompt redistribution of budgetary funds between line items, subheads, target programs or categories of expenditures within the functional classifier of budget expenses. The main distributors of funds (such as the regional and municipal Education Committees) need to be able to quickly shift funds between budget users or line items. In the Budget Code, matters of this kind are regulated under Articles 233 and 234. As with the distribution of paid service revenues, the situation here is different in different regions and municipalities.

29. There is a danger that the implementation of the system of Treasury-controlled budget execution as prescribed by the Budget Code will be an obstacle for the attainment of financial and economic independence by budget-financed institutions. However, there is an opportunity to minimize these negative effects by adjusting the various modes of operation of the regional (municipal) Treasury system. This is confirmed by the various regions who are currently implementing different models of operating under the regime of Treasury control over budget execution.

30. The Draft Federal Law "On Amendments and Additions to the Russian Federation Budget Code As Regards Regulating Inter-Budget Relations", currently under consideration by the State Duma, would empower the Federal Treasury to provide cashier services for all types of budgets within the Russian Federation budget system, which would imply the transfer of all accounts to the Federal Treasury. Actually, this would slash the fairly modest degree of fiscal autonomy available to the regions and municipalities today, and worsen the position of budget-financed institutions themselves by further restricting their rights through delegating the cashier's functions to the Federal Treasury. Centralizing the budget process by channelling budget execution operations at all levels through the Treasury would deprive the regional and municipal administrations of the right to select independently the most suitable models of budget user financing oriented towards the preservation of financial and economic independence. The regions and municipalities serviced by the territorial branches of the Federal Treasury would be compelled to observe very imperfect budget legislation which often contradicts with other legislation (the Education Law, for example).

31. Thus, if implemented, the Treasury control scheme would start generating at least three categories of problems for the financial and economic independence of schools:

- The first is that the large number of line items or sub-heads to be included in a school's budget, according to the Budget Code, would be detrimental to the flexibility of school budget execution.
- The second is the nature of the 'approval' of school budgets by the Treasury, which checks *a priori* that the allocation of funds between categories is in line with prescribed norms.
- The third is the need to obtain permission from the Treasury for reallocation of funds among categories and quarterly monthly budget periods.

The Role of Minimum Standards and Budget Norms in Education Financing Mechanisms

32. *Per capita* budget financing and financial and economic independence are two mechanisms that are capable of ensuring adherence to the principle “money follows the student”. However, the amount of desirable *per capita* allocations still remains an open question in Russia. The easiest way, of course, would be to proceed from the aggregate educational budget of the past years by simply dividing it by the number of students (using appropriate coefficients). Although superficially attractive, this approach would almost certainly result in the underfinancing of the state educational standards. Hence the idea of introducing a *per capita* norm that would be viewed as the minimum standard of government spending on education and an essential element of the *per capita* financing scheme.

33. The work to introduce a mechanism of *per capita* financing and to ensure school autonomy was approved by the Ministry of Education and carried out through World Bank projects implemented in several pilot regions. As far as the minimum social standards of government spending per service unit are concerned, the relevant work went beyond the education sector and was closely connected with the efforts to amend Federal legislation in the social sphere as a whole. The changes in Russia’s general budget expenditure policy and the conceptual refusal to adopt any minimum social standards or norms of government spending per service unit have prevented the full-scale implementation of the relevant policy reforms in the Bank projects or the sharing of best practices in the development and application of mechanisms of *per capita* financing to education.

34. Education financing standards as a legally prescribed norm appeared back in 1992, when the Education Law was passed. By the late 1990s, a fairly well adjusted system of sub-laws had been developed to regulate formula-based *per capita* financing and the performance of budget-financed organizations enjoying some financial and economic independence. There were detailed regulations concerning the use of extra-budgetary resources. As a result, over the subsequent 10 years, the educational institutions that stringently observed the principle “money follows the student” did attain financial and economic independence in real terms. The schools that offered educational services of an exceptionally high quality attracted additional numbers of students, increased the amount of budget funds allocated to them and developed meaningful incentives to attract extra-budgetary support. However, this failed to develop into a prevalent trend in the high school education system, and the number of such well-to-do schools remained under 10 percent of the total for a long time.

35. The Education Law stipulates that educational institutions shall be financed on the basis of federally and locally established norms of financing calculated per student of each type, kind and category of educational establishment. The law also defines the federal financing norms as the minimum possible ones. This means that the *per capita* norm as the underlying element of school financing has been formally effective since 1992. The Budget Code, too, establishes norms of financial spending as the basis of budget planning, and specifies some threshold budget sufficiency norms. By the logic of the current Budget Code and in line with the Education Law, the education sector normative of *per capita* budget financing is deemed to be the norm of minimum government spending on general education.

36. Despite the existence of a legally-prescribed norm of formula-based budget financing, repeated attempts to adopt or legally implement this norm at federal level have been in vain. The

latest such attempt was made in the summer of 2003, when the Educational Standards Law was being drafted. The State Duma's Education Committee proposed an article introducing a monetary evaluator of the worth of minimum government spending on education. After the first reading of the draft, the proposed article was abandoned. Having failed to obtain from Moscow any piece of legislation on minimum social standards or norms of budgetary spending on certain budget services, many regions proceeded to pass their own laws on threshold levels of budget sufficiency and/or on minimum social standards. Laws of this kind have been passed in the Republic of Karelia, Perm *Oblast*, Krasnoyarsk *Krai*, and elsewhere. In these cases, formula-based spending on educational institutions is part of the general norms of budget expenditure.

37. The education financing norms developed by a number of ministries and other government agencies were turned down by the State Duma for several reasons. In the first place, the proposed norms were to be calculated based on certain monetary criteria reflecting the natural norms of people's demand for the relevant industries' services, without any cost limitations. Secondly, the proposed methods of norm calculation were non-transparent, because most of the factors taken into consideration were deemed to be subjective. Besides, the use of budget sufficiency norms created an illusory picture of some abstract, "objective" budget needs that allegedly determined the desirable volumes of budget expenditure irrespective of the actual level of budget revenue.

38. The main argument against a norm-based approach to budget planning was that if all the social norms prescribed under current legislation were taken into consideration while calculating the actual budget needs, the required expenditures would be several times higher than what the budget could possibly afford.

39. Many Russian regions have annually reviewed their laws establishing *per capita* norms of financing basic social services, including those in education. They have made the relevant calculations using historical norms to determine the general amount and structure of the required expenditures. Established under the law, these norms are deemed to be the basis for budget planning depending on the number of students and with due regard for the factors pushing up the costs.

40. As new legislation on expenditure-related obligations and the delineation of budgeting powers is being drafted today, the prevalent point of view is that the Federal Government should refrain from taking upon itself any additional financial obligations (financial mandates). Viewed in this light, the introduction of federal norms has very few chances of being a success. Other legislation under development, specifically the Law "On the General Principles of Local Self-Government Organization in the Russian Federation", is permeated with the same spirit. It is the constituent entities (Subjects) of the Russian Federation that are required, under the law, to establish norms of spending on education (excluding communal expenses) for the purposes of calculating the required amount of subventions to municipalities. Thus, despite the requirements written into the Budget Code, the development of threshold norms of budget sufficiency or *per capita* financing has actually been halted at federal level now.

41. With all of the above taken into account, the role of *per capita* financing norms in education should be reconsidered. These norms should not only develop mechanisms to make more efficient use of budget resources, but should also ensure that budget-funded educational services are

financed at a level sufficient to meet existing educational standards. With legislation undergoing a thorough review, specifically with no government spending on various budget services guaranteed under the law any longer, the said norms should be viewed in the first place as criteria for evaluating the worth of a minimum set of educational services of a certain volume and quality to be guaranteed by the state. This means that *per capita* budget financing should guarantee that each student, regardless of his/her place of residence, the financial potential of the relevant municipality, or other factors, would be offered educational services of at least a standard volume and quality². In the process, it would be essential to give as much attention to the individual student's needs as possible by selecting an appropriate training program (from the number of general programs, programs for children with special needs, etc.). This would constitute a system of *formula-based per capita financing*.

Lessons of International Experience

42. Before discussing the issues that have arisen or possible policy options to improve the impact of the new financing scheme on the efficiency of resource allocation and to reconcile treasury control of regional budgets with school autonomy, it may be useful to look briefly at international experience in this field. In 1999, UNESCO published a comprehensive review of formula funding in schools (Ross and Levačić 1999), including four case studies (Australia, England and Wales, the US and Canada, and New Zealand). All of these are examples of the 'radically decentralized' approaches to educational administration, on which the *per capita* financing scheme for Russia is modeled. The proportion of a school's budget that is determined by a formula differs between countries (and within countries) but in all cases the school has direct control over that part of its budget. This does not mean that education is unregulated, however. For instance, Table 1 shows the regulatory framework, within which formula funding plays its part, that has operated in England since 1988. This is a particularly useful model for Russia in its efforts to implement a scheme with many of the same features.

² It should be noted that the regional experience of introducing *per capita* norms has been mixed. In a number of regions, the level of financing of low-enrolment schools has dropped considerably. The dangerous practice of "dispossessing" elite schools (lycees and gymnasia) that used to provide high-quality and innovative educational services due to increased financing has been growing ever more widespread. As a result, the relevant norm has failed to restrict the flow of funding "from below" while turning into an incentive for undue egalitarianism and a check on the flow of funding "from above".

Table 1: Constituent Elements of School-based Management in England post-1988

Stakeholders to whom decision-making is decentralized	Management domain for school-based decision-making	Regulation
<p>School governing body:</p> <ul style="list-style-type: none"> – responsible for managing the school; – delegates day-to-day responsibility to head-teacher. <p>Parents:</p> <ul style="list-style-type: none"> – elect parent governors; – have some choice of school. <p>Local authority:</p> <ul style="list-style-type: none"> – sets overall budget within central government limits; – responsible for special education, admissions policy, capital program, property maintenance, central services, etc. <p>Business community:</p> <ul style="list-style-type: none"> – involved in local training, education action zones; – co-opted as school governors. 	<p>Budget:</p> <ul style="list-style-type: none"> – schools manage their own budget for almost all their needs. <p>Physical resources:</p> <ul style="list-style-type: none"> – 2 categories of schools, (1) those owned by local authority have ‘tenant’ responsibilities, (2) others control all assets. <p>Staffing:</p> <ul style="list-style-type: none"> – determined by governing body, the legal employer. <p>Students:</p> <ul style="list-style-type: none"> – school admits students according to its admissions policy. <p>Curriculum:</p> <ul style="list-style-type: none"> – schools have discretion on how to teach & organize the national curriculum. <p>Performance:</p> <p>Schools must set targets for national test & public examination results.</p>	<p>Use of resources:</p> <ul style="list-style-type: none"> – financial audit; – teacher qualifications, pay & conditions nationally set with increased local flexibility; – national employment laws; – no limitations on class size; – no minimum space rules; – health & safety legislation. <p>Product specification:</p> <ul style="list-style-type: none"> – national curriculum; – national tests & other performance indicators; – inspection of educational standards & quality; – minimum school hours; <p>Market conditions:</p> <ul style="list-style-type: none"> – exit & entry – new schools, school closures, change in maximum number of students must be approved by Dept of Education. – information about school performance is published; – parents have some choice of school; – admission policies more permissive.

Source for Table and text: Levačić 1999: Table 8.1.

43. As Table 1 suggests, formula funding in England gives schools a financial incentive to recruit students and gives parents choice of school (subject to a place being available and the child meeting the admission criterion), and thus is an essential component of the ‘quasi-market’ for schools. The creation of a national curriculum and of an elaborate national testing system, combined with national publication of test and examination results and regular inspection of schools and publication of inspectors’ reports, was intended to stimulate autonomous schools to improve quality, in order to recruit more students and hence increase their funding.

44. Delegating budget decision-making to school level was a major innovation, but has been less controversial than other aspects of the scheme (such as the details of the formula, the ‘league table’ of examination results, and confusion over the complex rules concerning other channels of funding³). Certainly, the concerns that have arisen in Russia about possible Treasury or Finance-Ministry interference in the details of school budget setting have been absent in England

³ See BBC (2003).

(and in the other countries covered by Ross and Levačić). The main budgetary problem is adjustment of a school's total budget share for differences between the estimated and actual numbers of students. The budget share, based on estimates, is announced in March (a few weeks before the beginning of the financial year), students are newly recruited at the beginning of the school year in September, and a national census of students is carried out in January. Budget shares are not changed during a school year but are adjusted from year to year to reflect differences between estimates and outcomes. Schools are allowed to carry forward surpluses and deficits⁴ into the next financial year, and they can keep all non-budget income earned (mainly from renting premises or from sponsorship). As in Russia, schools must invite competitive tenders for services such as building, maintenance, catering, and sports and leisure management. And all schools have the right to open their own bank accounts for their delegated budgets.

45. Among the Central and Eastern European Countries reviewed in Fiszbein (2001) and Davey (2002)⁵, the Czech Republic has perhaps moved furthest towards the kind of formula funding scheme for schools that is envisaged in Russia⁶. A formula is used only for the centrally-funded salaries component of school budgets, as follows. The number of pupils in the autumn of each year is used to calculate the 'normative' (or efficient) number of teaching and non-teaching staff, and hence the fund for wages. A school director can distribute this wage fund, based on normative numbers of staff, as he/she chooses – either employing the maximum number at a low average wage, or reducing the number and increasing wages. The municipalities are responsible for funding the other expenditures, current and capital, of basic state schools and kindergartens, but local conditions rather than formulae usually determine the amount allocated to each school. Schools can keep such funds that have not been used and carry them over to the following year, and can even use them for extra remuneration if necessary. However, if they do so, the central government is likely to reduce its contribution to the remuneration fund by a similar amount. Revenues from the sale and rental of central government property (which many school buildings are) must be handed over to the state budget, but in the case of municipal property, municipalities usually let schools use such revenues in a flexible way – for instance, for repairs and maintenance or the purchase of teaching materials. Although there is no evidence of Finance-Ministry interference in school budget preparation or of inflexibility in budget use, detailed line-item budgeting does cause some problems in the Czech Republic. For instance, Krátký et al. (2002) raise the question of how to classify for budget purposes a tape recorder that the director uses in the morning to listen to the radio news and that is also used in music classes, or a photocopier that is used for general purposes but also to copy parts of textbooks, etc.

46. Another transition country that has implemented a decentralized *per capita* financing (PCF) system is Armenia: over 300 pilot schools have been granted a new autonomous legal status and receive per pupil funding on a lump sum basis. A very simple formula is being used, with the allocation to a school depending only on the number of pupils and its location. Schools have enjoyed their new flexibility and autonomy, in spite of some initial problems. They have also enthusiastically participated in the School Improvement Program which awarded funds for autonomously devel-

⁴ Within reason. A school with a large and persistent deficit becomes a candidate for closure, and surpluses may be a sign of inefficient management.

⁵ Fiszbein covers Albania, Bulgaria, the Czech Republic, Hungary, Poland and Romania; Davey covers the Czech Republic, Hungary, Poland and Slovakia.

⁶ See Hendrichova et al. (2001) and Krátký et al. (2002) for detailed descriptions of the Czech system.

oped projects on a competitive basis. The associated objective of school rationalization and efficiency improvement seems to have been more elusive, however.

47. In summary, this brief overview of international experience shows **that there is no necessary conflict between centralized treasury control of expenditure and school autonomy (including school own bank accounts), and draws attention to some important aspects of proposed policy for Russia.** In particular, it highlights the danger of expecting the introduction of a simple new financing system to solve all the problems facing the education sector described at the beginning of this Note. For instance, competition between autonomous schools will not, on its own, result in an improvement in quality: it has to be supported, as in the English example in Table 1, by the building up of national systems for curriculum, testing, and publication of each school's test and examination results and of the regular reports of school inspectors. And, if such competition is not to result in a further deterioration in equity of access and outcomes, it has to be modified by allocation formulae which favor recruitment of and payment of special attention to students with physical, intellectual or socio-economic difficulties.

Outstanding Issues

48. Two key sets of issues are discussed here:

- those issues that have affected the smooth introduction of *per capita* financing to date in Russia; and
- perceived problems in relation to budget flexibility and school autonomy because of the introduction of the Treasury system and the Budget Code.

I. Implementation of the *Per Capita* Financing scheme to date:

49. In general, six factors determine whether conditions are favorable for successful implementation of a *per capita* financing scheme⁷.

- **A clear and agreed policy environment** with explicit objectives that are intelligible, prioritized and widely accepted.
- **Adequate technical infrastructure**, particularly accurate information on school enrolments by grade level, enrolment in specialized courses, important student characteristics such as socio-economic background, language fluency and educational achievement, and school site features such as size, location and running costs.
- **Transparency and open dialogue.** In addition to the Boards of Trustees at school level, municipal, regional, and national fora (including political leaders, policy makers, administrators, school directors, teachers, teacher organization representatives, and members of school Boards) should engage in continuous dialogue.
- **Willingness to accept change.** There will be 'winners' and 'losers' under the new system. A willingness to change therefore needs to be generated among stakeholders well in advance of full implementation of the system.

⁷ See Ross and Levačić (page 252) for further discussion.

- **Resources for implementation and maintenance.** *Per capita* financing formulae are not set in stone: they will need constant updating. They should be as simple as possible, in the interests of minimizing the costs of data collection and analysis.
- **Research support.** Three different types of research are needed: applied research, to establish per-student costs for different levels and types of program; educational policy research, to monitor the impact of the system and to suggest useful changes in formulae; and basic research on the links between resource usage and learning outcomes at school level, to inform national-level decisions on resource allocation.

50. Many of these pre-conditions are not yet present in Russia. The recent attempts to define minimum educational standards and the responsibility for providing finance to meet those standards are a step in that direction, but further steps are needed. The need for suitably trained technical staff, and adequate computer hardware and software is not yet met. The process of training of stakeholders for transparency and open dialogue, and for management of the system has hardly started; nor have the building of institutions, such as Boards of Trustees, and the clear and participatory planning needed to promote willingness to change. Resources for implementation and maintenance of the system and for research support are also inadequate (although capable researchers are available).

51. Experience so far with *per capita* financing of schools in three regions also suggests (as does international experience) that it takes some time for the efficiency benefits of the system to be felt. Only in Samara Oblast has experience with the scheme been long enough for some evidence of positive impact to emerge.

II. The Treasury system and the Budget Code

52. In April 2003, a conference on the ‘introduction of formula-based schools funding under Treasury control’, in Togliatti, Samara Oblast, identified several problems for *per capita* funding arising from the introduction of Treasury control:

- a decrease in the autonomy of schools and in their flexibility in use of funds;
- a difference between the legislative and regulatory frameworks of Treasury control and the reality of its operation, which hampered the implementation of *per capita* funding schemes; and
- an insufficient level of skills among school administrators/accountants and regional and municipal officials for the introduction of these new financial models.

53. The conference made the following proposals for consideration by the Duma Committee on Education and Science, the Ministry of Finance, the Ministry of Education, and regional and municipal administrations and Departments of Education and Finance:

- to adopt federal legislation which ensures by 2005 that regional budget subventions are available to general education institutions on a *per capita* basis;
- to remove schools’ extra-budgetary funds from regulation through Treasury control⁸;

⁸ This is a potentially dangerous recommendation. In a properly functioning Treasury system extra-budgetary funds should be part of a school’s budget and managed by the Treasury.

- in each of the seven federal districts to form a network of schools that would pilot the introduction of *per capita* funding under Treasury control;
- to ensure the development of federal legislation for effective financial support of education at the municipal and school levels;
- to amend the Budget Code in such a way as to ensure a smooth transition to *per capita* funding and school autonomy⁹;
- to speed up the development and implementation of training and re-training programs for regional, municipal and school administrators, taking advantage of lessons learned in the ERP pilot regions;
- to make available to other regions information on the progress achieved by ERP pilot regions, including the development of *per capita* funding under Treasury control;
- to recommend that the Ministry of Education holds annual conferences on the introduction of new financial mechanisms and school autonomy.

54. Progress in dealing with these problems in each of the three regions is reviewed in Annex B. In general, the extent to which Treasury systems have been compatible with school autonomy in the regions that are implementing *per capita* financing depends mainly on the flexibility with which treasuries have approached their role. In the Chuvash Republic and (after some initial difficulties) Yaroslavl, treasuries seem to have accepted that they have a technical and not a policy-making role and the system is working reasonably well; however, in Samara more work will be needed to arrive at a workable solution.

Promising Policy Options

I. Develop implementation plans to ensure the smooth introduction of the per capita implementation scheme in the Russia Federation

55. The policy implications of implementation experience so far are as follows:
- (a) It underlines the importance of the new regulations guaranteeing sufficient state expenditure, through subventions from the federal to local budgets if necessary, in support of minimum standards. The *per capita* financing system cannot achieve efficiency and quality improvements if the total amount made available for education is inadequate. This is one of the lessons of what has happened to teachers' real wages in Samara. The new law on subventions needs to be implemented and carefully monitored. After more than a decade of financial crisis, the funds needed for renovation of schools, as well as for other quality-boosting purposes, are substantial. The number of school-age children is falling and prospects for GDP growth are good but, even so, it will be important to achieve the State Council's target of increasing public expenditure on education as a proportion of GDP from 3 per cent in 2000 to 4.5 per cent by 2006.
 - (b) 'Quasi-markets' in state-provided education can be dangerous without an adequate regulatory framework. National requirements for graduates and a testing system, combined

⁹ I.e. to reduce the number of line items and make it easier to reallocate funds between them.

with public availability (national publication) of test and examination results and regular inspection (attestation) of schools and publication of inspectors' reports, are needed to stimulate autonomous schools to improve their efficiency and the quality of the education that they provide. Exit, entry and school size also cannot be left entirely to the market: who is responsible for making decisions about these things and the criteria to be used have to be clear. With autonomous schools, financial audit becomes even more important and systems for this have to be developed. Some regulations need to be abolished, however – for instance, limitations on class size – to allow the flexibility that the system needs. And the precise extent of local flexibility on teachers' pay and conditions needs to be defined.

- (c) Institutional capacity building is needed in order to implement the *per capita* financing system and to ensure school accountability. Special attention should be paid to the development of school-level Boards of Trustees, mechanisms to strengthen the role of parents and the creation of feedback systems. The stakeholders to whom decision-making is decentralized under the PCF system also need to be trained. All three regions report a lack of budget-planning skills among school directors and accountants. Members of Boards of Trustees and local authority staff need similar training, and parents need to be aware of how the new system works. Particularly in the case of vocational schools, links with the local business community need to be built up.
- (d) There are local variations in the formulae being used for allocation of funds. As long as they are consistent with the 'money follows the student' logic of the new system (and with the equity objective), it may not matter much. In England, for instance, different local authorities use different formulae. But some federal overview may be needed here.
- (e) The experience of the pilot regions to date demonstrates that, although education resources are decentralized to the municipalities, adjustment coefficients are not working well. Consequently, school budgets continue to be based on a formula which, if used strictly, does not cover basic educational services in some schools. Therefore, *per capita* financing systems are still implemented only on the municipal level.

56. A ten-step implementation plan for the *per capita* financing scheme in the three regions was developed by the regions and the World Bank in 2001, as in Table 2.

Table 2: 10-Step Implementation Plan for the *Per capita* Financing Scheme

1.	Adjustment of the legal and regulatory framework
2.	Development of a methodology for computation (e.g. adjustment coefficients)
3.	Analysis/Auditing of the budgetary allocation system
4.	Development of software to compute <i>Per capita</i> Values
5.	Purchase equipment to support implementation of the scheme
6.	Development of learning material for training in financial management
7.	Training needs analysis
8.	Training and re-training of regional and municipal administrators, and school directors
9.	Implementation of school autonomy
10.	Piloting the <i>per capita</i> scheme in a number of municipalities/schools

Source: World Bank (2001).

57. To this 10 point list, we might add today, a further point which is the importance of defining the minimum standards for the various educational programs that make up the overall education budget.

58. Some of these steps (1, 2, 3, 4, and 6) were for implementation at the federal level, others at the regional/ municipal level (5, 7 and 8), and others at the regional/ municipal and school level (9 and 10).

59. The Federal Ministry of Education could usefully convene a meeting of the three regions currently implementing per capita financing of schools to review the progress of this implementation plan, with particular reference to the six policy recommendations made in the previous section.

60. Such a meeting could also lay the basis for disseminating the scheme to other regions, which should now proceed as quickly as possible.

II. Harmonize the operation of the per capita financing and school autonomy policies with the Federal and Regional Treasury systems

61. There are three possibilities to be considered for policy in this area. One is that of a series of local compromises – agreements at the regional level between the Education Department and the Finance Department/Treasury, along the lines of those struck in the Chuvash Republic and Yaroslavl. This is useful in the short run, but does not provide a long-run solution for the Federation as a whole. It would be an extremely wasteful path to follow, diverting the efforts of busy education professionals from increasing efficiency and quality towards lengthy and often frustrating negotiations with their counterparts.

62. A second possible option is to move towards a change in the status of schools (and other public social-service institutions). Such institutions would become a new type of legal entity – eligible to receive budget financing allocated on the basis of capitation or a fee for services, to provide additional services for private fees and to enjoy some operational autonomy. This might be similar to the English school-based management model (within a careful regulatory framework) described above. A senior official in the Ministry of Finance announced in October 2003 that the Budget Code would indeed be amended to transfer some entities from the status of budget institutions to non-commercial organizations. However, this will be politically controversial and could take some time.

63. The third possible option is to develop national guidelines for regional Treasury control practices. The Togliatti conference recommendations could be a starting point for this. A streamlining of budget classifications, planned for 2005, will be helpful to this process, but meanwhile national guidelines are needed to rein in over-zealous local budget administrators who, according to a senior federal Finance Ministry official, are at the root of the problem – being even more restrictive than the Budget Code (the framework for the operation of sub-national treasuries) requires. Whatever progress is made with other reforms, the development of such national guidelines should be an urgent priority. Without them, it will be much more difficult for the *per capita* financing schemes to get off the ground. The Establishment of a committee including representatives of the two line ministries

most affected (Ministry of Education and Science and Ministry of Health and Social Protection) as well as Ministry of Finance and Ministry of Economy, may be the best way forward. Such a committee should also include professions, including School and Hospital Directors as well regional administrators of both health and education services.

References

- BBC, 2003, How Schools Get their Money, [www.http://news.bbc.co.uk/go/pr/ft/-/2/hi/uk_news/education/2996679.stm](http://news.bbc.co.uk/go/pr/ft/-/2/hi/uk_news/education/2996679.stm)
- Canning, Mary, Peter Moock and Timothy Heleniak, 1999, Reforming Education in the Regions of Russia, *World Bank Technical Paper No. 457*, Washington D.C., World Bank
- Davey, Kenneth (ed.), 2002, *Balancing National and Local Responsibilities: Education Management and Finance in Four Central European Countries*, Budapest, Local Government and Public Service Reform Initiative, Open Society Institute.
- Diamond, Jack, 2002, The New Russian Budget System: a Critical Assessment and Future Reform Agenda, *Working Paper 02/21*, Washington D.C., IMF.
- Fiszbein, Ariel (ed.), 2001, *Decentralizing Education in Transition Societies: Case Studies from Central and Eastern Europe*, Washington D.C., the World Bank.
- Hendrichova, Jana, Frantisek Bacik, Jana Svecova, Lenka Slavikova, Stanislav Karabec and Cestmir Medek, 2001, Czech Republic, Chapter 4 in Fiszbein.
- Johnson, Martin, 2003, *Schools Budgets – Fair Enough? A Comment on the Review of Education Formula Spending*, London, Institute for Public Policy Research, February.
- Krátký, Michal, Petr Linhart, Lenka Dostálová and Ludmila Oswaldová, 2002, Financing and Administration of the Educational System in the Czech Republic, Chapter 4 in Davey.
- Levačič, Rosalind, 1999, Case Study 2: Formula Funding of Schools in England and Wales, Chapter 8 in Ross and Levačič.
- OECD (2001), *Knowledge and Skills for Life: First Results from PISA 2000*, Paris: Organisation for Economic Co-operation and Development.
- Potter, Barry H., and Jack Diamond, 2000, Building Treasury Systems, *Finance and Development*, September.
- Ross, Kenneth N., and Rosalind Levačič (ed.), 1999, *Needs-based Resource Allocation in Education via Formula Funding of Schools*, Paris, UNESCO, International Institute for Educational Planning.
- World Bank, 2001, *Project Appraisal Document on a Proposed Loan in the Amount of US\$50 million to the Russian Federation for an Education Reform Project*, Report No. 21782-RU, Washington D.C., the World Bank.
- World Bank, 2002, *Project Appraisal Document on a Proposed Adaptable Program Loan in the Amount of US\$231 million to the Russian Federation for a Treasury Development Project in Support of the First Phase of the US\$400 million Treasury Development Program*, Report No. 23718-RU, Washington D.C., the World Bank.

Annex A: The Impact of the *Per Capita* Financing Scheme

The evidence on the impact of the *per capita* financing scheme so far is mixed. In Samara, where it has been in operation for more than five years, there is evidence of positive impact on some efficiency indicators. The number of schools and classes has been reduced in line with the fall in the number of pupils, and the number of staff has fallen faster – yielding a significant increase in pupil/teacher and pupil/non-teacher ratios. Although women continue to dominate the profession, the proportion of over-50 teachers has remained low. However, teachers' real wages fell over the 1997-2003 period, in spite of a 17 per cent reduction in staff numbers. Total expenditure on education in Samara rose by only six per cent over this period, allowing only a nine per cent increase in spending on salaries and squeezing the resources available for non-salary and capital expenditure. Non-salary expenditure per pupil rose by only 14 per cent, in spite of a 16 per cent reduction in the number of pupils, and capital expenditure per school fell. There was a shift in the pattern of financing over the period, with a decline in the proportion funded from the regional budget and an increase in the importance of municipal and non-budget funding.

There is encouraging evidence from individual schools of increases in the number of students per class and in pupil/teacher ratios and of increases in the proportion of expenditure aimed at school development. In one school, non-budget funding rose from just over two per cent of the total in 2000 to over 12 per cent in 2002: these funds were spent on in-service teacher training (16 per cent), computer class equipment (51 per cent), expansion of rabbit farming (4 per cent), additional support for socially unprotected children (19 per cent) and materials for making furniture (10 per cent).

In the Chuvash Republic, it is too early to expect any dramatic impact from the recent introduction of *per capita* financing of schools. So far, there are no signs of improvement in indicators of educational efficiency. The number of teaching and non-teaching staff has been falling, but more slowly than the number of pupils. As a result, both the pupil/teacher and the pupil/non-teacher ratio has fallen in recent years. Schools and class sizes have been getting smaller. There are no signs of success in recruiting younger teachers – the proportion of teachers over fifty years of age has been increasing – and the teaching profession in the republic is still predominantly female. The lack of success in recruiting younger teachers and the continued overwhelming reliance on female teachers are related to trends in the region's labor market. Although teachers' salaries more than tripled in 1997-2002, regional average salaries increased even faster. A major indicator of success for the *per capita* financing scheme would be a narrowing of the gap between salaries inside and outside the education system: an increase in pupil/ staff ratios will probably be needed for this purpose.

Revenue for, and expenditure on, education have recovered well from the 1998 financial crisis. In real terms, they show a 32 per cent increase over the whole 1997-2002 period. The share of salaries in total expenditure has been held at around 60 per cent, and although the share of non-salary current expenditure has fallen recently it is higher than in 1999; and the share of capital expenditure has risen particularly fast since then. As a result, non-salary current expenditure per pupil and capital expenditure per school have reached record post-transition levels. Non-budget revenue has also risen fast, maintaining its share of total revenue (even when in-kind items are excluded). These trends are encouraging, but a few more years' data are needed before the financial impact of the new funding arrangements can be isolated.

In Yaroslavl, experience with the *per capita* financing scheme has been even shorter. Schools are happy with the new system, which they see as a means of improving quality: by attracting more pupils and hence more finance they hope to increase teachers' salaries and thus to recruit and retain more qualified teachers, and to spend more on maintenance. Their attitude is favorably affected by the 40 per cent increase in school budgets in 2003, though this may be unconnected with the new system. Some negative side-effects may result: discussions with regional and municipal officers and school directors and staff in September 2002 revealed that one school was already eliminating special classes for students with learning problems, because of their high cost and small enrolment, and the future of special programs in music, theatre and arts (open free of charge to all children in the community regardless of which they go to) was in doubt.

Annex B: The Treasury System, the Budget Code and the PCF Scheme: Regional Experience

In Samara, at a meeting in May 2003, attended by a federal Deputy Minister of Education, the Head of Department of Education and Science in Samara and his staff, and the Head of the Department of Finance of the Samara Region, the broad outline of a compromise system was agreed to be feasible, as follows:

- A school receives a total allocation of budget funds (block grant) based on the *per capita* formula.
- The school director, together with its Board of Trustees, works out an itemized budget for the use of these funds, for approval by the Department of Education.
- The school sends this itemized budget to the Department of Finance for approval.
- The Department of Finance approves the budget for execution by the Treasury.
- The school director and Board of Trustees are able to make changes in the allocation of the budget at agreed intervals, with the approval of the Treasury.

However, various details of the system remained to be formalized in an agreed document setting out the principles for the operation of Treasury control in relation to autonomous schools in Samara.

- The first is the number of line items or sub-heads to be included in the budget: the Education Department would like these to be as few as possible, in the interests of flexibility.
- The second is the nature of the ‘approval’ of the budget by the Finance Department: it is understood that this would be a formality, the structure and content of an autonomous school’s budget being a matter for the head teacher and the Board of Trustees, but this needs to be confirmed.
- The third is the ease or difficulty of changing a budget once it is agreed: this is partly a matter of the number of sub-heads, but also depends on the procedures, and the intervals at which changes can be made.

In the Chuvash Republic the situation is already rather better. Regional and municipal treasuries seem to give sufficient flexibility to schools to prepare and manage their budgets without affecting their autonomy and without compromising the overall fiscal sustainability of the consolidated budget of the Republic, as follows.

- Arrears of wages and payments for utilities have been eliminated.
- Schools prepare their own budgets in line with the PCF formula and such budgets are approved by the Ministry of Education at *raion* level.
- Quarterly limits, based on the budgets prepared by the schools, are then issued by the relevant treasury: applications to change the quarterly budget (including changes in budget categories, transfers between items and postponement of expenditure to later in the year) are considered once a quarter, and typically it takes only from one to five business days for the treasury to approve such changes.
- Non-budget revenue of schools is also under treasury control.

Some difficulties still remain in the Chuvash Republic, chiefly because there are numerous categories in the budget: instead of one utilities line, for example, there are separate lines for heating, hot water, electricity. Each of these items is a matter of treasury control. Nonetheless, the Chuvash experience may be of interest to other regions about to adopt the PCF system.

The same is true of Yaroslavl. As already described above, it introduced *per capita* financing of schools in 2003. Treasury control of general schools (financed from the regional budget) has already operated for three years in Yaroslavl town; federally-financed initial vocational schools have worked with the Treasury control system for eight years. The experience of the vocational schools has been particularly instructive. In the early years rigid line-item budgeting was enforced: no redirection of funds within the budget was allowed, even if it affected a school's capacity to deliver an acceptable education (for instance, diversion of funds to repair a broken pump). The Department of Education redistributed funds 'illegally' and was taken to task by the Treasury, so it took the Treasury to court. It won seven cases against the Treasury and finally an appeal to a higher court also found in favor of the Education Department. This process has convinced the Treasury that it has a technical and not a policy-making role: relations with the Department are now good and extend to help with problem-solving.

The model that has emerged in Yaroslavl, as Treasury control is about to be extended from the town to the whole *Oblast*, is as follows:

- There is no interference from the Treasury at the stage of budget planning – the school only has to convince the Department of Education about the correctness of its budget.
- There are eight main budget categories, with sub-items within them – reallocation across categories takes one month (with formal clearance from the Ministry of Education), but across sub-items within a category can be done without permission.
- Funds not used within a year cannot be carried over to the following year.
- Non-budget funds are covered by Treasury control, but do not affect the amount of budgetary funding.
- Schools have their own bank accounts.



THE WORLD BANK

This policy note reviews experience so far with the implementation of a new financing scheme for general education in the Russian Federation and also briefly discusses the lessons of international experience in the field. Persistent resource problems in Russian education are a reflection of the substantial fall in real GDP over the past decade, combined with comparatively low level of public expenditure on education as a proportion of GDP. These problems also reflect the traditional process of budget allocation to schools focused on inputs rather than on outputs. The note discusses the issues of adopting new financing approach based on the principle of 'money follows the student', proposes a number of solutions, poses questions to be solved and formulates policy options and recommendations.



**World Bank Russian Country Office
The World Bank (IBRD)**

Bolshaya Molchanovka 36-1
121069 Moscow, Russian Federation
tel: +7 (095) 745-70-00
fax: +7 (095) 745-70-02
www.worldbank.org
www.worldbank.org.ru
moscow@worldbank.org

The World Bank

1818 H Street NW
Washington DC 20433 USA
tel: +1 (202) 477 1234
fax: +1 (202) 477 6391
www.worldbank.org
www.worldbank.org
feedback@worldbank.org

ISBN 83-88911-04-X