

# MUNICIPALITIES IN THE RECONSTRUCTION AND TRANSFORMATION OF CENTRAL AMERICA

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# MUNICIPALITIES IN THE RECONSTRUCTION AND TRANSFORMATION OF CENTRAL AMERICA<sup>1</sup>

## 1. INTRODUCTION

The devastating damage caused by Hurricane Mitch and George to several countries of Central America — especially Honduras and Nicaragua — has focussed international attention on these countries. The estimates of the recovery costs of Hurricane Mitch range from \$7.5 to \$8.5 billion. This huge sum of money far surpasses the financial wherewithal of the affected countries. The real root of the continuing vulnerability to future disasters is the poverty of these countries, combined with poor institutional capacity, and the lack of trained personnel.

The high costs of recovery and reconstruction require that all the resources these countries possess must be brought to bear on reconstruction and these basic, root causes of continuing vulnerability. Local government is a resource in waiting in many of the affected countries, an undertapped resource.

Experience has shown that countries that have suffered such devastation are often subject to future, similar events. There are a number of reasons for this. For instance, the silting of the Choluteca River in Honduras leaves that country exposed to new flooding as soon as heavy rains return. Environmental damage to steep slopes caused initially by imprudent agricultural practices left these countries vulnerable to disaster. Improper land planning and enforcement in municipalities left people to reside in obvious, but cheap, flood zones. With regard to earthquakes and volcanic eruptions, which have also plagued this region over the years, these countries remain vulnerable both because their poverty continues to encourage poor constructions and because homes and other buildings are built in inappropriate locations.<sup>2</sup> The lack of resources, trained individuals, and inadequate institutional development at many levels not only leave these countries vulnerable to disaster, they also remain without adequate means for disaster mitigation and after-the-fact recovery.

Local governments can play an important role in the national reconstruction and economic and social transformation of these countries to ensure greater participation of all segments of society in richer and more modern and democratic societies.

This paper provides a review of recent progress and setbacks in local-government development. It then discusses the rationale for incorporating local governments into the reconstruction and transformation processes. Finally, the paper suggests a number of concrete recommendations for the affected countries and the international donor community to ensure that local government is fully supported and exploited in this vital program.

## 2. THE LOCAL AUTONOMY MOVEMENT

Political reform in Central America has been a recurring event. However, for the most part constitution-making seems to have finished, although Nicaragua, leaving the Sandinist decade behind, has been the latest to create a new political constitution. The constitutions of Central America all make reference to municipal autonomy. The Guatemalan Constitution of 1985, El Salvador's 1983 Constitution, Hondura's

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of 1982, Panama's of 1970, Costa Rica's of 1949, and the two most recent Nicaraguan Constitutions of 1986 and 1995 all clearly specify that municipal government is autonomous, both financially and politically.

These constitutions have been followed up by implementing codes, such as the Salvadoran municipal code of 1985, the Guatemalan municipal code of 1988, the Nicaraguan municipal code of 1986, the Panamanian municipal code of 1971, the Costa Rican municipal code of 1971, and the Honduran Municipalities Law of 1990.<sup>3</sup> These have often been followed up by specific legislation defining municipal taxing authorities or regulations.

The movement for decentralization and municipal autonomy is summarized as follows.

The Central American movement toward decentralization is an essentially home grown approach with no clear model from elsewhere in Latin America nor anywhere else in the world. In South America, for the most part, the decentralization movement has been centrally guided, focusing on transferring resources from the central to the local level, with limited initiatives to increase the revenue-raising authority of local governments. The Central American approach, while promoting increases in centrally-financed resource transfers, has focussed first and foremost on municipal autonomy by striving for greater local revenue-raising authority. One reason for the development of this "bottom up" strategy has been the initiative of mayors, who favor raising their own revenues and controlling their own destiny as opposed to receiving transfers, which are subject to continual second guessing and manipulation by central authorities. (Bidus, 1995) Mayors' organizations, such as the Municipal Corporation of El Salvador (COMURES), the Municipal Association of Nicaragua (AMONIC), and the Honduran Municipal Association (AHMON) have played pivotal roles in getting the municipal interests onto the legislative agenda in their respective countries. These organizations have continued to fight for decentralized power, for keeping the municipalities' interests before national legislatures, for defending local autonomy, and in helping to encourage the increasing independence of mayors from national party politics.

At the same time, municipal-support agencies, such as the Salvadoran Municipal Development Institute (ISDEM) and the Institute for Municipal Development (INFOM) in Guatemala have been important contributors to improving the technical capacities of municipal staff. These municipal support agencies are institutions of the central government, except the Municipal Development Foundation (FUNDEMUN), the Honduran counterpart, which is a non-governmental organization.

Despite these far-reaching reforms, there is still considerable unattained potential.

### **3. RATIONALE FOR INCORPORATING MUNICIPALITIES IN RECONSTRUCTION AND TRANSFORMATION<sup>4</sup>**

Local government does not represent competition to central government, nor should it be seen as a poor, country cousin coming to town with hat in hand seeking handouts. Instead, local government can be viewed as merely another level of the State, with certain comparative advantages and disadvantages. It is the comparative advantages of local and central government that need to be exploited in order to maximize national efforts in the reconstruction and transformation of these countries. Some of these are discussed below.

## **Allocative Efficiency**

In many ways, local governments can more effectively execute certain expenditure programs. For instance, because of local government's proximity to its local electorate it can be expected to more accurately reflect the special, local wants and desires within its purview. Public services such as street lighting, traffic control, trash collection, urban land use, are all obviously local in nature. These services could be provided by central government, but it is unlikely that the need for these services would be the same throughout a nation. In some localities populations might prefer to have more resources devoted to traffic control and greater attention placed on public security. Decisions about this type of resource allocation can better be made at the local level with considerable participation of the electorate.

At the same time, certain public services are purely national in scope. For instance, national defense by its very nature must be provided by central government, since this protection affects all of society. This is not to say that local guards or militia cannot play a role in the defense of the nation, but nowhere in the world is national defense not a central-government function.

Public health and basic schooling are fuzzier in that it is not quite clear what roles should be played by which levels of government. In small countries national policies on standards, for instance, should be set at the central-government level. Yet, direct service provision might be provided by local government, national government, or often by special district-level authorities. In larger countries, provincial governments or education boards might set standards while schooling is provided by even lower levels of government.

## **Productive Efficiency**

In many cases local governments can more cheaply provide services compared to central governments, even for projects that are more national or super-regional in scope. For instance, the contracting, implementation and supervision of public works and reconstruction programs, even in a small country, can often be much more effectively done and at lower cost at the local level.

In the evaluation of the Municipalidades en Acción (MEA) Project in El Salvador, it was found that many public works were implemented by municipal governments at costs from one-third to two-thirds lower than when the same types of works were executed by central government agencies. Reasons for this include: closer supervision, greater control over work crews, shorter travel distances, scrutiny by the electorate, and greater accountability by elected and appointed local officials.

## **Fiscal Efficiency**

There are certain taxes and revenues that simply should not be collected or imposed by local government. For instance, import or trade duties should never be collected on domestic or internal trade. Value-added taxes and import duties should only be collected by central governments. Usually corporate and individual income taxes are national-level taxes, although local jurisdictions will often "piggy-back" their own taxes on these. The property tax can be imposed at the national level; however, it is better to apply it at the local level. Where the property tax is a major contributor to local revenues, the value of property, the level of taxation and the quality of locally provided public services are closely tied.

## **Mobilization and Self-Help**

Local governments, especially mayors, can play an import leadership role in mobilizing a population in times of emergency or reconstruction, or even for development planning. The case of Morolica in Honduras is one where the mayor was very instrumental in ensuring that both national and international resources were mobilized to help rebuild this devastated community.<sup>5</sup>

Mayors and local development committees have at times been pivotal in the development of local land-use plans and in attracting industry to their towns. Mayors and City Councils have already been playing an important role in post-Mitch reconstruction. For instance, the Municipality of Choluteca, Honduras secured the land where the victims of the flooding who have lost their homes will be located and where their new homes are being built. The mayor and municipal employees have helped coordinate the work of Non-Governmental Organizations in the relief activities.

## **Democratic Processes**

Municipal development has played an important role and has been a direct result of expending democratic processes in the region. In 1980 only three Latin American countries elected their mayors, while in the rest of the region mayors were appointed as a part of national political patronage. Today, 17 Latin American countries directly elect their mayors at the local level, and in an additional seven the mayors are appointed by the elected municipal councils.<sup>6</sup>

Citizen participation at the local level, when it results in concrete improvements in local welfare, has led to increasing faith in non-violent, political means for expressing opinion and to increased tolerance of the opinions of others.

Democratic election of mayors and councils is absolutely essential to attain the benefits of comparative advantages discussed above. If local taxpayers cannot vote out incumbents, there is little likelihood that local expenditure programs would be any better devoted to local needs and desires than if these programs were centrally provided. Without elections mayors would probably not be able to serve as catalysts for local development, they could not be leaders since no one would follow. Without elections, competition for the best providers of services at the local level would not occur.

Democratic processes and citizen participation are not just niceties that all peoples should enjoy; they are absolutely essential elements in attaining the potentialities of local government.

There is a close connection between typical economics thinking and the democratic processes that foster municipal-government development. Namely, strengthened local-government development adds competition to the political realm. For instance, where local-government development is both democratic and technically and fiscally strong, local governments can compete against central governments for the “affection” or approval of voters.

It is absolutely necessary that measures are consciously taken to ensure that the imperatives of national reconstruction do not cause progress in democratization to get sidetracked.

## A Comprehensive Theory of Transfers

National reconstruction and transformation will require adequate finance mechanisms, among which should be appropriate municipal transfer systems. Once the following basic premises are accepted, the efficacy of transfers from central to local government becomes startlingly clear:

- many expenditures are better made at the local level; most revenues are better collected at the national level;
- central and local governments are merely different levels of the same state;
- and State revenues belong to the people, not specifically to the jurisdiction that happens to collect them.<sup>7</sup>

Now that a clear need for transfers has been established, a few rules of transfers should be adhered to:

- transfers should not discourage local revenue efforts;
- transfers should be made according to clear rules;
- transfers can be established to ameliorate differences in economic endowments among local governments;
- transfers can be used to partly fund current or regular operations of municipalities; and
- transfers can be an efficient mechanism for attaining central-government or national-level objectives.

Clearly, municipal development requires a solid dosage of fiscal federalism, with an appropriate distribution of powers and responsibilities among the levels of government, adequate municipal taxation and fee generating capacity, and an appropriate mix of transfer mechanisms.

## 4. MUNICIPAL FINANCE

Municipal finance has been a central issue in local-government development. The importance of municipal finances will only increase with the implementation of national reconstruction and transformation programs.

### A Broad Agenda for Municipal Finance Systems

The following are the most salient issues outstanding in municipal finance systems in Central America today. This itemization of municipal-finance issues is followed by discussions of some specific cases.

**Inadequate use of the property tax:** The property tax is about the most ideal tax for municipal government financing, yet it is woefully underexploited in Central America. In Honduras the property tax generates only about 20% of municipal revenues. In El Salvador there is no property tax. In Guatemala the property tax is only implemented in about 10% of municipalities, although it is authorized nationally. To raise property tax use the following would need to be done:

improve urban land tax registries (cadastres); create rural land tax registries; design and legislate property taxes where they do not yet exist; and, undertake policy-education activities to help explain to the public the need for and the desirability of property taxes.

**Need to improve outmoded tax systems:** Some of the taxes used in Central American municipalities are either economically inefficient, socially unfair, or biased against small and microenterprise development. For instance, the asset tax in El Salvador is regressive, discriminates against small businesses, and has an inappropriate base. In Honduras the gross receipts tax cause cascade effects that can distort business decisions.

**Need to review other municipal revenues:** Traditional “fees” are collected for street lighting, street pavement, trash collection and other municipal services. These “fees,” however, actually have the characteristics of taxes rather than fees for services. They are usually based on the size, shape, or location of an urban property. This fee system should be modernized and incorporated into modern property tax systems. Where fees for services can actually be appropriately linked to municipal service usage and where distortions are not created, appropriate fees should be developed.

**Need to develop municipal revenue codes:** There is inadequate legislation with regard to how municipal revenue systems are to operate. National municipal revenue codes would establish:

- the common terms to be used in the country; procedures to follow with regard to filing, collecting, audit, and records maintenance;
- rights and responsibilities of taxpayers;
- powers and responsibilities of local tax authorities; insertion into national laws, such as commerce and penal;
- penalties and procedures for establishing and applying penalties; and
- appeal and ombudsman.

It might be worthwhile to develop a model municipal code for region-wide use and adaptation to national needs. Many of the Central American municipal tax systems are very similar, and these similarities are on the rise. Therefore, a model code developed for the region could be quite useful. It would likely also be useful for other countries in Latin America and the Caribbean.

The Inter-American Center of Tax Administrations (CIAT) has already created a model tax code for national level tax systems. Other countries in Latin America, such as Argentina, are developing municipal revenue codes.

**General municipal transfer systems should be reviewed:** Some transfer systems might need to be reviewed to ensure they comply with the criteria of good transfer systems. In other cases it would be enough if the central government would comply with its own transfer legislation. The case in point here is Honduras where transfers have been completely under-funded since 1993.

**Greater access to bank financing:** Legislation needs to be reviewed to determine how it may impede bank financing or the issuance of municipal bonds. This has already been done in some places, such as El Salvador and Honduras. Also, steps should be taken to improve credit worthiness and encourage municipal ratings. Credit worthiness can be enhanced by stabilizing revenue and transfer systems, and by improving fiscal transparency.

### Specific Case Discussions:

The 1990 Municipalities Law of Honduras is widely claimed as establishing a firm basis for municipal government development and increasing autonomy. Two particular issues remain outstanding, however. The first and most obvious is that despite the fact that this law establishes a general transfer of 5% of central government tax revenues to local governments, this target has not been attained since 1992. Indeed, the share of these transfers in central government tax revenues has fallen steadily year after year.

Honduran municipalities are not empowered to impose their own taxes. Rather all taxes are determined by the 1990 Municipalities Law, although municipal authorities do have the power to set certain rates for some taxes within rigid guidelines. Although on the surface this seems to be inconsistent with concepts of local autonomy, there have been few comments or criticisms and this has not been raised as a policy issue within Honduras. Indeed, this system seems to be working rather well, as the rules of the game are quite clear.

In Nicaragua, municipalities are required to submit annual revenue plans (*Plan de Arbitrios*) to the National Assembly for approval. Recently, a new bill has been drafted to allow municipal councils to establish tax rates, within bounds, for a set of taxes that will be imposed throughout the country. This would be very similar to the tax sections in the Honduran Municipalities Law of 1990.

A municipal transfer law is being considered by the Nicaragua National Assembly. The bill would establish a methodology for directing transfers to municipalities. The proposed transfer is 3% of the central government current revenues.

The Salvadoran General Municipal Tax and Revenues Law of 1991 establishes that municipal councils may propose tax legislation. The law sets general guidelines in conformity with good public finance practices, but in no sense mandates that taxation or tax rates be the same throughout the country. Municipal councils draft legislation for their own municipalities and submit the draft legislation to the Legislative Assembly, which can then enact the legislation as law or reject it.

The Salvadoran situation appears quite the opposite of the Honduran situation. It seems that municipalities are given considerable leeway in the development of their own tax systems. However, this is misleading. The final decision as to whether a municipal tax bill is passed into law rests entirely with the Legislative Assembly. The Assembly's decisions may have nothing to do with best practices, the financial needs of the specific municipality, and can be inconsistent with the guidelines established in the General Municipal Tax and Revenue Law. Indeed, the entire process is politicized at the national level and totally delinked from local financing needs.

In December 1997, the Salvadoran Legislative Assembly passed a law establishing that 5% of "the national budget" would be transferred to municipalities. While this has been achieved in 1998 the law has been challenged as unconstitutional since it usurps the executive branch's budget preparation authority.

In Costa Rica (1995), Nicaragua (1995), and Guatemala (1994) the property tax authority and administration was devolved to local government. Despite this devolution of authority, local governments in these countries have made very little use of this potentially very important revenue source. For instance, in Guatemala only about 10% of municipalities actually collect this tax revenue. Honduras, where local government has been managing the property tax for several years, still collects relatively little, and there are no rural land tax registries in the country.

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Municipalities are also able to access bank and other lending sources. The PROMUNI program, implemented by the Central American Bank for Economic Integration, has assisted municipalities in Guatemala and Costa Rica to access private-bank loans, which are then discounted (bought back) by PROMUNI. There is a possibility that this program will be reinvigorated and expended into El Salvador and Honduras.

Honduran municipalities are already borrowers from national banks, but they are required by law to borrow only for investment projects. Loans are made by commercial banks, in particular, the Banco Occidente, to many municipalities. In addition, Honduran municipalities had been borrowing from a specialized public-sector bank, Banco Municipal Autónomo (BANMA), which was created in 1963. Unfortunately, BANMA's low recuperation rate has caused this institution to essentially close its door.

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Cáceres (1999) notes that the legislation already exists for municipalities in El Salvador to borrow from financial institutions in the country, but that very few have actually done so. In part, this seems to be due to unfamiliarity on the part of bankers and others of the opportunities that municipalities might offer them. It also seems to be related to the fact that mayors have made limited or no moves in this direction.

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## **5. TRANSPARENCY IN MUNICIPAL AFFAIRS**

The need to strengthen transparency of municipal activities and finances will increase with their substantive participation in reconstruction. At the same time, before municipalities can hope to have much greater access to funding for their projects, they will need to take steps to improve the transparency of their operations and to improve the flow of relevant information.

There has been considerable progress made in terms of making municipal government more democratic and participatory and in terms of improving the transparency of its operations. Yet, there is still more to be done.

Transparency can be improved at a basic level through rules that mandate public hearings and frequent disclosures of proposed budget plans. More fundamentally, however, the transparency of the budget process depends on the strength of local democratic institutions. Active civic groups, clear rules for the financing of elections and political parties, a free and competitive press and an independent judiciary are all

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crucial to exposing and thereby discouraging lobbying or corruption in the budget-making process. When local democracy is weak, important areas of public life escape social scrutiny, interest groups exert undue influence, and opportunities for deficit spending increase. (Hausmann, 1998)

Fiscal transparency means being open to the public about the structure and functions of government, fiscal-policy intentions, public-sector accounts, and fiscal projections. Fiscal transparency strengthens accountability and increases the political risk associated with maintaining unsustainable policies. It can therefore enhance credibility, the benefits of which will be reflected in lower borrowing costs and stronger support for sound policies by a well-informed public. In contrast, nontransparent fiscal management can be destabilizing, create inefficiency, and foster inequity.

National legislation needs to ensure that municipal finances are maintained according to international standards. In particular, municipal financial data should be classified according to the economic and functional classifications provided in IMF (1986).

In most countries of the region, national public finance data do not fully incorporate municipal finances in the accounts of the Non-Financial Public Sector (NFPS). For instance, in Nicaragua only Managua's finances are included in NFPS accounts. In Honduras the NFPS accounts include only Tegucigalpa's and San Pedro Sula's fiscal data. This is inadequate, provides a faulty picture of the overall fiscal condition of a country, and can lead to inappropriate planning.

While all the countries of the region have been moving to integrated financial management systems for central government organizations, this reform has mostly not been extended to municipal governments. The exception is El Salvador, which has initiated the Municipal Integrated Financial Management System (SAFIMU) as a component of its national program. Other countries, such as Nicaragua have made moves toward establishing integrated systems of budget, accounting and improved audits, but in general these have been undertaken mostly independently of national-level development of integrated management systems.

It is imperative that the reporting, accounting and audit responsibilities for municipal investment projects be strengthened, both within the municipal governments themselves as well as for national-level general accounting and audit agencies. Strengthened and expanded municipal participation in national affairs must be accompanied by improved internal and external controls and reporting. Not providing adequate attention to these functions can eventually create disenchantment with the movement to greater municipal autonomy and impede the deepening of democratic practices.

## **6. SOCIAL INVESTMENT FUNDS**

Social Investment Funds (SIFs) are a rather recent development. Initially created by the World Bank and other international financial institutions as a means of deflecting criticism that their structural adjustment and macroeconomic stabilization programs were disproportionately hurting the poor, SIFs seem to have long outlasted their initial purpose. They have developed into, usually, efficient arms of the central governments in their countries with the purpose of implementing relatively small infrastructure investment projects. SIFs have generally been considered rather effective since they have been able to move money and implement projects with less bureaucracy than other central-government agencies and have generally been more successful at reaching more, often heretofore neglected parts of the country. There have been dissenting views, however.

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Central government funds for small-scale infrastructure and other capital projects are mainly channeled through the SIFs. Municipalities play a minor role in the planning and implementation of these projects. This practice works against a continuing process of decentralization and increasing citizen participation (and public scrutiny) of the use of public funds, and it constrains the development of more efficient, more responsive local government.

USAID/Honduras has used various channels for its municipal development funds during the past ten years: some were channeled directly to municipalities in 1989-1992. More recently, some USAID funding flowed through the Municipal Development Bank (BANMA) during 1993-1997. Since the demise of BANMA, USAID support has mainly been through the Honduran Social Investment Fund (FHIS), for infrastructure projects at the municipal level.

The FHIS has established four categories (A,B,C,D) of municipalities with regard to their participation in the design and implementation of infrastructure projects. The criteria for placement in one of the categories are:

level of revenue; administrative capacity; community participation (town meetings) and social promotion; index of nutrition and literacy; financial capacity; and size of population.

Those municipalities with the highest “score” are placed in category “A” and they are expected to assume a greater level of responsibility and exercise more autonomy in implementation of capital projects. Those in the lower categories are to have less authority and responsibility for implementation of projects funded through the FHIS.

From discussions with a number of mayors and other municipal employees, it seems that this system is not yet in practice. The system was developed just before the arrival of Mitch and was planned to be initiated in 27 municipalities.

Discussions with Honduran central-government officials reveal that a justification for not transferring to municipalities the monies that are mandated in the Municipalities Law of 1990 is that the money is instead transferred to the FHIS, which in turn undertakes projects in municipalities. Given that everywhere in the country is within some municipality, except when on the seas, this argument is a bit disingenuous. The issue of whether municipal governments should receive the transfers that have been established by law or be content with projects undertaken by FHIS is at the core of attitudes toward effectively granting true autonomy to municipalities.

## **RECOMMENDATIONS**

### **Differentiated strategies and policies**

It is important to keep in mind that not all municipalities are created equal. There is a great diversity among the region’s municipalities. Capital cities usually dominate strongly the overall municipal picture. In some countries capital-city municipal revenues equal or exceed combined municipal revenues from all the other municipalities in the country. Donors already recognize this diversity, as evinced by the fact that their municipal development programs often do not include the capital city while they focus on a core of secondary cities.

In the reconstruction program and other programs of transformation, donors and national governments need to continue to recognize this diversity. Smaller or less well managed municipalities should, of course,

be encouraged to continue to improve their capacities. However, they should also be encouraged to undertake joint activities and investments with neighboring municipalities. These could include the establishment of water authorities, construction of secondary schools, road repair, and other similar activities.

**Donors should investigate the feasibility of channeling some of their resources for reconstruction directly to some municipalities**

This is happening already, but to a very limited extent. The PROMUNI program has helped some municipalities in attaining bond financing. The Inter-American Development Bank has made loans to San Pedro Sula and Tegucigalpa, although with central-government guarantees, as well as to Puerto Cortés. USAID generally does not provide financial assistance directly to municipalities, in part because the certification process would be too time consuming and costly to incorporate all the municipalities in these countries. Nonetheless, donors should investigate how some municipalities might more directly be included in their project activities.

Of course, regulations related to sovereign debt or to accounting and reporting standards must be retained. Nonetheless, alternative means for directing donor resources to municipalities should be investigated.

**Encourage SIFs to give greater role to municipalities**

To some extent, Social Investment Funds in the region have been fulfilling many of the roles that might have been left to municipal governments. In part, this has occurred because of the vacuum of inadequate municipal government when the SIFs were first established. However, recognizing the increased capacities of municipal governments and their important role in the democratization processes of their countries, SIFs should be encouraged, or required, to have municipal governments play a greater role in undertaking local development activities.

SIFs should be required to incorporate municipal-government participation in all their projects. Again, consistent with recommendation “a” and cognizant of the diversity among municipal governments, there is a need to incorporate different degrees of municipal participation in project design, supervision, and implementation.

**Strengthen municipalities to meet these increasing demands**

Those municipalities that at present are capable of design, supervision and implementation of SIF projects should be given extensive control and responsibility for these projects. Municipalities that have been doing well managing their recurrent programs will be required to rise to the challenge, for which they will require training, technical assistance, and other institutional strengthening.

Municipalities that are not yet capable of such autonomous control over SIF projects should be provided with technical assistance and other institution-strengthening assistance so that they can become capable of autonomous management of some of the the SIF projects. Given the timeframe of the reconstruction program, those municipalities that would be given this assistance must be selected immediately and selection should be based upon the likelihood of rapid advance.

**National governments and donors should assure themselves that the Social Investment Funds are up to the challenges they face**

The SIFs will be major conduits for reconstruction resources. In Honduras the SIF is expected to receive from the central government double the transfers that it received last year. While preliminary indications are that the Honduran SIF has been able to manage large flows in the first few months of this year in a highly satisfactory manner, concern exists that this may not prevail.

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Before pouring great amounts of new funds into the SIFs of the region, donors and host countries are advised to undertake management audits of these SIFs to ensure that project design, management, supervision, financial controls and other internal systems are sufficient to handle these increased flows.

### **Take advantage of the *cabildos abiertos* and organizing and planning strengths of municipalities in the reconstruction effort**

Care must be taken to ensure that the rush to reconstruction does not set back the advances made in participatory, municipal planning. At the same time, donors and national governments are encouraged to utilize the municipal governments and their mechanisms for participatory municipal planning as a means of project selection, development, supervision and implementation.

### **Encourage central governments to meet the laws on transfers**

The full amount of general municipal transfers that have been established by national laws should be met. The case of Honduras is the most egregious, where the transfer target of 5% of current revenues has not been met in years and where the ratio has in fact been declining throughout the 1990s. Of course, it is not clear that this recommendation will be immediately implemented given the precarious state of Government of Honduras' finances.

### **The IMF's *Code of Good Practices on Fiscal Transparency* should be adapted and adopted by municipal governments, and its manual should be applied in practice.**

Fiscal transparency should lead to better-informed public debate about the design and results of fiscal policy, whether at the national or local level. It would help to make municipal governments more accountable for the implementation of policy and thereby strengthen credibility and public understanding of policies and choices. To foster good governance and to improve fiscal transparency among member countries, the International Monetary Fund has developed a *Code of Good Practices on Fiscal Transparency* and has developed a manual for its implementation. The IMF has also developed self-evaluation materials that could be used by either central or local governments in assessing their compliance with the code.

The Code comprises four basic areas:

- clarity of roles and responsibilities;
- public availability of information;
- open budget preparation, execution, and reporting; and
- independent assurances of integrity.

Donors can help broaden integrated financial management systems to reach local government

Donor-funded programs to establish integrated financial management systems in central governments and parastatal organizations should investigate the feasibility of incorporating municipal finances into these same systems.

It is important to note, however, that in most of the countries of the region, municipal governments are very small. It may not be worth the effort to incorporate them fully into the national integrated financial management systems. However, it might make sense to develop "lite" models of municipal-level integrated financial management systems. These should be investigated, especially keeping in mind recommendation "a" that not all municipalities require the same treatment.

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## NOTES

<sup>1</sup> This paper results, in part, from research undertaken for the International City/County Management Association and the U.S. Agency for International Development's Bureau for Latin America and the Caribbean. Their support in this research is greatly appreciated. However, the opinions and findings expressed here are only the author's and should not be attributed to these organizations or anyone else. This paper was discussed in a CASE seminar and useful comments were provided. In particular, I wish to thank Clarence Zuvekas and Jorge Sanguinety for their helpful input. Of course, all errors are only attributable to myself. The comments and opinions expressed in this paper do not necessarily reflect the opinions of anyone other than myself.

<sup>2</sup> Friday (1999) states: "People die, are injured, or lose their homes because they continue to live in unsafe infrastructures and in vulnerable locations, and they do so because these are the most rational options available to them."

<sup>3</sup> A new municipal code has been drafted and submitted to the National Assembly of Nicaragua but it has not yet entered into discussions. Passage is expected sometime later in 1999.

<sup>4</sup> Much of this section is developed in Melhado and Gallagher (1995).

<sup>5</sup> See Anderson (1999).

<sup>6</sup> See Hausmann (1998).

<sup>7</sup> For instance, the Customs Administration does not determine how the revenues it collects will be budgeted. Nor does the Internal Revenue Department determine the allocation of income tax receipts.