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15A 29741

**ACTION MEMORANDUM FOR THE DEPUTY ASSISTANT ADMINISTRATOR FOR DEVELOPMENT TECHNOLOGY, DSB**

**THRU : DS/PO, Robert Simpson**  
**FROM : DS/UD, William R. Miner**  
**SUBJECT: DS/UD Project, "Urban Financial Management"**

SEP 17 1979

The subject project paper was approved at a project review meeting on June 20, 1979, over which you presided. The approval was subject to certain clarifications and further justification which are contained in an addendum attached to the project paper and entitled "Project Review Issues and Comments." The Asia Bureau representative did not support the undertaking, in part because of a lack of country specific sites. There has been subsequent discussion with representatives of the Office of Housing. A draft copy of the project review issues and comments paper was discussed with each of the urban liaison representatives in the other regional bureaus and verbal clearances were given.

State-of-the-art work will be undertaken by a \$10,000 purchase order and will be used to guide implementation of the other components of the project. Professional services for the other components of the project, to develop the financial planning methodology and to help build fiscal capacity, will be procured competitively. The purchase order documentation has been submitted to DS/PO. The PIO/T for competitive procurement will be submitted when the project has been approved.

DS/UD is prepared to continue with implementation of the project in accordance with schedules set out in the project paper. However, given the requirement of Congressional Notification - which means effectively an additional four to six weeks in the project approval and obligation process - and competing matters, there may be slippage from those schedules.

**RECOMMENDATION:** That you approve the project paper by signing Part II of the PAF. The PAF, Parts I and II, and the project paper and its addendum are attached.

**Clearances**

AFR/DR, L. Hellman \_\_\_\_\_  
ASIA/TR, T. Arndt \_\_\_\_\_  
LAC/DR, H. Iuek \_\_\_\_\_  
NE/TECH, E. Keys MacManus \_\_\_\_\_

**APPROVED:** J. L. Bruce

**DISAPPROVED:** \_\_\_\_\_

**DATE:** 10/23/79

DS/UD:WRMiner:mg:8/6/79

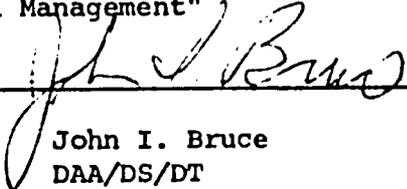
PROJECT AUTHORIZATION AND REQUEST FOR ALLOTMENT OF FUNDS

PART II

I hereby authorize a grant not to exceed three hundred and seven thousand dollars (\$307,000) to finance the project as described in the attached project paper.

Attachment: Project Paper: "Urban Financial Management"

Signature: \_\_\_\_\_

  
John I. Bruce  
DAA/DS/DT

Date: \_\_\_\_\_

10/23/79

PAF

DS/UD

Project No. 931-1110

AGENCY FOR INTERNATIONAL DEVELOPMENT  
**PROJECT AUTHORIZATION AND REQUEST  
 FOR ALLOTMENT OF FUNDS PART I**

1. TRANSACTION CODE

1

A ADD  
 C CHANGE  
 D DELETE

PAF

2. DOCUMENT CODE

5

3. COUNTRY/ENTITY

Inter regional

4. DOCUMENT REVISION NUMBER

5. PROJECT NUMBER (7 digits)

931-1110

6. BUREAU/OFFICE

A SYMBOL  
 DSB

B CODE  
 10

7. PROJECT TITLE (Maximum 40 characters)

Urban Financial Management

8. PROJECT ACTION TAKEN

APPROVAL  
 DECISION

A APPROVED  
 D DISAPPROVED  
 DE D'AUTHORIZED

9. EST. PERIOD OF IMPLEMENTATION

YRS.  1   
 QTRS  4

10. APPROVED BUDGET AID APPROPRIATED FUNDS (\$000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE		E. 1ST FY 80		H. 2ND FY		K. 3RD FY	
		C GRANT	D LOAN	F GRANT	G LOAN	I GRANT	J. LOAN	L GRANT	M. LOAN
(1) SD	720			307					
(2)									
(3)									
(4)									
TOTALS									

A. APPROPRIATION	N. 4TH FY		O. 5TH FY		LIFE OF PROJECT		C. PROJECT FUNDING AUTHORIZED THRU	A. GRANT	B. LOAN
	D. GRANT	P. LOAN	R. GRANT	S. LOAN	T. GRANT	U. LOAN			
(1)							1 - LIFE OF PROJECT 2 - INCREMENTAL LIFE OF PROJECT	1	
(2)									
(3)									
(4)									
TOTALS									

12. INITIAL PROJECT FUNDING ALLOTMENT REQUESTED (\$000)

A. APPROPRIATION	B. ALLOTMENT REQUEST NO.	
	C. GRANT	D. LOAN
(1) SD	307	
(2)		
(3)		
(4)		
TOTALS	307	

13. FUNDS RESERVED FOR ALLOTMENT

TYPED NAME (i/hw/, SER/FM/FSD)

SIGNATURE

DATE

14. SOURCE/ORIGIN OF GOODS AND SERVICES

000  941  LOCAL  OTHER

15. FOR AMENDMENTS, NATURE OF CHANGE PROPOSED

FOR PPC/PIAS USE ONLY	16. AUTHORIZING OFFICE SYMBOL	17. ACTION DATE	18. ACTION REFERENCE (Optional)	ACTION REFERENCE DATE
		MM DD YY		MM DD YY

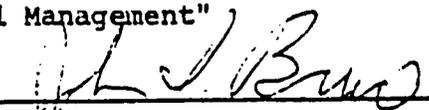
PROJECT AUTHORIZATION AND REQUEST FOR ALLOTMENT OF FUNDS

PART II

I hereby authorize a grant not to exceed three hundred and seven thousand dollars (\$307,000) to finance the project as described in the attached project paper.

Attachment: Project Paper: "Urban Financial Management"

Signature:

  
\_\_\_\_\_  
John I. Bruce  
DAA/DS/DT

Date:

10/23/79

PAF

DS/UD

Project No. 931-1110

## URBAN FINANCIAL MANAGEMENT PROJECT

### Project Review Issues and Comments

#### I. Site Selection Criteria

Sites will be identified in consultation with regional bureaus, concerned field missions and host countries, using the following criteria:

- A. Existing projects which benefit the urban poor.
- B. Ongoing or planned projects in financial planning and capacity building.
- C. Opportunities for innovative research and development activities consistent with project objectives.
- D. Receptivity of the field mission and of the host country institutions to activities of this kind.

The expectation is that there will be activities in three geographic regions. Encouraging signs are some existing and planned projects in the Philippines, Egypt, Bolivia, Costa Rica and the Dominican Republic and the reported interest of several African countries in such matters.

Municipal development institutions (MDI) have been established in several countries in Latin America which have operated.

municipal credit activities successfully for a large number of municipalities. The urban financial management project could be particularly beneficial in one or more of these countries to improve financial planning and public service delivery systems.

II. Relationship to RAD Projects, Local Revenue Administration and Managing Decentralization

The urban financial project is designed to improve the capacity of urban local governments, particularly at the intermediate level and in provincial centers, to develop and manage the financial resources needed to provide essential services to meet basic human needs. It focuses on the development of methods of fiscal analysis and forecasting with particular emphasis on the relationship between fiscal capacity and economic conditions, and it includes the development of financial policies and budget planning in such areas as capital improvements, purchasing, accounting, fund balances, debt practices, and personnel procedures. This approach requires a continuing examination of service levels as well as revenue sources and levels, including changes in the economic base of a community. It requires also an analysis of revenue and expense beyond the immediate budget year, thus broadening perspectives and forecasting future direction, and, at the same time, lessening uncertainty in the financial planning process.

The emphasis in RAD's Local Revenue Administration project is on field testing new approaches to generate local revenue for projects directly beneficial to the rural poor; that is, encouraging more participatory modes of financing rural development including a new look at voluntary contributions, increased reliance on user fees and other kinds of revenue which will stimulate local action. RAD's project, Managing Decentralization, emphasizes the use of resources to design, implement, and evaluate projects, strengthen the capacity of decentralized institutions (such as local government, special purpose districts, and deconcentrated field services of ministries), and to identify service areas where "debureaucratization" might provide expanded services at lower costs. More specifically, since USAID mission staffs are the direct beneficiaries of this four year effort, the project would increase their capacity to identify and resolve administrative problems inherent in regional approaches to decentralization.

The RAD projects are designed, therefore, to accomplish improvements in the quality of life of the rural poor by emphasizing increased participation of the beneficiaries and focusing on greater mission capacity to support decentralization efforts

directly beneficial to the rural poor. The urban financial management project, on the other hand, emphasizes skills needed to understand the relationships between economic variables and revenue and expenditure projections and to reduce risk and uncertainty in financial planning. There is no coordinating effort required other than a monitoring of the RAD projects.

III. Historical Data Concerning Previous A.I.D. Efforts in the Public Administration Sector

Public administration reform in years past centered around A.I.D. efforts to provide added resources (e.g., generating tax income) enabling local governments to have a greater role in development. This, at least, was the focus in Latin America. Also, development assistance examined impediments to effective development administration, including the inadequacies of officials and technicians to accomplish development goals.

Organizational and managerial skills were particularly weak, so, efforts concentrated on establishing schools of public administration (e.g., Philippines) and up-grading managerial skills generally. The administrative weaknesses of government at all levels were examined in terms of development constraints. There was a major effort to direct some resources to management requirements to improve project implementation and to respond more

effectively to existing needs of the poor. These initial efforts to improve local development administration capacity can be significantly enhanced by adding new skills in financial planning, including knowledge of the kinds of economic data needed in local fiscal decision-making.

IV. Procurement of Professional Services

The project is composed of several components -- namely, the state-of-the-art paper, specific methodology for evaluating the financial condition of a city with applicable field testing and consultation, and the formation of fiscal capacity building practices. The state-of-the-art work will be undertaken separately and will be used to guide the implementation of the other components. Professional services to develop the methodology and help build financial management capacity, the other components of the project, will be procured competitively.

V. Project Justification

While it is obviously true that many cities in the developing countries do lack administrative autonomy, central governments in a number of countries have, in fact, expanded local authority over revenue sources, granted greater borrowing power and

encouraged local governments to use existing authority more effectively. Furthermore, local officials even in situations where autonomy is largely lacking, have considerable implementing authority. Therefore, while the project may not be applicable in all countries, it is believed that there are enough host country situations in which it could be tried.

The fundamental idea behind this project is very much in keeping with a growing concern of the General Accounting Office (GAO). As a result of its studies of local government finance in Latin America and more recently in Africa, the GAO is expected soon to recommend Congressional action to amend the foreign assistance act so that a "reasonable" amount of resources can be used to improve local government financial management capabilities.

The World Bank has expressed interest in a collaborative role, stating that this project is well worth pursuing. In a recent press release, the Bank announced a \$70 million loan for use in improving, in part, municipal administration and finances in medium-sized cities in Brazil. The FY 1981 ABS (Egypt) includes an urban financial management project intended to improve urban development decision-making.

AGENCY FOR INTERNATIONAL DEVELOPMENT

**PROJECT PAPER FACESHEET**

1. TRANSACTION CODE

A ADD  
 C CHANGE  
 D DELETE

PP

2. DOCUMENT CODE  
3

3. COUNTRY/ENTITY

Interregional

4. DOCUMENT REVISION NUMBER

5. PROJECT NUMBER (7 digits)

931-1110

6. BUREAU/OFFICE

A. SYMBOL DSB B. CODE  10

7. PROJECT TITLE (Maximum 40 characters)

Urban Financial Management

8. ESTIMATED FY OF PROJECT COMPLETION

fy  80

9. ESTIMATED DATE OF OBLIGATION

A. INITIAL FY  79  B. QUARTER  3  
 C. FINAL FY  80  (Enter 1, 2, J, or 4)

10. ESTIMATED COSTS (\$000 OR EQUIVALENT \$) - )

A. FUNDING SOURCE	FIRST FY			LIFE OF PROJECT		
	B. FX	C. L/C	D. TOTAL	E. FX	F. L/C	G. TOTAL
AID APPROPRIATED TOTAL			317			317
(GRANT)	( )	( )	317	( )	( )	317
(LOAN)	( )	( )	( )	( )	( )	( )
OTHER U.S.	1.					
	2.					
HOST COUNTRY						
OTHER DONOR(S)						
TOTALS			317			317

11. PROPOSED BUDGET APPROPRIATED FUNDS (\$000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE		E. 1ST FY 79		H. 2ND FY 80		K. 3RD FY	
		C. GRANT	D. LOAN	F. GRANT	G. LOAN	I. GRANT	J. LOAN	L. GRANT	M. LOAN
(1) SD	720	867		317					
(2)									
(3)									
(4)									
TOTALS				317					

A. APPROPRIATION	N. 4TH FY		O. 5TH FY		LIFE OF PROJECT		12. IN-DEPTH EVALUATION SCHEDULED
	P. GRANT	Q. LOAN	R. GRANT	S. LOAN	T. GRANT	U. LOAN	
SD					317		<input type="checkbox"/> MM <input type="checkbox"/> YY <input type="checkbox"/> 06 <input type="checkbox"/> 80
(1)					317		
(2)							
(3)							
(4)							
TOTALS					317		

13. DATA CHANGE INDICATOR. WERE CHANGES MADE IN THE PID FACESHEET DATA, BLOCKS 12, 11, 14, OR 15 OR IN PRP FACESHEET DATA, BLOCK 12? IF YES, ATTACH CHANGED PID FACESHEET.

1 NO  
 2 YES

14. ORIGINATING OFFICE CLEARANCE

SIGNATURE *William R. Miner*  
 William R. Miner

TITLE  
 Director, Office of Urban Development

DATE SIGNED

MM DD YY  
 03 23 79

15. DATE DOCUMENT RECEIVED IN AID/W OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION

MM DD YY

AGENCY FOR INTERNATIONAL DEVELOPMENT

**PROJECT IDENTIFICATION DOCUMENT FACESHEET**

TO BE COMPLETED BY ORIGINATING OFFICE

1. TRANSACTION CODE

A

A = ADD  
C = CHANGE  
D = DELETE

PID

2. DOCUMENT CODE

3. COUNTRY/ENTITY

TAB -- Interregional

4. DOCUMENT REVISION NUMBER

5. PROJECT NUMBER (7 DIGITS)

931-1110

6. BUREAU/OFFICE

A. SYMBOL  
TA/UD

B. CODE  
 08

7. PROJECT TITLE (MAXIMUM 40 CHARACTERS)

Urban Financial Management

8. PROPOSED NEXT DOCUMENT

A.  3  2 = PRP  
 3 = PRP

B. DATE

MM YY  
01 2 7 9

10. ESTIMATED COSTS

(2000 OR EQUIVALENT, \$1 =)

FUNDING SOURCE		AMOUNT
A. AID APPROPRIATED		600
B. OTHER		
C. MOST COUNTRY		
D. OTHER COUNTRY(S)		
TOTAL		600

9. ESTIMATED FY OF AUTHORIZATION/OBLIGATION

a. INITIAL FY  7  8

b. FINAL FY  8  1

11. PROPOSED BUDGET AID APPROPRIATED FINES (2000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE		E. FIRST FY		LIFE OF PROJECT	
		C. GRANT	D. LOAN	F. GRANT	G. LOAN	H. GRANT	I. LOAN
(1) SD	720	600		300		600	
(2)							
(3)							
(4)							
TOTAL				300		600	

12. SECONDARY TECHNICAL CODES (maximum six codes of three positions each)

310 | 710

13. SPECIAL CONCERNS CODES (MAXIMUM SIX CODES OF FOUR POSITIONS EACH)

BU | INTR

14. SECONDARY PURPOSE CODE

660

15. PROJECT GOAL (MAXIMUM 240 CHARACTERS)

Improve the resource base for the equitable provision of essential services and the poor's access to them in urban centers in developing countries.

16. PROJECT PURPOSE (MAXIMUM 420 CHARACTERS)

Help develop and test effective and innovative means of national and local financing of essential services.

17. PLANNING RESOURCE REQUIREMENTS (staff/funds)

- (a) Direct hire project manager
- (b) Consultants

18. ORIGINATING OFFICE CLEARANCE

19. DATE DOCUMENT RECEIVED BY AID/W, OR FOR AID/W DOCUMENT DATE OF DISTRIBUTION

Signature: William R. Miner *[Signature]*

**PROJECT PAPER**

**URBAN FINANCIAL MANAGEMENT:  
Practices and Linkages Contributing to  
Fiscal Stability**

**March 1979**

**OFFICE OF URBAN DEVELOPMENT  
BUREAU FOR DEVELOPMENT SUPPORT  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
U.S. DEPARTMENT OF STATE  
Washington, D.C. 20523**

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## Summary and Recommendation

### Summary

The world's population is increasing by 200,000 inhabitants each day. At the end of this century, developing countries are expected to add 1.3 billion people to their urban populace. Each city in the developing world, as a result of this enormous demographic pressure, is hard-pressed to maintain acceptable standards of livability.

Cities in transition, experiencing rapid growth, are also confronted with severe fiscal stress. All are encountering the uncertainties of fiscal imbalance - higher service delivery costs and growing difficulties in generating sufficient revenue to cope with this fiscal distress. National resources are, of course, limited, and intergovernmental transfers never will be sufficient to satisfy local government needs entirely.

Local officials in these cities must, therefore, recognize that budgetary processes in which customary approaches to financing services are matched against expanding local needs are essentially inadequate to ensure optimum and equitable service delivery. There is a need, for example, to recognize how changes in an urban economic base translate into changes in a city's financial capacity to maintain acceptable standards of livability.

The urban revenue base is influenced substantially by economic conditions. Understanding the implications of these economic variables vis-a-vis a city's financial capacity can enable local officials to adjust their financial planning to reflect economic trends and gauge more accurately the benefits of differing fiscal strategies.

It becomes necessary in this context to recognize that the financial capacity and the economic condition of cities are not separable. Their economic base will determine in large measure the financial options available to local officials.

As a result of this project local officials will be able to evaluate better the impact of a city's economic condition on the local revenue base, project future revenue and expenditures more adequately, understand the use of the budget as a management tool in fiscal decision-making generally and in determining financial policies, and match more effectively available resources against longer range needs of the cities.

The development process in such cities requires adequate financial management practices. Most, however, lack the financial management systems to utilize available resources effectively. As a result, decision-making is seriously impaired. Local officials frequently are unable to gather relevant financial information and when they

do it is often either inaccurate or incomplete. There is a lack of uniformity among and between governmental agencies. Internal controls are frequently weak or nonexistent. Such deficiencies in local financial management practices contribute to a breakdown in efforts locally to evaluate project efficiency and effectiveness..adequately.

Inadequate knowledge of worthwhile financial management practices for years has hampered efforts of local officials to achieve acceptable standards of livability in cities of the developing world. Mounting financial pressures, increased demand for public services, limited resources and fragmented service delivery arrangements make it imperative that local officials in these cities accept more innovative financial management practices.

A major aim of this project is to enable cities in the developing countries to attain a higher level of financial self-sufficiency so that more of the revenue required for maintenance of local services will be generated locally.

#### Recommendation

Authorization of a grant in the amount of \$317,000 with a life of project obligation in FY 1979 of this amount.

## URBAN FINANCIAL MANAGEMENT

### 2. Description of the Project

#### a. Purpose

This project is designed to promote efforts to assist local government officials and technicians in improving their financial management practices generally, broaden their understanding of the kinds of financial and economic data required in decision-making and policy formulation, and increase their knowledge of approaches and systems needed to generate financial information and revenue to ensure the effective utilization of scarce resources.

The research will focus on ways to improve the financial condition of the cities by (1) examining the current status of local government finances (2) increasing understanding among local officials of the various factors that affect the financial capacity of local governments to maintain acceptable standards of livability and (3) developing a methodology for evaluating the financial condition of the cities.

In the process of building analytical skills of local officials and improving local fiscal management, the first phase of the project will focus, in part, on the need for reliable financial forecasting, including identification of financial warning indicators. Concepts and techniques will be formulated in terms

local officials can understand. The second phase will emphasize financial management capacity building, including the establishment of a financial management resource capacity, which is more fully described on page 29.

The project proposes a new approach in fiscal planning or budget formulation shaped by the recognition that a city's financial capacity to maintain acceptable standards of livability is influenced by economic conditions found in the city. Therefore, the project will not focus directly on traditional sources of locally generated revenue or intergovernmental transfers as described elsewhere in this paper. Rather, the emphasis will be to increase understanding among local officials of the manner in which economic variables influence the financial capacity of local governments, and how these indicators can be utilized to strengthen a city's revenue base.

b. Background

In the next two decades, the world's population is expected to reach 6.5 billion, nearly double the number alive today, and by then an estimated 3.5 billion of this total will be urban settlers. The developing countries are expected to add 1.3 billion inhabitants to their urban populations, bringing the total urban dwellers in these nations to an estimated 2.1 billion or twice the number now living in cities in the developing world.

Although the nature of migration varies considerably through-

out the developing world, in many cities in Southeast Asia, for example, it accounts for at least 50% of the total population increase. The percentage of squatters and slum dwellers living in a number of Asian cities ranges from 15 to 50% of the city's total population and these are growing at twice the rate (6-17%) of the city as a whole.\*

In Jakarta, the squatter population is growing at 15% per year and in metropolitan Manila the slum population is increasing four times faster than the rest of the area's population. While such cities seemingly offer escape from the abject poverty in the rural areas, the strain on existing resources and services brought about by such rapid growth is evident.

Furthermore, 80% of the families in slums or squatter areas live outside the reach of basic public services. High capital costs to service such settlements are juxtaposed with severe underfinancing of urban services. This unprecedented urban growth obviously offers cities in the developing world a real challenge to absorb the new population in a positive way. Clearly, rural-to-urban migration plays a major role in reshaping the economic and social fabric of urban society in developing countries.

Urbanization Issues. Cities are simply growing too fast and lack the resources locally to provide even basic amenities.

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\*Annex C identifies urban and slum squatter growth rates in 11 cities in developing countries.

Accordingly, local governments generally have been unable to promote effective solutions to these problems of growth and poverty and it is quite clear they will be made worse with continued urbanization.

Thus, service requirements in cities in developing countries have outstripped their capacity to provide and to pay for them. Rapid population growth throughout the developing world has contributed also to the dilemma. Fiscal capacity is exacerbated further by a shortage of managerial talent and a lack of authority locally to obtain sufficient self-generated revenues. So, reliance on central government resources is generally heavy.

Furthermore, urbanization itself results in increased costs for public services. Movement from rural areas, for example, can diminish extended family relationships resulting in a need for social welfare programs. Also, as people congregate in smaller areas, cities must give much greater attention to human waste, disease, transportation, crime, utilities, traffic control, and roads.

The public sector obviously has a significant role in providing essential services, although for many, if not most, of the urban poor these services are often nonexistent. In Latin America, for example, only slightly more than half the urban population is served by piped water. In Asia, the percentage is much less.

Moreover, the poor often pay higher costs for such services. More often, though, they are left to their own devices for meeting basic needs.

The most critical needs are those which contribute to relieving human disadvantages - namely, housing, health care, education and employment opportunities. It should be obvious, therefore, that government policies directed toward the problems and potentials of urbanization ought to have as a starting point ways in which the quality of life of the poor can be improved measurably.

The urban poor are too numerous and their numbers are growing too rapidly in the developing world to be ignored. This suggests the need to improve the quality of public services available to the urban poor. In recent times cities in these countries have been confronted with increasing financial pressure resulting, in large measure, from growing demands for essential public services. The core of efforts to improve the capacity of cities in developing countries to provide these services is a sound economic and fiscal base.

Local government budgets hardly meet basic service needs and generally central governments do not provide sufficient transfer payments to the cities to bridge the growing gap. Furthermore, rapid growth clashes with efforts to provide even limited amenities within the framework of the present general revenue systems. More

over, the transitional nature of urbanization can't be controlled or manipulated by short-term measures, such as closing a city to migrants ( as was tried by Jakarta ) or expelling squatters from their dwellings ( as is attempted from time to time in most urban centers of the developing world ).

Such practices generally have resulted in unproductive uses of very scarce public resources as well as a measure of loss to the squatters themselves in terms of labor, personal savings and materials furnished to construct their habitat and commercial enterprises. The squatters usually return quickly, because they have nowhere else to go. They consider their present life better than it was before, including the potential of jobs, higher incomes and improved educational opportunities in the city, and are reluctant to leave these areas. Relocation will not work unless new sites offer better living and working conditions than the migrants have already gained.

In addition to the generally inaccessible location and the overcrowded conditions of their settlements, the squatters seldom are taxpayers and, therefore, lack equal access to the amenities of a city. The squatters and slum dwellers expect and get little from local government and tend to rely on themselves and on self-contained units or groups to meet basic needs. In any case, their large numbers would overwhelm the public service capability of most developing country cities.

Improvement of financial management capabilities in developing countries has lagged far behind modernizing efforts in other development sectors. Local officials are unable to produce useful financial information for decision-making and policy formulation, and program evaluation and financial performance suffers. Moreover the more attractive and remunerative jobs are located generally in central, not local, government which results in a brain drain of serious proportions.

Financing Equitable Services. In the years ahead the financing of local government in developing countries will be one of the most politically difficult tasks facing government. While local governments are creatures of the central government the latter has thus far avoided the task of readjusting the finances, responsibilities, and boundaries of local government to meet changing service and development needs. Such reform is not merely a matter of bringing about greater efficiency in the delivery of public services; it is also a matter of dealing with other constraints. If central government is to modernize the financial condition of local government, policies that contravene such efforts must be altered. Only central government in developing countries has the power to restructure local government finances to meet emerging needs.

Fiscal aid to the cities will continue to be essential to enable them to cope with development tasks. The amount of external assistance to local governments undoubtedly will have to increase dramatically in the coming years, and their structure and budgeting processes will have to be modified to reflect current urban realities.

Pressures on local governments to provide services have grown as urbanization has accelerated. Furthermore, increasing costs for basic services have not been matched by increased public revenue. There is inadequate local authority over revenue sources; in fact, central government frequently has reduced local revenue authority. In addition, there is uncertain central government fiscal support, as well as a general failure to recognize the linkages between the financial condition of the city and the city's economic base.

Thus, local governments typically have been left with revenue sources that are not expanding along with population despite rising expenditures and needs. They face a decided and growing imbalance between revenues and expenditures.

Unlike the United States, the issue is not whether central government should intervene, but what type of intervention is needed to improve the resource base in the cities for the equitable delivery of essential services to the poor. Central government assistance alone never will be sufficient to meet growing local

service needs, so such assistance must encourage burden spreading and resource sharing. Cities must be assisted to strengthen their financial condition and the local economic base and to understand the relationships between the two.

An example of the way in which economic conditions can impact adversely on the financial capacity of a city to provide basic services and facilities is to be found in Cleveland, Ohio, a city facing fiscal collapse and the first major urban center in the United States in more than 40 years to default on its financial obligations. The long term impact of this default is likely to be even more severe as usual sources of borrowing vanish. Although once a well-off industrial center, the city's economy is simply unable now to produce sufficient revenue to satisfy current budgetary requirements and indebtedness.

Revenue. Cities rely on a large number of revenue sources. A few are of major importance, as shown in Annex B. Taxes on property are heavily utilized by African and Asian countries with a British heritage. Cities in Colombia have developed relatively effective property tax systems. Sales taxes of various types are also a significant revenue source.

Two basic means are used extensively to transfer revenue to cities in developing countries; i.e., tax sharing and grants. In the Philippines and Thailand, for example, shared taxes are relied on heavily. Tax sharing helps to generate revenues from sources that often are not legally available to local governments, but it does increase centralization. Intergovernmental grants are used also as a means of providing additional funds to cities. They are allocated for specific purposes. Unconditional grants, used as local officials may desire have been used only sparingly.

A clear need exists to develop at least basic financial information, but data gathering constraints hamper research in cities in developing countries. There is, for example, a distinct lack of financial management capacity at the local level, a low level of consciousness of the need for financial forecasting and the bureaucracy itself hampers the collection of data for effective financial management decision-making. Furthermore, little information is available about the per capita costs of providing basic services.

Where the property tax has been relied on in the past for a substantial part of locally generated revenues by cities in developed countries, this reliance is gradually diminishing. In the United States, for example, the percentage of total revenues derived from the property tax decreased from over 70% in the early part of the present century to about 35% in the 1970's. Cities in the developing world likewise are becoming increasingly dependant upon non-tax revenues and particularly intergovernmental transfers; such trans-

will continue to become a more trenchant part of the general revenue systems of local governments in the countries. Juxtaposed with this growth in central government assistance is a growing dependence on central government revenue; such aid is actually growing at a faster rate than is locally generated revenue. At the same time, many local governments are facing tighter constraints on spending, as well as restrictions on the raising of revenue locally.

The increased use of central government agencies in the performance of local government functions is a major alternative to the continued reliance on locally generated revenue. A second is the direct financing of local government services.

The disruptive growth of population in developing countries is causing a quasi-revolution in local government revenue systems. Essentially, the trend has been away from a reliance on locally generated revenues to intergovernmental transfers. The sources of revenue examined in this section are classified in three broad categories: (1) locally generated nonproperty taxes, (2) locally generated nontax revenues and (3) transfer payments by the central government. All three constitute a search for viable alternatives to a reliance solely on the property tax.

Local Nonproperty Taxes. The increasing shift to nonproperty taxes is accompanied by a basic change in the economics of the developing world from a rural to an urban form. This evolution in the economic life of the developing world has had expression in efforts of local governments to consign some of the burden for the support of local services to revenue sources other than locally generated property tax revenue. Taxes can, for example, be levied on sales, income and privileges. They need safeguards, however, against inequity, maladministration, and possibly damaging economic effects. The following are major local nonproperty taxes:

General sales tax. These are taxes on retail sales of tangible personal property, although the tax base may include several specified services. They generally focus on consumer expenditures for goods. It is a good revenue producer for commercial centers. An added advantage is that some revenue is obtained from nonresidents. It also tends to create wide tax consciousness.

Gross receipts tax. These taxes are imposed on business and occupations and are measured by the gross receipts of such activities. This method of taxing the privilege of doing business is also used as a broad-based business tax imposed on every person or business engaged for profit.

Selective sales taxes. This is an excise tax on specific commodities or services, such as public utilities, tobacco products, amusements, and motor fuels.

Locally Generated Nontax Revenues. Local governments often have broad responsibilities over various business activity. Permits and licenses are issued in some instances - for example, for construction and for food vendors. Often a fee is charged.

Current charges based on the benefit principle, bear a relationship to the cost of providing the service. These are revenues received for performing certain services benefiting the person charged and also from the sale of services and commodities, such as rents and special assessments. Sanitation fees are levied for the collection and disposal of garbage and sewerage services for the provision of disposal facilities. Recreational facilities also generate revenue for such purposes as museums, art galleries, swimming pools, stadiums, and harbors. City housing projects account for some income. Airport charges, revenues from operation of canals, docks and wharfs and related facilities, and parking facilities produce revenue.

Interest earnings on deposits and securities and the sale of property generate revenue. Finally, there are special assessments imposed on property, which require formal assessment and are related to a specific benefit.

Intergovernmental Revenues. Local revenues in this category are derived from the central government. The function of this transfer of resources is to increase the capability of local government to (1) provide needed public services and (2) to furnish the impetus locally to enlarge certain local service functions.

Such revenues are in the form of grants, shared taxes or revenue sharing, and are provided for specified purposes. The local governments are expected to satisfy minimum standards. Shared taxes are based on an allocation to local government of their portion of a tax collected or imposed by the central government. General revenue sharing, a practice of transferring revenues to local government with few restrictions, is not generally practised in the developing countries.

A persistent shift toward more diversified revenue structures emerges in the literature and it is likely to continue as pressure builds for additional revenue. At the same time, increasing disaffection with the property tax (including widespread avoidance of property tax levies) forces officials to consider other revenue sources. With proper safeguards, a number of nonproperty revenues, such as local income and sales taxes and various user charges, could be considered more broadly to achieve equity in the funding of public services. It is clear that a major characteristic of current local government revenue systems is the under utilization

of nonproperty sources of revenue and the over reliance on the local property tax. Local officials need to have wider latitude in the selection of appropriate revenue sources.

c. Detailed Project Description

(1) Guidelines and Methodology. The first track of this project will introduce the approaches city officials in developing countries can use to evaluate the financial condition of their cities. These approaches will include developing practical guidelines for gathering and interpreting the data required in financial management and a specific methodology for evaluating the financial condition of the city.

The purpose of this track is to increase local officials' understanding of the factors that affect a city's financial condition. Such data properly interpreted can be utilized to establish local policies and managerial approaches intended to improve the financial fabric of the city.

Fiscal planning requires measures of effectiveness. If it is assumed that the broad purpose of local government in the developing countries is to support acceptable standards of livability\* throughout the city, it becomes necessary to measure the effectiveness

\* They include: promoting a healthy environment, satisfactory housing, compatible land uses, streets free of hazards, adequate water and sewer service, suitable drainage system, adequate fire protection, crime prevention, accessible recreation opportunities, and education, among others.

of public services actually provided against predetermined city standards for such service delivery. This requires identification of areas within the city purportedly receiving inadequate services, designing improvements in the delivery of needed services and then determining the financial resources required to achieve appropriate livability standards.

Thus, implementing steps will require (1) an analysis of local services actually contributing to livability, (2) establishing city standards for service delivery, (3) measuring the effectiveness of city services against established standards to identify areas within the city requiring improved services, (4) seeking appropriate citizen support and finally (5) a cost analysis to determine funding needed to achieve acceptable levels of services.

A number of assumptions about present conditions in developing countries frame the context of the project. These are:

- Reliable financial indicators are not being identified to project future local government revenue and expenditures and to evaluate the impact of fiscal decisions in terms of acceptable public services.
- Local officials do not understand the implication of the budget as a fiscal management tool to ensure the effective use of scarce resources and to establish appropriate fiscal policies.

- Local officials lack the ability to project adequately future revenue and expenditures.
- Local officials are not generating or using fiscal information satisfactorily in policy-making.
- New financial management methods are required to reflect sufficiently the impact of a city's economic condition on local government revenue capacity.

Methodology will focus on internal operations in the local government, including establishing revenue and expenditure profiles, and simultaneously emphasize economic conditions, including an examination of a city's population, housing, income, retail sales and employment, and the effect these economic variables have on the financial capacity of the city. An end product of the project will be guidelines written especially for local officials and city technicians. They will focus on a city's current financial condition, fiscal and economic trends, and the rate and nature of change concerning these trends.

The guidelines will assist local officials to gather and analyze relevant financial and economic data and suggest approaches in working with those likely to be affected by the project, including, of course, intended beneficiaries. The guidelines will also contain the most pertinent evaluation techniques being used for such purposes generally, as well as those specifically developed for this project.

Financial Condition. A look at the revenue base in relation to economic conditions is essential for an understanding of urban resource needs. Present financing arrangements of local governments in the developing countries are not adequate. There is an urgent need for more effective local revenue systems, but the literature indicates there is no clear consensus about the way in which an ideal system might be established.

Furthermore, there is in the developing world a decided trend to centralize financial decision-making resulting in a much larger role for central government in determining unilaterally how local government funds are to be spent. Central governments appear also to be placing greater restraints on direct assistance. Added to this general tightening of the strings of the entire local government financial structure is the decidedly uneven distribution of centrally funded resources.

It is imperative, therefore, in efforts locally to monitor the financial capacity of the city, to develop a suitable basis for forecasting. In other words, it is essential to develop a notion of what the financial condition of the city can be under different economic conditions and differing levels of public services. The performance of the local economy is critical to identifying appropriate forecasting mechanisms since the financial condition of a city

is, in fact, a product of the city's economic condition. The financial condition can be defined as measuring such factors as budgetary liquidity and the structure of short-term and long-term debt. The economic condition is a measure of such factors as retail sales, employment, and population, including dependency factors (i.e., those in school or too young or too old for income generating work).

The financial condition of the city is explained largely by the measure of its assets, liabilities, and future revenue capacity. However, such components of the city's financial condition as debt structure, capital facilities requirements, current liquidity, and ability to generate new revenue are directly influenced by the city's economic condition. Therefore, any examination of the city's revenue capacity must take into account the status of its economic base in determining the actual financial health of the city.

In the absence of greatly expanded central government transfer payments, cities in developing countries must, consider such measures as increasing local taxes and nontax revenue, or reducing already hard-pressed services to the urban poor. These approaches unquestionably can exacerbate the city's financial problems, and they along with efforts to find alternative financial resources may even be counterproductive.

It is essential to create a set of forecasting tools to identify the city's capacity to finance facilities and services. The approach outlined in this section is intended to measure the potential revenue capacity of local government, recognizing the impact various economic variables have on the city's financial condition. In deciding what needs to be measured, the economic variables such as population, income, employment, housing, and retail sales must be monitored closely, examining both the trends and the meaning of any changes in the variables.

The concept of a fiscal and economic profile of local government raises the broader issue of whether the financial condition of local government has any meaning independent of the revenue capacity of the central government. It is extremely doubtful that the central government can remain aloof from financial problems encountered by local governments in developing countries. Eventually the stresses felt at the subnational level will be experienced at the national level.

Economic Condition. The fiscal and economic health of cities in developing countries are not separable. A major determinant of the general fiscal health of the city is the level of economic activity. Cities cannot be strengthened fiscally unless they are revitalized economically. Therefore, efforts to provide jobs for the urban

poor and increase the level of public services available to them are consistent with a strategy of improving simultaneously the fiscal base of the city.

Local government budgeting is highly sensitive to changes in a city's economy. In other words, the economic conditions found in the city establish the parameters of its fiscal condition. A weak economic base results inevitably in diminished fiscal options available to the local government. In the United States, federal legislation has been profuse in efforts to subsidize jobs and investment growth in the private sector as a means of compensating cities for a weak fiscal base.

Any projection of the fiscal condition that looks even a few years into the future must give weight to underlying economic trends at the same time. Although prudent management can contribute to the city's fiscal strength, a weakening tax base obviously will impact on efforts to provide adequate services, resulting most likely in greater dependence on external assistance and other adjustments in local government general revenue systems.

Local government officials generally are unaware of the special kinds of data needed to analyze economic conditions in the city. Nor do they understand precisely how the local economy might impact on the city's financial condition. Moreover, they usually

don't know how to measure the relationship or how to monitor the linkages between the economic and financial conditions of the city. As a result, critical decisions are made affecting the budgeting process without data that are essential to an understanding of the economic vigor of the city.

What then are the economic variables a city should monitor? It is critical to analyze trends in population, income, employment, housing, and retail sales. Examining these variables should provide most of the information needed to determine the economic condition in the city. They are described in more detail below.

Population. This variable is one of the most objectively measurable of all variables. Population changes alter the scale of most local government revenue sources. When population is increasing, for example, taxable income, sales, and property values tend to increase also. Population growth also contributes directly to the taxable property base. Among the local revenue sources, the property tax is obviously most sensitive to population change.

In examining this variable it is necessary to look at its size, the rate of growth, age and sex distribution, geographic patterns, and trends in household formations. It is essential to know present population characteristics and population trends, because population changes influence directly economic condition in the city.

They will, for example, impact on the demand for housing, jobs, schools, and, of course, public services.

While population changes are not the only determinants of local government operating and capital requirements, they become indicators of the city's financial condition when linked with other economic variables. Knowing age and sex patterns enables the local government to anticipate likely changes in family formation, housing demand, school enrollment, leisure needs and shifts in the labor force. Geographic distribution can contribute to improved facility planning.

Income. Income data are an indicator of ability to pay for housing and consumer goods since they have direct impact on local government revenues, such as fees, permits, sales taxes and service charges. Knowing the distribution of family income enables a city also to identify and monitor generally the number of citizens living at poverty levels and to plan more realistically for their needs. By means of trend analysis the local government can determine whether spending is increasing or declining as a direct result of settlers' income.

A decline in per capita income can be a sign also of future trouble in the economy. It puts into perspective real purchasing power. If the cost locally of goods and services is rising more

rapidly than the rate of disposable income, it is quite likely the city can expect an economic decline with a resultant weakening of the city's overall financial condition.

Employment. An analysis of employment requires looking at both the size and distribution of employment by occupational type and, of course, the nature of the business, the level of unemployment and underemployment and wage levels also by type and business investment. Employment trends can assist in forecasting requirements for building space and aid in determining expected local government revenues and capital expenditures requirements.

It is important, though, for the local government to maintain an inventory of the types of businesses and the nature of land uses for business purposes. Such data will enable the city to estimate readily the fiscal impact of urban change related to land uses. Capital investment obviously will impact also on the financial condition of the city.

Housing. In most cities in the developing countries, providing public services for residential inhabitants is a significant cost to local government. It is seldom, though, that housing pays its own way. Nonetheless, people residing in the cities do contribute to the economic well-being of business and to the city generally;

for this reason, housing is an important variable in the city's economic base. The city should survey periodically housing and its characteristics, such as number of rooms, type of structure, age, and condition.

Retail Sales. Retail sales are a useful barometer of how well the city is doing economically. Taxable retail sales are a function of consumer expenditures within the trading area. If the volume of taxable retail sales is increasing substantially, it is obviously a sign that the local economy has momentum. Changes in retail sales have a direct impact on the fiscal condition of the city. In analyzing retail sales it is essential to gather data about the number of retail establishments, the type and the number of taxable transactions. Retail sales must then be related to disposable income as an index of tax revenues.

(2) Capacity Building. The second track will focus on financial capacity building. Inadequate knowledge of worthwhile financial management practices has for years hampered efforts of local officials to achieve acceptable standards of livability in cities of the developing world. Mounting financial pressures, increased demand for public services, limited resources and fragmented service delivery arrangements make it imperative that local officials in these cities accept more innovative financial management practices.

This track will include the formation of a financial management capacity to furnish the following kinds of services:

- Training and technical assistance on selected financial management topics, enabling local officials to gain the required awareness of and expertise to deal with relevant issues in financial management.
- A listing of practitioner-experts within the host country to serve as consultants for various local jurisdictions.
- A financial management library with shelf copies of relevant resource materials for local officials.
- Quick response research and data needed to fill gaps in available financial management literature.
- A catalog of financial management practices to assist local officials in fiscal planning. The catalog will be available at workshops, which will emphasize a sharing of techniques, concepts, and approaches focusing on revenue and expenditure forecasting, and particularly linkages between the cities' financial capacity and local economic condition.
- A national outreach effort to identify as replicable models exemplary financial management practices among local officials.

Project Outputs: The project is certain to result in financial management activities much more responsive to urban needs:

- Available resources will be matched more effectively against longer range needs of the cities.
- Local officials will understand the implication of the budget as a management tool.
- Local officials will have greater ability to project adequately future revenue and expenditures.
- Financial management information will be used more effectively in the decision making process.
- Local officials will be better able to establish more responsive fiscal policies.
- The capacity of local officials to use available financial management tools will be increased.
- Reliable indicators will be available to local officials and technicians to evaluate the impact of a city's economic condition on the local revenue base.

### 3. Project Specific Analyses

#### a. Economic Feasibility

Development of an institutional framework which will facilitate efficient and equitable financial management practices and a lessening of a city's dependence on transfers from the central government are major goals of this project. Likewise, improvement in financial management practices locally such as improved revenue and expenditure forecasting, better utilization of fiscal management approaches and systems and the ability to use relevant economic information in decision-making are among the project purposes.

The nature of this project, however, makes it rather difficult, if not impossible at this time, to make a suitable cost-benefit analysis. Specific project costs in terms of anticipated state-of-the-art studies, adaptive research and consulting services are itemized in the financial plan contained on page 39. The cost to the concerned cities and central government agencies cannot be computed, though, because data relating to existing financial practices and various institutional arrangements are not yet available. Similarly, it is not possible to determine now the significance local officials and technicians and central governments will attach to the anticipated benefits described on page 30.

b. Social Soundness Analysis

Cities in developing countries are becoming increasingly more dependent on central government revenue transfers and, as a result, political and fiscal policies in most developing nations are weakening local authority to govern and importantly to make choices. Effective decentralization in terms of fiscal revenue systems is generally considered in the developing world by leaders at the center as politically costly, for it means a lessening of central government power and, of course, creating other power centers that can then make claims on scarce financial resources.

Central governments historically tend to resist changes, especially regarding sources of revenue, which contribute significantly to increased authority at the local level of governance. This project is expected to promote self-supporting cities by encouraging

urban policies that (1) enhance local decision-making authority over various revenue sources, and (2) lead to more effective use of existing revenue sources. Thus, the overall effort will reduce fiscal imbalances among various public entities and, at the same time, focus on appropriate social equity issues.

Beneficiaries. Ultimately, the major beneficiaries of this project will be the urban poor in the selected cities whose numbers are growing rapidly. By the year 2000, for example, the developing countries will add 1.3 billion people to their urban populations - twice the number now inhabiting cities in the developing world. In 1975, there were 90 cities in the developing world with populations over one million. In two decades, there will be 300. Moreover, the urban population in these countries actually will grow in this period from 28% of the total inhabitants to more than 40%. In some cities in the developing world, more than half the total population consists of slum and squatter settlements as shown in Annex C. About half the new urban resident residents will be migrants and most, of course, will be unskilled and poor.

Local officials will, however, gain direct benefit in terms of increased awareness and knowledge of the various approaches and systems for generating financial and economic data and for using these data in decision-making. The project will also result in such data being accessible to interested citizens and the private sector generally.

Participation. Citizen support is considered essential to promote city policies and action in this sensitive area of financing public services equitably. Local official will be expected to establish effective communication networks with intended beneficiaries in terms of their responsibilities.

Citizen participation will include a continuous communication system involving, as appropriate, public hearings, media coverage, surveys to chart citizen opinion, advance notice about pending decisions and a full explanation of decisions actually made. Areas of decision-making in which citizens will be expected to participate include goal-setting and ranking of priorities, for example, in the allocation of locally generated revenue and national government assistance, which would be accomplished through the annual budget process and periodic monitoring and evaluating of the effectiveness of city services.

Citizen participation mechanisms will include information collection and dissemination, promoting citizen accessibility primarily by reducing physical and psychological barriers citizens are likely to encounter when they interact with their local government, involvement in actual decision-making related to public services issues, and accountability in which local officials are required to explain or defend their actions. Several approaches will be utilized in connection with the citizen participation strategy, including temporary convenings such as task forces, public hearings and briefings.

Citizen participation is expected to reduce feelings of both alienation and apathy and, at the same time, to strengthen their commitment to local government efforts to provide basic needs. Such interaction also will increase understanding about the kinds of resources needed to deliver services and to ensure that city policies are, in fact, the result of a collaborative effort. The increasing complexity of urban issues mandates such interaction.

Citizen participation, as outlined above, will result in more meaningful access to local officials and the processes that determine the city's quality of life, provide opportunities to foster broader public support and understanding in local government decision-making, facilitate exchange of information, foster a better understanding of the capabilities of local officials and encourage them to seek the views of greater numbers of citizens.

Local officials will be expected to encourage and promote the participation of women, as described above, appropriately in overall efforts to increase the capacity of local governments to utilize more fully available financial management tools and to improve financial management practices generally so that services collaboratively decided, in fact, will contribute to acceptable standards of livability.

c. Technical Feasibility

Cities in developing countries all face critical problems in financial management. The U.S. General Accounting Office reporting on more than 20 years of evaluating development assistance activities has concluded that there is a need to strengthen financial management practices. The World Bank is urging greater attention to municipal finance in expanding urban centers. Yet, little research has been undertaken in the developing world to examine critically the capacity of a city to furnish services and facilities so essential to achieve a desired level of livability in each area of the city.

This project will in Track #1 assist local officials to improve their financial management practices, especially in building analytical skills and in their monitoring of a city's financial and economic conditions.

The analysis of current financial management practices and the introduction of improved forecasting and financial management approaches will serve as the basis for the guidelines, which will contain relevant concepts, financial warning indicators, and economic and fiscal forecasting tools.

The research in Track #2 will expand opportunities among local officials for information sharing and technical assistance primarily through institutions currently providing such services to local government. This latter component of the project, capacity

building, will provide local officials with a focus for inquiries and information about their financial capacity problems. Both components are suitable for replication elsewhere. The recommended technology as described more fully in the guidelines and methodology beginning on page 18 and again beginning on page 28 should accomplish readily the expected project results noted on page 30. Moreover, local officials, as a result of this adaptive research, can expect a greater capacity to explore alternative strategies for financing local services.

The project will increase awareness and ability among local officials to use relevant financial and economic data for effective policy and service delivery decisions, and, at the same time, expand their knowledge of approaches to generate these data and then to focus this data on decision-making. It will promote better financial management practices and reduce dependence on a heavy inflow of national assistance.

The capacity building components will serve as a point of contact for quick response to inquiries, and it will utilize a wide range of local government practitioners and financial management experts. This segment will include financial management materials, a referral service for exemplary jurisdictions and provide training and limited technical assistance. A goal of this track of the project is to provide quick response tailored to specific needs of inquiring local officials.

Consultants with adequate experience in the analysis and utilization of financial and economic data related to urban finance and with knowledge of economic condition linkages are available to carry out the project purposes. They will be expected to use the most appropriate and innovative conceptual and analytical techniques.

The research, for example, will focus, in part, on measuring particular kinds of economic and fiscal distress. Analytical approaches will include an examination of economic conditions such as population, income, employment, housing and retail sales which were described earlier in this paper. Population is recognized as a major variable influencing a city's economic condition. The analysis of a city's fiscal condition will include an examination of its capacity to furnish services to areas of identified deficiencies rather than attempting to provide each section with the same level of services.

The growing complexities of urban governance and the dramatic increase in funding needs for basic local government services require a major research effort to provide local officials with up-to-date financial management information and practices.

d. Administrative Feasibility

This project requires specialists in the field of urban finance who have specific local government expertise and developing country experience. A team approach is anticipated. Host country expertise will be used as fully as possible.

More specifically, the team will consist of a public finance economist with considerable experience in local government finance and intergovernmental relations, a political scientist/public management expert capable of examining critically a city's internal organization and management processes, and an accountant with relevant skills in local government budgeting, including a knowledge of budgeting as a management tool in financial planning and policy formulation.

As a result of significant changes in technologies associated with urban finance which will be manifested in the guidelines and methodology developed by this project, it is proposed to assign technical and professional personnel on a person-to-person basis to work directly with local government officials in the application of these tools. This will be a subsequent or follow-on activity.

Arrangements for such assignments, generally on a short-term basis, will be made in consultation with the International City Management Association, Sister Cities International, the Municipal Finance Officers Association, the National League of Cities, the National

Municipal League and the State Department Liaison Office with State and Local Governments headed by Ambassador W. Beverly Carter.

e. Environmental Concerns

This project is essentially adaptive research and will have no direct environmental impact.

4. Financial Plan

Total project costs are estimated at \$317,000. This document, therefore, seeks approval of \$317,000 to finance the urban financial management project. Host government contributions are expected to be in-kind. Disbursement of AID/W funds will be as follows:

	<u>FY 1979</u>	<u>FY 1980</u>	<u>Total</u>
Core Consultant Staff			
Public finance economist (7 man-months @4,200)	16,800	12,600	29,400
Political scientist (7 man-months @3,000)	12,000	9,000	21,000
Public finance accountant (3 man-months @2,000)	2,000	4,000	6,000
Overhead (60%) and fringe benefits (30%)	31,050	23,040	54,360
Expert consultants (10.5 man-months @3,600)		37,800	37,800
Overhead (60%)		22,560	22,560
International travel and per diem			
Core staff	12,150	43,000	55,150
Expert consultants		20,000	20,000
Domestic travel - core staff	3,500	5,000	8,500
Host government subcontracts	7,500	15,000	22,500
Support package-clerical, printing, supplies, publications, workshops	10,000	30,000	40,000
Totals	95,000	222,000	317,000

5. Implementation Plan

The major project input by A.I.D. is an expert team which will be recruited by contract. Counterpart expertise will be furnished by appropriate host government agencies and local government entities. Participation of host government counterparts and particularly certain officials in local government entities will be encouraged to expand overall fiscal and economic analysis efforts.

An essential part of the project is to determine how urban financial management issues are perceived by the various central government agencies, as well as by local government entities responsible for financing urban services. At the central government level this approach will involve the Ministries of Planning, Finance, and Local Government; and at the local level, the chief executive officer (usually the mayor), members of local legislative bodies, the city treasurer, administrative officer (city manager), and representatives of decentralized central government agencies.

Overall management of the project will be the responsibility of the Office of Urban Development, Development Support Bureau (DS/UD). Field application will be the responsibility of the expert team, the host government and the field missions as appropriate.

It is anticipated that the contribution of the project manager will be in the following areas:

- Project management and monitoring activities.

- Extensive liaison with regional bureaus and missions to assure optimal use of the contractor's resources and to assist in determining priorities for the contractor's state-of-the-art and research activities.
- Professional input into the substantive activities of the contractor and review of the outputs.

Arrangements for the core of activities will be worked out between DS/UD and the contractor during the first month of the contract. The schedule of the activities will be specified through consultation with the regional bureaus, concerned missions, host governments, the contractor and the DS/UD.

The work of the contractor will consist of two phases:

- State-of-the-art studies, field application and consulting.
- Involvement in the formation of financial management capacity building in the concerned countries.

Arrangements will be worked out with at least three field missions and host governments for the contractor's involvement in ongoing consulting and field application related to the project purposes as described on pages 4 and 5. By the end of FY 1979, the following outputs will have been achieved:

- Field application and consulting arrangements will be worked out with at least one mission and host government, and plans will be underway for specific information dissemination activities.

- State of the art activities and applied research will be reviewed for the purpose of determining appropriate project modifications.

Consulting arrangements will be pursued on the basis of the predominant capability of Dr. Roy W. Bahl, Jr., Syracuse University, to accomplish in cooperation with others the purposes of this project. Dr. Bahl is uniquely qualified to provide consulting services in connection with the public finances of developing countries. A professor of economics in the Maxwell School of Citizenship and Public Affairs since 1973, Dr. Bahl's primary research and teaching interests are in public finance, urban economics and development.

His international experience includes relevant assignments with various departments of the World Bank, the International Monetary Fund, Harvard Institute for International Development and the governments of Kenya, Philippines, Korea and Egypt. He has also served as project director for numerous research activities on urban finance and has published extensively in the public finance field. It is anticipated that Dr. Bahl would have a substantive role in recruiting the remainder of the expert team.

Details of the proposed schedule of activities are noted in the table following this section.

The tasks outlined in this section will be organized as an integrated arrangement of research and informational activities, including forming a network of practitioner specialists in various aspects of urban financial management analysis and practice. These individuals will be linked to the information dissemination activities. Also, linkages will be established with a range of institutions working on urban financial management issues.

In an effort to establish a multiplier effect, a two level approach is proposed. Research in the first level (Track 1 as described in this paper beginning on page 18) will focus on improving forecasting mechanisms to enable local officials to project revenues and expenditures more effectively and to use more efficiently financial management information in decision-making. The research will produce an overview of fiscal management practices currently in use in the targeted cities, including an analysis of financial accounting practices, relationships between budgeting and development planning and the use of the budget for program evaluation. It will also consider perceptions expressed by central government agencies about local finance issues. At the national level this will involve consultation with the ministries of finance, planning and local government and at the local level, the views of chief executives, finance officials and members of legislative bodies. Officials of decentralized autonomous agencies will also be contacted. These expressions

will then serve as a forum for the exchange of views among those at different levels in the political system, providing relevant information about the climate for urban fiscal reform. USAID views regarding the importance of urban financial management will be solicited.

A general analysis of all local government fiscal functions will be undertaken to determine the efficacy of existing financial practices. Major sources of tax revenue generated in the targeted cities, for example, will be examined in terms of statutory authority for levying different taxes at the local level and as they relate to the tax rate structure, assessment procedures and collection practices. The analysis will focus on both growth and performance of major revenue sources in terms of population, income, employment, housing and retail sales. These economic variables are described beginning on page 25.

The research will also consider the actual effectiveness of assessment practices, the implication of tax exemptions, the use of penalties to enforce tax collection and the potential for tax revenue. User charges will be reviewed to determine the basis for these charges, their relationship to service costs and the extent of flexibility, if any, in the rate structures to allow suitable adjustments in the billing and collection systems.

The research will consider the role of the central governments regarding the transfer of funds to local entities as well as recent changes and

likely trends in such funding arrangements. Also, their role will be examined in connection with national control of local government financing. The types of transfers - tax sharing, formula assistance, ad hoc payments, cost matching or reimbursement grants - incentives or disincentives generated by the grants, efforts, if any, to reduce financial dependence of local government, comparisons of revenue generated within the city and accruing to local government will be compared to transfers from higher levels and finally, central government steps to support local governments by means of technical assistance and training will be studied.

Fiscal spending and planning will be examined to determine if expenditure responsibilities of local government are in line with revenue authority. Efforts to satisfy the needs of the poor and to establish standards which permit spreading of benefits to the disadvantaged will be reviewed. The nature of administrative and political processes by which financial decisions are actually made and the degree of coordination in fiscal planning with other public entities and with private organizations providing urban services will be analyzed.

This examination of urban financial management practices will focus further on institutional and administrative relationships between the local governments and central governments, organizational structures

defining functional responsibilities, the quality of the professional and technical staffs, the nature of budgeting, accounting and record keeping practices and whether these practices provide information regularly to assist in the analysis of a city's financial condition.

A major purpose of the financial management capacity building effort is to create an effective demand for good financial management information essential to sound decision-making. This approach will rely, in part, on the initiative of local officials to seek assistance. Local officials will be provided a basic learning package consisting of financial management guidelines as mentioned in the project description. These guidelines will address the role of key officials and technicians in the financial management process: forecasting revenue and expenditures, integrating budgeting, accounting and performance measures and the uses of financial warning indicators.

The guidelines will be distributed along with self-assessment checklists to help local officials clarify their specific problems and to determine their readiness to change financing practices. Workshops will take the resource package beyond dissemination. Technical assistance is to be provided through practitioner experts working with local officials and technicians demonstrating to them where there are real opportunities for change, helping to clarify problems and identifying resources available

for planning and implementing new financial management practices.

The capacity building effort in the second level will include development of financial management materials, including case studies, articles and exemplary working documents. Practitioner experts will assist in assessing these materials for completeness and importantly transferability. Local officials seeking information will be referred to other jurisdictions and individuals in cities who have dealt with financing problems.

A national outreach effort to identify exemplary financial management practices will be undertaken. Local officials are to be asked to suggest programs and practices of their own they believe are useful for others to consider. These will be reviewed for eventual dissemination to requesting practitioners. They will emphasize particularly issues of importance to officials in smaller cities.

The most worthwhile practices will be selected for use in workshops. Practitioners who have developed innovative approaches to key problems will share their experiences with others who might have an interest in implementing similar approaches in their own cities. Reports will then be prepared for dissemination describing the exemplary practices discussed at the workshops. The capacity building effort will also be a source for arranging peer matches of officials who actually use these exemplary practices with practitioners in other jurisdictions. This peer-matched

information exchange is a critical component of the project. In some cases, on-site technical assistance will be provided practitioner experts. Training will focus on priority financial management issues.

The U.S. General Accounting Office (GAO) in a recent report to the Congress suggests weaknesses in the financial management practices of developing countries are a major problem, and states that the international community must act to assist these countries in collaborative efforts to improve their financial management practices. Despite ample evidence, though, of severe deficiencies in such practices, donors are, according to the GAO ignoring the critical need to support developing countries in their efforts to upgrade urban financial infrastructure. This paper puts forth approaches in financial management reform not previously attempted by any donor.

**Implementation Schedule**

**FY 1979**

- |                              |              |
|------------------------------|--------------|
| 1. Contractor selected       | July 15      |
| 2. Contract signed           | September 15 |
| 3. Recruitment of core staff | September 30 |

**FY 1980**

- |  |              |
|--|--------------|
| 4. Review state-of-the-art proposal (SOAP) | October 15   |
| 5. Selection of three project sites        | November 15  |
| 6. Negotiate and approve work plan         | December 15  |
| 7. State-of-the-art work completed         | December 30  |
| 8. Work commences in country #1            | February 1   |
| 9. Interim project review                  | April 1      |
| 10. Work commences in country #2           | April 15     |
| 11. Work commences in country #3           | June 1       |
| 12. Interim project review                 | July 1       |
| 13. Final evaluation                       | September 15 |

6. Evaluation Arrangements

The project will be subject to periodic evaluation to provide appropriate feedback concerning overall project effort and to measure progress in connection with overall objectives. These appraisals are to be completed following guidelines established by the fieldmissions, host governments and the Office of Urban Development. A final evaluation will be made jointly by the host government, missions and DS/UD.

The following specific evaluations are planned during the life of the project:

- State-of-the-art papers will be evaluated both in terms of professional standards and their utility to DS/UD and to the project. This will be the responsibility of the project manager with assistance from appropriate officies in AID/W and external resources.

Six months: General evaluation of project outputs involving the contractor and DS/UD with particular emphasis on the effectiveness of arrangements for the applied research, information dissemination, and interaction among the regional bureaus, DS/UD, mission, host government and the contractor. This analysis will consider variations of existing project approaches as well as new ones. Project changes could result in specific modification which would be monitored to assure proper implementation.

**Nine months:** Interim evaluation by the missions, host governments, and DS/UD especially directed toward the results of the applied research and consulting and the functioning of the contractor, host government and mission relationships.

**Final evaluations:** All components of the project will be examined jointly to ascertain the results, findings, and experience acquired by all participants. The purpose of this will be to find out how well the project achieved expectations and also to identify particular portions of the project that might have merit for other cities. The evaluation will set out detailed approaches to continue and expand proven project concepts.

7. Conditions, Covenants and Negotiating Status

Conditions. Memoranda of agreements will be executed between the participating cities and the Ministry of Local Government specifying city and host government obligations, reporting requirements and other applicable provisions necessary to achieve project objectives. Each legislative body in the participating cities will adopt in accordance with applicable procedures a resolution concerning implementing features of the urban financial management project. The host government will assign appropriate and fully qualified urban finance and management specialists to the project.

**PROJECT DESIGN SUMMARY  
LOGICAL FRAMEWORK**

Life of Project: \_\_\_\_\_  
 From FY 1979 to FY 1981  
 Total U.S. Funding 317,000  
 Date Prepared: January 1979

Project Title & Number: Urban Financial Management

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Program or Sector Goal: The broader objective to which this project contributes:</p> <p>To improve the resource base for the equitable provision of essential services and access to them of the urban poor.</p>	<p>Measures of Goal Achievement:</p> <p>Understanding among host government national and subnational officials that the financing of urban public services must be linked to economic variables that impact on city's revenue capacity.</p> <p>Use of technologies geared to improving the financial condition of the city.</p>	<p>Acceptance of the technology</p> <p>Expert opinions</p> <p>Periodic and final evaluations</p>	<p>Assumptions for achieving goal targets:</p> <p>Appropriate methodology can be developed along with conceptual models.</p> <p>Evaluation techniques can be developed to establish local government revenue and economic profiles.</p> <p>Results of selected field demonstration projects will encourage replication elsewhere.</p> <p>Benefits of the technology will improve the quality of life for the urban poor.</p>
<p>Project Purpose:</p> <p>To assist in developing and testing effective and innovative means to evaluate a city's financial condition and introduce improvements in fiscal management and planning.</p>	<p>Conditions that will indicate purpose has been achieved: End of project status.</p> <p>Series of guidelines containing relevant techniques to analyze financial and economic variables and their linkages.</p> <p>Positive results from an assessment of the usefulness of the guidelines in selected cities.</p>		<p>Assumptions for achieving purpose:</p> <p>Arrangements with mission and host government to develop and test tools to evaluate the financial condition of local governments.</p>
<p>Inputs:</p> <p>Methodology to evaluate a city's fiscal condition by focusing on legislative and management practices and economic variables.</p> <p>Series of guidelines containing technologies useful in determining a city's financial condition. Training, technical assistance; listing of practitioner experts; quick response research, and identification of replicable fiscal management practices.</p>	<p>Magnitude of Outputs:</p> <p>Guideline series and model formats.</p> <p>Improved understanding of budgeting as management tool; increased ability to project revenue, expenditures; better use of fiscal data in decision making, more responsive fiscal policy formulation.</p>	<p>Completion, printing, and dissemination of guidelines and methodology.</p> <p>Completion of field tests of the guidelines and methodology.</p>	<p>Assumptions for achieving outputs:</p> <p>Host government and local governments will respond favorably to proposed technology.</p> <p>Local governments will use technology to understand financial and economic linkages.</p> <p>Technology will result in steadily growing revenue.</p>
<p>Inputs:</p> <p>A.I.D. grant funds of \$317,000</p> <p>16 man-months of consultant services</p> <p>Host country personnel and in-kind contributions</p>	<p>Implementation Target (Type and Quantity)</p> <p>Contract with specialists</p> <p>Project Agreement involving subnational entities</p>	<p>Contract(s) let</p> <p>Project Agreements completed</p>	<p>Assumptions for providing inputs:</p> <p>Project agreements can be arranged with host government and between host government and participating local governments.</p> <p>Host government personnel are available.</p> <p>Specialists in urban finance are available.</p>

## ANNEX B

SOURCES OF CITY REVENUE  
(In Per Cent)

<u>City</u>	<u>Property Tax</u>	<u>Sales Tax</u>	<u>Vehicle Tax</u>	<u>Amusement Tax</u>	<u>Other Tax</u>	<u>Licenses Tax</u>	<u>Other Income</u>	<u>Shared Income</u>
<u>Africa</u>								
Dar es Salaam	37	—	—	—	4	44	—	15
Lusaka	50	—	—	—	5	—	27	18
Nairobi	29	—	—	—	29	39	3	—
<u>Asia</u>								
Bangkok	15	39	6	5	10	3	2	20
Djakarta	2	—	26	27	4	2	10	29
Manila	22	11	—	—	2	27	12	26
Colombo	61	—	—	—	—	4	8	27
<u>Latin America</u>								
Bogota	30	8	2	2	2	39	3	14
Guatemala	21	11	3	—	19	38	8	—

Sources: Staff Papers, "Financing Cities in Developing Countries",  
International Monetary Fund, Vol. XXI, No. 2 Pages 364-5 ( July 1974 )

## Percent of Slum and Squatter Settlements for Selected Cities

<u>Country</u>	<u>City</u>	<u>Population ( 000 )</u>	<u>Slum/Squatter Settlements as % of City Population</u>
Afghanistan	Kabul	483	21
Cameroon	Yaounde	165	90
Ethiopia	Addis Ababa	737	90
Ghana	Accra	865	53
Guatemala	Guatemala City	778	30
India	Makassar	555	33
Kenya	Mombasa	255	66
Sri Lanka	Colombo	590	43
Tanzania	Dar es Salaam	334	50
Upper Volta	Ouagadougou	101	70

Source: Sector Policy, Housing, Annex 2, World Bank (May 1975)