Demand-Driven Rural Investment Funds (DRIFs) are the latest generation of social funds that are yielding impressive results in several countries in South America. This note reviews the Brazilian experience with the Programa de Apoio Comunitario (PAC) and the Fundo Municipal de Apoio Comunitario (FUMAC), and the Mexican experience with the Fondo Municipal Solidaridad (FMS).

Traditional social funds, which were implemented primarily in Africa and Latin America, have introduced reforms and demonstrated the capacity of local governments to implement their own programs. They remain, however, a relatively centralized development tool and may not be achieving their full potential as an instrument for reaching the rural poor.

DRIFs differ from traditional social funds in mainly two ways. First, DRIFs use innovative institutional arrangements and mechanisms to increase local participation and strengthen local governments. In both Brazil and Mexico, local communities generate and implement all sub-project proposals. Municipal governments are involved, according to various modalities, in the selection, financing, and supervision. In both cases, the presence of democratically elected municipal governments and intense citizen involvement in the management of DRIFs foster transparency and accountability.

Second, the design of DRIFs is tied to the country's intergovernmental fiscal relations in order to enhance their financial sustainability. In Brazil, substantial fiscal decentralization has already been introduced for the benefit of states and municipalities, making them able to contribute to the program. The federal government's sole responsibility in the process is to guarantee the IBRD loans made to the states. In Mexico, the federal government is the recipient of the IBRD loan and provides a matching grant to states to finance the FMS as part of its program of fiscal transfers.

Results from Brazil (PAC, FUMAC) and Mexico (FMS) suggest that DRIFs represent a new implementation instrument with a high potential for assisting the rural poor. In less than three years, over 46,000 community proposals have been prepared and submitted, and 18,000 projects implemented, benefiting more than 2 million poor Brazilian families. Ninety three percent of funds are now reaching the local communities — up from 45%. In Mexico's FMS local governments and communities have implemented 30,000 projects in three years at 30% to 60% below previous costs.

KEY FEATURES OF DEMAND-DRIVEN RURAL INVESTMENT FUNDS

Five key features define DRIFs:
1. A streamlined loan and credit agreement;
2. A demand-driven process;
3. A flexible operational manual;
4. Access to technical assistance; and
5. An efficient monitoring and evaluation system.

A Streamlined Loan and Credit Agreement

The agreement broadly defines the purposes and target groups of the DRIF, but does not describe operational details. It refers, instead, to the agreed Operational Manual.

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1. The "municipal" ("municipio") actually refers to the equivalent of counties or districts in other countries. Latin American municipios are primarily rural.

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A Demand-Driven Process: Participatory and Decentralized Local Development

Communities of poor people with a legal status and local governments are the main actors of DRIFs. Community groups generate all sub-project proposals and implement those prioritized and selected by local government entities.

DRIFs’ rules and mechanisms are tailored to suit local conditions and enhance local accountability and transparency. Both in Brazil’s FUMAC and Mexico’s FMS, elected municipal development committees (MDC), chaired by the Mayor, are key institutions in the selection process. MDCs prioritize and approve sub-projects presented by community associations. Subsequently, the state releases the funds directly to community associations (Brazil) or to local governments (Mexico).

The Brazil DRIFs feature interesting innovations. MDCs, for example, include a majority of civil society representatives (NGOs, religious groups, unions, rural communities), and only a few elected municipal councilors and government officials in order to ensure a wider representation of all segments of society. The third generation of Brazilian DRIFs, FUMAC-P, which is being currently piloted under FUMAC, gives the MDCs more responsibility for implementation and financial management. FUMAC-P Councils not only approve and supervise sub-projects but they also finance communities directly, within the constraints of a one-year budget.

A Flexible Operational Manual

The operational manual (OM) contains the detailed rules and mechanisms that guide the implementation and functioning of DRIFs. The OM is usually modified each year, and it is easily changeable by agreement between the Borrower and the Bank in order to incorporate lessons from successes and failures. This is a critical feature since the DRIF’s performance rests on rules and incentives that need to be adapted to local conditions and priorities.

Clear criteria, detailed in the OM, guide the targeting and disbursement of funds, sub-project eligibility criteria, and cost-sharing (local contributions), which is defined in a cofinancing matrix.

Targeting and disbursement of funds. DRIFs are only operating in the poorest regions: The Northeast in Brazil and the southern states of Mexico. In addition, specific rules further target the fund to the poorest rural municipalities and communities.

Once funds are released to local governments or communities, the associations contract with local entrepreneurs or NGOs to implement the projects, or the projects are implemented through community force account (mostly the case in Mexico). The loan and credit agreement specifically allows the use of direct contracting for procurement of small community-based works. MDCs and community groups supervise the implementation of sub-projects.

Evidence from Mexico (FMS) shows that annual allocations, known in advance, enable local governments to start effective planning. In both cases, the MDC disburses the funds to the community committee or association responsible for the project. In all sub-projects, community associations are responsible for procurement, which is done by local shopping and direct contracting. In the Mexico FMS, evaluations have shown that the simplicity and flexibility introduced by direct contracting was one of the main reasons for a project’s success.

Project eligibility criteria include, but are not restricted to, a financial ceiling, a limited implementation time, a negative and a positive list, and standardized unit or per capita costs. In both DRIFs, the cost of individual investments is limited to US$50,000 including local contributions. The average sub-project cost, however, is lower by more than half.

Cost-Sharing, defined in a cofinancing matrix, vary based on the type of sub-project. In Brazil, community associations must contribute a minimum of 10% of total sub-project costs, but the contribution can be higher for infrastructure projects (15%) and productive projects (20%). In Mexico, the minimum contribution is set at 20%. It reaches 30% for road paving and 40% for leisure facilities. These levels of local contributions provide communities with incentives for choosing investments with higher public good value. In addition, they call for greater community contribution for investments with higher private goods value.
Technical Assistance

Experience with the DRIFs indicates that there is more latent local technical capacity than is usually recognized by central governments. Local communities, however, still need access to technical assistance, and mechanisms for financing it should be built into the program. In Brazil, under PAC-FUMAC, community associations may use up to 8% of project costs to contract their own technical assistance.

Monitoring and Evaluation

The management and supervision of such a plethora of small local sub-projects coupled with the need for regular modification of the Operational Manual means that traditional management procedures are inappropriate. Ex-Ante controls are replaced by rules; eligibility criteria; Ex-Post Controls, such as an act signed by all the beneficiaries that confirms completion of the work; and post-project supervision missions.

Fine-tuned computerized databases are established and used to assist project monitoring efforts by allowing for analysis of trends and generic problems so as to modify the system of rules and incentives. Both in Mexico and Brazil, technical units have been created that are in charge of M&E, accounting and auditing, and redesign. In Mexico, however, the M&E system does not seem to be properly functioning.

Resistance and Obstacles

Accountability and Transparency

One major source of resistance to decentralized decision-making has been central governments and donors worried about transparency and accountability of local organizations. The rules, criteria, and incentives put in place by DRIFs are meant to ensure both accountability and transparency. For example, in Mexico, funds are given publicly to the mayor, and the rules for allocation are publicly disclosed. In Brazil, MDCs were set up as a mechanism for strengthening local governments and local democracy while dealing with problems of clientelism brought about by the concentration of municipal powers in the hands of the local elite. Civil society participants make up 80% of the MDCs and provide the checks and balances needed. In addition, municipal governments are encouraged to contribute about 5% of the total sub-project cost. When MDCs perform well and actively foster community participation, they “graduate” to FUMAC-P and benefit from a greater operational and financial autonomy. As a result of this built-in incentive, local government accountability to beneficiaries is enhanced.

Procurement and Disbursement Procedures

In centralized systems of service delivery, central procurement is designed to minimize costs and increase efficiency of execution. The experience of DRIFs shows that this is usually a counter-productive strategy. For example, the costs and delays involved in transporting materials from the capital to remote rural areas, as well as the frequent poor quality of the materials and works procured, offset any economies of scale. On the other hand, local shopping, direct contracting and community contributions through “force account” save public resources, boost local economies, and strengthen the capacity of local institutions. Experience also indicates that local communities often succeed in doing more with the resources they receive than centralized units. In spite of this positive evidence, however, central governments and donors are sometimes reluctant to share control and may resist this modus operandi.

Technical Standards and Specifications

Engineering culture is built around a set of rigorous standards, norms and specifications. Typically, technicians find it hard to relinquish control of project implementation to skilled local labor. Evidence from Brazil and Mexico shows that the quality of the work is satisfactory and often very good. In Mexico, the quality of school building construction and repair, paving, and simple road and bridge works was generally equivalent to that performed by contractors, but usually cost only one-half to two-thirds of the cost. In deprived rural areas, functionality is more prized than comfort and, the former does not require strict and often costly application of all technical specifications. To assist communities in managing project implementation, the Operational Manual contains standardized sub-project technical documents to which associations may refer.
**Income-Generating Projects**

The performance of productive or income-generating projects (a feature of the PAC-FUMAC, but relatively rare in the Mexico FMS) has been uneven. Income-generating sub-projects are more demanding in terms of financial and economic sustainability. More experimentation is needed on this front. Already, lessons learned from PAC-FUMAC regarding eligibility criteria, use, and access to these projects are being incorporated into the new generation of DRIFs. Key questions to be asked include the appropriate use of matching grants vs. credit and savings for income-generating sub-projects.

**Macroeconomic Balance**

DRIFs depend on the transfer of resources to local institutions which raises questions about their financial sustainability. In Mexico, the FMS has grown in size and coverage each year and has become a semi-permanent element of the national system of fiscal transfers. The current debate about the relationship between fiscal decentralization, macroeconomic management and growth has not yet generated definitive answers. It is clear, however, that the design of DRIFs should be tied to macroeconomic balance, stabilization and non-discriminatory agricultural policies.

**INSTITUTIONAL OBSTACLES IN THE BANK**

There is no natural home for DRIFs inside the Bank. Responsibilities for the design and implementation of DRIFs are scattered among different kinds of sector operations divisions and are now present in nearly all regions. As a result, the small and dispersed nature of the projects makes any up-front design and detailed appraisal difficult. While the Bank is already doing a lot of work in this area, it does not have a sufficient number of specialized staff to explore participation and the development of local institutions.

**CONCLUSION: NEXT STEPS**

The failure of integrated rural development (IRD) programs to sustainably improve the living standards of rural people has left a policy void that the Bank is now tackling. DRIFs are part of a strategy for improving the design, implementation and sustainability of rural development programs. Achievements from FMS and PAC-FUMAC have, indeed, been impressive. Sub-project quality has been satisfactory and often equal to that of more centralized programs. Participation during each phase of the project cycle has ensured better satisfaction of local needs, improved maintenance and sustainability, and increased local resource mobilization. Finally, reliance, albeit carefully monitored, on local governments and participatory mechanisms has strengthened local democracy and social cohesion.

DRIFs have been successful in scaling-up small-scale rural infrastructure projects but much remains to be learned about the scaling-up of income-generating and natural resource management projects. The next steps, in both DRIF research and pilot activities, should be in those directions.