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DECENTRALIZATION AND MUNICIPAL FINANCES IN NICARAGUA

Summary

An active decentralization policy was initiated by the Chamorro Government in 1990. Institution-building initiatives have involved the creation of INIFOM whose mandate includes the restoration of municipal capacities and the creation of equity among municipalities which have been subject to divergent financial conditions based on their different economic and resource base. This process is ongoing and progress is notable. However, the definition of the responsibilities of municipalities, the evolution of their tax base, ability to collect taxes and develop realistic investment programs in addition to running their daily affairs, are still in their infancy. Meanwhile donors play a major role with both positive results (resource transfer and building-up of skills) and negative consequences ('pet' geographical areas and project types, investment project rather than programming orientation, creation of a plethora of institutions). Seen in a dynamic context, the donor assistance has been helpful in setting the stage for home-grown municipal development if it is properly redirected. The report analyzes the financial basis for the municipalities, their sources of investment finance and an estimation of the total external contributions, the decentralization policies and their consequences, the institutional setting and its potential for conflict, new legislative initiatives and, finally, proposes areas where caution should be exercised and further analysis is required, assuming that the goal is the build-up of municipal capacities and autonomy.

Introduction

The first chapter contains background information on government policy and its direction. The second chapter on municipal finances describes the various transfer mechanisms and the municipalities' own capacity to raise revenue. The investment funding sources are mostly projects or programs funded by external aid with the exception of the funds transferred from the Government's capital budget through INIFOM. An estimation of total resource mobilization in favor of municipal investments is undertaken. The third chapter analyzes institutional conflicts and potential for conflict, not least through the sheer number of institutions involved. Chapter five summarizes the issues and recommendations and chapter six brings out the main conclusions.

1 GOVERNMENT POLICY AND BACKGROUND

Decentralization is determined in a broad sense as the assumption of responsibility for the delivery of public services in a defined location by a government elected by the citizens living in that area. The Government of Nicaragua sees effective decentralization as requiring financial autonomy, i.e., the strengthening of the ability of municipalities to mobilize financial resources, government redistribution of resources among municipalities (revenue sharing), development of technical capacities, introduction of a concept of identity of service delivery, promotion of competition for access to certain lines of financing and the obligation of municipalities to elaborate annual budgets and publish annual financial statements.

In a sense, municipal financial independence is nothing new in Nicaragua whose local authorities were for a long time used to handling their own affairs with almost no transfers from the Central Government (about 3% of their resources in 1992) while the municipalities' own resource mobilization as a percentage of GDP rose steadily from 0.33% in 1960 to 1.2% in 1991.

In the wake of the general deterioration of the public sector and increasing poverty in the seventies and eighties, the financial resources, particularly of the small urban and rural municipalities, dwindled in absolute terms, at the same time that migration and the civil war led to a diminishing of local skills. In 1994 Managua had a revenue per capita of 203 cordobas whereas the poorest had less than or around 10 cordobas.[1] The independence of municipalities was in actual fact restricted, inasmuch as the Central Government kept a tight rein on local governments, mostly through appointed mayors and local representatives of the central power (deconcentration).

As a policy of the Government, efforts to create genuine local institutions or decentralization took off in 1990. Among the first acts was the establishment of INIFOM (*Instituto Nicaragüense de Fomento Municipal*), in charge of the development of technical and administrative capacities of the municipalities. A number of small externally-funded projects attempting to strengthen sectoral activities at the local level have also sought to rely on municipalities as potential facilitators and providers of certain infrastructure services necessary for any sustained development in the rural and small urban areas.

In 1991, 143 decentralized entities or municipalities were established with no second-tier regional institutions except the two Atlantic regions which are endowed with Autonomous Regional Governments, necessitated by their very small, dispersed and marginally sustainable municipalities. Two more municipalities were added recently. Government institutions are present in the 15 departments and 2 autonomous regions but are purely delegations with little independent administrative powers—MINSA for example has departmental representations. The previous division of the country into regions (7 plus the two autonomous ones), however, still has some practical application for certain government agencies, e.g., INIFOM.

Decentralization is part of the ongoing reform of the public sector and democratization, bringing decisions closer to the citizens, seeing government as a facilitator, and at the same time making it operate more effectively and efficiently. The partial revision of the Constitution in 1995 instituted that not only municipal councils but also mayors and vice-mayors were to be elected directly and also declared that a percentage of government revenue should be transferred to the municipalities.

This change called for a revision of the Municipalities Law of 1988. The Commission on Decentralization chaired by the Minister of INIFOM, with the Ministers of Health, Education, the Interior (*Gobernación*) and Finance, the Director of the water authority INAA, and the Vice Minister of the Presidency in charge of Matters of State or their representatives as members, was created in 1994. A Commission consisting of mayors of AMUNIC (*Asociación de Municipios de Nicaragua*), INIFOM and German foreign aid did the ground work. The draft Municipalities Law was presented at the end of 1995. This Law is now under debate in Parliament as well as in the different institutions affected by it and shall be discussed below in Section 3.2.1 on municipal responsibilities. The presentation of a separate Decentralization Law to complement the decentralization process with the transfer of resources and enhanced capacities of municipalities was also envisaged, but it is not clear how far this has advanced.

[1] *Fortalecimiento del Sistema Municipal de Nicaragua* mentions Santa Maria, San Pedro Norte, Rancho Grande, Cinco Pinos and La Paz Centro in the latter category. They are all small rural or mostly rural municipalities. León ranked in the top position with 365 cordobas/capita.

2 RESOURCE MOBILIZATION AND FINANCIAL TRANSFERS

2.1 Current Situation

2.1.1 Own resources

Sales taxes

Currently, municipalities have access to a 2% sales tax which is imposed on the producer or wholesaler commercializing the products. This is the most important single source of income for the municipalities, amounting to about 36% of overall income in 1992. The tax is felt to be inequitable as it is superimposed on the ordinary 15% sales tax and does not accrue to the municipalities in which the product originates. In principle it should be levied on the buyer but in practice the beneficiary is often the municipality of an intermediary market place. It has been decided to reduce this tax to 1% in 1997 with a view to its final abolition in 1999. Its strength has been its ability to generate resources for the municipalities at large, *albeit* with adverse redistributive effect for the poorest municipalities.

Some product taxes (coffee and sugar) accrue to the municipalities of origin but are collected by the state after which they are channeled directly back to the municipalities in question. This is not a constant flow but subject to various variables.

Property taxes

The most potentially important source of income is the property tax which was recently transferred to the municipalities. It is an annual rate of 1% on the assessed value of properties calculated by multiplying the different physical components by fixed unit prices. Twenty per cent can then be subtracted and possibly an additional sum of 10-45,000 cordobas at the discretion of the municipal governments. Its weakness at present is that property tenure involves contentious issues so that this tax is most effective in the larger municipalities with more valuable properties and a higher degree of land titling and registration.

Vehicle tax

The vehicle tax has also been transferred to the municipalities. Unfortunately its imposition does not require payment in the municipality of the owner. This has induced some municipalities to give discounts distorting the revenue base further as small municipalities have very few registered vehicles and the tax—even when paid where the vehicles belong—would barely help them.

Others

Over and above this there are various registration fees and stamp duties as well as user fees, particularly for solid waste and cemeteries, which in principle should cover 60% of costs. Municipalities can impose taxes on businesses but are not really equipped to assess their turnover and income. Other possible revenue sources include use of municipalities to collect taxes for the state, including the 15% sales tax, against a fee.

2.1.2 Transfers and grants

The budget of municipalities receives injection of funds from both the Government and donors through INIFOM. The program *Juntos Podemos*, which is inscribed in the Government investment budget, started in 1992 with a budget of 3.2 million cordobas.

Table 1 below presents the evolution of the *Juntos Podemos* program as well as the envelope of 'specific projects' which, as the name indicates, are projects that are mentioned in the PIP. They are introduced and voted by the National Assembly.

Table 1: Projects Included in the PIP (million cordobas)

Year	Juntos Podemos	Specific Projects	Total
1992	3.2	-	3.2
1993	5.2	3.8	9.0
1994	8.5	14.3	22.8
1995	16.4	21.7	38.1
1996	43.1	22.4	65.5

A third category of internal resources should be added, *viz.* government counterpart contributions to aid projects, amounting to 1.4 million cordobas in 1996. This was used to 'gear' external grants (15.8 million cordobas) and a loan (19.8 million cordobas). In addition, INIFOM allocated 500,000 cordobas to the strengthening of INIFOM's investment preparation and execution role in line with the introduction of the SNIP (*Sistema Nacional de Inversión Pública*) and 400,000 cordobas to perform municipal diagnoses and studies. The total channeled through INIFOM was thus budgeted for 103.4 million cordobas in 1996. The grants are Swiss and USAID contributions whereas the loans referred to is the World Bank Rural Municipalities Project (Protierra) which has not been approved yet. How this was done in previous years is not known. The projects in the PIP with external funding are for countrywide investments in slaughter houses, bridges, municipal markets, rain-water drainage and roads.

In 1996 the block grants and specific project allocations allowed for a total of 654 projects of which 484 in the *Juntos Podemos* program. In August this year 234 projects were in execution and 70 concluded in the *Juntos Podemos* program whereas 127 specific projects were in execution and 61 concluded. This means that *Juntos Podemos* falls short of the total estimated by 180 projects. The total of finished projects and projects in execution reached 20.8 million cordobas, i.e., less than half of the budgeted amount for the municipalities. The specific projects, on the other hand, surpassed the original number of 170 projects by 18 projects. The realized budget will be 28.3 million cordobas versus the budgeted 22.4 million cordobas or 26% higher. In part this can be explained by the fact that *Juntos Podemos* is a type of block grant based on rough estimates of specific projects which are subject to change and refinement before execution. None of the counterpart to the external aid of 1.4 million cordobas had been disbursed in August, apparently because the Technical Investment Committee had not programmed it.

INIFOM disburses 50% in advance on an approved project and the rest on the basis of justification of funds. In *Juntos Podemos* the contribution through INIFOM accounts for 60% of a project while the beneficiary community has to contribute 20% (it can be in kind or labor) and the local government 20%. This may be a contributing factor to the delay or non-execution of parts of the budget.

2.1.3 Project funding through other institutions

FISE (*Fondo de Inversión Social de Emergencia*), MAS (*Ministerio de Acción Social*) and PNDR (*Programa Nacional de Desarrollo Rural*) are other sources of investment funding at the local level which, with some variation, are approved in consultation with the municipalities.

FISE particularly undertakes social investments in schools and health posts, MAS is a program for local employment creation and PNDR for rural development. As the FISE funding does not enter the public budgets directly, i.e., neither figures in the central nor the local government financial reporting, these investments are assigned through the sector ministries and institutions that FISE works with. Some of the funds allocated through INIFOM may also stem from FISE. PNDR, similarly, escapes the local budgets but is of more marginal relevance for municipal finance since it concentrates more on productive investments and activities than infrastructure. Considering these agencies separately, the means and criteria of the programs can be presented as follows:

Institution	INIFOM	FISE	PNDR	MAS
Resource availability (1996 on)	Govt:Annual Donors: US$45.7m million[2]	US$107m	US$?	Own resources: Annual allocation, EU: ?
Annual budget 1996	Govt: US$8.0m Donors: US$7.2m[3]	US$30m	US$?	1996: US$1.2m 1995: US$2.9m
Objective	Municipal development	Social impact amelioration, poverty alleviation	Facilitate rural development	Employment generation, reintegration of war victims
Target beneficiaries	All municipalities	All municipalities according to criteria including poverty	Producers, traders	Unemployed and poor willing to work for low wages in conflict areas
Subproject size	Max. US$ 12,500	Max. US$ 50,000	US$ 20,000-500,000	Small but no defined ceiling
Project type	Streets, drainage, sports grounds, solid waste, clean-up measures, cemeteries	Health posts, primary schools, latrines, water in marginal urban and concentrated rural areas	Rural roads, other infrastructure, productive investments, training	All types, only 20% can be used for materials, no equipment
Project eligibility criteria	Request from municipalities	Request from municipality and approval from sector ministry	Participating entities with acceptance of Devt. Committee	Community request through Devt. Com.and Mayor
Counterpart contribution	20% community, 20% municipality	None	None	10% contribution from beneficiary
Selection criteria for municipality	70% by formula, the rest assigned specifically by Nat. Assembly	Formula elaborated in accordance with poverty map	Formula elaborated after poverty map	By Technical Investment Committee
Municipal budgeting	Yes	No	No	Yes
Preparation of projects and tendering	Municipalities under supervision of INIFOM	FISE	Beneficiaries	Municipalities for the employment creation program
Evaluation system	Project profile, technical evaluation	Cost-effectiveness	None	Projects so small that criteria not developed, priority listing by community

[2] Including some technical assistance and credit components which it is difficult to isolate and US$30 million of the World Bank Protierra project. However, the projects listed in 2.1.4.b, i.e. those that are only institution-building are excluded. For projects spanning from a past date into the future, the figures are calculated on a pro rata basis.
[3] Comprises donor contribution in grants included in the PIP and the projects listed in 2.1.4 .a. below with the exception of the World Bank loan. Exchange rate: US$1 = 8.5 cordobas.

FISE establishes annual targets for each municipality according to its criteria and based on the poverty mapping. INIFOM budgets the resources it will propose for the municipalities annually after a review of their requests as a lump sum for each municipality, aggregated at the departmental level in the PIP. FISE and PNDR are highly donor-funded so that in sum the larger part of investments is ultimately of donor origin. Furthermore, as investments are channeled through various agencies with different agendas, be they government, donor, local intermediary agency or NGO, the priority-setting will easily be influenced more by what is available than by the municipalities' own development targets.

2.1.4 Externally funded projects through INIFOM

The external funding entering PIP is so far limited to those sources requiring counterpart funding (USAID, CODESU, World Bank). Some 13 externally funded projects support institution-building of the municipalities and INIFOM as well as local investments. With the exception of the World Bank project, these are all outside the PIP. This practice will presumably change in 1997. The projects that are in execution or awaiting execution are presented below, separated into those with an investment or preinvestment component and those that are purely institution-building:

a. *With investment/preinvestment component*

(1) SIDA has projects in Region I and the West covering five department capitals (the poor *barrios*). This includes a credit scheme for microenterprises and housing as well as municipal infrastructure (first of all pavements of roads, storm water drainage, sewerage). The project is coordinated with the SIDA project working with the departmental health units (SILAIS) on training of health personnel, infrastructure in health centers etc. The total sum of this project, which spans the period 1993-97, is US$7.6 million including a microcredit component of 20% of the total. 1996: 1.9 million cordobas.[4]

(2) The Danida/INIFOM project works inside the regional office of INIFOM and covers the entire Region I (technical assistance, transfers to municipalities and investments). Project period: 1994-98. Amount: approximately US$7.2 million.[5] 1996: 1.1 million cordobas.

(3) The European Union works with UNDP on local development in 6 municipalities of Managua. This project includes microenterprise and production credit, technical assistance and housing construction for a total of about US$460,000 in the period 1996-98.[6] 1996: US$400,000.

[4] These figures are from *Fortalecimiento del Sistema Municipal de Nicaragua*, October 1995. In a recent internal document from INIFOM, *Informe de Proyectos con Financiamiento Externo*, August 1996, this figure is given as US$5.5 million which may be for 1996 onwards. Divergent figures may indicate, that there is no update for currency variations and, at the very least, that the overall data base is missing. With respect to the program for 1996, a separate INIFOM table is used, i.e. a consistent set of figures.

[5] Source: Danida, *Institutional Strengthening of Instituto Nicaragüense de Fomento Municipal (INIFOM)*, Draft Project Document, May 1996

[6] The figures for this project and onwards are from the INIFOM document *Informe de Proyectos* quoted in footnote 4. In some cases this document cites different figures in the text and in the accompanying table. Another INIFOM table is used as confirmation of some figures.

(4) A 'triangular' project (Netherlands, the Czech and Slovak Republics and Nicaragua) aims at twinning municipalities in Nicaragua with towns in the Czech and Slovak Republics. It totals US$2.7 million for 1996-99. 1996: US$600,000.

(5) Finland supports infrastructure and habitat, health and some credit in 4 municipalities. US$3.8 million for the period 1994-98. 1996: US$1.2 million.

(6) Forty-one municipalities will benefit from a study and equipment for solid waste collection and treatment supported by of Japan. US$235,000 for 1995-96. 1996: US$95,000.

(7) Japan will also develop master plans for the improvement of León, Granada and Chinandega. US$150,000 for 1996-98. 1996: US$50,000 (own estimate).

(8) The World Bank and Nicaragua have recently concluded negotiations on the Rural Municipalities (Protierra) Project which will be executed in conjunction with the Ministry of Natural Resources. The project will amount to a total of US$41 million (of which US$30 million from the World Bank) and will support poverty reduction in resource-poor areas coupled with municipal development. More than half of the total will be used for grants for community and municipality subprojects. The geographical locus will be the Western (90%) and the Atlantic Regions (10%). The project will probably be cofinanced by GEF for the biodiversity element on the Atlantic coast. The government/beneficiaries/municipalities would contribute US$11 million to the project (current proposal).

b. *Institutional strengthening*

(9) SIDA, together with UNDP, is supporting a project targeting an appropriate cadastre at municipal level by formulating a draft law for a tax system on real estate and testing it in 10 municipalities. Approximately US$497,000 in 1996-97. 1996: US$206,000.

(10) A GTZ project (FAMU) aims exclusively at technical assistance in the financial, organizational and planning area to strengthen municipal autonomy. US$3.2 million in 1992-99. 1996: no information given by GTZ to INIFOM.

(11) UNDP and Spain are working on strengthening 45 municipalities throughout the country with respect to their administrative capacities. The project is now in its second phase (1996-98) for US$461,000. 1996: US$215,000.

(12) A UNDP/Spain/SIDA sponsored project aims at the consolidation of the democratic and participatory process. The project involves training of municipal personnel. US$744,000 for 1996-97. 1996: US$681,000.

(13) A Danida project expected to be approved soon will assist in carrying out of the ARI (*Acuerdo de Reestructuración Institucional*), i.e., the restructuring and refocusing of INIFOM's role. US$685,000 over the period 1996-98.

Other projects

More than 300 NGOs are active in the country including several important international ones. They tend to work at the local level and contribute to local investments and recurrent expenditure. Most of this is unrecorded in public finance statistics. The practice of 'twinning' with important European and American cities also leads to considerable income for those larger

cities or towns that are able to attract munificent sisters. Some of this is captured in the INIFOM project mentioned in 2.1.4.a (4) but not all. The Association of Municipalities AMUNIC receives about US$7 million in support from USAID for small projects and a special capital fund. This project is not reported in the PIP and is not included in the above.

2.2 Government Transfers: Proposed Reforms

The proposed new Municipalities Law includes an Article (46) suggesting that the state will assign 5% of tax revenue to the municipalities. The Law also specifies the criteria for distribution to the municipalities, which would be subject to revision every four years on the basis of per capita income (inverse relationship), rural and urban population (more weight on the former), land area, revenue collection indicators, deficit in the delivery of municipal services and municipal poverty. The draft Law furthermore prescribes that the municipalities should use 75% of those funds for investments and maintenance and 25% for recurrent costs. The 5% of tax revenue for municipalities has been included in the Government's budget proposal for 1997 amounting to about 250 million cordobas.

Over and above this, the municipalities will have access to local funding through municipal taxes, rates, special contributions, fines and municipal participation in fiscal taxes, i.e., an open field which will in itself change nothing in the existing tax regime. The possibility for municipalities to borrow from private or public banks is opened up by allowing them to guarantee the loans on its investment fund and property holdings.[7]

2.3 Conclusion on Investment Preparation, Budgeting and Execution

The investment funds available to municipalities are so diverse and uncoordinated, the criteria for preparation and 'budgeting' so incoherent and inconsistent that municipalities have difficulty orienting themselves. In fact, municipal preparation and budgeting are indistinguishable—or by and large absent—for foreign aid projects and the funding agencies or programs that are set up as intermediaries of foreign aid. The presence of these different procedures to access budgetary and extrabudgetary funds adds up to making the process opaque. The changes underway aim at resolving some of these problems, most notably those at government level. However, the donors have not clearly signaled that they will change their ways of operating.

3 INSTITUTIONS

3.1 INIFOM

INIFOM was formally established in 1990 with a board of 40 members of whom 34 are mayors (2 from each department and autonomous region). The president has cabinet status.

INIFOM's mandate is to spearhead local government development and should :

(a) undertake training programs for municipal authorities and employees; (b) carry out studies and investigations; (c) give technical and legal assistance and services to projects of the municipalities;

[7] Concern about absence of clarity on this issue was expressed in the Staff Appraisal Report (green cover) on the Rural Municipalities Project, based upon the study *Propuesta para un Sistema de Transferencias Fiscales del Gobierno Central a los Municipios*, by Hernando Garzon, 1995.

(d) promote environmental education; (e) give financial and administrative support to the implementation of municipal development programs of national interest; (f) promote the coordination of national and municipal investment programs; (g) spearhead the coordination and exchange of experiences among municipalities; (h) exercise the attributions and competencies that the Executive Power delegates to it with respect to the municipalities; (i) promote the cooperation, assistance and information between the central, regional and municipal administrations; (j) stimulate, manage, channel and, as the case may be, administer the international cooperation for municipal development; sign contracts and international credits with municipal targets; (k) support the twinning relations between Nicaraguan municipalities and municipalities and institutions of other countries; and (l) take on any other function that the laws assign to it or that derives from its nature and goals.

In practice INIFOM is placed in a difficult intermediary position between the state and the municipalities, not least through its role in channeling the Government's resources to the municipalities (supposedly derived from points (h) and (j) above). The reason for this channeling is that INIFOM is held accountable for the *Juntos Podemos* funding. Apart from the questionable justification for this, it also involves a delay in payments. The *Juntos Podemos* program, however, will cease when the new transfer system is approved.

The evolution of INIFOM is characterized by a concentration of efforts on the development of municipal investment projects rather than on institutional strengthening and capacity building of municipal institutions. The impression left after examining the list of externally-funded municipal projects enumerated in 2.1.4 is that the measures to develop the own strengths of the municipalities are in the hands of the donors.

INIFOM recently signed an ARI with the Executive Committee for Reform of the Public Administration (CERAP) in which the weaknesses of INIFOM are spelled out. The preoccupation with channeling resources is one of them and the concentration on 'projects' another. The major task of INIFOM to undertake training programs suffers due to lack of its own resources. The recurrent budget for INIFOM was in 1996 barely 10 million cordobas, of which the operational budget for INIFOM amounts to 5.2 million and current transfers to 4.6 million. The latter includes monies for training of staff, but most of it is for the maintenance of museums and other institutions. This means that there is high donor dependency in the training area as well.

Another weakness is that the Decentralization Commission was established after INIFOM was set up—that is, INIFOM does not really have an express mandate in decentralization as yet and at any rate it does not have the means to carry out the decisions. Furthermore, INIFOM has relatively too many managers and support personnel and too few professional staff members. It also does not have adequate information systems, let alone systems that could be utilized in the municipalities. According to the ARI, INIFOM shall develop a system and instruments for municipal strengthening, one of which will be to tailor the SIGFA to the municipal level. An important human resource aspect is the development of a municipal career structure.

These points of view are not represented in the draft organic law that has been prepared for INIFOM to replace the existing presidential decree. As it is not clear who has prepared it—except that it is obviously based on INIFOM's views—or what its status or the likelihood of approval is, it shall not be discussed at length here. The important thing to mention is that it goes against the grain of some of the other legal initiatives and current thinking by reconfirming the double nature of INIFOM as both part of the Central Government and offering support to the municipalities and

seeing an additional role for INIFOM in the coordination and supervision of the process of decentralization. It restates the participation of the mayors in the conduct of INIFOM, and proposes to strengthen the role of INIFOM with respect to the selection of projects, the channeling of resources and supervision of their spending.

3.2 Municipalities

3.2.1 Responsibilities

The defined municipal responsibilities under the current law are: establishment and maintenance of public parks and squares, streets, cemeteries, markets, libraries (if such exist), sports fields and facilities, solid waste, storm drainage. Shared competencies with the Central Government include schools, health, water supply and sewerage.

The draft Municipalities Law proposes to further extend the powers of the municipalities. According to the draft they will be: (a) public cleanliness, including solid waste disposal, storm and water drainage; (b) coordination with the 'national entity' in charge on the construction and maintenance of health posts and preventive health care participation; (c) market cleanliness, cemeteries maintenance; (d) urban, suburban and rural development, land use, street maintenance; (e) culture, sports and recreation; (f) construction, maintenance and administration of water, sewerage, waste water disposal and electricity (the distribution network at household and public level); (g) urban transport; (h) protection of the environment; and (i) tourism promotion, human rights, especially childhood protection. Education is absent.

3.2.2 Examples of municipal finances

Most (122) municipalities had a budget of less than 2 million cordobas in 1995 including transfers and grants. Twelve municipalities had an income of less than 100,000 cordobas.

Two examples of the breakdown of municipal finances are given below:

Condega with 26,000 inhabitants expects in 1996 to collect about 670,000 cordobas from the citizens for a total budget of 1.6 million cordobas (41% in own financing), i.e., nearly 1 million cordobas in grants and transfers. The investment budget falls short of this by some 125,000 cordobas as ordinary resources do not cover the municipality's running costs.

La Trinidad has 17,900 inhabitants and a revised budget for 1996 of 1,896,000 in expenditures and income. Of those resources, grants amount to 653,000 and more than 350,000 are government transfers so that altogether own resources account for about 45% of income. Both examples point to a substantial increase in government transfers from 1992.

As a concrete example of direct donor transfer to the municipalities the Danida/INIFOM project summarized in point. 2.1.4.a (2) can be mentioned. It includes transfers to municipal governments and the topping-up of tax income by the following criteria: Each municipality of the project area (Region I) received 45,000 cordobas over the two first years of the project for office equipment and supplies. Operational costs are supported by 3-4 cordobas per inhabitant and for investments by 10 or 20 cordobas per capita (10 in the first year of the project, then 20 in the second year and onwards, falling to 10 cordobas in the last year). Over and above this, an

incentive payment related to tax collection efforts will be instituted as of this year, which corresponds to a declared government policy (competition for funds according to efficiency).

3.2.3 Capacities

Municipalities diverge markedly in their financial and managerial capabilities. Although it is impossible to assess recent developments on the basis of a short mission, there is a palpable sense of improvement. New computerized systems are being installed, for example, first of all as financial management tools, including property registry,[8] and for other essential tax base information. Altogether 14 municipalities have property registries by now. The rest have a more limited registry of tax payers. INIFOM has issued a manual on municipal finances which is no doubt useful in the introduction of categories but it is only a first cut. Computerization and software introduction is mostly done on a project basis so that uniformity is not ensured.

Some municipalities are of very dubious viability, i.e., they cannot keep an administration of any reasonable size and quality. The mayor in one of the poorest, San Lucas, bought two mules with the project funds of the Danida/INIFOM project just to get around in the municipality. Needless to say, there are no proper office facilities in such a location. But most municipalities will by now have a mayor's office and some hired staff to be in charge of the civil registry, the budget, minutes (handwritten) of the council meetings, and collection of taxes and fees. Public tender should be undertaken for projects above 200,000 cordobas according to Nicaraguan rules, but weaker municipalities are not able to do so. This lack of capacity is a direct reason for the passing-on of the responsibility for major works to a fund such as FISE.

3.2.4 The planning process in the municipalities

Various project and institutional publications have been issued on the participatory process. Danida for example is active in this field and so is MAS. With variations, the process is the following:

First a technical assessment or diagnostic is done by means of the Development Committee (the local entity created at the instigation of MAS typically consisting of local representatives of MED, MINSA, the army, clerical establishment, major interest groups, etc. headed by the mayor), an NGO, or donor project, or aided by MAS personnel. Meetings are then held with the communities (one municipality, for example has 64 communities) to ask the population how they assess and prioritize their own needs. These are then classified and aggregated at *comarca* or microregional level. From there they are sent to the municipal development committee. Next step is the municipal council approval and the exercise concludes with a town meeting (*cabildo*). The communities prioritize their needs within the sectors of education, housing, health, roads, electricity and water, i.e., not just those that are defined as municipal tasks.

A difference in methodology consists in the actual involvement of the local authorities or stakeholders in the evaluation of the results. MAS, for example, tends to use a technician to assemble the material and evaluate it, whereas others insist on the municipalities doing their own collation. Some donors also send in teams doing the work for the municipalities without ensuring that the methodology is replicable.

[8] Can be done for tax purposes only without registry of deeds.

3.2.5 Proposals for improvement

The Decentralization Commission proposes quite generally that a Law on Decentralization, a career system for municipal employees, creating a model for the municipal financial base, and a law on citizens' participation should be presented. Systems for municipalities training, computerization and information systems are to be developed (see also Section 3.1).

Various studies have been or will be executed so as to overcome recognized weaknesses. One question is the transformation of FISE from a social investment emergency fund into a permanent institution at the service of the municipalities. FISE itself will spearhead four studies: (i) popular participation, (ii) establishment of preventive maintenance funds, (iii) the monitoring and evaluation system at municipal level, and (iv) manuals.

3.3 Decentralization and Deconcentration

The distinction between decentralization, i.e., self government, and deconcentration, presence of the central government at the local level, is useful in indicating where responsibilities belong and how to execute them. Theoretically, it can be said that services such as health and education should adhere to nation-wide standards and that their benefits accrue to the nation as a a whole. On the other hand, in education and health local participation is adding to the efficiency of the service and can help articulate particular needs. Until now the Government and local level have shared responsibilities.

A number of pilot projects (154) have been carried out in education, channeling resources to municipal education councils with representatives of parents and the education establishment. Some of the funding has come from the World Bank Basic Education Program. The funds transferred are administered for minor maintenance and teachers' salaries. INAA has transferred the administration of potable water and sewerage to 14 municipalities in Matagalpa and Jinotega. The Ministry of Communication and Transport has established agreements with four municipalities for the creation of construction modules administered by local infrastructure committees with participation of producers.

In health, SILAIS (*Sistema Local de Atención Integral de la Salud*) are deconcentrated entities at the departmental level, receiving some 22% of the recurrent budget of MINSA for consumables, water, electricity, telephones, etc. There are discussions to combine this with an element of decentralization to the municipalities which are for the first time this year included in the planning process. Also there are cases of local commissions administering principal health centers.[9]

4 INSTITUTIONAL CONFLICTS

The capacities of the municipalities in their actual state make it difficult to implement a full-scale decentralization program rapidly.

[9] Each municipality has a health center with several doctors and some beds or a health center with a general practitioner. On average there are about 6 health posts in a municipality with an auxiliary nurse in permanent attendance or a doctor visiting.

A specific issue is piped water. Discussions have been ongoing for a period of time on the degree of involvement of municipalities in water supply schemes. At this time INAA is nearly exclusively in charge of water supply and sewerage systems at the local level. It has a program financed by FISE for marginal urban and concentrated rural areas, excluding the dispersed rural areas from sewerage investments. In order to accelerate the coverage with water and sewerage systems, various models can be discussed: municipalities forming water bodies, using contractors for works and maintenance, or INAA could be in charge of construction with municipal maintenance responsibilities. A major question to settle is revenue sharing and collection of fees.

Some local authorities think that FISE is uncooperative. Municipalities are not involved in the costing of FISE projects, let alone in their monitoring and evaluation. It is a fact that FISE does not pass its funds through the municipal treasury and does not report its costs. Some observers and beneficiaries express that FISE is too expensive, that it does not utilize local resources sufficiently and that it does not systematically plan the utilization of the resources destined for each municipality with the local authorities who often claim that they could execute works more cheaply if they were in charge. FISE staff maintain, on the other hand, that the local workers are not sufficiently skilled, that municipalities cannot handle the intricacies of contracting, etc. More important is the criticism that FISE does not ensure sustainability. It does so in a formal sense by requesting proof of a maintenance and operational budget for the works undertaken but the institutional sustainability is not assured.

Obviously there is conflict potential between FISE, MAS, INIFOM and municipalities in various combinations. All are active in the participatory process development. Donors, too, may have specific interests, geographical areas, concepts or 'products' wrapped up in projects whose concept they will want to extend to the whole territory. By working relatively independently on strengthening municipal processes, they may in fact rather impede the creation of a manageable total than aid in it. An example is the diversity of financial management systems now being installed in some municipalities. If INIFOM does not take the lead to suggest a reasonable common system, it will later on be more difficult to develop a 'municipal SIGFA'.

There is also some criticism or local discontent that decentralization is rather decentralization of problems without allocating adequate means for their solution and that some measures have been decentralized in order for the Government to cut its own budget. This criticism is difficult to verify because responsibilities have been transferred on a piecemeal basis. As municipalities have access to all sorts of funding, there is no scarcity of investment funds if a municipality knows how to access them. An appropriate criticism would be that there is no concerted attempt at municipal development through all the different agencies active in the field. It may also be that too much investment funding is available as compared with the needs for recurrent costs. The transfer proposal will rectify this but will require substantial assistance in planning, programming and project development to the municipalities to be effective.

A proposition related to this is that decentralization and deconcentration go hand in hand. That involves the risk that deconcentrated entities take over from the decentralized ones (for example, that development committees crowd out the municipal councils) but properly understood, both are needed at the local level.

An important institutional deficiency is the absence of a judicial system (including the civil police) to support legislation at the local level. Existing institutions have to absorb this function, i.e., decide legal conflicts, both municipality versus the individual and municipal institutions among

themselves, and they also have to undertake a control function for which there should be other authorities. In this case, the presence of deconcentrated legal institutions may be advisable.

5 ISSUES AND RECOMMENDATIONS

Key issues revolve around resource mobilization, delimitation of responsibilities, the plethora of funding sources with different and overlapping agendas, and local capacity constraints:

- When deciding on revenue transfers to the municipalities factors to be considered: equity, the need to satisfy basic services as stipulated by the Central Government, and the access of municipalities to resources. Government transfers aim exactly at the latter inequities. Own resource mobilization tends to be positively correlated with the capacity to satisfy the needs of the population and the larger municipalities perceive larger contributions per capita than the smaller ones. Although the size of their needs are relatively more modest, the resource-poor rural municipalities are considerably poorer than the larger urban ones by any standard.
- The draft Municipalities Law encompasses too many areas without clear demarcation of the respective responsibilities of the Government and the municipalities. As it is evident that the municipalities are not able to fulfill all the needs enumerated, not only because of financial but also manpower and management constraints, this generous attribution may not help in the development of sound schemes.[10]
- There are problems of compatibility of the draft INIFOM organic law with the Municipalities Law, first of all as regards the channeling of resources. The Municipalities Law does not mention INIFOM in the channeling of resources as does the INIFOM draft. There is no doubt that it takes longer to channel resources through INIFOM than if they were transferred directly. In addition, this detour can be perceived as paternalistic.
- The relationships between INIFOM and AMUNIC should be clarified. The principle should be that the mayors' interests are articulated through AMUNIC. Therefore the mayors should not be represented (at least not with such force) in the board of INIFOM.
- The discussions with INAA reflect an institutional conflict approaching a battle for turf instead of the interest of the beneficiaries. In all likelihood both parties assume that more responsibilities will lead to more resources.
- There is conflict potential also among municipalities which are currently developing their own tools of management. Imposing uniform standards may be felt to impair their autonomy but absence of such will increase the difficulties of giving consistent outside assistance.
- Government transfers also involve oversight over the use of resources. A local supervision committee (*Comité de Vigilancia*) along the Bolivian model is foreseen but in addition management auditing should take place more regularly. External control is exercised by the Auditor General's Office (*Contraloria*) which until now barely has the capacity to do so (see section on Control and Auditing). However, in the areas of shared responsibilities of the Central Government and the municipalities, some oversight by the Government could be instituted over and above the supervision exercised by the executing agency. This should be done by an agency other than INIFOM.
- A further issue is the element of deconcentration which may facilitate the cooperation between the Government and municipalities.

[10] The issue is if a 'competence' is a duty or a right. The draft Municipalities Law states that, *El municipio ejerce, .., competencias en las siguientes materias:...*' (then follows the assignments listed in 3.2.1). If the Law means to give rights to the municipalities, then they are also free not to exercise them.

- The current modalities of investment funding lead to less emphasis on horizontal needs, i.e., consistency and cohesiveness at the local level, than desirable. Also it is difficult for the municipalities to see what resources they are actually perceiving.
- Municipal viability is questionable for some entities which have very low revenue base. Others will suffer from the loss of the sales tax. If they do not quickly find a substitute for the sales tax, there is a danger that both groups will be unable to cover their recurrent costs and the proportion 75:25 investment and maintenance to operations in the proposed government transfer scheme may be unrealistic.
- Some concern is voiced that block grants to municipalities are not an adequate allocation because they lead to a breach of project viability criteria, e.g. social criteria will predominate. This concern has to be weighed against the basic impossibility of deciding a whole country's investments on the basis of single projects. Following strict criteria for viability will furthermore tend to reinforce existing strengths.

The matrix below presents possible policies and recommendations corresponding to the above.

Issue	Policy Direction	Actions recommended
I. Revenue transfer to municipalities (MUN)	Transfer related to government tax revenue	Consider the obligations and needs of municipalities
II. Definition of municipal responsibilities	Assigning rather vast competencies to MUN	Define clearly what MUN have to do on their own and which are shared responsibilities with Central Government. Develop contract programs with MUN on own and shared tasks.
III. Regulatory status of INIFOM as an institution in between the CG and MUN	Not clear if it will maintain this role	Define INIFOM clearly as an instrument of MUN
IV. Relationship between INIFOM and AMUNIC	Mayors' interests represented by AMUNIC but also through INIFOM at present	Should be clarified so that functions are not overlapping, INIFOM a public advisory entity and AMUNIC a private body directed towards the political level.
V. Institutional conflicts	Left to negotiation or unresolved	Introduce a policy that will be a flexible instrument of cooperation
VI. Municipalities adhering to uniform standards	Autonomy defended by municipalities	INIFOM to take leading role in disseminating standards and formats that will be acceptable to municipalities, such as financial management and accounting
VII. Government oversight	Not defined except external audit	CG should define an oversight role for shared responsibilities as an 'internal control' function
VIII. Deconcentration of government institutions	Increasing at the same time as decentralization is but there is also a commingling, e.g. CG representatives enter into MUN through Devt Committee	As long as it is clear what are the attributions of the different institutions, deconcentrated and decentralized entities should work together on issues such as schools, health and major works
IX. MUN defining own needs	Not clear	Should be the basis of negotiations between MUN and sources of funding. In the medium/long term: those sources should enter the MUN budgets.
X. MUN viability	Defined as one of the criteria for MUN	Ensure basic operational viability of MUN if they are clearly not self-sustaining or find other solutions
XI. MUN independence over funds distributed according to social criteria could misallocate resources	Social criteria dominating	MUN to develop longer-term investment plan in coordination with INIFOM

6 CONCLUSIONS

The main recommendations of municipal development include development of cost-sharing models with government institutions, the setting-up of municipal investment programs weighing social equity against economic and financial viability criteria and, in so doing, probably realizing that some areas should be dealt with at a larger scale. Major conclusions include:

- Cost-sharing models of financing of the Central Government and municipalities could be envisaged, for example, in some municipalities a centralized agency such as INAA can be in charge of major works, the municipality of maintenance, INAA of supervision. The municipalities would pay back INAA for the investments according to a model to be developed. Other municipalities may be able to take over more of the tasks.

- Contract programs should be developed at a minimum for the weaker municipalities to clearly stipulate respective responsibilities and targets in social and economic infrastructure development - not just sector by sector. A Decentralization Law would presumably clarify some of the issues involved in the transfer of responsibilities, but a law would not and should not detail the situation of all municipalities.

- The formation of larger entities of the municipalities should be encouraged so that they can be in charge of major works.

- With respect to investment planning and programming, INIFOM should be coordinating the municipal investment plans, offering assistance etc. based on the diagnostic performed in the municipalities. But INIFOM should not as such approve individual projects.

- FISE and other programs should work more closely with the municipalities and, in the longer term, channel their resources through them.

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