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ECONOMIC FEASIBILITY OF THE MUNICIPAL DEVELOPMENT PROJECT

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EXECUTIVE SUMMARY

The Municipal Development Project has three components -- a Skills Building Component, a Technical Assistance Component, and a Municipal Development Fund Component. The Skills Building Component involves the training of municipal officials and civic leaders in democratic processes, such as citizen participation in the decision-making process, and in a number of aspects of municipal administration, including financial management, budgeting, and project planning and implementation. Improved tax administration in particular appears to offer great opportunities for increasing the fiscal capacity of the municipalities, enabling them to accelerate the provision of such basic services as water and sewage systems, streets and roads, education and public health services. The Technical Assistance(TA) Component targets assistance to a selected number of municipalities and to agencies of the Central Government. Once again the assistance to the municipalities has great potential resulting from improved financial administration and in such other areas as budget control and project planning and implementation. The third component, the Municipal Development Fund will make loans to municipalities that have profited from the training and technical assistance component and demonstrate an ability to plan, implement, and manage municipal provision of basic public services.

Given the problems that the municipalities are experiencing in keeping the real estate tax rolls current and in collecting delinquent taxes and user charges, a rather small expenditure on training and technical assistance, assuming the political will to collect taxes and fees in a timely fashion, has a very great pay-off. The Skills Building Component is estimated to have a Net Present Value(NPV) more than double the planned expenditure with a Benefit/Cost(B/C) Ratio of 3.2 and an Internal Rate of Return (IRR) of 54%. In addition, the Hondurans employed in the program are indirectly benefitted and there are intangible benefits as well. Similarly, the Technical Assistance Component is expected to provide substantial tangible and intangible benefits, showing a B/C ratio ranging from 1.95 to 5.8, depending on the assumptions made. The principal contributions are made by improved financial management and the creation of a public and/or private research and training program to continue technical assistance to municipalities not targeted in this component. The benefits of the Municipal Development Fund(MDF) lie in the quality of the projects to be funded.

A proposed budget of $10 million for the Skills Building and TA Components will be provided by USAID while the Government of Honduras(GOH) will finance the MDF with a contribution of $15 million from funds previously made available to it by USAID. The Fund and its expected accumulation will revert to the Government

of Honduras at the expiration of the project.

The strengthening of the municipalities resulting from this program is expected to a celerate the provision of needed physical and social infrastructure which in turn in expected to accelerate economic growth in Honduras, with consequent benefits of higher employment and incomes. The acceleration of potable water and sanitary waste systems coupled with improvements in education and health services is expected to reduce infant mortality and improve the quality of life of the citizens of Honduras.

While the project has substantial benefits even in the absence of a proposed municipal law, the Government of Honduras is considering proposals the would involve the municipalities in decisions of the central government that affect them, give the municipalities a greater measure of home rule, and decentralize central government agencies that provide services in the municipalities. The political effect of such a law would help the municipalities attain greater fiscal capacity and, coupled with the training contemplated by the project, strengthen democratic processes in Honduras.

The Economic Feasibility of the Municipal Development Project

Introduction

The Municipal Development Project has both political and economic objectives. Although they have a high social value, one cannot quantify the value of accomplishing political objectives. One can ask what the probability is that the project will attain its political objectives and whether there is a more cost effective way of achieving those objectives. Assuming that there is no more cost effective way of achieving the political objectives and that the probability of achieving those objectives is high, the decision-maker or makers who must approve the project have to make the subjective judgment that the sum of money proposed to fund the project is better expended on this project than on other projects or programs competing for those resources. Given that the project also has economic objectives, such as accelerating the provision of basic public services and doing so more efficiently, there may be economic benefits associated with the political objectives which should be taken into account in evaluation of the project. Economic benefits may be both tangible and intangible, the former being easier to quantify and the latter often as difficult to value as political accomplishments.

Strengthening democratic institutions requires making those institutions effective in the delivery of tangible benefits to their constitutents, including an increase in their economic welfare. As the institutions closest to the people, the municipalities offer the greatest possibility for citizens to participate in decision-making for the provision of the public services upon which their daily live and future welfare depend. At this stage in Honduras's development, these services are as basic as the provision of water and sanitary waste disposal, education, health services, roads, and electricity.

The proposed project has three components. One, a Skills Building Component involves the training of municipal officials and leaders of formal and informal citizen's groups in citizen participation in the decision-making process and in several areas of municipal administration. A second component is the Technical Assistance Component which involves diagnosis of the management problems faced by a selected lnumber of municipalities and provision of experts to work with municipal officials in solving those problems. It also involves technical assistance to the central government in devising and implementing a municipal reform law, in decentralizing central government agencies, and in developing a national research and training unit to provide technical assistance to the municipalities. The third component is the creation of a Municipal Development Fund to finance project in the selected municipalities that are planned and approved with citizen participation, conditioned on the demonstration of a capacity to plan and implement the project, to amortize the capital

costs, and to manage and finance its operation and maintenance.

This evaluation is made on the basis of different assumptions respecting the evolving national policy toward the municipalities. The best scenario assumes: 1) a comprehensive set of legislation covering increased home rule for the municipalities, their involvement in decisions affecting the use of national lands, natural resources, and provision of infrastructure; and 2) a comprehensive operational plan setting forth the basis for the interaction and cooperation between the central government and the municipalities. The middle scenario involves merely a decentralization of urban functions currently performed by central government agencies and increased participation by municipal officials in the decisions of such agencies. The worst case scenario is no change at all in the relations of the central government with the municipalities.

The project will have a seven-year implementation period beginning in FY90. USAID will provide $10 million to finance the Skills Building and TA components and the GOH will provide a counterpart of $15 million out of funds earlier made available to it by USAID, the fund to revert to the GOH at the project's termination.

The various components of the MDP should produce substantial benefits to the people of Honduras. Some of these benefits are intangible such as the strengthening of democratic processes and the people's commitment to democracy. While it may be hard to quantify an intangible benefit such as this, events in Eastern Europe and elsewhere suggest that not only is democracy desirable for its own sake but it makes a contribution to the economy by encouraging and stimulating individual initiative and private enterprise and makes productive enterprises more responsive to the wants of the people.

Increasing the fiscal capacity of the municipalities will enable a more rapid extension of potable water and sanitary sewage systems, solid waste disposal, roads and communications, and electricity as well as the development of social infrastucture with consequent beneficial effects on health, the quality of life, employment, and economic growth. The increased resources of the community will enable improvements in education and health services, increasing the productivity and capabilities of the population. The Municipal Development Fund component, coupled with technical assistance, will promote effective project planning and implementation in the targeted municipalities and provide a model for other municipalities.

Training and technical assistance will increase efficiency in the delivery of public services, keep the real estate tax base current, reduce tax delinquency, and increase the equity of the tax system.

Devolution of powers to the municipalities coupled with training and technical assistance should enable them to relieve pressing problems of land tenure, low-income housing, and to improve forestry practices.

Stages of the analysis

The methodology employed in the evaluation of the project employs three stages: financial analysis, economic analysis, and social analysis. The evaluation is from the nation's point of view. Financial analysis estimates the financial benefits and costs accruing to Honduran citizens, businesses and governments as a result of the project. The calculation is done at market prices of the year 1990, that is, in constant prices. Economic analysis recalculates the benefits and costs in terms of opportunity costs, or shadow prices. In financial analysis, for example, wages paid Hondurans employed in the project, are shown as a cost, but in economic analysis, the increased incomes of workers are shown as a benefit. To put it another way, the real cost to the society is what their income would have been in the absence of the project, their opportunity cost. In economic analysis, indirect effects on third parties are taken into account as well as intangible benefits and costs. In social analysis, the distribution of the benefits and costs among different income classes is calculated to determine the impact of the project on the distributin of income.

The components to be valued are the Skills Building Component, the Technical Assistance and Training Component, and the Municipal Development Fund Component. The evaluations are made initially under the worst scenario described above, i.e., assuming no significant political changes. Then the effects of the best and second-best scenarios will be considered.

A. The Skills Building Component

The Skills Building Component focuses on citizen group/local government relationships and is targeted to all 289 municipalities in Honduras. It contemplates the expenditure of $2,539,000 in local currency over a four year period from FY1991 to FY1994. It is expected to provide 2040 officials an average of about four days of training each. About forty percent of the training is targeted toward developing community participation skills on the part of government officials and community leaders and communicating the essence of the Municipal Development Program, making local governments responsive to community needs. A third of the programs will involve training sessions of up to two weeks with municipal officials in the areas of financial management, planning and budgeting, development planning, and project preparation, evaluation and implementation. The manuals, guides, and instructional materials prepared for the training sessions will be made available to municipal officials, libraries, and educational institutions and

are expected to be used in programs conducted by the Honduran government and municipal government associations beyond 1994.

The municipalities are expected to benefit by the increased competence and capabilities of their personnel, be able to provide more and better services at a lower average cost, and be able to absorb the demands that economic growth will place upon them. Better planning, more efficient service delivery, and improved economic and social infrastructure are the indirect benefits of such training programs. In addition, there is the social value of strengthening democratic values that accompanies increased responsiveness to citizen's wants, an essential goal of the skills development program and to increased citizen participation in the decision-making process.

The following are some of the direct and indirect benefits of this component:

1. Even though their exposure to the subject is short, the participants are bound to learn how to do something better than they are currently doing. Whether they become more effective managers and employees will depend on their status and responsibility. The more authority they have to innovate, the greater the benefits can be. Participants should also benefit personally if better performance is duly recognized and if better performance is reflected in salary increases. To avoid double-counting, the financial benefits of the participants will be counted in the benefits to the municipality since the latter must be realized for personnel to be recognized and rewarded and the rewards to personnel for improved job performance will come out of the municipality's benefits.

2. The increased efficiency in the delivery of public services that can be expected should be substantial relative to the costs of the program. In the programs dealing with financial management especially, the implementation of a single good administrative procedure has the potential to contribute substantially to revenues, to the collection of taxes, and reduction of tax delinquency. Similarly, improvements in development planning, planning and budgeting, and in project preparation and implementation will enable the municipality to deliver more services at the same budget level and provide increased services at a lower average unit cost.

3. Improved tax administration, especially the collection of delinquent real estate and occupation taxes, will not only increase government revenues but will result in a more equitable distribution of the burden of financing the municipalities. The implementation of a single good administrative procedure has the potential to contribute substantially to revenues, to collection of taxes, or to the reduction of tax delinquency. So far as taxpayers are concerned, higher tax burdens are a cost but from the

community's point of view, the increased equity of taxpayers sharing equally the burden of government more than offsets the costs to delinquent taxpayers. The more equitable distribution of the tax burden is a net gain.

4. The manuals and guides prepared for the sessions included in the cost of the program are expected to be disseminated to the mayors and council-members in each of the municipalities. The slight additional cost should be more than compensated by the wider distribution of the contents of the programs.

Financial benefits of the Skills Building Component.

1. The benefits are expected to accrue widely since the programs are extended to personnel of all of the municipalities. The benefits are expected to be substantial from the programs in Municipal Financial Management. Opportunities to increase revenues by improved tax administration abound. Not every participant can be expected to apply what he or she has learned, but a single participant can produce revenue benefits many times the cost of his participation. Justification for this assumption will be found in the Annex to this report which describes the current defects in administering the real estate tax and the sizable tax delinquency problem. A factor of 3 on the average is assumed for the Financial Management courses, i.e., benefits are assumed to be three times the cost of the course and they should continue beyond the project's life. The benefits from the courses in Development Planning, Planning and Budgeting, and Project Preparation and Management are more speculative but should be at least equal to the cost of the course. There are too many intervening variables including time itself to justify an assumption of greater benefits, though they are possible. The participant may not engage in those activities soon enough after attending the program to realize those benefits.

The value of the Orientation, Community Participation, and Panel Discussions are assumed to be equal to the cost of the programs. However, the benefits are intangible and will be counted in the economic analysis.

2. The production of manuals and instructional materials is assumed to have a value beyond the life of the program. Even a small increase in administrative capabilities per municipality will result in substantial total benefits when multiplied by nearly two hundred municipalities. The Project Paper does not mention plans to publish and distribute the manuals and selected instructional materials. The project should be reshaped to include distribution to a wide variety of municipal and central government officials, chambers of commerce, university professors and other interested personnel and organizations. The costs of producing such materials for wider distribution are only the costs of printing and distribution and are estimated at $10.00 for each the four

municipal administration programs, 2,000 each to be printed and distributed, and a distribution cost of $2.00 each for a total cost of $24,000 or $96,000 for the four courses in municipal administration. It is assumed that the present proposed budget will permit the absorption of the costs.

Benefits are calculated for those distributed to each of the 289 municipalities with an average of five copies each, and are estimated to average ten times the cost, or 1445 multiplied by $12.00 for each of the four management training programs, or $69,360 (1445 x $12 x 4), effective with the second year of the program and continuing for ten years.

The benefits are accumulated during the first five years of the life of the program. Two assumptions have been made respecting the duration of the benefits. One calculaton assumes that the benefits do not continue beyond the fifth year; the other that the benefits continue until the eleventh year. There would seem to be little reason for the short-life assumptions except that in the past the municipalities have shown little ability to retain key personnel. It is hoped that one of the outcomes of this project will be continued improvement in municipal administration, with fewer setbacks. The longer life expectancy of improvements in municipal administrtion may be justified.

Financial Costs of the Skills Building Component

Half of the MDP overhead costs are allocated to this component and half to the Technical Assistance component; also half of the Evaluation and Special Studies that have been budgeted. The Component's direct costs are taken from the project paper.

Results of the Financial Analysis

A discount rate of 13.75 percent was selected to calculate Net Present Value (NPV), the Benefit/Cost ratio, and the Internal Rate of Return. It approximates the rate of interest on World Bank and IDB loans. It may understate the real rate of return on capital investments in Honduras but it reflects the terms on which Honduras when it re-establishes its credit could be expected to borrow in international markets. The results of the analysis appear in the following two tables, utilizing different assumptions about the duration of the benefits. The NPV is $752,000, the B/C ratio is 1.24, and the IRR is 25.22 percent under the assumption of short-lived benefits. The NPV is $6.83 million, the B/C ratio, 3.19, and the IRR is 54.28 percent under the assumption of a longer benefit period.

Economic analysis

In economic analysis, sometimes called efficiency analysis, benefits and costs that are not calculated in financial analysis

are taken into account. These include benefits to the nation and its citizens arising from the effects of foreign exchange transactions, gains to employees arising from their increased incomes occurring as a result of the project, indirect effects on competitors, customers, and suppliers, externalities such as education and health benefits, and intangible benefits such as recreational, cultural, and other values of prized by the society. All of these are involved in the project as a whole. Only the following are considered in the Skills Building Component.

1. Foreign exchange benefits and costs.

All of the funds for this component come from foreign sources. As a result, there is a substantial foreign exchange benefit to Honduras. The amount of the benefit depends on the real value of foreign exchange to Honduras compared to the official rate. The usual methodology for calculating the so-called shadow price of foreign exchange understates the real value of foreign exchange since the Government is in arrears on its international obligations. However the rate of exchange in the parallel market has risen to more than twice the official rate, L4.2 to the dollar instead of L2 the dollar, at the time of this writing. The new government of Pres. Callejas has prescribed the use of the parallel market rate for all but the most essential imports. The Standard Conversion Factor calculated by customary methods results results in a coefficient of 0.945 (L2 / 2.12) for 1988. Because it is so close to 1.00 and because the parallel rate may undervalue the domestic currency, no foreign exchange adjustment will be employed in this analysis.

2. Gains to employees. The wages and salaries paid to Honduran employees in this project are considered high by Honduran standards. Professionals, secretaries, clerical, and drivers receive a remuneration at least twenty-five per cent higher than Honduran rates. An adjustment of 0.8 is applied to wages and salaries of Honduran personnel; that is to say, 20 percent of their wages are considered a project benefit.

3. The intangible benefits estimated for the Orientation, Community Participation, and Panel Discussion programs are included as economic benefits.

4. None of the other indirect and external benefits and costs normally considered in economic analysis apply to this component. They do apply to the anticipated increased government expenditures on water, sewerage, roads, changes in land use, etc. considered below in this report.

Results of the Economic Analysis

As expected, there were significant benefits occurring as a result of shadow-pricing wages and salaries of those Hondurans

employed in the project and the inclusion of the intangible benefits of the Orientation, Community Participation, and Panel Discussion programs. The NPV is $1.3 million, the B/C ratio, 1.4, and the IRR, 41 percent under the assumption of short-lived benefits. Under the long-lived assumption, the NPV is $3.9 million, the B/C ratio, 3.41, and the IRR, 60 percent.

Social Analysis of the Skills Building Component.

The beneficiaries of the increased efficiency of municipal governments is the entire community, and the distribution of benefits roughly accords to the distribution of income in the community. Therefore all will benefit. However, because of the homestead exemption and the exemption of parcels of low value under the real estate tax, the 50% of the population with the lowest incomes will benefit more than those with higher incomes.

The social analysis indicates an improvement in income distribution as a result of the project. When the spending of increased tax receipts for physical and social infrastructure is considered, the improvement in income distribution is further enhanced.

B. The Technical Assistance Component.

The Technical Assistance component has both a national and local government perspective. In the national government agencies, it is expected to create a capacity to train future municipal officials in the areas of community participation; financial management; planning and budgeting; and project planning, evaluation and management. It will also facilitate the transition in the devolution of powers to the municipalities. In the ten to twelve municipalities targeted for technical assistance, it will contribute even more to municipal efficiency in the delivery of public services than the Skills Component. The projected cost of the program is $5,181,000 plus one-half of the MDP management cost. It is expected to begin in FY90 and run through FY96.

Municipal Component

A preliminary reconnaisance survey will serve to identify the special needs of each of the ten or twelve municipalities targeted for technical assistance. The technical assistance will then be tailor-made to meet the requirements of the municipality. Municipal administrators and employees will obtain the personal assistance of experts in solving their problems. As a result of such technical assistance, the municipality should be able to:

1. develop and maintain cadasters utilizing their own personnel,

2. improve tax collection administration,

3. develop planning and budgeting skills,

4. develop the capacity to prepare, evaluate, and implement infrastructure projects.

5. develop municipal policies respecting the financing of certain projects by means of betterment levies (special assessments).

The benefits to be achieved are the following:

1. Increased efficiency in the delivery of public services. As a result, the municipalities will be able to deliver more services at the same budget level and provide increased services at a lower average unit cost.

2. Improved tax administration, as a result of up-to-date assessment rolls and the collection of delinquent real estate and occupation taxes, will increase government revenues and result in a more equitable distribution of the burden of financing the municipalities. Care should be taken since higher revenues are offset by higher tax burdens of the taxpayers affected. However, the more equitable distribution of the tax burden resulting from improved tax administration is a net gain. Further, program and project evaluation should ensure that the expenditures financed by increased tax revenues will make a greater contribution to society than the use taxpayers would make of the funds paid in taxes. Given the vast needs for infrastructure, education, and health expenditures and the economic growth such expenditures will make possible, that should prove to be the case. A benefit equal to twice real estate tax collections is projected under the worst and middle scenarios and four times under the best scenario.

3. Improved zoning and regulation of land use, including residential, industrial, commercial, agricultural, and forest and mineral properties. This is expected to result in the privatization and titling of residential and agricultural properties, in the development of industrial parks, and facilitate the preparation of real estate assessment rolls. Increased lotification for low-income households is expected with more control over national lands by the municipality and better use of municipal lands.

4. Improved budget control and avoidance of waste by improved planning, programming, and budgeting capability. These benefits are subsumed under increased government efficiency above.

5. Improved project identification, evaluation and implementation. This is expected to result in the expansion of water and sewage systems, road construction, school buildings, etc. and devising means of financing such projects. The indirect effects should prove substantial accelerating the delivery of vital municipal services by better project planning and improved project management. The

benefits and costs will be considered in the evaluation of the development loan fund.

Quantification of the benefits is difficult. Only periodic post-evaluations can provide reliable estimates. However, when assessment rolls have been brought up-to-date, which is only one of the expected benefits, depending on the date of the last cadastral survey, the value of taxable property on the rolls at least doubles and often quadruples. Delinquent real estate taxes often amount to fifty percent or more of the potential tax yield. And good tax collection enforcement has also been shown to pay off significantly. The assistance rendered in this program should reduce tax delinquency substantially. Improved planning, programming and budgeting should result in the abandonment of ineffective programs, reduce waste, and get things accomplished in a more timely fashion. Suffice it to say, there is the potential of great benefits relative to the cost of the program. A doubling of the real estate tax yield is projected under the worst and middle scenarios and a quadrupling under the best scenario which assumes an increase in the rates of the real estate tax . Moreover, the successes achieved in the targeted municipalities will be replicated more easily and inexpensively in those municipalities that have not been targeted.

Diagnostic surveys of a few municipalities undertaken for AID recently all show substantial delinquency rates. One is a municipality targeted for this project, La Ceiba. In 1988, La Ceiba budgeted Collection of Delinquent Taxes in the amount of Ls.1.15 million and collected Ls.0.24 million, or 21.2 per cent. It collected 84.5 per cent of the budgeted real estate taxes, budgeting Lps.0.372 million and collecting Lps.0.314 million. The real estate tax yielded 23.6 per cent of total current revenues. Tela and Choluteca included in the survey showed much higher delinquency rates than La Ceiba. Except for San Pedro Sula, the other targeted municipalities are all smaller. A recent survey of Juticalpa reported that revenues varied greatly from year to year. It recites,

> This behavior is due to a combination of factors: little support by the local authorities to the tasks of cadaster, deficient tax administration (register of taxpayers and mechanisms of payment), non-use of the legal steps to readjust taxes (the revaluation of real estate for tax purposes was not implemented in the year 1985 even though it was mandated by law), and weaknesses of administrative controls that presumably present an opportunity for an important waste of resources.

Further, there is no evidence of any attempt to collect delinquent taxes. A similar survey of Choloma, another of the targeted municipalities recites:

The municipalities in Honduras have the legal authority to exercise administrative as well as legal collection measures which are seldom used. Choloma had in September, 1989, a delinquency amount exceedingly high: L1,170,419.00, or one and one-half times the current revenues of the year 1988. Of the total owed by the taxpayers, 34% was related to water service, other services, 20%, the head tax, 24%, 24% real estate taxes and 12% of the tax on commercial establishments of various types. Certainly, cadastral information (an administrative aspect) and a lack of will (a political aspect) join to produce high delinquency.

Clearly improved tax administration and enforcement should produce substantial gains in revenue for the municipalities.

Financial benefits of the TA Municipal Component.

1. Tax administration -- An increase in tax revenues of an average of 25 percent in the targeted municipalities, equal to about L.3.6 millions per year by the fifth year. If the technical assistance component emphasizes tax administration in the first year, half that increase should be obtained by the third year.

2. Other technical assistance in municipal administration, while not expected to produce such dramatic results will increase efficiency, reduce waste, etc. by 10 percent or more or about L1.7 millions per year by the fifth year.

National Component

1. Development of a research and training capacity in an agency of the central government and in associations of municipalities. Forty trainees are contemplated. The benefits the trainees will receive in increased lifetime incomes is substantial but is subsumed in the benefits to the municipalities. Eventually, all 289 municipalities should benefit from the creation of a group of trainers. There are costs in maintaining such a group of about $1 million per year (in Honduran currency) but the benefits should be more than double the value of the technical assistance to the targeted municipalities in the municipal component. Conservatively, the net benefits derived from such a group of trainers is valued at $2 million annually.

2. Assistance to the central government in planning and programming the grant of home rule or limited home rule, including the ability to set tax rates. The increased resources made available to the municipalities by a devolution of powers will enable the municipalities to accelerate the creation of social and physical infrastructure. The benefits will be considered in the section on economic growth.

3. Assistance to the central government in planning and programming the devolution of national lands to the municipalities, and developing policies for privatizing parcels and increasing municipal control over the use of public lands. This should have the effect of making more efficient use of public lands for private purposes and for infrastructure. The benefits will be considered part of the benefits of economic growth.

4. Assistance to the central government in devising a formula-based program of grants-in-aid to enable the municipalities to deliver municipal services to the poor. The benefits are derived from an improved distribution of income. Assuming L100 million is made available to municipalities under such grants, the social benefit will be the increase of real income of the affected poor minus the social value of the L100 million had it been left in the hands of taxpayers. No attempt at quantification is made. Under the worst scenario, which assumes no change in central government policy and no municipal reform law, there will be no formula-based grants and no benefits are projected.

5. Assistance to the central government in devising a program of revenue-sharing to enable the municipalities to fund the construction and maintenance of roads. The benefit is the presumed efficiency of municipal decisions of what roads to build and maintain compared to the efficiency of decisions at the national level. The presumption will not be made. There is however an increase in the overall equity of the tax system since currently local expenditures on roads cannot be financed by fuel taxes. No attempt will be made to place a value on such increased equity.

6. Assistance to the central government in developing a policy of oversight to prevent fiscal irresponsibility, fraud, waste, and abuse. The benefits created are the avoidance of waste and fraud. The benefits are too intangible to be valued.

The benefits of the Technical Assistance National Component is to develop a more rational allocation of responsibilities for the provision of municipal services that will enable such services to be delivered in a more timely and efficient basis. The research and training component will facilitate on-going training of municipal officials and employees, with the benefits indicated above.

Results of the Financial Analysis of the TA component

The results of the analysis show substantial benefits to the municipalities. Under the assumption of no lasting benefits and without taking the benefits of increased research and training capacity into consideration, the NPV is $4.6 million, the B/C ratio is 1.95, and the IRR is 53.73 percent. With long lasting benefits, the NPV is $17.2 million, B/C ratio, 4.54, and the IRR, 70.99 percent. With the benefits of a more or less permanent research and training unit, the benefits rise dramatically. Even with no lasting

benefits assumed from the municipal component, the estimate of $2 million in benefits from the research and training unit results in a NPV of $10.5 million, a B/C ratio of 3.2, and an IRR of 66.3 percent.

Results of the Economic Analysis of the TA component

Adjusting for the wages paid Hondurans employed in the project using a factor of .8 in determining their opportunity costs raises the NPV, B/C ratio and IRR even more. Under the assumption of no lasting effects from the municipal component, the NPV is $10.6 million, the B/C ratio, 3.2, and the IRR, 66.7 percent.

C. Municipal Development Fund

The purpose of the fund is to encourage and reward improved municipal performance. The targeted municipalities will be encouraged to submit projects identified and planned with the involvement of citizens and citizens' groups for funding. The fund administrators (to be identified) will make loans to the municipalities to fund those projects evaluated and proven worthy of funding and which provide for repayment out of assured revenues such as user charges, grants-in-aid, betterment levies, or demonstrable municipal capacity to amortize the investment as scheduled. Funds will be advanced for feasibility studies where appropriate and market rates of interest will be charged. The Fund will consist of $15 million in local currency and will begin operations in FY91. At the expiration of FY96, the assets of the Fund will revert to the Government of Honduras.

The Fund is expected to realize returns at the market rate of interest less administration costs. Although the very nature of the fund indicates that the yield will be at or about the appropriate discount rate, i.e., the market rate of interest less an administration cost, with a B/C ratio of 1.00 and an Internal Rate of Return equal to the discount rate, such ratios understate the benefits to be obtained. Each project funded is expected to have an IRR well in excess of the discount rate. Given the backlog of needs, all of the projects should be supra-marginal.

D. Grant of home rule to the municipalities, affording them the opportunity to set tax rates, fees, and charges; and formalizing and regularizing grants-in-aid and revenue sharing.

The grant to the municipalities of the power to set their own tax rates and the formalizing and regularizing grants-in-aid and revenue-sharing, will increase the taxable capacity of the municipalities enabling them to improve and fund a larger number of municipal services. The benefits depend on the value of the services provided. Given the vast needs for infrastructure, social and physical, the negative effects of diminished disposable income of taxpayers should be more than counter-balanced by the benefits

[illegible] FAMILIES TECHNICAL ASSISTANCE COMPONENT 4-11-90

Returns effects lasting beyond the termination of the program

	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
MOP COST ALLOCATED TO TECHNICAL ASSIS (1/2)											
MOP Management, foreign	-91	-182	-182	-91							
MOP Management, domestic	-82	-163	-163	-82							
Evaluation and special studies, foreign			-183								
Evaluation and special studies, domestic			-67								
DIRECT COSTS: TECHNICAL ASSISTANCE COMPONENT											
From Worksheet Totals foreign	-241	-483	-483	-483	-241						
domestic	-370	-740	-740	-740	-370						
TOTAL COSTS	-784	-1568	-1818	-1396	-611						
BENEFITS--TECHNICAL ASSISTANCE MUNICIPAL COMPONENT											
Develop and maintain cadasters		100	500	1200	1900	2600	2600	2600	2600	2600	2600
Improved tax administration		200	400	600	800	1000	1000	1000	1000	1000	1000
Planning and Budgeting		30	90	150	210	240	240	240	240	240	240
Project preparation and implementation		30	90	150	210	240	240	240	240	240	240
Use of betterment levies		20	100	200	300	400	400	400	400	400	400
Increased efficiency		120	300	480	660	840	840	840	840	840	840
BENEFITS--TECHNICAL ASSISTANCE NATIONAL COMPONENT											
Research and training capacity						2000	2000	2000	2000	2000	2000
Development of municipal home rule		intangible									
Devolution of national lands		intangible									
Formula-based grants-in-aid		intangible									
Formula-based revenue-sharing		intangible									
Oversight of budgets, fraud, and waste		intangible									
TOTAL BENEFITS	0	500	1480	2780	4080	7320	7320	7320	7320	7320	7320
BENEFITS MINUS COSTS	-784	-1068	-338	1384	3469	7320	7320	7320	7320	7320	7320

NET PRESENT VALUE @.0875 =	23133
Present value of benefits =	27993
Present value of costs =	-4860
BENEFIT/COST RATIO =	5.76
INTERNAL RATE OF RETURN =	0.7815

[illegible] TECHNICAL ASSISTANCE COMPONENT 4-11-90

Assuming no effects from the municipal component lasting beyond the termination of the program)

	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
MOF COST ALLOCATED TO TECHNICAL ASSIS (1/2)										
MOF Management, foreign	-91	-182	-182	-91						
MOF Management, domestic	-82	-167	-167	-82						
Evaluation and special studies, foreign			-187							
Evaluation and special studies, domestic			-67							
DIRECT COSTS: TECHNICAL ASSISTANCE COMPONENT										
From Worksheet Totals foreign	-241	-483	-483	-483	-241					
domestic	-370	-740	-740	-740	-370					
TOTAL COSTS	-784	-1569	-1818	-1396	-611					
BENEFITS--TECHNICAL ASSISTANCE MUNICIPAL COMPONENT										
Develop and maintain cadasters		100	500	1200	1900	2600				
Improved tax administration		200	400	600	800	1000				
Planning and Budgeting		30	90	150	210	240				
Project preparation and implementation		30	90	150	210	240				
Use of betterment levies		20	100	200	300	400				
Increased efficiency		120	300	480	660	840				
BENEFITS--TECHNICAL ASSISTANCE NATIONAL COMPONENT										
Research and training capacity						2000	2000	2000	2000	2000	2000
Development of municipal home rule	intangible									
Devolution of national lands	intangible									
Formula-based grants-in-aid	intangible									
Formula-based revenue-sharing	intangible									
Oversight of budgets, fraud, and waste	intangible									
TOTAL BENEFITS	0	500	1480	2780	4080	7320	2000	2000	2000	2000	2000
BENEFITS MINUS COSTS	-784	-1068	-338	1384	3469	7320	2000	2000	2000	2000	2000

NET PRESENT VALUE @.0875 = 10542
Present value of benefits = 15402
Present value of costs = -4860
BENEFIT/COST RATIO = 3.17
INTERNAL RATE OF RETURN = 0.6630

15

COST ANALYSIS TECHNICAL ASSISTANCE COMPONENT 4-11-90

Assuming no effects from the municipal component lasting beyond the termination of the program

	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
MDP MGT ALLOCATED TO TECHNICAL ASSIS (1/2)											
MDP Management, foreign	-91	-182	-182	-91							
MDP Management, domestic	-82	-167	-167	-82							
Evaluation and special studies, foreign			-187								
Evaluation and special studies, domestic			-67								
Economic adjustment (.2 x .289)	5	9	9	5							
DIRECT COSTS: TECHNICAL ASSISTANCE COMPONENT											
From worksheet Totals foreign	-241	-483	-483	-483	-241						
domestic	-370	-740	-740	-740	-370						
Economic adjustment (.2 x .4471)	33	66	66	66	33						
TOTAL COSTS	-779	-1559	-1909	-1391	-611						
BENEFITS--TECHNICAL ASSISTANCE MUNICIPAL COMPONENT											
Develop and maintain cadasters		100	500	1200	1900	2600					
Improved tax administration		200	400	600	800	1000					
Planning and Budgeting		30	90	150	210	240					
Project preparation and implementation		30	90	150	210	240					
Use of betterment levies		20	100	200	300	400					
Increased efficiency		120	300	480	660	840					
BENEFITS--TECHNICAL ASSISTANCE NATIONAL COMPONENT											
Research and training capacity						2000	2000	2000	2000	2000	2000
Development of municipal home rule		intangible									
Devolution of national lands		intangible									
Formula-based grants-in-aid		intangible									
Formula-based revenue-sharing		intangible									
Oversight of budgets, fraud, and waste		intangible									
TOTAL BENEFITS	0	500	1480	2730	4090	7320	2000	2000	2000	2000	2000
BENEFITS MINUS COSTS	-779	-1059	-329	1339	3469	7320	2000	2000	2000	2000	2000

NET PRESENT VALUE @.0875 =	10565
Present value of benefits =	15402
Present value of costs =	-4837
BENEFIT/COST RATIO =	3.18
INTERNAL RATE OF RETURN =	0.6670

[illegible] TECHNICAL ASSISTANCE COMPONENT 4-11-90

[illegible] effects from the municipal component lasting beyond the termination of the program

	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
MOF MGT ALLOCATED TO TECHNICAL ASSIS (1/2)											
MOF Management, foreign	-91	-182	-182	-91							
MOF Management, domestic	-82	-163	-163	-82							
Evaluation and special studies, foreign			-193								
Evaluation and special studies, domestic			-67								
Economic adjustment (.2 x .289)	5	9	9	5							
DIRECT COSTS: TECHNICAL ASSISTANCE COMPONENT											
From Worksheet Totals foreign	-241	-483	-483	-483	-241						
domestic	-370	-740	-740	-740	-370						
Economic adjustment (.2 x .4471)	33	66	66	66	33						
TOTAL COSTS	-779	-1559	-1309	-1391	-611						
BENEFITS--TECHNICAL ASSISTANCE MUNICIPAL COMPONENT											
Develop and maintain cadasters		100	500	1200	1900	2600	2600	2600	2600	2600	2600
Improved tax administration		200	400	600	800	1000	1000	1000	1000	1000	1000
Planning and Budgeting		30	90	150	210	240	240	240	240	240	240
Project preparation and implementation		30	90	150	210	240	240	240	240	240	240
Use of betterment levies		20	100	200	300	400	400	400	400	400	400
Increased efficiency		120	300	480	660	840	840	840	840	840	840
BENEFITS--TECHNICAL ASSISTANCE NATIONAL COMPONENT											
Research and training capacity						2000	2000	2000	2000	2000	2000
Development of municipal home rule	intangible										
Devolution of national lands	intangible										
Formula-based grants-in-aid	intangible										
Formula-based revenue-sharing	intangible										
Oversight of budgets, fraud, and waste	intangible										
TOTAL BENEFITS	0	500	1480	2780	4080	7320	7320	7320	7320	7320	7320
BENEFITS MINUS COSTS	-779	-1059	-329	1389	3469	7320	7320	7320	7320	7320	7320

NET PRESENT VALUE @.0875 =	23156
Present value of benefits =	27993
Present value of costs =	-4837
BENEFIT/COST RATIO =	5.79
INTERNAL RATE OF RETURN =	0.7852

[illegible] ANALYSIS SKILLS BUILDING COMPONENT

(Benefits effects lasting beyond the termination of the program)

	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
MDP MGT ALLOCATED TO SKILLS BLDG PRO (1 2)											
MDP Management, foreign	-91	-182	-182	-91							
MDP Management, domestic	-82	-163	-163	-82							
Evaluation and special studies, foreign			-183								
Evaluation and special studies, domestic			-67								
DIRECT COSTS: SKILLS BUILDING COMPONENT											
From Worksheet Totals foreign	-441	-161	-121	-41							
domestic	-230	-540	-440	-400	-190						
TOTAL COSTS	-844	-1047	-1157	-613	-190						
BENEFITS--SKILLS BUILDING COMPONENT											
Orientation programs											
Community participation programs											
Panel discussions											
Financial management programs		300	600	750	750	750	750	750	750	750	750
Municipal development planning		75	225	375	450	450	450	450	450	450	450
Planning and budgeting			150	300	375	375	375	375	375	375	375
Project preparation and management			150	300	375	375	375	375	375	375	375
Distribution of manuals			48	96	96	96	96	96	96	96	96
TOTAL BENEFITS	0	375	1173	1821	2046	2046	2046	2046	2046	2046	2046
BENEFITS MINUS COSTS	-844	-672	16	1208	1856	2046	2046	2046	2046	2046	2046

NET PRESENT VALUE @.0875 =	6831
Present value of benefits =	9955
Present value of costs =	-3124
BENEFIT/COST RATIO =	3.19
INTERNAL RATE OF RETURN =	0.5428

[illegible] SKILLS BUILDING COMPONENT

4-10-[illegible]

(Reflecting no effects lasting beyond the termination of the program)

	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
MOP NOT ALLOCATED TO SKILLS BLDG PRO (1/2)											
MOP Management, foreign	-91	-182	-182	-91							
MOP Management, domestic	-82	-163	-163	-82							
Evaluation and special studies, foreign			-183								
Evaluation and special studies, domestic			-67								
DIRECT COSTS: SKILLS BUILDING COMPONENT											
From Worksheet Totals foreign	-441	-151	-121	-41							
domestic	-230	-540	-440	-400	-190						
TOTAL COSTS	-844	-1047	-1157	-613	-190						
BENEFITS--SKILLS BUILDING COMPONENT											
Orientation programs											
Community participation programs											
Panel discussions											
Financial management programs		300	600	750	750						
Municipal development planning		75	225	375	450						
Planning and budgeting			150	300	375						
Project preparation and management			150	300	375						
Distribution of manuals			48	96	96						
TOTAL BENEFITS	0	375	1173	1821	2046	0	0	0	0	0	0
BENEFITS MINUS COSTS	-844	-672	16	1208	1856	0	0	0	0	0	0

NET PRESENT VALUE @.0875 =	752
Present value of benefits =	3876
Present value of costs =	-3124
BENEFIT/COST RATIO =	1.24
INTERNAL RATE OF RETURN =	0.2522

[illegible] SKILLS BUILDING COMPONENT

[illegible] to effects lasting beyond the termination of the program) 6-11-90

	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
MOF MOT ALLOCATED TO SKILLS BLDG PRO (1/2)											
MOF Management, foreign	-91	-182	-182	-91							
MOF Management, domestic	-82	-163	-163	-82							
Evaluation and special studies, foreign			-183								
Evaluation and special studies, domestic			-67								
Economic adjustment (.2 x .289)	5	9	9	5							
DIRECT COSTS: SKILLS BUILDING COMPONENT											
From Worksheet Totals foreign	-441	-161	-121	-41	-274						
domestic	-230	-540	-440	-400	-190						
Economic adjustment(.2 x 0.8145)	38	88	72	65	31						
BENEFITS-TOTAL COSTS	-839	-1038	-1148	-509	-464						
Orientation programs											
Community participation programs	30	45	30	30	15						
Panel discussions		113	150	150	120						
Financial management programs	23	68	45	68	45	23					
Municipal development planning		300	600	750	750						
Planning and budgeting		75	225	375	450						
Project preparation and management			150	300	375						
Distribution of manuals			150	300	375						
			48	96	96						
TOTAL BENEFITS	53	600	1398	2069	2226	23	0	0	0	0	0
BENEFITS MINUS COSTS	-786	-438	250	1460	1762	23	0				

NET PRESENT VALUE @.0875 =	1317
Present value of benefits =	4599
Present value of costs =	-3281
BENEFIT/COST RATIO =	1.40
INTERNAL RATE OF RETURN =	0.4100

10

[illegible] ANALYSIS SKILLS BUILDING COMPONENT

[illegible] effects lasting beyond the termination of the proc am)

4-11-90

	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
(DF MGT ALLOCATED TO SKILLS BLDG PRO (1/2)											
MDF Management, foreign	-91	-1[illegible]	-182	-91							
MDF Management, domestic	-82	-163	-163	-82							
Evaluation and special studies, foreign			-183								
Evaluation and special studies, domestic			-87								
Economic adjustment (.2 x .289)	5	9	9	5							
DIRECT COSTS: SKILLS BUILDING COMPONENT											
From Worksheet Totals foreign	-441	-161	-121	-41	-274						
domestic	-230	-540	-440	-400	-190						
Economic adjustment(.2 x (.8145)	38	88	72	65	31						
BENEFITS-TOTAL COSTS	-839	-1038	-1148	-609	-464						
Orientation programs											
Community participation programs	30	45	30	30	15	15	15	15	15	15	15
Panel discussions		113	150	150	120	120	120	120	120	120	120
Financial management programs	23	68	45	68	45	45	45	45	45	45	45
Municipal development planning		300	600	750	750	750	750	750	750	750	750
Planning and budgeting		75	225	375	450	450	450	450	450	450	450
Project preparation and management			150	300	375	375	375	375	375	375	375
Distribution of manuals			150	300	375	375	375	375	375	375	375
			48	96	96	96	96	96	96	96	96
TOTAL BENEFITS	53	600	1398	2069	2226	2226	2226	2226	2226	2226	2226
BENEFITS MINUS COSTS	-786	-438	250	1460	1762	2226	2226				

NET PRESENT VALUE @.0875 = 3887

Present value of benefits = 11199

Present value of costs = -3261

BENEFIT/COST RATIO = 3.41

INTERNAL RATE OF RETURN = 0.6034

received by the community's residents from the delivery of the municipality's services financed by their taxes. Regularizing grants-in-aid so that municipalities may budget such funds in advance will similarly increase the capacity to budget improvements in municipal services and make municipalities better credit risks for obtaining loans to finance projects. Revenue-sharing would do the same. Two candidates for revenue-sharing are the sales tax and the tax on automotive fuels.

The justification for grants-in-aid is the disproportionate numbers of poor in different municipalities that require municipal services but are not able to pay taxes or user charges. The justifications for revenue-sharing are two: first, an equitable way of financing municipal roads is the tax on automotive fuels and a national tax is more appropriate than local gasoline and diesel fuel taxes; and second, the national government has pre-empted two broad-based taxes, leaving the municipalities with the real estate tax, with local business taxes (which are being abused by taxpayers who do business in more than one municipality) and with occupation taxes.

Coupled with the devolution of powers to the municipalities ought to go some of the funds currently allocated for these purposes by the national government.

E. Increased citizen participation; and regular separate local elections.

Separate municipal elections and increased citizen participation are related. Their purpose is to make local governments more responsive to their citizens' needs and to strengthen democratic processes and values. Since municipal residents are taxpayers, they ought to have significant input in the making of tax and expenditure decisions by their governments. Local governments as the level of government closest to the people are more easily controlled by their citizens. Commitment to democratic values can be said to be instilled by responsive governments. Although intangible, it has to be highly valued.

F. Devolution of control of national lands to the municipalities.

With the responsibility of maintaining cadastral records and the fact that the real estate tax yield depends on land use and on complete and accurate description of each parcel of land in the municipality, municipalities have a vital interest in land uses and their effects on values. The purpose of zoning land uses is to maximize and maintain land values. National agencies are much less concerned since they derive no revenue from the real estate tax. It is expcted to contribute to lotification for low-income housing.

By itself, the devolution of power over national lands will not create benefits. The benefits arise from improved land uses and

from improved real estate ta administration. Improved land uses are the result of privatization of public lands for residential, commercial, industrial, agricultural, and other uses. Among the uses likely to have the indirect effect of promoting economic growth are making lands available for agricultural and industrial uses. Acceleration of the distribution of land to landless farmers would contribute directly to economic growth, especially if coupled with increased access to credit, secondary roads to market, and agricultural extension services. Industrial zoning and creation of industrial parks with all the infrastructure required would give tremendous impetus to manufacturing growth. It should also result in increased lotification for low-income housing. Again, although intangible, it has the potential of relieving a very great problem.

G. Accelerated spending on social and physical infrastructure expected to result from the project. These include accelerated spending for water, sewerage, waste disposal, streets and roads, electricity, education, and health. The combination affords the possibility of accelerating the economic growth of Honduras substantially.

1. Water, sewerage, solid waste disposal, and health services. The lack of potable water and sanitary waste disposal is a primary factor in the high rates of infant mortality in Honduras. Although down from 80/1,000 births in 1980, the infant mortality rate continues high at 62/1,000 in 1988. The average for Central America was estimated at 45.2/1,000 in 1986.It is estimated that 29 percent of all infant deaths are dues to water borne diseases, and 13.7 percent of all deaths. The importance of clean water is evidenced in an Epidemiology and Family Health Survey conducted in Honduras in 1987. Neo-natal and infant mortality rates were substantially lower in those households that had piped water than those that used public piped water, and highest in those that had neither. The rates were also highly rated to the level of education of parents. Those households with indoor toilets had much lower incidence of infant mortality than those with latrines or with no facilities.

Construction costs for delivering water services are estimated at L150 per capita for urban water, and L140 for rural water. A report of an engineering firm CINSA in 1988 reported the cost of installing a water system in San Jose Colinas was L105.62 per capita and to install sanitary sewers in the municipality of Gracias was L92.10 per capita. Other estimates of construction costs for urban sanitary sewers are L334 per capita and L40 in rural areas.

2. The effects of the construction of rural roads under USAID projects was made, in 1988 by Development Associates Inc. They found the overwhelming problem was the lack of proper maintenance. Placing resources and resposibility for their maintenance on the municipalities would contribute greatly to solving this problem. They found that the people and businesses in the regions served

prospered substantially from the improved access to markets and supplies. Land usage and productivity increased, access to schools and school participation rates increased, including secondary school attendance. There were more jobs for women, for blacks and other minorities. New industries were established, including export industries. The variety of agricultural products and their value increased, with greater fruit, vegetable, dairy, and beef production. There was increased access to health facilities. Many new social organizations, producer associations, and cooperatives were formed. And new public transportation businesses, carrying people and cargo.The effects on economic growth of improved roads are dramatic.

In a contract with SECOPT, CINSA, an engineering firm, agreed to construct 1150 km. o roads for L318 million, or L27,652 per kilometer. Other estimates are as low as L40,000 in rural areas and several times higher in urban areas.

IV. Education and health expenditures

Although the responsibility of the central government for education and health expenditures is primary, municipalities expend eight percent of their current revenues on education as well. The increased capacity of the municipalities expected to result from the project under all of the scenarios will automatically increase spending for schools. The importance of vocational and technical schools to the development of the agricultural and manufacturing sectors cannot be overstated. Honduras which now has greater literacy rates, greater participation rates in primary schools than ever before, has the conditions to benefit from more advanced training and to supply the cadres required for economic development.

The national illiteracy rate was 40.5% in 1984 and is considerably lower now. The rate in 1984 was higher in rural areas, 51.2%. and lower in urban areas, 30%.

V. The project's contribution to economic growth

Strengthening the fiscal capacity and the management capabili- stability, provide greater efficiency in the delivery of public services, and facilitate a period of unparalleled economic growth in Honduras. Some of the conditions precedent to rapid growth, to the take-off of the Honduran economy, already exist. The country has abundant natural resources, the beginnings of a thriving agricultural sector, and the number and quality of workers that would make such growth possible.

The abundance and quality of Honduras's forestry resources have long been recognized and their exploitation and development have been a target of public policy for decades. Unfortunately, instead of relying on the private sector, the government undertook the role of managing those resources with very negative results.

Forestry activities were nationalized in 1974 with creation of COHDEFOR (Corporacion Hondureña de Desarrollo Forestal). Instead of the hoped for development of its major natural resource, the country contracted debt which has been difficult to amortize and instead of reaping an adequate return, the government has been forced to subsidize the corporation's activities and amortize the external debt that was created. COHDEFOR is reported to have lost $290 million in the intervening period. Instead of higher productivity, the government confronted reduced productivity. The losses of Corfino, the government operated sawmill, amounted to a substantial sum. Allegations of corrupt practices in the operation of government sawmills have been made. Some sawmills have been privatized but managing the forests has appeared to be beyond COHDEFOR's capabilities in spite of considerable external assistance.

Some argue that the municipalities should control the forestry sector by transferring responsibility for regulating forest use to the municipalities. While they are unlikely to do any worse, there is no reason to suppose that they would do better.

What the sector needs is privatization under rules that would ensure good forest management, rules similar to those applied to the exploitation of public lands in the U. S., for example or by the large firms in the private sector who manage their own forests. Where forestry rehabilitation and development are in order, private ownership and investment should be encouraged, domestic and foreign. The sector has long been ripe for productive development and could be a considerable source of employment and income for Honduranss and should contribute to public revenues directly by the payment of royalties and indirectly by augmenting income tax receipts of the federal government and real estate tax receipts of local governments.

The country has considerable reserves of silver, gold, lead, zinc, tin, iron, copper, coal, pitchblende and antimony, but so far has exploited only silver, lead, zinc, and small amounts of gold. It is doubtful that the municipalities would fare better if control and ownership of the resources were transferred to them. Just as in the case of development of the forestry sector, development of mineral resources should be left to the private sector. It should not be difficult to secure foreign private investment under terms advantageous to Honduras. Just as in the case of forestry, government revenues would be increased directly by royalties and indirectly by increased income tax and property tax revenues.

Although the country's topography appears at first glance to make it unsuitable for agricultural exploitation, the country has barely touched its potential. Of its nearly 11.9 million hectares, only two are devoted to crops and 3.4 million to pasture. It is extimated that only 20 percent of the total land area suitable to agricultural production is being utilized. Bananas, coffee, and

sugar have been the main domestic and export crops with corn, sorghum, and beans being the other important products. But recent developments in fruit production show great potential; currently, melons, pineapples, and citrus are being exported, and the potential for other fruits and vegetables, e.g., tomatoes, apples, cauliflower, squash, etc. is equally great. One advantage of the tree crops is that level land is not essential, increasing the potential area that can be devoted to agricultural production.

Growth during the past decade has occurred in the fishing industry. Shrimp and lobster exports grew from relative insignificance a decade earlier to $61.4 million in 1987 and its potential has only been scratched.

Honduras, therefore, has the natural resources to support considerable economic growth and increased employment. It also has a population with greater capabilities than ever before. The public school population has comprised a high percentage of the eligible age groups for more than a decade. It has a young population and a larger proportion have secondary school training than ever before. More emphasis needs to be placed on technical and vocational training and the cohorts exist that could benefit from such training.

In addition to natural resources and labor force potential, Honduras has actual and potential hydro-electric resources to provide a cheap and abundant amount of electric energy required for the development of manufacturing. It currently meets nearly all of its domestic requirements for electricity from hydro-electric resources and exports electricity to neighboring Nicaragua.

In spite of all of the foregoing productive resources, the country's industrial sector is the smallest in Central America. What has prevented its development has been a combination of mercantilist public policies, a socialist orientation in its economic planning, and excessive economic chauvinism. There are many historical reasons for the existence of these policies. But protectionism and socialism contribute little to economic development. Such manufacturing development that has occurred has been in the export-oriented industries under private enterprises. Government experiments in entrepreneurial activities have had uniformly negative results, producing a crisis and falling productivity wherever they have been tried. They not only failed to produce benefits for the country; they drained resources from the private sector where they could have been put to productive use.

The mere existence of such resources is no guarantee that growth will occur. What needs to be done is to release the latent energies and capacities of the Honduran people. The project to decentralize decision-making, develop greater local autonomy, to increase the fiscal capacity of local governments, and improve their management skills will enable the municipalities to provide

a physical and social environment where private enterprise can thrive. The policy is an important condition to the take-off of the Honduran economy.

Each of the project elements is expected to contribute to the economic growth of Honduras by making possible a more rapid development of the social and physical infrastructure of the municipalities. Most do so by increasing the revenues of local governments enabling them to finance the increased expendi-tures for such purposes. Some do so by giving municipalities access to capital funds that would be unavailable without the project. Others do so by raising the managerial and administrative competence of municipal supervisory personnel, increasing the technical competence of municipal employees, and making possible a more efficient delivery of municipal services. Whether or not they may reasonably be expected to do so is the purpose of the benefit-cost analysis that follows.

While the project's components, particularly the Municipal Development Fund and Technical Assistance components, are targeted toward the departments and urban centers in the North Coast and Northeast regions, municipalities in other regions of the country will benefit from the training components of the project. In addition, the whole country is expected to benefit from the reforms which have been urged on the national government which include greater home rule in the setting of tax rates, fees and charges; devolution of authority and control over national lands; regularizing grants-in-aid to the municipalities; and introducing revenue-sharing with respect to automotive fuel taxes and the national sales tax. This project has the potential of accelerating economic growth considerably.

ANNEX A

Capacity of the municipality to finance public services

Although the municipality has authority to provide all sorts of services not pre-empted by the central government, with the exception of a few larger cities like San Pedro Sula, they have not done so. The obvious reasons for not undertaking to provide wanted public services is the inadequate tax base, central government constraints on their powers to tax, and possibly a lack of leadership.

The diminutive role of the municipalities in the Honduran economy is clearly evident from a comparison of the tax revenues of the central government and the municipalities. Tax revenues of the central government amounted to Lps 1,196 million in 1988 while tax collections of local govenments amounted to about Lps 36.9 million, or three percent of the total. In 1985, they were estimated at 3.7% percent.(fn. Price Waterhouse/IBAM, Estudio the la Administracion Tributaria Nacional, Tegucigalpa, 1987.) These figures understate the relative importance of local governments somewhat since about half of local government revenues are derived from non-tax sources such as rents, fees, and so on. Even so, local governments probably account for about six percent of total government current revenues.

Municipal Tax and Non-tax Revenues

The central government has pre-empted two broad-based taxes, the income tax which accounted for 28.6 percent of tax revenues in 1988 and sales and related taxes which produced 34.7 percent, and taxes on foreign commerce, another type of sales tax, 35.5 percent. The only broad-based tax left to the municipalities is the real estate tax which provides about 18 percent of local government revenues (12 percent or less in the three representative municipalities included in this study).

The principal sources of local government revenues are shown in the following Table.

Revenues of Local Governments as a Percentage of total revenues, Honduras, 1988.

Category	Choluteca	Jutiscalpa	Choloma	All Municipalities
Rentas y ventas, etc. (Rents of properties, etc.)	35	11	12	6.2
Imp. a establecimientos (Taxes on businesses)	22	22	19	16.0
Ingresos Servicios Publicos (Service Fees and charges)	10	17	27	24.4
Imp. Bienes Inmuebles) (Real Estate taxes)	9	10	12	18.0
Imp. Fijos				

(Fixed taxes)	9	14	13	7.0
Imp. vecinal (Head taxes)	3	)	)	7.2
Imp. de clasification municipal (Tax on certain activities)	4	) 26	) 17	4.0
Otros, no clasificado Other or not classified	8	)	)	17.2
Total	100	100	100	100

NOTE: Categories may vary somewhat from municipality to municipality since financial statistics are not uniformly reported.

As the table shows, the real estate tax accounts for 18 percent of municipal current revenues, but in the three representative cities, the yield is 12 percent or less. Fees and charges account for 24.4 percent of current revenues but only 10 percent in Choluteca. In the latter city, rents and sales of property accounted for 35 percent but in the average city only 6.2. Similar variability is found with the other sources of income.

Real estate taxation

The yield of the real estate tax is limited by the fact that assessed values are not kept current, by the low rate legislated by the central government, and by inadequate enforcement administration. The levy on real estate cadastral values is set at 1.5 mills or 0.15 percent. In many countries, effective rates of two to three percent are common, 13 to 20 times higher. Cadasters have a one-time impact and then are eroded by failure to keep them up-to-date. And delinquency rates of 50 percent or more are not uncommon. A 1987 study previously referred to found cadastral rolls in Honduran municipalities out-of-date, incomplete, and characterized by improvisation and a lack of technical criteria, low revenue, high delinquency; and rapid turnover of personnel.

The real estate tax is the prinicipal source of revenue of local governments in the United States and other countries. It is one of the two principal broad-based taxes in Brazil, the other being a value-added tax on service industries including construction, distributive trades, and professions. Without doubt, the rapid growth of Brazil from an agricultural producer to the eighth industrial power of the world has been made possible by the infrastructure created and services provided by state and local governments. As we shall have occasion to examine below, municipalities in Honduras have an important role to play in the country's economic development. The real estate tax is the great neglected source of municipal revenue in Brazil.

The economic characteristics of the real estate tax make it the most desirable broad-based tax for municipalities. Obviously, this is not the place to go into the economics of the tax in detail but some of the advantages of the real estate tax are worth noting.

1. The real estate tax is economically neutral, it neither favors nor penalizes different land uses and economic activities. The tax is borne by the land-owners and cannot be shifted to tenants or customers. To put it another way, the tax on the value of the improvements (buildings) is shifted to the land-owner reducing the price he can obtain for the parcel. The value of any real estate parcel is the capitalized value of the prospective or expected income stream net of the actual or imputed payments to the other factors of production employed in the land use and net of the tax levy, too. The capitalized value of the net income stream so calculated is the capitalized value of the economic rent, the value of the land. Since the other factors of production are variable but the supply of land is fixed, the incidence falls on the factor which is fixed, that is, land, on the land-owner. This is so as long as the parcel, land plus improvements, has a value after taxes that exceeds the replacement value of the improvements.

2. The base of the tax, when assessments are kept up-to-date, is elastic with respect to GNP. That is, as a country develops, the value of real estate increases at a faster rate than production increases. As the municipality develops, the yield of the tax increases faster than population and economic activity.

3. The tax is proportional to the value of real estate and because the ownership of real estate is highly concentrated, the tax imposes a greater burden on the rich, on corporations, and large landholders than on the landless. In addition, the tax is progressive among residential owners and small landholders as a result of the homestead exemption of Lps 20,000 and of the exemption of parcels valued at less than Lps. 10,000.

4. Techniques of tax administration have improved so much in the past several decades that maintaining assessments up-to-date, enforcing collection, and doing all of that at reasonable cost is in the competence of local governments regardless of size.

The real estate tax, properly administered, is an ideal tax for financing local governments. It is underutilized in Honduras.

Business and occupation taxes

Every business and occupation is covered by such taxes as the Tax on Commercial, Industrial, Mining, and Agricultural Enterprises, Impuestos Fijos, and Impuestos sobre Clasificacion Municipal. The first uses the volume of sales as the base, but fixed amounts are estatlished for each bracket. For example, a business enterprise with sales over Lps 1 million pays Lps 300 monthly, one with sales rom Lps 500,000 to Lps 1 million, Lps 200 monthly. Taxes similar t these are so-called gross receipts taxes which apply a rate to the sales of the firm. Unfortunately, the bracket rates are not proportional as may be seen from the above example. The tax is in fact regressive. Although economists frown on gross receipts taxes, the latter would be better than the present system of taxes that affect businesses, and those that affect occupations such as barbers, beauty salons, photographers,

etc.

Non-tax revenues

About half of the income of municipalities comes from non-tax sources such as rents, sales of property, fees or charges for municipal services which might include water, pavements, lighting, fire departments and so on. Clearly, there is a good case for user charges. They should be used to amortize projects where the municipality produces a good or service which if produced in the private sector would be sold at market price. This is clearly the case with water, electricity, and so on. Charges for services that cannot be allocated by prices should be made through a tax. Charges for fire department and police services should be proportional to the value of the property protected, suggesting that such services be financed through the real estate tax.

ANNEX B

I. Current role of the central government in the delivery of municipal public services.

Responsibility for providing water, sewage, streets and roads, education, and health has been delegated by law to central government institutions. In addition the central government has assumed responsibility for providing technical assistance, for oversight of municipal budgets, and for providing municipalities with access to capital markets.

Among the institutions responsible for the delivery of services to municipalities are the Servicio Autonomo Nacional de acueductos y Alcantarillados (SANAA), the Secretaria de Comunicaciones, Obras Publicas y Transporte (SECOPT), the Empresa Nacional de Energia Electrica (ENEE), and the Corporacion Hondurena de Desarrollo Forestral (COHDEFOR), the Ministry of Natural Resources, the Ministry of Health, and the Minister of Education. Those in the category of providing technical assistance or having powers of oversight are the Direccion General de Asesoria y Asistencia Tecnica Municipal which pertains to the Secretaria de Gobernacion Y Justicia, the Direccion Ejecutiva des Catastro Nacional (DEC) which pertains to the Secretary of Planning (SECPLAN), and the Banco Municipal Autonomo (BANMA).

SANAA

SANAA has the responsibility for construction, operation and maintenance of water systems in the principal cities. It currently operates 95 systems in Tegucigalpa, 15 secondary cities and 79 municipalities in rural areas. There are 2,000 water systems in current service in Honduras. Even in the municipalities served, large proportions of the population lack access to piped water and sewage systems although the demand is very great. Some of the larger cities like San Pedro Sula operate their own systems and many are desirous of doing so but lack the financial resources to undertake the task themselves. It serves water to 121,000 subscribers and sewers to 58,000, principally in the vicinity of Tegucigalpa. An evaluation made by Arthur Young international in April, 1989 recites:

> The performance of SANAA in respect to the demand for water service is deficient, given that only a small proportion of its subscribers in the area Tegucigalpa / Comayaguela receive water service twenty-four hours a day. Part of the reason is that SANAA has not developed water sources capable of providing the quantity necessary to satisfy the increasing demand in the area of Tegucigalpa. Besides, SANAA's weak financial condition has made it difficult for it to adequately maintain its treatment plants and systems of distribution. Outside the area of Tegucigalpa, the quality of SANAA's water services is deficient due to the financial condition of SANAA as well also to the highly centralized structure of responsibi-

lit and authority, which has made it difficult for its local and regional offices to respond to subscribers' needs.

Moreover its sewage system lacks treatment plants and sewage and storm drainage is discharged without treatment.

Of 86 municipalities with populations between 10,000 and 80,000, 83 had water systems and 15 had sanitary sewers. Of those that had water and sewage systems, a substantial proportion of the households did not have access to the grids. It is estimated that 86.1 percent of urban households are connected to water systems while an additional 8.0 percent live within 200 meters of a water spigot, and that 56.0 percent of rural households have access to a water system. 60.5 percent of urban households are connected to sewer systems, 27.7 percent have latrines or septic tanks, while 66 percent of rural households have such facilities.

SECOPT

SECOPT constructs, repairs and maintains roads and streets and other public works upon the request of municipalities. It has limited funds of its own and substantial areas of the country lack paved roads or roads that permit travel in the rainy season. Only 17 municipalities have paved streets. The financing of additional projects depends on the willingness and ability of the municipalities to finance them. It Direccion General de Urbanismo (DGU) cooperates with the munipalities in the preparation of urban development plans. Although about thirty-five of the principal cities are supposed to be included in its scope, only two plans were developed in the past five years and two others are in progress.

DEC and SECPLAN

DEC has the legal authority to conduct cadastral surveys and to inventory natural resources everywhere in the country. By contract with municipalities, it prepares and up-dates the cadasters that form the base for the imposition of the real estate tax. Its principal effort has been directed to the support of agrarian reform and providing good titles to land. Since 1987, it has prepared cadasters in the cities of Puerto Cortes and the Villa de San Antonio. As a result of those cadasters, the yield of the real estate tax in both cities increased substantially.

Since the beginning of 1987, departments and municipalities classified as urban are required to coordinate their development plans with SECPLAN. Development boards have been created in the departments but implementation has been slow.

SECRETARIA DE GOBERNACION Y JUSTICIA

Gobernacion is responsible for oversight of the departments and municipalities. Through the Direccion General de Assessoria y Asistencia Tecnica Municipal, it is also supposed to provide

technical assistance in administration, cadastrers, and budgeting. In practice, its limited resources have permitted it to do little more than to review and approve the budgets of the municipalities.

BANMA

BANMA was established in 1961 as a development bank for the municipalities, making loans and providing technical assistance to the municipalities. Its shareholders are the municipalities which are required to budget an annual contribution to augment the capital of the bank and to keep their liquid funds on deposit with the bank. The amount of delinquent loans representing funds borrowed by the municipalities amounted to about Lps 47 million, or seven percent of its capital, forcing the bank to reduce personnel and to practically suspend its technical assistance activities. It is currently executing grants from the Interamerican Development Bank involving cadastral surveys.

ENEE

Created in 1957, ENEE is charged with providing electrical service to all parts of the country. Of the existing municipal systems, some 60 percent are operated by ENEE, the remainder by the municipalities or by private enterprises. The latter accounts for about nine percent. Municipalities wanting service or extensions of the existing grid can accelerate service by co-financing the construction required. Sixty-five municipalities have electric systems.

COHDEFOR and the Ministry of Natural Resources

COHDEFOR was established to manage, conserve and rationally exploit the forest resources of Honduras. Since timber is an important natural resource of many municipalities, the municipalities have a substantial interest in the management and taxation of forest resources. A tax on the cutting of timber is collected by COHDEFOR and remitted to the municipalities concerned.

The Ministry of Natural Resources was similarly established to regulate and control the mineral resources of the country and the municipalities likewise have an interest in how such resources are utilized.

There are frequent complaints of a lack of communication and coordination of the activities of these agencies with the municipalities.

THE MINISTRIES OF EDUCATION AND HEALTH

The Ministry of Education is charged with providing primary and secondary education is all the municipalities. In practice, eight percent of municipal budgets is ear-marked for education and supports the construction and maintenance of schools and even teachers' salaries. Only two municipalities have technical schools.

The Ministry of Health is charged with the provision and maintenance of hospitals and health centers in the municipalities. Some of the larger municipalities supplement the services provided by the Ministry of Health. Forty-five municipalities have medical centers.

II. Authority of the municipalities in the delivery of public services.

There are few restrictions on what public services the municipalities may supply to its citizens. What restrictions exist are due to the pre-emption of certain services by the central government or by the autonomous institutions created by the central government. As noted above, the delivery of water and sewage systems is a responsibility of SANAA. Some municipalities have their own water, sanitary sewage, and storm drainage systems. Others that want to control their own grids have to negotiate with SANAA for the privilege. The same is true for energy, roads, and other public works.

In practice, municipalities provide services in addition to the foregoing that include the following: solid waste disposal, the provision and operation of public markets, slaughterhouses, bus terminals, street lighting, paving, parks and recreation, libraries, social services, etc.

Fiscal capacity of the municipalities

The municipalities are restricted in the kinds of taxes and their rates which limit their capacity to raise revenue. Tax delinquency is a serious problem so that municipalities often collect less than half of what the existing taxes ought to yield. As a result, municipalities often look in favor of entrepreneurial activities such as the provision of markets in order to get an additional source of revenues. The cadasters which form the basis of the real estate tax are often permitted to deteriorate, the rate is specified which likewise limits the amount that the municipalities can levy. The rate of all other municipal taxes are similarly specified and are uniform throughout the country.

The formation of citizen's groups like the patronatos, makes it possible for citizens to make voluntary contributions in time and money to help finance and implement projects they are interested in.

Municipalities have the power to impose betterment levies to finance projects, which many do. But most have little or no experience with such levies and do not take advantage of this potential source of financing desired public works projects.