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Municipal Development Funds and Intermediaries

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Where rapid urbanization strains the capacity of local governments to provide necessary public services, municipal development funds can channel new investments to municipalities and strengthen local government.

Urban populations are growing at nearly double the rate of population growth in developing countries, putting considerable pressure on local governments to expand their physical and social infrastructure. Crowded cities are short of funds and unable to attract investments to expand the facilities, services, and enterprises needed to upgrade urban areas. To compound the problem, municipal governments, which bear most of the responsibility for urban areas, lack the financial and technical resources.

One way to route new investments to local municipalities is to establish municipal development funds. These funds lend money to municipal clients (or provide a mix of grants and loans) for long-term conventional investments in urban infrastructure, commercial plants, housing, and other important facilities.

These funds have attracted the support of international aid donors because they offer a way to provide wholesale funding for a wide range of urban investments. Most of the recent aid projects are at an early stage. Donors have focused on developing appraisal skills and establishing technical standards for the projects, but equity is a prominent objective, particularly for investments in water supply, sanitation, and other neighborhood improvements. Typically the funds combine financing with measures to strengthen the financial and technical capacity of local governments.

To date, a few of these funds have improved the capacity of local governments to operate, expand, or recover costs. But the record of recent minicipal development fund programs is better. The new funds improve the distribution of funding for urban investment and strengthen municipal governments. .

This paper is a background paper for the 1988 World Development Report. Copies are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Rhoda Blade-Charest, room S13-060, extension 33754.

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MUNICIPAL DEVELOPMENT FUNDS AND INTERMEDIARIES

Part A: Evolution and Objectives

Introduction

1. Interest in Municipal Development Funds and the institutions which handle them has revised strongly over the last five years. Several existing funds are being reformed and recapitalised; new funds are being created in countries like the Philippines where they have not featured before. Strong expectations surround their potential role.

2. The precise objectives of these funds vary from country to country, as does the emphasis among them. But the basic problems which they address form a common context. In developing economies urban populations are growing at the rate of 3.8% per annum, i.e. nearly double the general rate of population growth. Huge absolute increases are still being experienced by the primate cities - half a million a year in Cairo and Mexico City, a quarter of a million in Jakarta and Seoul. But the majority of the urban population is still in cities under five hundred thousand and most countries proclaim a policy of physical decentralisation - of promoting the development of secondary towns to relieve pressure on the major conurbations.

3. All cities are experiencing major difficulties in expanding their physical and social infrastructure to cope with the growth in population. It is particularly difficult for the secondary towns, which typically lack a base of existing plant, skills and influence on which to build.

Responsibility also lies primarily with systems of municipal government which are usually the weakest tier in financial and technical resources. Such systems have often been undermined by neglect or more deliberate policies of withdrawing functions, revenue sources and general political authority.

4. Municipal Development Funds have the basic purposes of channelling more investment in urban infrastructure through municipal government and of strengthening the capacity of these institutions in the process. They have attracted the support of international aid donors because they offer a mechanism for "wholeselling" urban investment, i.e. for the provision of aid funds to wi[illegible] diffused investments, often of a minute scale by donor standards.

5. This paper seeks to describe these developments in funding channels and their intended institutions, and, so far as possible, to evaluate them. Judgement must, however, be extremely tentative, since most of the recent round of innovations and aid projects are at an early stage.

6. Some initial definition is necessary, though difficult because the terminology has been used very loosely. "Municipal Development Fund" (MDF) is taken to mean a pool of money operated at a level above that of the individual municipality, for investment in urban infrastructure, services and enterprise through municipal government or its subsidiaries. The literature often confuses Municipal Development Funds with the institutions - banks,

secretariats, associations etc - which control and channel them. This paper will however distinguish the institutions from the funds by describing them as "municipal development intermediaries" (MDIs).

7. The term "municipal" is widely used to describe the government of towns, which in many traditions have been incorporated "islands" of human settlement, divorced from the administration of their rural hinterlands. "Municipal" services are habitually urban in character. In much of Latin America and the Philippines, however, the "municipio" commonly refers to a town and its surrounding rural area, which are administered together. In such cases municipal services may well include rural facilities such as feeder roads, crop drying and storage, and nurseries.

Historical Development

8. MDFs and MDIs are far from new concepts. Together with Japan every Western European country, barring the Republic of Ireland and Switzerland, has a well established central institution channelling investment credit to local government, the majority dating from the 19th Century. Their origins vary however. The Belgium Municipal Credit Bank, the Danish Municipal Credit Association, the Bank for Netherlands Municipalities, the Japan Finance Corporation for Municipal Enterprises, the Norwegian Municipal Bank and the Spanish Local Credit Bank were all specifically established to provide loan finance for local government. The Central

Savings Bank of Vienna and the German Municipal Bank are directly or indirectly under municipal control, but lend to a variety of public agencies and private enterprises including local government. The Municipal Development Fund operated by the French Caisse des Depots et Consignations, the Italian Cassa Depositi e Prestiti and the Portuguese Caixa Geral de Depositos are effectively "windows" within institutions holding and investing a variety of state controlled savings, pensions and insurance funds.

9. It is worth noting that a number of the older European institutions, particularly those in Austria, France, Italy, Portugal and Spain, were established as much to provide a reliable outlet for private savings as to finance public investment. Indeed localised savings banks, postal or municipal, were (and in some cases remain) their principal source of funds.

10. In the last thirty years MDFs have spread rapidly through Africa, Asia and Latin America. Brief research for this paper has identified MDIs in twenty one third world countries: Bolivia, Brazil, Cameroon, Colombia, Costa Rica, Dominican Republic, Guatemala, Honduras, India, Jordan, Mexico, Morocco, Nicaragua, Niger, Panama, Paraguay, Peru, Senegal, Tunisia, Turkey and Venezuela. Loan channels for municipal government operated directly by government departments without an intermediary have been identified in a further ten countries: Indonesia, Kenya, Pakistan, Philippines, Sri Lanka, Tanzania, Thailand, Uganda, Zambia and Zimbabwe. In Brazil and India funds operate

at both national and some state or metropolitan levels. This list is probably incomplete.

11. The form of these funds and institutions varies widely. But some common models and traditions (partly colonial) exist. These include:

(1) Loans funds or local authorities operating out of ministries of local government. These are characteristic of anglophone countries such as Kenya, Sri Lanka, Tanzania, Uganda, Zambia and Zimbabwe. They are normally revolving funds, capitalised from government budgets, occasionally with foreign aid supplements.

(2) "Windows" for grants and loans to municipal infrastructure ("Fonds d'Equipement Communal") operated by national "Caisse de Prets" managing state controlled pension, insurance and savings funds. The model is found in francophone states of North and West Africa though reproduced in the erstwhile Brazilian National Housing Bank.

(3) Autonomous institutions for the promotion of municipal government (Instituto de Fomento Municipal or Instituto para Desarrollo Municipal) developed, often with USAID assistance, in several Latin American countries - Bolivia, Colombia, Costa Rica, Guatemala, Paraguay, and Venezuela for example. These bodies

have been intended to supply technical assistance and training as well as loan finance. A heavy emphasis on development of municipal water supply and sewerage systems has characterised these bodies and it has been common for them to design and build such facilities directly, handing them over to municipal enterprises for operation and debt service.

13. Historically few of these third world institutions and funds have developed a capacity for sustained assistance to municipal government and investment on the scale needed. Most have been undercapitalised. They have tended to play a narrow and passive financing role, applying little technical or financial appraisal to the schemes they have funded, and offering little positive assistance to municipalities other than capital finance. Those which have been mandated to provide technical assistance, have tended to concentrate skills and resources on the direct execution of capital works, which are handed over to municipalities for operation and debt service; while this has added to the stock of urban infrastructure, it has done little to promote the capacity or commitment of municipalities to operate or expand it effectively or to recover costs. Repayment disciplines have not always been maintained. MDIs in Honduras, Kenya and Morocco, for example, have experienced (and tolerated) substantial arrears, and the latter two made new advances to bodies which were in default on existing loans.

Recent Developments

14. The 1980s have witnessed a revival of interest in MDFs and MDIs, with much encouragement from the international agencies. World Bank loans to programmes involving MDFs are in progress or under negotiation in at least fourteen countries (Brazil, Honduras, India, Indonesia, Jordan, Mexico, Morocco, Nicaragua, Philippines, Senegal, Sri Lanka, Thailand, Tunisia and Turkey). Other agencies have been active also; the Inter American Development Bank, for example, has been assisting MDFs in Colombia, Honduras, Panama and Paraguay.

15. Each programme has distinct characteristics; there are even significant variations between World Bank assisted programmes in three Brazilian states (Parana, Salvador and Santa Catarina); the same applies to programmes in two Indian states (Tamil Nadu and West Bengal). But virtually all the programmes are concerned both with financing a specific stream of urban investment, and with longer term institutional development - with enhancing the financial and technical capacity of municipal government, and of the central institutions which should or could support it.

16. Two broad objectives underlining these programmes can be discerned. The first is to mobilise additional resources for urban public investment. The first step is obviously the initial injection of funds from the donor and the counter-part contribution, usually larger,

from central or state government. (The latter may be further enhanced if the donor funds are capitalised, i.e. repaid from the government budget without reimbursement by the MDI). A second enhancement may stem from the capacity of the MDI to tap domestic financial markets through bond and debenture issues. But ultimately most of these programmes aim to exact additional resources from the municipalities themselves through

- debt service obligations
- operation and maintenance expenditure
- using any surplus of revenue over operationa .penditure for debt servicing rather than direct capital expenditure

These aims are reinforced by those elements of programme expenditure or covenants which involve improved revenue administration or more stringent cost recovery.

17. The second broad objective is to improve the utilisation of resources. This is pursued in a number of directions

- injecting rational criteria into the geographical and sectoral distribution of municipal development funds
- developing the criteria and capacity for sound financial and technical appraisal of projects financed by MDFs.
- persuading gove ments to substitute distribution through MDFs for ad hoc capital investment programmes
- assisting municipalities with design and execution of investment programmes

- improving operation and maintenance of urban infrastructure

18. While these aims underlie most if not all the current programmes, there are significant differences in emphasis. The Latin America programmes are particularly concerned with rationalising flows of government finance funds and improving municipal access to them. The Mexican BANOBRAS Loan aims to encourage Mexican authorities to borrow more on the strength of a recently improved revenue base. The loan to BANMA Honduras is chiefly to help improve municipal revenues so that they can keep BANMA in business. The development of a capital grant/ loan programme through the Calcutta Metropolitan Development Authority is only one part of a comprehensive package of capital investment and municipal reform in the Calcutta Metropolitan District. World Bank assistance to the development of an MDF in Sri Lanka will follow on a current intensive package of technical assistance. Despite similarities in context and aims, the wide diversity of practice among MDFs and MDIs needs to be recognised at this stage by looking at their detailed characteristics.

Part B: Characteristics

Institutional Location

19. An inventory of MDFs and the agencies which administer them is at Appendix A. They are managed basically either by a government ministry/secretariat or by an autonomous institution.

20. Direct administration by central government is normally in the hands of the Ministry of Local Government or the Interior (e.g. Kenya, Sri Lanka, Tanzania, Thailand, Tunisia, Uganda, Zambia, Zimbabwe), but occasionally handled directly by the Ministry of Finance (e.g. Indonesia and the Philippines). In the case of Nicaragua and Parana and Santa Catarina states in Brazil the Funds are controlled by state planning secretariats. Banks may however be used to channel the loan, i.e. to disburse and recover on behalf of central government. This is the case with the Parana and Santa Catarina funds, the Indonesian INPRES programmes and the Tunisian CPSCL.

21. "Autonomous" institution means an agency with a separate legal and financial identity. The precise nature of the institutions acting as MDIs varies widely, however, together with their degree of real autonomy in decision making. A number of types can be described:

(1) Municipal Development Banks. There are only a few examples of such banks whose primary concern is the financing of municipal investment, e.g. the Municipal Credit Bank of Belgium, the

Danish Municipal Credit Association, BANMA, Honduras, the Jordan CVDB, the Bank for Netherlands Municipalities and the Municipal Bank of Norway. The Kerala Urban Development Finance Corporation acts virtually in this capacity.

(2) Municipal "windows" within banks with a wider remit, e.g. BANOBRAS Mexico, the Colombian Central Mortgage Bank, the National Housing Development Bank of Senegal.

(3) Municipal "windows" within institutions established to manage state controlled pensions, insurance and saving funds, as in Brazil, France, Italy, Morocco, Niger and Spain. The Indian Life Insurance Corporation specifically finances municipal water enterprises.

(4) Municipally controlled savings banks, which lend to a range of public and private agencies including local government. The Central Savings Bank of Vienna and the German Municipal Bank are prime examples.

(5) Institutions established to provide a range of services to local government including credit, technical assistance and direct construction of urban infrastructure. The Latin American examples have already been described in paragraph 11 (3)

The Iller Bank of Turkey has been particularly involved in direct construction.

(6) An association of municipalities - the case in the Dominican Republic.

(7) A metropolitan development authority. The Calcutta Metropolitan Development Authority combines operation of a programme of capital loans and grants to municipalities with other planning and investment responsibilities.

22. In the majority of cases management of these institutions is appointed by central government, either under statutory powers or as the sole/major share holder. However, municipal government is frequently represented on boards of management either as share holders or by statutory right. Such representatives form the majority in the case of the municipally owned banks (e.g. Austria, Belgium, Denmark and Norway).

23. There are very few but significant examples of private sector involvement in the management of MDFs/MDIs. The French Real Estate Credit Corporation, which lends extensively to municipalities and other agencies for housing development, is a limited company which associates government and private capital in its shareholding and management. The Colombian Central Mortgage Bank uses its Municipal Develcpment Funds (FFDU) to discount part of loans advanced by commercial banks to municipalities.

The British Public Works Loan Board is 100% Government controlled, but its membership is drawn equally from the ranks of local government and City finance institutions.

Sources of Funds

24. At Appendix B I have sought to update a tabulation of sources of finance for MDFs compiled by the United Nations in 1972.

25. In Japan and Western Europe the MDFs have been very largely funded by the financial markets. Initial subscription of share capital by either central or local government has been important in establishing control and credibility, but insignificant as resources for lending. The mechanisms for tapping the market have varied, however. Direct private savings deposits have been important in Austria, Belgium, Germany, Italy and Portugal, attracted in competition with commercial outlets. Otherwise financial institutions - pensions funds, insurance companies, commercial banks - have been the major sources, either through bond issues or directly negotiated deposits.

26. By contrast, the third world MDFs have been largely financed from public funds. Most of the autonomous MDIs have the power to offer bonds publicly, but few do so. Where private savings are tapped, it is normally through loans from, or deposits by central banks or state controlled pension and insurance funds. The very

large loan operations of the Brazilian Housing Bank, for example, were basically financed from the 8% payroll levy for retirement/unemployment benefit. (There are, of course, exceptions; both the Colombian Central Mortgage Bank and the Mexican BANOBRAS have received substantial funding from bond issues; the Jordan CVDB attracts time deposits by insurance companies). International donor finance has played some part in capitalising MDFs, particularly where loans to governments for this purpose have been passed on to the Funds in grant form. Its significance has been greater, however, in establishing procedures, disciplines and credibility - though not always to lasting effect.

27. But the larger source of capital to most third world MDFs has normally been appropriations from government budgets or direct allocation from tax revenues. The Turkish Iller Bank now receives 3% of national tax revenues, the IDM Paraguay 10% of real estate taxes, 2% of municipal current revenues, and a 2% tax on the value of imported liquor, the Calcutta Metropolitan Development Authority 50% of octroi.

28. Internal generation is, of course, a further source of finance to most Funds. This is particularly the case where initial capital from central government or donors is not repayable. But even where it is reimbursable, substantial resources can be generated over time from "spread" with imaginative management. The Parana State Fund in Brazil, for example, is

repaying a World Bank loan over fifteen years, but on-lending for three to eight year periods. The Tamil Nadu Fund hopes to build up 21% of its capital from internal generation, such as a 2.5% spread in interest rates and borrowing with a five year grace period but lending with none. Internal generation is now financing 58% of new lending by the CVDB, Jordan, 50% by BANOBRAS, Mexico and 44% by the Colombian FFDU.

Grants and loans

29. MDFs basically lend money to municipalities for long term investments at quasi-economic rates of interest (i.e. covering interest obligations to providers of capital plus costs of administration). There are a number of exceptions, however, involving elements of grant or subsidised interest.

30. Grant elements arise in a number of forms:

(1) Matching grants attached to loans (varying from 100 to 200% in the case of Santa Catarina State Brazil, or 0-30% in Mexico, depending on the size and revenue capacity of the municipality).

(2) A mix of grant and loan depending on the nature of the project. For example, Calcutta Metropolitan Development Authority allocations consist of:

- 100% loan for markets and water supplies
- 2/3rds loan 1/3rd grant for drains, parks, roads, terminals etc
- 100% grant for slum improvement.

(3) A grant/loan mix varying with the repayment capacity of the municipality in Honduras.

(4) Direct central government expenditure on trunk infrastructure within a Philippines Municipality to the value of 40% of loans it obtains for other work.

31. Interest rates may be subsidised also in a number of forms:

(1) Government sharing the cost of interest payments to the Fund with the municipality (3:7 in Mexico, 50:50 in Senegal).

(2) Interest rates varying with the size of the city (Colombia).

(3) Interest rates varying with the nature of the project (Parana State, Brazil)

(4) MDFs receiving revenue from grants or tax shares which allow low rates of interest to be charged (e.g. 2-4% in Tunisia).

Eligibility

32. Normally all municipal authorities are eligible for loans from MDFs. Allocations may simply depend on bids by individual authorities, with some assessment of priorities if funds are inadequate to meet them all. Alternatively municipalities may be given a quota within which to apply, as in the case of the Calcutta FAM. In a few cases allocations are linked to national targets for particular

sectoral investments (the case of the Indonesian Market Loan programme in the past, or primary health centre loans in Uganda in the 1960s).

33. Some restrictions by size or location may, however, be attempted. Capital cities are excluded from borrowing from the Fund in Costa Rica, Jordan and Paraguay, and four large cities in Panama. Santa Catarina Fund is restricted to municipalities of less than fifty thousand population, the Calcutta Fund to local authorities in the Calcutta Metropolitan District, the Salvador Fund in Brazil to the Salvador metropolitan region.

34. Other tests of eligibility may be applied, apart of course from normal debt service criteria. These relate chiefly to preparation of investment programmes and acceptance of operating and revenue administration guidelines which will be discussed later.

Objects of Investment

35. The most common objects of MDF investment are the conventional elements of municipal infrastructure: water supplies, sanitation, drainage, roads, street lighting, flood control, refuse collection and disposal, markets, slaughter houses and bus terminals.

36. Other objects of investment which are sometimes included are:

(1) Vehicles and equipment.

(2) Tax mapping.

(3) Productive plant, e.g. industrial workshops and estates, crop nurseries, storage and drying facilities.

(4) Recreational facilities.

(5) Social infrastructure - schools, clinics etc.

(6) Commercial premises - offices, shops etc.

(7) Housing development.

<u>Security and debt service</u>

37. Assessing the debt service capacity of the municipal clients is one of the most difficult aspects of managing an MDF. Most funds rely simply on the statutory limitations on the incurring of long term debt which are regular features of municipal government systems.

38. Such limitations normally consist of a conventional set of ratios of debt or debt service to revenue. In the case of the Santa Catarina Municipalities in Brazil a composite set of ratios applies:

- Total outstanding debt must not exceed 70% of the previous year's total revenue.
- The debt contracted in one year must not exceed 20% of annual revenue.
- Debt service should not exceed 15% of previous year's revenue.

The latter stipulation also applies in Indonesia and Tunisia. 15% of annual revenue represents a typical legal limit on debt service.

39. The difficulty, of course, is that formula ratios of this type are not particularly helpful in predicting the real impact of increased debt charges on a

municipal budget. In the case of a self liquidating investment - water supplies or markets, for example - capacity to service a loan depends upon the internal financial viability of the investment project, not on the general state of the municipal budget. In the case of non-self liquidating projects - roads, schools etc - capacity to repay a loan depends upon current revenues exceeding regular commitments (personnel, operation and maintenance); ability to service a loan should be judged by estimating the foreseeable trends in both elements. The French Caisse des Depots bases its lending to individual municipalities on financial forecasts, not on debt service ratios. The Jordan CVDB has had to change its eligibility criteria to individual financial forecasts, after the misleading quality of debt service ratios became clear.

40. Two of the Indian experiments represent serious attempts to reconcile lending targets to municipal capacity. In the case of the Calcutta Metropolitan District, debt service is part of the notional expenditure forecast used in calculating deficit grants, which assume certain target levels of frugality in spending and efficiency in revenue collection. (A very similar provision existed in Uganda in the 1960s). In the case of the Tamil Nadu Fund (still under negotiation) a varying mix of grant and loan is to be used to keep debt service within limits established for each municipality by a forecast of expenditure and revenue, again assuming target standards of performance.

41. Assessing the capacity of municipalities to service MDF lending does appear in most cases to be a somewhat superficial process. The reasons are possibly two-fold. The first is that most Funds assume that enhanced ability to service loans will result from the various incentives built into their lending. The second is that most do not have a worry since loans are secured by liens on inter-governmental transfers. In several cases national revenue shares are credited initially to the municipalities' accounts with the MDI, so that recovery of loans involves no more than a journal entry.

Incentives to municipal performance

42. Municipal Development Institutes in Latin America were intended from the outset to combine lending with the promotion of municipal capacity through technical assistance and other incentives. Such aims have become characteristic of recent programmes in other regions to create or enhance MDFs. The instruments can be divided into those concerned with the quality of expenditure and services, and those concerned with the revenue base.

43. The most common and basic concern of recent MDF programmes has been to improve the technical appraisal of investments financed by them. Donor aid has focussed upon developing appraisal skills on the part of MDI staff and the imposition of technical standards and criteria with which projects should comply. Minimum engineering design specifications are an obvious component of such standards,

but economic and social equity criteria are also prominent; simple designs and standards offering a service to a high proportion of low income users and residents characterise these specifications, particularly for investments like water supplies, slum improvement, solid waste management or sanitation.

44. But the concern in a number of cases extends beyond the scope of the immediate project. Several MDFs such as those in Salvador and Santa Catarina, Brazil, Nicaragua, the Philippines or Tamil Nadu State, India, insist that projects can only be financed within the framework of medium term investment plans which municipalities must produce to qualify for assistance. BANMA, Honduras, requires municipalities to produce plans of action for improved operation and maintenance of services. Several of the Latin American MDIs provide assistance with surveys, physical zoning and traffic plans. The beneficiary municipalities in the Philippines must establish mayoral task forces to improve operation and maintenance of services. The Calcutta Metropolitan Development programme including the MDF also seconds technical staff from state government to all municipalities.

45. On the revenue side the most common focus is on cost recovery practices. Conditions for MDF assistance are fairly standard. Water supply schemes, markets, commercial refuse collection, slaughter houses and bus terminals must be fully financed by user charges, rents and fees covering both operation and maintenance and amortisation of debt. Investment in non-self liquidating

projects, such as roads, domestic refuse collection and social services, must be accompanied by improvement in taxation. Technical and financial assistance, tax mapping, consumer listing etc may be part of the MDF intervention. Specific revenue convenants imposed. The Calcutta Municipal Corporation, for example, was committed to increase its water rates and introduce metered charges for commercial/industrial users, and improve collection of property tax from 60% of demand in 1982/83 to 85% by 1987/88. Salvador City was required to make a similar improvement in collection efficiency and increase the number of registered taxable properties from 360,000 to 450,000 by 1987. BANMA, Honduras, has taken over responsibility for collecting revenue arrears in the Central District. Finally, training, particularly in budgetary and financial control, has been organised by several MDFs; acceptance of training support has been a condition of loans in Mexico and the Philippines.

46. A number of programmes have been explicitly designed to encourage municipalities to borrow. Simplifying access to loan finance is one element in this together with training in the procedures. The World Bank's BANOBRAS Loan aims to reduce interest structures from over fifty to one, signatures from sixty five to three, and processing time from as much as five years to an average of three months. The Colombian Central Mortgage Bank has produced excellent manuals describing what projects are eligible for assistance by the FFDU, and explaining the specifications, procedures etc in relatively simple terms.

Part C: Cases

Introduction

47. The previous paragraphs have concentrated on individual features of MDFs/MDIs; it has not provided a comprehensive picture of any particular programme. It may be useful at this stage to give a brief descriptions of a sample of MDFs which illustrate a wide difference in both institutional and financial form.

Brazil: Parana State Municipal Capital Improvement Programme

48. Parana State MCIP finances urban infrastructure and public services in 287 market towns with populations below fifty thousand. Larger towns and the region surrounding the state capital are excluded. The programme aims to compensate the more rural municipalities for a revenue sharing system (based on the origins of value added tax) and a local tax base which favour larger urban centres, and to counteract pressures for rural urban migration.

49. A current four year programme aims to disburse $150m through the MCIP, of which 65% has been contributed from the State budget and 35% from a World Bank Loan. The World Bank Loan component has been on-lent to municipalities which choose to apply for loan finance for projects forming part of approved multi-year investment programmes and which can meet statutory debt service requirements. The State Government contribution is in the form of capital grants distributed in two ways:

(i) 50:50 matching grants to those municipalities taking sub loans under the programme

(ii) a per capita allocation to all the eligible municipalities with a slight weighting in favour of areas of faster economic and urban population growth.

50. The anticipated distribution of the current programme is

-	roads and bridges	43.3%
-	water, sanitation and electricity	10.5%
-	miscellaneous infrastructure	11.2%
-	community facilities	23.0%
-	equipment and vehicles	7.0%
-	technical assistance	5.0%

Specifications and criteria have been applied aiming at wide diffusion of services, low cost and labour intensive technologies and a bias to low income beneficiaries.

51. The Fund has been administered by the State Economic Planning Secretariat (SEPL), but loans are disbursed and recovered by the Parana State Bank. The Bank has deducted repayment and interest from the municipal shares of the State's value added tax (ICM) which are disbursed through its accounts. Appraisal and supervision have been provided by twenty SEPL regional offices. Technical assistance covering design, tendering and supervision of works, preparation of town zoning plans, cadastral

registration, property tax assessment and administration, and accounting practices was meant to be provided by two institutions: The Parana Municipal Assistance Foundation (FAMEPAR) and the Parana State Public Works Company (EMOPAR); in the event it has proved difficult to negotiate a satisfactory programme of service by these agencies.

52. Municipalities have been expected to repay the loan elements of the programme and to operate and maintain the investments through a series of cost recovery measures including

(i) direct charging of beneficiaries for street related improvements

(ii) user charges for services and utilities

(iii) improved registration, assessment and collection of the urban property tax (liability for which would be extended to new areas by the investments in infrastructure)

53. The Capital Improvement Programme was launched in 1981, but initially on a purely grant basis. The revised programme including the World Bank participation and the provision of loans, has effectively been in operation since 1984. A full evaluation has not been made and would in any case be premature. In particular no evidence is available on the impact of the programme on municipal finance or the implementation of the cost recovery objectives. As mentioned there have been long

delays in providing the technical assistance in this particular direction. Nor is there evidence concerning overall project quality.

54. Where the programme has apparently exceeded beyond expectation is in the diffusion of investment and in changing the quality of state municipal relations. Only 50% of municipalities were expected to take up loans; over 90% have done so. Great pressure is being exerted by municipalities on the State Government to continue the programme and, although the World Bank loan is repayable by the MDF, there has been sufficient internal generation to turn it into a revolving fund. State funding has been transformed from a mechanism of ad hoc patronage to a formula set of allocations to which municipalities are entitled and within which investments can be planned by them. Average project costs have been only $27,000; there is evidence of widespread community participation and satisfaction created by the unprecedented access to funds on such a small and diffused scale.

India: Calcutta Municipal Development Programme

55. The Calcutta Metropolitan area comprises two municipal corporations, 37 municipalities and 165 small peri-urban authorities. For twenty years from 1960 onward the central and state governments attempted, with international assistance, to address the chronic needs

of the conurbation for planning and investment through metro-wide organisations such as the Calcutta Metropolitan Planning Organisation and the Calcutta Metropolitan Development Authority, which effectively bi-passed this extremely fragmented system of municipal government.

56. The weakness of municipal government and its lack of participation in the urban development programme created increasing problems, however, in terms of the local reticulation of major infrastructure, its operation and maintenance and cost recovery. A Municipal Development Programme has therefore been implemented in the 1980s with several elements including

- revised legislation governing the constitution and management of local bodies
- a resumption of municipal elections
- creation of a central valuation board to supervise and improve property tax assessment
- secondment of technical staff to municipalities
- a revised grant structure reforming the provision of grants and loans for both current and capital expenditure

57. The revised grant structure provides grants for current expenditure, which are estimated to close the gap between operations and maintenance expenditure (including salaries and debt service) and current revenues from taxes, user charges etc. The "gaps" are calculated in advance on the

basis not of actual budgets but of target levels which assume

(i) percentage ceilings on the annual increases in current spending

(ii) progress towards a 100% recovery of water supply costs through user charging

(iii) specific increases in the assessed rateable value of property and in the percentages of property tax demands and arrears collected

These grants are administered through the Local Government and Urban Development Department of the West Bengal State Government. The targets have assumed that the percentage increases in municipal revenue would outrun the percentage increases in expenditure, so that the deficit grants would decrease as a proportion of current revenue from 58% in 1983/4 to 40% by 1986/7, though of course increasing in absolute terms.

58. The Municipal Development Programme also provides a mixture of grants and loans to municipalities for capital development purposes. The mix of grant and loan depends upon the nature of the project as explained in paragraph 30(2). Project designs must fall within a range of minimum and maximum standards and service delivery norms (illustrated at Appendix C). The programme envisaged disbursement of $73m between 1983 and 1988, on a range of investments including water supplies, drainage, sanitation, slum improvement, parks, crematoria, transport infrastructure, markets and community halls.

The capital grants/loans are administered by the Calcutta Metropolitan Development Authority as part of a total investment programme in Calcutta funded by a mixture of resources including

- Government of India budget appropriations
- Government of West Bengal budget appropriations
- IDA credits
- borrowing from public sector financial institutions
- 50% share in octroi receipts within the Calcutta Metropolitan area

The allocations to individual municipalities have been based upon population, but with a minimum of rupees 1 crore per municipality (approximately $1m).

59. The allocation of current budget deficit grants and capital grants/loans are linked by two conditions

(i) if municipalities realise a lower deficit than anticipated in the calculation of their deficit grant, the savings in deficit grant are converted into an additional capital grant

(ii) if municipalities realise a larger deficit than anticipated in the calculation of their grant, the gap will be bridged by additional deficit grant but at the expense of an equivalent cut in their capital grant/loan allocation.

Performance on expenditure control, cost recovery and tax administration is therefore intended to have a direct impact upon the size of local investment programmes.

60. Again only interim assessments of achievement are available. Practical problems have arisen in such elements as the staffing of state bodies concerned with appraisal and monitoring, or the installation of the water meters necessary to improve user charging. Massive litigation over revised property tax assessments (covering one third of all assessments by the Calcutta Municipal Corporation) has delayed much of the anticipated increase in rateable value. In particular the State Government has proved reluctant to implement the full incentives implicit in the revised grant structure; cuts have been postponed so far in capita allocations to municipalities exceeding "target" deficits in current budgets. The numbers of local bodies which have managed to confine their deficits within projected limits has declined from 22 in 1983/4 to 10 in 1985/6.

61. Nevertheless positive achievements seem clear in at least two respects. The first is the quality of implementation of capital investment through the municipalities. Not only are infrastructural improvements being far more widely distributed by municipal participation, but the supervision of contractors by local elected officials has also proved far more effective; local accountability in this respect has worked. Secondly

significant improvement has occurred in the collection efficiency of local taxes and charges, even if their assessment base has fallen short of expectations. The Calcutta Municipal Corporation, for example, achieved it target of collecting 85% of current property tax demand two years ahead of schedule, has introduced graduated water rates for domestic consumers and increased its tariff for industrial and commercial consumers.

Jordan: Cities and Villages Development Bank

62. Jordan originally operated a Municipalities and Villages Loans Fund under the aegis of the Ministry of Municipalities and Rural Administration. In 1979 it was transformed by law into an autonomous Cities and Village Development Bank. The Bank was established to provide investment finance and assistance to municipal and village councils, with the object of promoting widely distributed access to infrastructure and employment.

63. The Bank's share capital is subscribed by the Government, the Central Bank of Jordan and the municipal and village councils. It is administered by a Board chaired by the Minister of Municipalities and Rural Administration, but the extremely capable general manager is largely responsible for its operation.

64. The CVDB disbursed $140m in loans to municipal and village councils in its first five years and anticipated lending a further $73m over the period 1985-88. By the beginning of 1985 equity and internally generated reserves represented 40% of its funds; the remaining 60% have been contributed by municipal deposits, loans from the Central Bank, time deposits by financial institutions and international aid.

65. Municipalities and village councils in Jordan are financed principally by

(i) shares of nationally collected taxes on petroleum, imports and vehicle registration

(ii) a property tax assessed and collected on behalf of local government by the Ministry of Finance

(iii) a variety of locally administered taxes and user charges.

The national revenue shares and the property tax collections are credited to the accounts of municipal and village councils with the CVDB, and loan repayments and interest charges are debited directly to these accounts.

66. During the first five years two-thirds of CVDB lending was used on road construction and land acquisition, reflecting the phenomenal pace of urban settlement during that period. The balance was spent on school buildings, water supplies, sewerage, electrification, clinics and revenue earning projects (markets, workshops,

rental office blocks, bus and taxi stations, car parks, slaughter houses etc). It has been anticipated that commercially focussed projects would occupy a greater proportion of lending during the current phase, both because much basic infrastructure has been provided and because the Government has recently taken over responsibility for construction of schools and main roads.

67. The spread of urban physical and social infrastructure (paved roads, schools, clinics, piped water, electricity etc) to virtually all settlements, however small and remote, has been a remarkable feature of Jordan's recent development, and more so considering its rate of urbanisation. The CVDB has undoubtedly played a major role both in financing this investment and in supervising its quality through its criteria and standards, its appraisal and monitoring. It has developed a very positive attitude towards its client municipalities and has taken on an increasingly active role in general financial and technical advice and training.

68. The general impact of these operations on municipal finance has been more equivocal. Up to 1985 the only financial limitation on municipal borrowing was a requirement that debt service should not exceed 80% of the annual shares of national revenues. This secured CVDB's ability to recover loans from municipal revenues passing through its accounts, but was a misleading

indication of municipal capacity to borrow. It over estimated the borrowing ability of smaller bodies highly dependent on revenue shares, and probably under-estimated that of larger towns with substantial other revenue sources. In 1985 fresh criteria were substituted which examined both the current liquidity of individual municipalities and forecast the revenue surplus over current expenditure to which debt service is in practice charged. The result was to expose a growing indebtedness on the part of a number of municipalities, and some slowing down in the overall rate of CVDB lending.

Part D: Discussion

Introduction

69. How far do MDFs/MDIs meet the objectives and fulfil the high expectations which often surround them? This raises a series of questions which can only be answered in a very tentative way, given the rapid nature of this survey and the incomplete experience of the recent round of developments.

Should Municipalities Borrow?

70. MDFs transmit grants as well as loans and are concerned with more than straight financial flows. Nevertheless loan finance is at the heart of virtually all MDF operations. Moreover lending is central to the ideology of a number of the recent MDF experiments.

Programmes such as those in Mexico and Colombia and under negotiation in Indonesia positively encourage municipalities to borrow more for capital investment purposes. One cannot avoid the feeling that the international development banks particularly are wedded by the nature of their own operations to a belief that borrowing is the right way to finance investment. Is it?

71. In discussing this question a distinction is normally drawn between self liquidating and non-self liquidating investments, ie. between those which should generate extra revenue to service a loan and those which do not (at least not directly). In fact this distinction only affects part of the argument - whether loan finance can be afforded. Where revenue is available as an alternative to loans, the other arguments apply.

72. To borrow money for investment which should generate revenue is rarely cortroversial in itself. There is some confusion,however, over the nature and purpose of "self financing" or "revenue generating" projects. They can refer to services which municipalities conventionally provide or are expected to provide, but for which the users are expected to pay, e.g. water supplies or commercial refuse collection. These are expected to cover their costs. They are not provided in competition with private enterprise, although the alternative of providing such services through franchises may well be available.

73. The terms can also refer to commercial operations into which municipalities enter, possibly in competition with private enterprise, and with the object of making net profits, ie. of meeting costs and subsidising other municipal services. MDFs do not usually draw the line between these two types of "revenue generating projects" and often indeed encourage the latter. But borrowing to invest in commercial operations for a commercial purpose is open to a number of questions. Firstly, is municipal government good at commercial operations? Experience is far from encouraging, and there are many characteristics of municipal government which are inimical to successful commercial operations - some of them justifiably so. Secondly, should municipal government be competing in areas open to private enterprise? Thirdly, should commercial opportunism be a substitute for an equitable system of taxation (whether through local taxation or transfers) as a source of finance for public goods?

74. There is a case for municipalities engaging in investment of a commercial nature, where it will stimulate the growth of the local economy - where it will promote private enterprise. Industrial sites and workshops, joint venture city centre redevelopment may be examples. But the prime motive of such investment should be the contribution to urban development, not revenue generation per se.

75. Far greater argument surrounds loan financing of non-self liquidating investment in main roads, clinics, parks, schools etc. On the one hand it is often held that loan finance effectively imposes the costs of capital development on the future as well as current beneficiaries. Moreover it significantly accelerates the pace of investment; if a municipality has revenue surplus to its operational and maintenance costs, it can obtain far more investment by using this to service debt than by direct capital expenditure. There are a number of contrary arguments. Firstly the unfairness of visiting full costs on current beneficiaries may be cancelled out by the benefits they derive from investment by previous generations. Secondly, borrowing as opposed to full budgetary appropriation may breed irresponsibility, with municipalities undertaking projects or building at standards to which they would not give priority if the full cost fell immediately on the taxpayer. Instant popularity may be pursued at the cost of overstraining resources in the future. There is the further macro economic objection that increasing public sector borrowing is inimical to the wider economy because it encourages inflation and "crowds out" investment in productive enterprise, (itself countered by the view that public investment creates demand for private enterprise). These arguments tend to be resolved pragmatically. Municipal governments which have a buoyant tax and transfer base tend to finance capital expenditure largely from revenue; those which do not rely heavily on loan finance.

76. MDFs can, however, be defended against the standard criticisms of loan finance only if they apply

(1) a sound system of financial forecasts to judge the capacity of municipalities to take on additional debt;

(2) rational criteria for defining and assessing the types of investment eligible for their support.

Do municipalities need a public sector credit institution?

77. Given that municipalities are justified in borrowing money for capital investment, do they need a source of credit in the public sector? Why cannot they rely on the commercial banking system?

78. Commercial and public sector credit are not, of course, mutually exclusive. Local government in Western Europe borrows from private financial institutions as well as from MDIs. MDIs borrow from the financial institutions, predominantly so in Western Europe. Credit may well be packaged, as in the Colombian case where the MDF is used to discount varying proportions (but never all) of commercial bank lending.

79. If municipalities were dependent directly and entirely upon the financial markets, it is unlikely that they would have equal access to loan finance. Smaller, poorer, more remote municipalities would probably have more difficulty in borrowing and pay more heavily for it. This would be contrary to national policies of social equity or physical decentralisation.

80. Moreover private financial institutions are unlikely to be concerned to provide the degree of technical appraisal and support of which MDIs are capable. They might be concerned to assess the financial viability of self-liquidating investments or the general repayment capacity of municipalities in the case of other projects; indeed they should be more concerned than public sector MDIs which are secured by liens on transfers rather than local revenues. But traditional banking disciplines have been considerably undermined by the liquidity of recent years and in practice there is just as much danger of irresponsible levels of lending by the private financial institutions.

Have MDFs/MDIs increased resources for urban investment?

81. The varying scale of investment financed by MDFs is reflected in the following sample figures:

Country	Fund	Year		Investment Per Capita $ pa
Belgium	Municipal Credit Bank	1983		112.0
Brazil	Parana State MCIP	1983-86	(forecast)	18.8
	Santa Catarina State MDF	1986-93	(forecast)	4.1
	Salvador FEREM	1986-94	(forecast)	7.0
Colombia	FFDU	1987-90	(forecast)	6.7
Denmark	Municipal Credit Institution	1983		17.8
France	Deposit and Consignment Bank	1983		101.0
Germany	German Municipal Bank	1982		32.0
India	Calcutta FAM	1983-88	(forecast)	2.0
Italy	Deposit and Credit Bank	1983		42.2
Japan	Finance Corporation of Local Public Enterprises	1983		42.5
Jordan	CVDB	1987	(forecast)	14.3
Mexico	BANOBRAS	1984		2.3
Norway	Municipal Bank Municipal Pension Fund	1985		73.0
Pakistan	Annual Development Programme	1984-85		2.3
Paraguay	IDM	1980		0.5
Spain	Local Credit Bank	1983		8.0
Tunisia	CPSCL	1984		0.4

82. These figures indicate the massive scale of municipal investment financed by some European MDIs. In 1983 MDIs lent 46 billion francs to local authorities in France, 3,979 billion lira in Italy. They financed 80% of local authority investment in Belgium, 35% in the Netherlands. This scale of operation reflects the wide range of local government responsibilities in Western Europe, the established practices of loan financing and the strength of municipal ability to service debt. It also reflects the strength of the capital markets since this lending was predominantly financed through the MDIs by private funds and savings. But the MDIs' access to these markets reflected the scale and security of local government finance.

83. Clearly the third world MDFs are operating generally on a far more modest scale. The basic conditions are so much more restricted - the range and scale of municipal investment, the local revenue base, the capital market. Some extra funds have been extracted from central government as initial capital, as counterpart funds for international aid or for reimbursing foreign loans where these have been capitalised in the MDF. Much central government investment in MDFs, however, is simply a re-routing of existing capital outlays or transfers.

84. Capital markets have been tapped by third world MDIs, but mainly those markets under public control. This has not been without problems. Where the MDI is itself a

custodian of insurance/pension/savings funds some conflicts of interest can arise. Lending for long term investment may not always be compatible with trustee commitments liable to unpredictable cash flow fluctuations, particularly those sensitive to economic changes. The Brazilian Housing Bank has apparently been an acute victim of this problem. Where MDIs have developed relatively stable turnovers and diversified portfolios, such risks are less acute.

85. As mentioned at the outset, the larger source of increased resources implicit in most MDF objectives is local government itself - through counterpart funds, through debt service and operations and maintenance obligations, and through the various cost recovery measures built into conditions or specifications of loans. Has this been achieved?

86. Pirie Gall, appraising the US AID assistance to Latin American MDIs in the 1970s was pessimistic. "Municipalities frequently seem in worse financial condition under MDI lending programmes. We did not find that programmes rewarded efforts at local financing, but provided a substitute for this"(1). The recent round of development has undoubtedly attempted to do better, but the evidence of achievement is not clear. It has to be said frankly, that, with one or two exceptions such as the Calcutta programme, donors do not appear to follow up the cost reccvery condition of loans in any systematic way. In

(1) Pirie M Gall "Municipal Development Programme in Latin America", (Praeger, 1976)

the majority of cases the MDI is recovering its loans directly from transfers so that its own viability and debt service are not conditioned by the cost recovery efficiency of its clients. The financial strain on Jordanian authorities, for example, only surfaced when ability to sustain a further round of borrowing came into issue.

87. In a number of cases e.g. Colombia, Mexico and Turkey, enhanced MDF operation has coincided with major reforms of the local revenue base, normally associated with revenue sharing. The local authorities have not been dependent upon enhanced local charging or taxing to sustain the debt and maintain facilities. In others, some improvements in registration of tax payers/ consumers and collection efficiency have been achieved. Making more people pay what they already should pay,is an administratively and politically feasible goal. Less success has attended efforts to make people pay more - to update property tax assessments, increase tariffs etc. Revaluations have been carried out in parts of the Philippines and Thailand,for example,but their implementation postponed. Colombia enacted strict requirements for indexing property tax values, but they have been very partially implemented. Central governments have been as much in default in this respect as the municipalities.

88. A basic problem is that so far as the taxation elements of cost recovery are concerned, MDF programmes have tended to focus narrowly on the property tax. There are fundamental problems in getting the most politically exposed of all tiers of government to exploit the most politically sensitive of all taxes, which are not going to be overcome simply by the incentives of a loan or a dollop of technical assistance. Moreover in times of austerity when governments are having to make unpopular cuts in public expenditure, subsidies etc, they do not want to add insult to injury by harassing people for more property tax. It simply is not high on anyone's political agenda.

Have MDFs/MDIs improved the utilisation of resources?

89. MDFs are not completely proof agains political chicanery or bad judgement. Political pressure has bounced Funds into unsound investment. The Moroccan FEC has been seriously undermined, for example, by default on major loans to the Casablanca transport undertakings which were forced on it. One Kenya council obtained a loan from the Local Government Loans Authority in one day by applying to the Minister in person through a good will mission.

90. Misallocation has resulted too from central technocrats using MDFs to finance investment on their own pet schemes, which municipalities have been reluctant to pay for, utilise or maintain. Pirie Gall applied this criticism to water supplies constructed by some of the Latin

American Institutes and handed over to municipalities for maintenance and debt service. The Indonesian market loan programme (Inpres Pasar) suffered from central targetry which ignored any local assessment of needs. The Cameroon FEICOM invested heavily in public works machinery for leasing, which municipalities did not want, could not afford and have neither used nor maintained.

91. But lessons have been learned and the record of recent MDF programmes has been better. Rationalisation of central government financial flows was a major objective of a number of these programmes, particularly in Latin America - both as to distribution and purpose of investment. Moreover municipal initiative in choice and execution of investment has been given far greater emphasis.

92. All the cases described in Part C illustrate the ability of MDFs to finance a wide range of small scale and geographically diffused investments. This is a welcome contrast to the nature of most nationally and internationally financed investment, and might facetiously be called the Heineken Factor. To see the standard of infrastructure in a remote Jordanian village is to believe.

93. This diffusion has of course put a strain on the ability of MDIs to appraise the projects they are financing. The adoption of sound specifications with minimum and

maximum standards seems important in guiding municipal planners, speeding processing and relieving strain on the MDF staff. Demanding the preparation of comprehensive multi-year investment plans as a prerequisite for project finance is of more dubious utility. Whether it has improved municipal planning is unclear; much of the work tends to be done by central planners and consultants; it certainly slows down implementation.

<u>Are MDFs better managed by an autonomous institution?</u>

94. Autonomous MDIs have a number of hypothetical advantages. It is hoped that they will be immune from political pressure, and more disciplined in allocating funds between municipalities, in appraising projects and in exacting recovery of loans.

95. In practice these advantages are not proven. Both autonomous agencies and government secretariats have shown themselves capable or incapable of disciplined performance in these respects. A municipal bank in Honduras, a "window" within the Moroccan Casse de Depots and the Kenyan Ministry of Local Government have all failed to recover defaulting loans. A municipal bank in Jordan, a state government secretariat in Brazil, a metropolitan development authority in India have successfully channelled investments to small projects as described in Part C.

96. An autonomous institution should of course be more concerned about the financial viability of its borrowers and their projects. This has not necessarily been the case. There are several reasons. As already mentioned, MDIs are often able to recover loans from transfers. Most of them undertake municipal lending as part of wider operations; default by municipalities may be covered by other revenue sources - shares of taxes, for example, or custody of state controlled funds. MDIs are not necessarily under great obligation to their own funders, particularly where initial capital is not repayable and is supposed to "revolve".

97. Another hope of autonomous MDIs is that they will attract energetic, able professional staff, who are positive and sympathetic in their attitudes to municipal clients. The Ministries of Local Government are often preoccupied with the politics of central/local relations; they have often been unattractive places of employment for professionally qualified and ambitious staff; their attitudes are often unduly paternalistic or legalistic, insufficiently supportive or promotional.

98. Some success has been achieved in this direction. The CVDB, for example, has seventy established staff. One third are graduates, the majority under forty, half female (at all grades). The Technical Department employs ten engineers, five financial analysts and three economists. Pirie Gall writes of Latin America

"the MDIs have succeeded in attracting well-motivated, well-trained individuals, most of them young and energetic, in the fields of engineering, project economics and public administration" (2).

99. The problem is maintaining the motivation of capable staff and the positive ethos of the organisation as a whole. For all the theory and the experience indicate that while individuals may be altruistic, organisations are inherently self-interested. This is all too often illustrated in the behaviour of MDIs. Financial managers have been preoccupied with turning over the money, the engineers with building water supplies etc for municipalities to maintain, the planners and architects with devising plans for municipalities to execute. The real promotion of municipal autonomy and capacity gets lost in this preoccupation with the projects, with the disbursements and repayments, the rates of return, which satisfy the image and ambitions of the MDI as an entity and its staff as individuals.

100. The ideal role conjured up for MDIs is essentially pro-active and promotional. Can an organisation be expected to sustain this character into institutional and individual middle age? This brings us to the crucial issue of accountability.

(2) op cit

How can performance and accountability be sustained?

101. The record of third world MDFs and MDIs tends to be one of fits and starts. Governments have bouts of commitment to decentralisation and municipal development, and MDFs are funded and staffed with enthusiasm. But then an electoral reverse, an economic crisis, a drought changes the priorities; forms remain but not the commitment. Donors support an MDI; the attention they bestow and the resources they contribute enhance motivation; their policing helps the staff resist political pressures to deviate from stated objectives and professional norms. But the aid moves on, the pressures return, the glamour recedes, the momentum is lost; self-preservation takes over.

102. The other problem is the organisational version of the Peter Principle. An MDI gets a reputation for achievement in what is a difficult field. Immediately governments and donors home in with more resources or fresh tasks. Capacity becomes over-burdened and performance slips.

103. How can performance be sustained? It is worthwhile looking again at the European MDIs, not as an ideal, but because they have stayed the course. Three points may be relevant. Firstly, they are all in some degree of competition for funds and borrowers. They are having to compete to obtain deposits or sell bonds with other financial institutions. They are not the only source of loan finance for municipal government.

They have to be accountable to both lenders and borrowers to maintain their position.

104. Secondly, they are acting as true intermediaries between funds and individuals looking for investment outlets and municipalities able and willing to borrow. The role is less demanding in some senses than that of a third world MDI which can only fulfil its objectives by a constantly pro-active stance - fighting for a share of investment funds, fighting to maintain and improve programme performance, and often swimming against a political tide in both respects.

105. Thirdly, MDIs in Western Europe are more client driven, because the municipal customers are less dependent both in fact, and in self image, and more self confident, more securely resourced.

106. Ultimately it is only the strength of municipal government which can guarantee the sustained effectiveness of an MDF/MDI, not the reverse. A number of features are important to this. One is the electoral process. Without being unrealistically pious about grass roots democracy, one has to recognise that the accountability of local government is dependent upon elections. One can no more expect a local government to run effectively under appointed administrators or party nominees (as is so often the case) than one can expect a petrol engine to run smoothly on diesel. One major reason why the municipal development programme is showing results in

Calcutta is because mayors and councillors are once again elected after years of supersession. One major reason for the success of a programme like the Parana State Capital Improvement Programme is the existence of mayoral elections. But electing officials is not enough; they have to be in office long enough to take some responsibility for their actions. Bi-annual elections without provision for re-election, as practiced in some Latin American countries, does not promote accountability.

107. The second prerequisite for stronger municipal clientele is a sound current revenue base. It is worth noting that transfers feature prominently in financing most Western European municipal systems, and that local taxation, though important in most countries, is basically on income or expenditure rather than property. If management programmes are to focus on promoting the current revenue base, a more catholic attitude to both tax sources and the role of recurrent transfers is necessary.

108. The third point is that municipal government in much of Western Europe is operating from a far stronger local economic base. Appendix D is a quotation from Pirie Gall's appraisal of Latin America MDFs. It argues that much MDF investment does not address the fundamental backwardness which causes the weakness and inertia of municipal government. This extract is included because it is challenging, not because it is wholly true. It probably underestimates the contribution which

municipal infrastructure makes to local economic development, and the knock-on effects which a highly participative programme can have on local self-confidence and, therefore, enterprise. Nevertheless the concern of governments and donors with urban development has lacked the attention to the productive base which has characterised rural investment.

109. This is to argue that the sustained, lasting strength of an MDF is dependent on the strength of local government, and not the reverse. Accountability to the municipal client is critical. But if municipal development is really dependent upon a wider set of political, financial and economic factors which are largely independent of MDF operations, this does not mean that those operations do not contribute to it. Routing more investment through local government, exercising its capacity for programme choice and supervision, reversing the pattern of demand, all help to build up the self-confidence in municipal government, as well as enhancing the physical and social plant which local people and businesses enjoy. This can be a frustrating process because central government often has vested interests in maintaining patronage, and local leaders may find safety in continuing the dependent role. But restoring the effectiveness of local government is basically a matter of reviving its accountability and self-esteem; persistence by MDIs, governments and donors is justified and necessary.

APPENDIX A

COUNTRY	FUND	ADMINISTERING AGENCY	AGENCY TYPE	FINANCING CHANNEL	SOURCE OF FUNDS	OTHER ASSISTANCE PROVIDED
AUSTRIA	Zentralsparkasse und Kommerzial Bank, Wien		Central Savings and Commercial Bank	Loan	Private Savings Deposits Deposits by Financial Institutions	Social, Cultural and Business Promotion
BELGIUM	Credit Communal de Belgique		Municipal Credit Bank	Loan	Private Savings Deposits Municipal Deposits	
BOLIVIA	SENDU (National Urban Development Service)		Municipal Development Institute	Loans	Foreign Loans ?	Training
BRAZIL: Parana State	Municipal Capital Improvement Programme	SEPL	State Planning Secretariat	Loans Grants (Formula and matching)	State Government Grant Foreign Loan	Project Design Tendering Town Planning Cadastral Survey
Salvador Met Region	FEREM (Metropolitan Development Fund)	CONDER	Metropolitan Development Agency	Loans	State Government (from National Revenue Sharing) Foreign Loan	Project Design
Santa Catarina State	Municipal Development Fund	GAPLAN	State Planning Secretariat	Loans Grants (Formula and Matching)	State Government Grant Foreign Loan	Project Design Revenue Administration Financial Trainin
CAMEROON	Fonds Special d'Equipement et d'Intervention Intercommunal (FEICOM)	Caisse de Prets	Central Deposit Bank	Grants (defacto)	10% share of local taxes Government Grant	Municipal Trainin Equipment Leasing
CANADA: Alberta Province	Alberta Municipal Financial Corporation		Municipal Credit Bank	Loans	Provincial and Municipal Share Capital Bonds	

COLOMBIA	Fondo Financiero de Desarrollo Urban (FFDU)	Banco Central Hipotecario (BCH)	Central Mortgage Bank	Discounting Loans by Commercial Banks	Government Grant BCH and Central Bank Credits Bonds Foreign Loans	
COSTA RICA	Instituto de Fomento y Asesoria Municipal (IFAM)		Municipal Development Institute	Loans	Government Grant Revenue Shares Bonds Foreign Loans	Cadastral Survey Central Purchasin Municipal Trainin
DENMARK	Kreditforeningen af Kommuner i Danmark		Municipal Credit Bank	Loans	Bonds	
DOMINICAN REPUBLIC	Liga Municipal Dominicana		Association of Municipalities	Loans	Government Grant	Municipal Trainin Town Planning
FRANCE	Caisse des Depots et Consignations		Central Deposit Bank	Loans	Reserves of Postal and Local Savings Banks	
GERMANY: Federal Republic	Deutsche Girozentrale Deutsche Kommunalbank		Central Municipal and Savings Banks	Loans	Reserves of Municipal Savings Banks	
GUATEMALA	Instituto de Fomento Municipal (INFOM)		Municipal Development Institute	Loans	Government Grant Revenue Shares Bonds Foreign Loans	Public Works Design & Executio Central Purchasin Town Planning
HONDURAS	Banco Municipal Autonomo de Honduras (BANMA)		Municipal Deposit and Credit Bank	Loans	Government Grant Municipal Deposits (5% of Revenue) Bonds Foreign Loans	Project Design Financial Trainin
INDIA: Calcutta MDA	Fund Assigned to Municipalities (FAM)	Calcutta Metropolitan Development Authority	Metropolitan Development Agency	Loans Grants	Federal/State Government Grants Revenue Share (Octroi) Bond Issues (to Public Sector Institutions)	Project Design

Kerala State	Kerala Urban Development Finance Corporation		Municipal Credit Bank	Loans	Municipal Deposits	
Tamil Nadu State	Municipal Development Fund	State Government		Loans	State Government Grant (Foreign Loan under negotiation)	
All-India	Life Insurance Corporation		National Corporation	Loans	Re-insurance Premia	
ISRAEL	Bank for Israeli Local Authorities		Municipal Credit Bank	Loans	Government Loans Bank Loans Municipal and Private Share Capital	
ITALY	Cassa Depositi e Prestiti		Central Savings Bank	Loans	Postal Savings Deposits Stock Issues	
JAPAN	Finance Corporation for Municipal Enterprises		Municipal Credit Bank	Loans	Bonds Deposits by Financial Institutions	
JORDAN	Cities and Villages Development Bank		Municipal Deposit and Credit Bank	Loans	Government Share Capital Bonds Municipal Deposits and Share Capital Central Bank Loans Financial Institution Deposits Foreign Loans	Municipal Traini
KENYA	Local Government Loans Authority	Ministry of Local Government		Loans	Government Grant Local Authority Deposits Foreign Loans	
MEXICO	Banco Nacional de Obras y Servicios Publicos (BANOBRAS)		National Public Works Bank	Loans Matching Grants	Government Grant Bonds Loans Deposits Foreign Loans	Municipal Traini

MOROCCO	Fonds d'Equipement Communal (FEC)	Caisse de Depot et de Gestion (CDG)	National Deposit Bank	Loans	Government Grant Bonds Central Bank Loans National Insurance Deposits	
NETHERLANDS	Bank voor Nedulandsche Gemeenten		Municipal Credit and Deposit Bank	Loans	Municipal Deposits Bonds	
NICARAGUA	Secretaria de Asuntos Municipales (SAMU)	Fondo Especial de Desarrollo (FED)	National Development Bank	Loans	Government Grant Foreign Loans	
NIGER	Caisse de Prets aux Collectivites Locales (CPCL)	Credit de Niger	Central Bank	Loans	Government Grant Share of Local Taxes (3%)	
NORWAY	Kommunal Landspensjonskasse		Municipal Pensions Fund	Loans	Municipal Employees' Pension Contributions	
	Norges Kommunalbank		Municipal Credit Bank	Loans	Bonds	
PAKISTAN	Annual Development Programme	Federal and Province Govts		Loans	Government Loan (by domestic borrowing)	
PANAMA	Municipal Development Fund	Central Bank		Loans	Government (?) Foreign Loans	
PARAGUAY	Institute de Desarrollo Municipal (IDM)		Municipal Development Institute	Loans	Government Grant Revenue Shares (national and local) Foreign Loans	Project Design Municipal Training
PHILIPPINES	Municipal Development Fund	Ministries of Finance and Public Works and Housing		Loans (with matching expenditure by government)	Foreign Loan	Municipal Training
PORTUGAL	Caisia Geral e Deposito		Central Savings Bank	Loans	Public Agency Deposits Private Savings Deposits	

SENEGAL	Fonds d'Equipement des Collectivites Locales (FECL)	National Housing Bank (BHS)		Grants (Loan scheme in preparation)	Government Grants (Foreign Loan under negotiation)	
SPAIN	Banco de Credito Local de Espana		Municipal Credit Bank	Loans	Government Loans	
SRI LANKA	Local Government Loans Fund	Ministry of Local Government		Loans	Government Grant/Loan	
SWEDEN	Kommunkredit		Association of Local Savings Banks	Loans	Bonds	
	Kommunlaneinstitutet		Municipal Credit Bank	Loans	Bonds	
TANZANIA	Local Government Loans Board	Ministry of Local Government		Loans	Government Grant	
THAILAND	Municipal Development Funds	Department of Local Administration	Ministry of the Interior	Loans	Deposits of Municipal Revenue Surplus	
TUNISIA	Caisse de Pret et de Soutien des Collectivites Locales (CPSCL)	Banque de Developpement Economique de Tunisie (BDET)	National Development Bank	Loans	Government Grant National Revenue Shares	
TURKEY	Iller Bank		Central Credit and Public Works Agency for Provinces and Municipalities	Loans	National Revenue Shares Government Grants	Design and Execution of Public Works
UGANDA	Local Authorities Loans Fund	Ministry of Local Government		Loans	Government Grant	
UNITED KINGDOM	Public Works Loans Board		Municipal Credit Agency	Loans	Government Borrowing (through National Loans Fund)	

VENEZUELA	Fundacion para el Desarrollo de la Comunidad y Fomento Municipal (FUNDACOMUN)		Municipal Development Institute	Loans	Government Grant Foreign Loans	Design and Execution of Public Works Community Development Town Planning Municipal Training
ZAMBIA	Local Authorities Loans Fund	Ministry of Local Government		Loans	Government Grant	
ZIMBABWE	General Development Loan Fund	Ministry of Local Government and Town Planning		Loans	Government Grant/Loan (?)	

APPENDIX B

MUNICIPAL DEVELOPMENT FUNDS - SOURCES OF FINANCING
(excluding funds generated by lending operations)

1. Grant from Central Government: Cameroons, Columbia Dominican Republic, Costa Rica, Guatemala, Honduras, India (Calcutta MDA), Kenya, Mexico, Morocco, Nicaragua, Niger, Paraguay, Senegal, Tunisia, Turkey, Uganda, Venezuela, Zambia.

2. Loans from Central Government: Israel, Mexico, Pakistan, Spain, Zimbabwe.

3. Foundation Grant from Central Government: Norway.

4. Grants from State Governments: Brazil (Parana and Santa Catarina).

5. Share Capital Contributed by

   (1) Central Government: Japan
   (2) Central and Local Government: Jordan, Mexico, Netherlands, Spain
   (3) Provincial and Local Government: Belgium, Canada (Alberta)
   (4) Local Government: Turkey
   (5) Local Government as a percentage of annual revenues: Honduras
   (6) Private investors as well as central and local government: Israel, Mexico.

6. Deposits of Reserves and Working Balances:

   (1) Central Government Agencies: France, Italy, Portugal
   (2) Local Governments: Belgium, Honduras, Jordan, Kenya
   (3) Local Governments (as a fixed percentage of revenues or surplus): Niger, Paraguay, Thailand, Turkey

7. Deposits of Private Savings Received by the Institution itself: Austria, Belgium, Mexico.

8. Deposits of Postal Savings Banks: France and Italy.

9. Deposits of Reserves of National/Local Savings Banks and Insurance Funds: Canada (Alberta), France, India (LIC), Italy, Morocco, Portugal, West Germany.

10. Deposits by borrowers of a fixed percentage of loans: Belgium, Denmark.

11. Proceeds (or shares) of specific national or local taxes:

Brazil (Salvador):	Federal Participation Funds and Fuel Tax
Cameroons:	Capitation Tax, Patente, Licences (5%)
Costa Rica:	Liquor Taxes
Guatemala:	Liquor Taxes
India (Calcutta MDA):	Octroi (50%)

Paraguay:	Real Estate Tax (10%) and Liquor Tax
Tunisia:	National Taxes included in the Municipal Fund (FCCL)
Turkey:	All National Taxes (3% share). Consumption Tax (5%).

12. Loans from Banks: Brazil (Salvador), Jordan, Mexico, Morocco.

13. Loans from International/Bilateral Agencies: Bolivia, Brazil (Parana, Salvador, Santa Catarina), Columbia, Costa Rica, Guatemala, Honduras, India (Calcutta MDA), Jordan, Kenya, Mexico, Morocco, Nicaragua, Panama, Paraguay, Philippines, Senegal, Venezuela.

14. Bonds/Debentures/Time Deposits subscribed by financial institutions and private investors: Austria, Belgium, Canada (Alberta), Columbia, Denmark, Honduras, India (Calcutta MDA), Italy, Japan, Jordan, Mexico, Morocco, Netherlands, Norway, Sweden, United Kingdom (through the National Loans Fund).

15. Pension Contributions of Municipal Employees: Denmark, Norway.

APPENDIX C

CALCUTTA MUNICIPAL DEVELOPMENT PROGRAMME

SECTOR SERVICE DELIVERY NORMS

These norms, drawn up by CMDA and the municipalities, are intended to reflect the minimum needs focus of the program.

Sector Subproject Component	Service Delivery Norms Minimum	Maximum
Water Supply	5 gpcd.	25 gpcd.
Drainage	component specific: waterlogging per % target population	component specific: waterlogging per 100% target population
Service Privy Conversion	1 communal privy 25 population	1 communal privy 10 population
Solid Waste Management	component specific: tons collected per target population	component specific: tons collected per 100% target population
Local Road Improvements	target population within 20 minutes walk of nearest metallic road	target population within 5 minutes walk of nearest metallic road
Bustee Improvements	component specific municipal service improvements per % target population	municipal service improvements per 100% target population
Markets	provision of 50 sq.ft. covered space/1,000 people	provision of 600 sq.ft. covered space/1,000 people
Parks & Playgrounds	basic improvements to existing facilities	basic improvements to existing facilities, provision of additional park-playground areas
Cremation Grounds	maintenance of current facilities	provision of hygienic facilities for disposal of bodies

PHYSICAL DESIGN STANDARDS FOR THE MDP

Sector Subproject/ Component	Physical Design Standards	
	Minimum	Maximum
Water Supply	concentrated Population deep tubewells with secondary distribution system; provision of standpipes for EWS dispersed population spot tubewells	secondary grid connected to primary grid; house connection
Drainage	unlined surface drains	surface drains with concrete slab covering at critical locations
Service privy conversion.	sanitary latrines to seat level only	sanitary latrines with superstructure
Solid Waste Management	hand cart and intermediate VAT collection, final disposal by trailer truck	tricycle rickshaws/ transfer stations for primary collection. Tractor trailers to final disposal or secondary transfer stations; pilot composting plants
Local Road Improvements	brick paved roads	black topped metallic roads protected against erosion
Bustee Improvements	provision of shallow tubewells, street lighting, open surface drainage, communal sanitary latrines, brick paved pathways	provision of water taps and standpipes, intermediate vats for solid waste collection, open surface drainage, communal sanitary latrines, brick paved pathways
Markets	tubular structure with asbestos roofing and brick paved flooring, water supply, solid waste collection, lighting, open drainage, brick paved circulation system	concrete structure with same services as minimum standard but also with provision of parking spaces
Parks & Playgrounds	wire fencing; basic seating	brick wall or metal boundary fence, basic seating, basic play facilities
Cremation Grounds	proper boundary wall to ground	proper boundary wall and covered area for mourners

Notes: The above standards were agreed by CMDA in discussion with the municipalities. It is the intention that all municipal subprojects should fall within the range of standards prepared for each sector. Differences in design standards between municipalities (e.g., water supply) reflect (i) differences (quality of groundwater, density of population, etc.); (ii) availability of necessary transmunicipal infrastructure (e.g., primary distribution system), and (iii) sector priorities of the municipalities themselves.

APPENDIX D

Extracts from Pirie Gall
"Municipal Development Programs in Latin America"
(Praeger 1976, pages 55-57)

The Economic Growth Element in Municipal Development*

The best tax system in the world will yield little from a stagnant or declining economy, and this applies at the local level no less than at the national. In our view, insufficient attention has been paid to this basic reality in the municipal development programs, and this represents a major flaw that should be rectified if the municipalities are to move to a more comprehensive developmental role. The current programs have not yet moved to the next stage of linking public investment to incentives for industrial (including agroindustrial), tourism, marketing, and other enterprises that would provide new income to the population, and by derivation, new revenues to the municipalities.

The investor, whether private or public, looks for economic factors to be provided by local governments, such as water, sewer, and power of industrial scale; refuse collection capable of handling massive amounts of waste; access to major transportation networks and markets; and land located and prepared to suit his needs. In addition, of course, the investor needs labor and raw materials, which may be found locally or imported if other factors compensate.

Until economic factors are effected by local action (in collaboration with national plans and operations), the municipalities will continue to exhibit the universal problems of weak finances, unskilled and undermotivated administration, and physical unattractiveness. Installing minor public works, new tax and accounting systems, and administrative reorganization will be but marginal improvements and of little lasting value or fundamental development impact without a reorientation or expansion of the scope of the effort toward economic concerns.

The type and scale of public works being carried out by the municipalities with MDI assistance do not, in their present form, have much impact on the economic factors. On close examination of the subprojects, as reflected in Table 2.2

*See Appendix A, example 5.

in Chapter 2, we found that very few of the projects had a direct or significant positive economic impact on either the communities or the municipal corporations, although the subprojects were often billed as being economic in their efforts.

It may be useful to classify and define the subprojects under two categories as we see them. One category we call social infrastructure and the other economic infrastructure.

Categories Of Municipal Subprojects: Social Infrastructure/Economic Infrastructure

A rough way of stating this classification is to say that social infrastructure makes people more comfortable in their poverty, while economic infrastructure serves directly to alter the condition of poverty itself by encouraging new investment, new employment, and increased income. Both are important, and social infrastructure is often necessary to create some preconditions for improvements in productivity. However, there appear to be limits to the extent that municipal governments can develop, finance, and manage services and social infrastructure unless economic growth is also occurring, and it may be necessary to promote municipal development activity more directly aimed at the economic factors as the next stage in municipal development. We have classified municipal subprojects under the two headings as follows:

Social infrastructure: municipal building; street paving; refuse collection (residential); residential water, sewer, electrical installations; housing; clinics, health posts, primary and secondary schools; street lighting; parks and playing fields; and street cleaning.

Economic infrastructure: transportation terminals (see below); highways (feeder, secondary); industrial waste disposal; electric, water, and sewer installations of industrial capacity; land acquisition and preparation for industrial, commercial, or tourism uses; vocational training facilities; crop storage facilities; input storage facilities; and irrigation systems.

Municipal markets, slaughterhouses, and transportation terminals (bus stations, ferry terminals) may fall under either heading, depending on their scale and use patterns. Most of the markets and slaughterhouses we observed were social rather than economic, offering better housing for the same activity. Where such facilities are of sufficient scale to encourage new production, diversification, and commercialization of production, we would regard them as economic. Where passenger terminals include new commercial space and activity for new entrepreneurs, they lean toward the economic. Where they merely replace wood with cement and the same businesses take the space, they may represent nothing more than beautification, and thus be primarily social in impact.

As defined above, few of the commonly financed municipal/MDI subprojects, with the exception of feeder roads, fell under the economic infrastructure heading. In our experience (and past involvement in industrial location questions), parks, paved and lighted streets, or a new municipal office building may make a marginal difference to an industrial investor, but they will not be determinant. We feel that the balance should be shifted in the future to more of the economic category of infrastructure, without, of course, neglecting the other factors and needs.

As Tables 2.1 and 2.2 on project benefits (see Chapter 2) show, we found that the municipal corporations did not always fare well economically under the MDI lending programs. Municipalities in all the countries we have visited and studied have frequently found themselves in worse financial condition because of such projects, having to add staff to manage them, having increased their indebtedness to the point of being ineligible for further financial support, finding that managing the new facility is more complex and costly than anticipated, and that the community is not willing to pay the user fees, that the concessionaire in the bath house loses money and fails to renew his contract. The facilities have not added to the tax base in any measurable way by creating new economic activity. Often such projects as municipal markets and slaughterhouses represent nothing more than the same people doing the same thing, but inside a better building (if the maintenance machinery works).

Employment generation is often cited as a community economic benefit related to municipal projects. This generalization is difficult to sustain after visiting the sites. In our observations the projects are built using labor-intensive methods requiring large numbers of persons carrying materials, moving earth, and mixing cement, and a few skilled laborers laying block, installing plumbing, or building roof supports. The skilled laborers often move from town to town or work for a contractor full time, while the unskilled are local farmers or farm laborers. When the project or complex of facilities is built by a contractor, as in Guatemala, the firm is often based in another, larger city. The result, in terms of local employment generated by the construction projects, is that the work is temporary, supplemental to other income, rather than representing a new career for the local workers. There may be some marginal multiplier effect in the form of increased consumption, benefiting local shopkeepers, and the laborers may be exposed to some construction skills, which are always marketable in a developing country. But none of this adds up to significant economic income-generating impact.

We therefore recommend that municipal development strategies take explicit account of the economic growth element and that, where it is appropriate in terms of such development priorities as increasing rural employment or dispersing industry, opportunities be seized by the MDIs and the local governments to expand their involvement in creating well-planned and designed economic infrastructure.

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