Précis

OED

22972

WORLD BANK OPERATIONS EVALUATION DEPARTMENT SPRING 1999 NUMBER 178

Municipal Development Projects: Building Institutions and Financing Local Development

SIXTY-THREE OF 75 COUNTRIES WITH POPULATIONS greater than 5 million are now pursuing decentralization policies that devolve functions and responsibilities to local governments. But the decentralization process is severely constrained by a lack of institutional capacity among local governments, limited local resource mobilization, and limited access to long-term financing for investment programs. Municipal development projects (MDPs) are designed to remedy some of these problems while preparing local governments to borrow in capital markets. Since the early 1980s, 16 World Bank–financed MDPs have been completed in 11 countries, and 19 additional projects are currently being implemented in 15 countries, with total lending of US$2 billion. How well are these projects doing the job they were intended to do?

The Operations Evaluation Department (OED) has addressed this question with an impact evaluation study of MDP projects in Brazil and the Philippines. Earlier, performance audits of the projects found they had significant impacts on the living conditions and productivity of residents in participating municipalities, as well as significant unintended positive effects on the local economy. The impact evaluation report, which builds on those findings, concludes that the projects have had clear impacts on municipal finance. It demonstrates—for the first time—that MDPs can be effective in building local institutions.

Design of the Study

The impact evaluation assessed the effects of MDPs on the capacity of local government institutions in the areas of fiscal and financial management and planning and implementation of investment programs. It also assessed direct impacts on the ben-

eficiaries as anticipated by the projects and indirect side-effects on the development of local economies, focusing on employment and income generation. The study evaluated the impacts of four successful MDPs: the first and second MDPs in the Philippines and MDPs in the states of Paraná and Rio Grande do Sul in Brazil.

Three sets of data were collected and analyzed: municipal finance data of local governments, a sample survey of mayors in Brazil on capacity building, and a survey in the Philippines of stall-holders in public markets. The study benefited from an unusually complete data set that allowed both "with-without" project and "before-after" project comparisons. At both the municipal and the beneficiary levels, the study compared impacts on the participating municipalities with conditions prevailing in the nonparticipating municipalities. It also contrasted initial conditions with the conditions after project implementation. To supplement the data, the study reviewed and analyzed project implementation records; interviewed government officials, nongovernmental organizations, and beneficiaries; and visited project sites.

Reform First, Investment Second

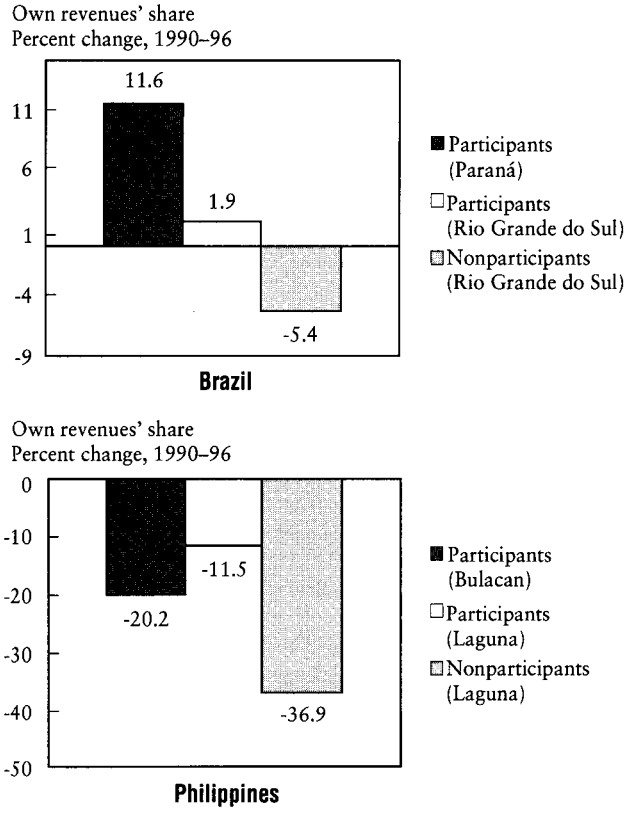
The Brazil and Philippines MDPs were almost identical in their objectives and design, but had different implementation strategies. In Brazil, a statewide "wholesale approach" encouraged as many municipalities as possible to participate in the fiscal reform program financing technically simple projects such as street paving. In the Philippines, a more selective approach allowed a smaller number of eligible municipalities to finance revenue-generating projects such as public markets. In both countries, the programs had two main instruments: fiscal reform and investment programs.

The design of the Brazilian projects specified that to apply for a subloan, a municipal government had to submit a financial action plan and a comprehensive reform package. Reforms had to include plans for training and technical assistance to aid institutional development. The Philippines projects required a similar financial action plan. The preparation and implementation of investment subprojects, therefore, enhanced institutional capacity by offering experience in every phase of a project cycle, from the feasibility study to construction work. The sequencing of the projects—reform before lending—proved critical to their success.

Improving Fiscal and Financial Management

The extensive municipal finance data point to significant MDP impact on the strengthening of municipal fiscal and financial management. The OED study examined five dimensions of this issue: financial autonomy, local revenue generation, cost recovery, budget balance, and financial leverage.

FIGURE 1: MDP Impact on Financial Autonomy



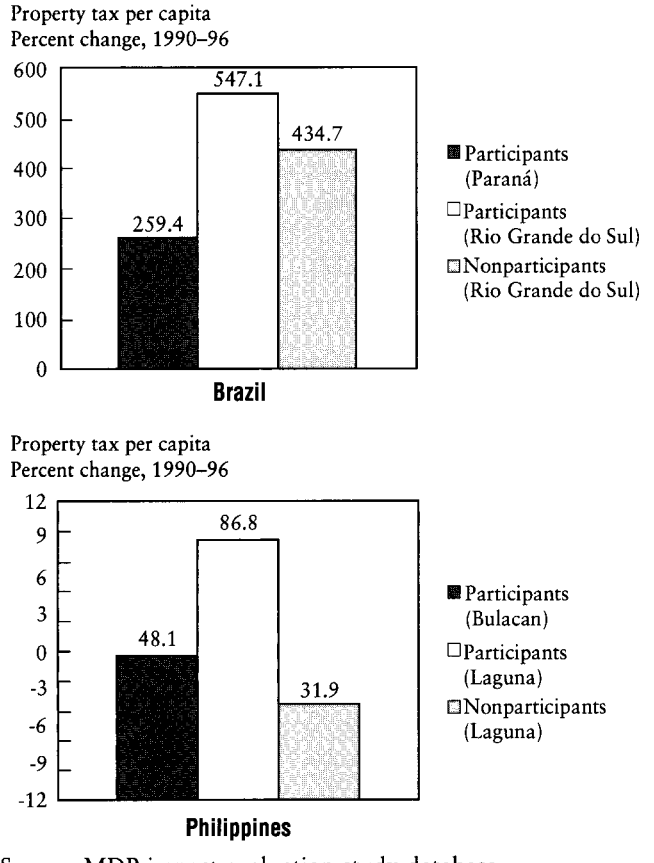
Source: MDP impact evaluation study database.

Financial autonomy is the degree to which municipalities are able to generate, through local taxes and betterment charges, revenue they can directly control. The MDP projects were designed to increase this "own revenue." Analyses of the municipal finance data found that MDP-participating municipalities in Brazil and the Philippines outperformed nonparticipants in financial autonomy. In Brazil, the own revenues of participants rose as a share of total revenues, while those of nonparticipants declined. In the Philippines, all municipalities saw a decline in the share of own revenues against total revenues (resulting from an increase in revenue sharing after a 1991 change in government policy), but the shares of participant municipalities declined less sharply than those of nonparticipants (figure 1). Moreover, the study found that participant municipalities relied on their own revenues to a greater extent than nonparticipants, and that they succeeded in mobilizing more of these revenues.

Since property taxes constitute a large portion of own revenues, municipal performance in their collection was viewed in the OED study as an indicator of municipal effort to enhance autonomy and improve creditworthiness. In both countries property tax collection per capita generally increased more rapidly in participating than in nonparticipating municipalities (figure 2).

In Brazil, participating municipalities in Rio Grande do Sul did much better than those in Paraná and nonparticipating municipalities in direct cost recovery through levying and collecting betterment charges. The weaker performance in Paraná was brought about by less rigorous control of tax collection performance in the financial action plans and project leverage. In the Philippines, MDP operations approached direct cost recovery by allowing municipalities to borrow and invest in revenue-generating services such as local public markets. The success of direct cost recovery, the study found, depends on making the activity an explicit condition for investment and on close monitoring by the MDP project team during implementation.

FIGURE 2: MDP Impact on Property Tax Collection



Source: MDP impact evaluation study database.

As an indicator of creditworthiness, the OED study examined changes in budget balance for participating and nonparticipating municipalities. The data show that MDP participants performed better in their attempts to balance the budget than nonparticipants. In Brazil, as a result of economic difficulties at the macro level, the financial balance of all municipalities deteriorated, but less so among MDP participants. In the Philippines, the contrast between participants and nonparticipants is even sharper. Participants generally moved into surplus, while nonparticipants remained in deficit.

Finally, the study found a correlation between a municipality's MDP investment (as a share of total investments) and the degree of impact the project had on policy. This suggests that the more closely a municipality is engaged in its MDP projects (that is, the greater the MDP project leverage), the greater the impact will be.

Building Local Government Capacity

The results of the survey of mayors in Rio Grande do Sul highlight their awareness of the improvements made under the MDP project. Participant municipalities valued most highly the institutional development interventions designed to increase the efficiency of resource management and to improve the management of investment subprojects, including better procurement procedures. Professional training, information technology, and community participation were also highly valued. Awareness of these advances in the municipality had an important side-effect: successful participants openly promoted the MDP project and its principles among municipalities still not involved.

The survey identified several areas in which local government capacity was improved by the MDP project:

- Fiscal adjustment improved and municipal own revenues increased.
- Contacts among municipalities, private companies, and the community became more intense.
- Municipal administrations became more efficient and entrepreneurial.
- Municipal employees became more highly valued as staff.
- More attention was given to the environment.

The project achieved these capacity improvements at a time of major change and difficulty for municipalities in the State of Rio Grande do Sul. It appears that by helping municipalities to stabilize, the MDP project contributed to a more balanced approach to economic development at all levels.

Developing Local Economies

Most of the subprojects financed by MDP in the Philippines—such as public markets, bus terminals, and slaughterhouses—were revenue-generating enterprises. The local economic effects of these projects were significant. Pulilan, for example, was in a low income class of municipalities before it financed a public market through MDP. By 1995, when the MDP project was completed, the municipality had moved up to the second income class, the living standard of its 60,000 people

had risen significantly, and municipal own revenues rose from 7 million to 25 million pesos.

A case study that compared economic impacts of the MDP-financed public market in Pulilan with the conditions in a nonparticipating municipality, Guiguinto, detailed the project's impacts on local economic development. The market not only had a positive effect on employment and income generation through its operations, it also triggered the development of a new business center, because more than 40 new small enterprises opened near the public market, including restaurants, drug stores, a gas station, banks, and gift shops. All this activity also had significant side-effects: expansion of market linkages to other municipalities and regions, indirect employment effects, and stimulation of the local real estate market.

Agenda for the Future

The financing needs of municipalities vary, depending on their size and stage of socioeconomic development. In the Philippines MDP program, small, resource-poor municipalities tend to finance rather simple, low-risk, revenue-generating projects first, such as public markets. By successfully completing such a project and generating increased revenues, they enhance their creditworthiness. They can then expand their investments to public infrastructure projects such as roads and drainage. As they continue to grow, municipalities need to finance economic infrastructure for manufacturing and commerce and social infrastructure for household consumption. Eventually they are ready to "graduate" from the MDP program and start borrowing from the private capital market. Experiences in both the Philippines and Brazil show such progress. This catalytic role of the municipal development projects is analogous to that of the World Bank in helping developing countries until they "graduate" from the Bank.

Conclusions and Lessons

The municipal development projects in Brazil and the Philippines examined in the OED impact evaluation study achieved what they set out to do. They promoted municipal government reforms and improved fiscal performance. In doing so, they enhanced the managerial capacity of local institutions and stimulated a more entrepreneurial view among mayors of their administrations, which ensures continued development.

To sustain and build upon this record of achievement, the study makes several recommendations:

- MDP policy reform instruments should be diversified to broaden project impacts, replicating the success with improved property tax collection in other components of own revenues (such as local service taxes in Brazil) and the success of revenue-generating projects (such as in the Philippines).
- Good project design at the outset is essential. Initial misconceptions on the part of a municipality are difficult to reverse later. The clearer the conditions and requirements, the more likely it is that success will follow.
- Competition among municipalities should be promoted through disseminating success stories. Successful MDP participants are the best promoters of effective practices.

Précis

Performance Audit Reports: *Brazil: Municipal Development Project in the State of Paraná and Municipal Development Project in the State of Rio Grande do Sul*, by Kyu Sik Lee, Report No. 18011, June 12, 1998; and *Philippines: Municipal Development Project and Second Municipal Development Project*, by Kyu Sik Lee, Report No. 16800, June 12, 1997. Impact Evaluation Report: *Building Institutions and Financing Local Development: Lessons from Brazil and the Philippines*, by Kyu Sik Lee and Roy Gilbert, Report No. 18727, December 11, 1998. Available to Bank Executive Directors and staff from the Internal Documents Unit and from regional information service centers, and to the public from the World Bank InfoShop: 1-202/458-5454
fax 1-202/522-1500
e-mail pic@worldbank.org.

Please address comments and inquiries to the Editor-in-Chief, Elizabeth Campbell-Pagé, tel: 1-202/458-5365, fax: 1-202/522-3125, e-mail: ecampbellpage@worldbank.org

Please address publication requests and inquiries to OED, tel: 1-202/458-4497, fax: 1-202/522-3200, **e-mail: OED Help Desk@worldbank.org**

This and other OED publications can be found on the Internet, at **http://www.worldbank.org/html/oed**

OED Publications

1999

1998 Annual Review of Development Effectiveness

Appréciation de l'efficacité du développement:
L'évaluation à la Banque mondiale et à la Société financiére internationale

Determinar la eficacia de las actividades de desarrollo:
La evaluació en el Banco Mundial y la Corporación Financiera Internacional

Evaluation Capacity Development in Africa

Lessons from Urban Transport

Lessons of Fiscal Adjustment

Nongovernmental Organizations in World Bank–Supported Projects: A Review

Philippines: From Crisis to Opportunity

The World Bank, the Grant Program, and the CGIAR:
A Retrospective Review

1998

1997 Annual Review of Development Effectiveness

Assessing Development Effectiveness: Evaluation in the World Bank and the International Finance Corporation

Evaluation and Development: The Institutional Dimension (Transaction Publishers)

Financial Sector Reform: A Review of World Bank Assistance

India: The Dairy Revolution

Rebuilding the Mozambique Economy:
Assessment of a Development Partnership

Public Sector Performance—The Critical Role of Evaluation

The World Bank's Experience
with Post-Conflict Reconstruction

1997

1995 Evaluation Results

Agricultural Extension and Research:
Achievements and Problems in National Systems

Fiscal Management in Adjustment Lending

Mainstreaming Gender in World Bank Lending: An Update

Paddy Irrigation and Water Management in Southeast Asia

Poland Country Assistance Review:
Partnership in a Transition Economy

Reforming Agriculture: The World Bank Goes to Market

Zambia Country Assistance Review:
Turning an Economy Around

1996

1994 Evaluation Results

Industrial Restructuring:
World Bank Experience, Future Challenges

Lending for Electric Power in Sub-Saharan Africa

Social Dimensions of Adjustment:
World Bank Experience, 1980–93

The Aga Khan Support Program: A Third Evaluation

Book sales available from:
The World Bank
PO Box 960
Herndon, VA 20172-0960
USA
Fax: (703) 661-1501
Tel: (703) 661-1580
Internet: http://www.worldbank.org
From the World Bank homepage, select publications.
E-mail: pic@worldbank.org

Précis Order Form

Complete this coupon and return to:
The World Bank
Operations Evaluation Department
Partnerships & Knowledge Programs (OEDPK)
1818 H Street, N.W.
Washington, D.C. 20433, U.S.A.
Attention: Editor-in-Chief

There is no charge for mailing Précis. For quicker service, call (202) 458-4497 or fax this completed order form to (202) 522-3200. E-mail address: ecampbellpage@worldbank.org

QUANTITY	TITLE	PRÉCIS #

PLEASE PRINT CLEARLY

Name_____

Address_____

City_____ State_____

Postal Code_____

Country_____

Telephone_____

Recent OED Précis

NUMBER

177 Nongovermental Organizations in World Bank–Supported Projects: A Review
176 Meeting the Health Care Challenge in Zimbabwe
175 Development Effectiveness, 1998: Opportunities in a Volatile Environment
174 Disaster Assistance
173 Support for Smaller Enterprises
172 PCR: El Salvador
171 PCR: Uganda
170 PCR: Bosnia & Herzegovinia
169 Post-Conflict Reconstruction (PCR)
168 India's Dairy Revolution
167 Philippines: From Crisis to Opportunity
166 Financial Sector Reform
165 A Borrower's View of the World Bank
164 Rebuilding the Mozambique Economy
163 1997 Annual Review of Development Effectiveness (ARDE)
162 Kenya's Geothermal Development Program
161 Côte D'Ivoire: Devaluation's Benefits
160 Feeder Roads in Brazil
159 Transport in Thailand: Lessons for Institutional Development
158 Agriculture in Hungary
157 Reducing Flood Hazards and Traffic Congestion in Tunisia
156 Best Practices in Urban Development: Learning from Brazil
155 Two Projects in One: Lessons from Jamaica
154 Sustaining Rural Water Systems: The Case of Mali