



Research Triangle Institute

COSTA RICA

***MUNICIPAL DEVELOPMENT DIAGNOSIS
AND POLICY PROPOSAL***

by

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**Research Triangle Institute
Research Triangle Park, North Carolina**

for

**U.S. Agency for International Development
San Jose, Costa Rica
Contract No. PDC-1008-I-9068-00
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I. EXECUTIVE SUMMARY

This report suggests a strategy and policy framework for implementing a decentralization program in Costa Rica and offers recommendations concerning what could and should be the role of USAID and other donors in assisting with the implementation of decentralization measures. It analyzes the kinds of decentralization that could be carried out without constitutional or legislative changes, relying solely on administrative actions by the executive branch of the government.

The report examines the evolution of the present situation, especially since 1949, in the historical, economic, and cultural context of Costa Rica. It describes the present division of labor between the central government and parastatal institutions and municipal governments. The emphasis is on the way in which essentially local public services and public sector goods are provided at the local level. The conclusions draw on the analysis of what is, how it came to be, and the kinds of red-flag warning signals one should be conscious in making recommendations for decentralization in Costa Rica. Finally, some programmatic principles and projects are suggested that USAID can evaluate in an effort to encourage and support an efficient decentralization program. Lessons of experience from other countries that adopted decentralization policies -- specifically Colombia and Indonesia -- are described in Annexes 2 and 3. These lessons may be useful to USAID and the Government of Costa Rica in formulating decentralization policies.

This study was initiated by a growing perception in Costa Rica that the centralization model, which served the country well for several decades following adoption of the 1949 Constitution, has run out of steam and is inappropriate for the challenges of social and economic development during the 1990s and beyond. There is an emerging consensus that centralization of revenues and functions in the central government and autonomous centralized institutions must now, somehow, yield to a process of strengthening local and municipal capacity to deal with many of the public sector services. There is not yet any consensus, however, on just what specific things should be done, how they should be done, and in what sequence they should be undertaken. The report describes four major forms of administrative decentralization - (a) deconcentration, (b) delegation, (3) devolution, and (4) privatization and deregulation -- each with different characteristics.

This study is an effort to provide some focus to the decentralization dialogue in Costa Rica. It seeks to shift the discussion from an ideological and philosophical framework to pragmatic evaluation of specific measures that are available to the Government of Costa Rica.

The study found that inhabitants of the geographic area now comprising Costa Rica, at least since the period of the Spanish Conquest, have always been subject to a unitary form of government. Sovereignty, the final power of authoritative decision-making, has been lodged firmly in the center, unencumbered by effective claims from other, subordinate levels of government. These traditions of dependency and paternalism will be difficult to modify, even among those who give lip service to the ideas of

decentralization and local autonomy. The transfer of responsibility for many local services to central government agencies that occurred in the post-1948 period has further solidified the historical primacy of central government. Successful decentralization, therefore, will require carefully developed strategies that respond to social, as well as technical, constraints and that provide a sufficiently long time frame to accommodate incremental change.

At present, centralized control of the provision of local goods and services is pervasive and overwhelming in Costa Rica. Central control is exercised through laws, the control of revenue and funding sources, and through fiscal controls and auditing powers. Municipal authorities have little voice in these matters. As a consequence, citizens find no reason to look to municipal governments in the hope of improving services. It is not surprising, consequently, to find that municipal governments enjoy little prestige or authority. Many argue that there is a corresponding lack of municipal competence to supervise the provision of local goods and services in any event. The self-justifying logic is ineluctable: Municipalities do not have resources or the ability to provide goods and services so centralized institutions provide them. Therefore, there is no municipal capability to provide local goods and services and centralized agencies must continue to provide them.

Certain highlights emerge from this selective review of the provision of local public goods and services.

- Central Government institutions have nearly complete control of most all local public sector goods and services.
- In addition to exercising control through the physical delivery of goods and services, significant additional controls are exercised through fiscal control and audit authority over municipal revenues, budgets and expenditures.
- Some inefficiencies in the centralized system have become increasingly apparent. There is a presumption that some municipalities now could deliver some goods and services more efficiently than presently is done.
- Particularly troublesome and controversial is the role of Community Development Associations. Often there is a lack of coordination with municipal officials. In all cases, there is a worrisome competition to receive the partidas específicas from the legislators.

It should not be surprising to learn that the centralization model of the state has absorbed a growing percentage of the labor force and that the state has become less of a positive element in economic growth. These statistics when taken together offer a powerful warning. They show that the public sector has been growing in size while becoming a drag on the economy. Almost the entire central government budget revenues (some 95%) are absorbed by recurrent expenditures. At the same time, open unemployment is about as low (some 5%) as is possible without provoking inflationary rises in costs and prices. The implication seems clear that continued economic

development and growth must depend on a shift of reliance and resources from the central government to the more productive private sector and perhaps, to some extent, to municipalities.

The broad administrative and legal reforms now being contemplated by COREC (Comisión Consultativa Sobre la Reforma del Estado), however, will require extensive political and administrative support. Experience with such wide-ranging reforms in other countries suggests that the ability of the government of Costa Rica to implement COREC's recommendations will depend on the existence of, or the ability to create, appropriate political, administrative, organizational and behavioral conditions that allow decisions to be made and implemented by local governments, private organizations and cooperative associations.

Experience with decentralization efforts in other countries suggests that programs are more likely to be successful if initially they are modest rather than all-encompassing in scope. Programs need lengthy periods of gestation, testing, training and technical assistance. It is not necessarily paradoxical, therefore, to find that the first stages of decentralization often require close supervision; and supervision and training are necessary not only for local government units but also to modify the procedures and mindset of centralized institutions. Given these lessons, the following policy and programmatic recommendations are suggested to guide USAID's programs in Costa Rica:

1. Because finance lies at the core of any decentralization program in Costa Rica, a reexamination of the source of municipal revenues will be a necessary early effort. Because of its importance, financial analysis can and should be more profound in Costa Rica than generally is feasible elsewhere. In addition to a routine analysis of the sources and uses of actual and potential municipal revenues, the examination should address the appropriations of existing administrative and legislative procedures as well. It is recommended that USAID support this effort.

2. The newly elected government has endorsed decentralization as an integral part of its intended program. In view of the complexity of the subject matter, however, it would be advisable to invite to a conference in San Jose, as soon as possible and preferably during or immediately following the work of the transition team, the principal officials who expect to be involved in designing and implementing decentralization programs. The potential exists thereby to save much time by promoting the decentralization dialogue -- a search for consensus on goals, programs, language, and techniques.

3. A productive procedure to promote a gradualist approach to decentralization is to take advantage of possibilities to involve local governments in larger regional and national projects. This has been done successfully for projects in education, health, agriculture, natural resource management, and transportation in several countries. Among the most immediately relevant possibilities in Costa Rica are:

- Replication of the kind of infrastructure projects in 8 municipalities that was successfully promoted by USAID in Costa Rica.
- Selection of municipalities to participate in the proposed solid waste disposal program.
- The design and implementation of a Watershed Management Program.

4. A number of separate events are coming together to make imminent the prospects for a successful watershed management program in Costa Rica. At the same time the IDB is proceeding with the preparation of a major waste treatment and water and sewerage project, principally for the San José Greater Metropolitan Area. Among the many agencies which are involved (for example, on the Secretaría Técnica de Cuencas) is IFAM. Basically, the project would encourage municipalities to prepare projects, with the technical assistance of experts listed by the STC as qualified. When approved by the STC, the projects could be financed through IFAM. The project envisages the possibility of financing a broad range of local services -- potable water, upgrading and maintenance of local roads, sewerage and solid waste treatment, sanitary landfills.

It is recommended that all municipalities be invited to participate and that the selection of those which do participate in the program at the outset be based on the creditworthiness and municipal management assessments referred to earlier. This procedure has the dual advantage of beginning to emphasize local freedom of choice and, at the same time, maximizing the probability that the projects will be successful from the start.

5. IFAM is the premiere municipal advisory agency in Latin America and has performed many valuable functions over the years. For the most part, it has done them with outstanding professionalism. The way in which it has operated, however, is not suitable to the new role that it can and should have in a program of decentralization.

An early step in decentralization should be serious consideration of a much more extensive deconcentration of IFAM offices, at least to the regional level. It will take time before IFAM can relinquish policy-making or significant financial authority to regional offices; but it can begin with deconcentration of its offices at least for a regional level.

IFAM will need to develop a capability for the economic evaluation of projects in order to be able to advise municipalities on capital investment projects. Until now, IFAM has financed relatively small projects for which a sophisticated economic analysis would not be warranted. Simple tests of creditworthiness and financial analysis were sufficient. This will be inappropriate if, as expected, municipalities increasingly seek financing for larger capital development projects. IFAM will have to develop an economic analysis capability.

6. Finally, the role of IFAM as a financing agent should be rethought. As even larger amounts of money become involved in financing capital projects, the dangers grow that there can be a conflict of interest between IFAM's role as an advisor assisting municipalities to prepare projects and IFAM's role as a source of approving and financing those projects.

II. INTRODUCTION

The request for this study stemmed from a possibility that Article 170 of Costa Rica's Constitution would be reformed. The proposed reform would shift 10% of central government revenues to municipal governments over a 10-year period. The transfer of additional revenues to local governments would be accompanied by a corresponding transfer of primary responsibility for the provision of some basic services from the central government to municipal governments. The transfer of revenues and responsibilities, in turn, would require technical assistance and training to enhance the capability of municipal governments to fulfill their expanded role.

These expectations provided the basis for the Scope of Work for this study. (See Annex 1, "Statement of Work".) The contractor was asked, essentially, to examine the relationships between (a) the municipalities and local development associations and (b) the principal central government institutions that are involved in the provision of basic services at the local level. The examination would describe and assess the evolution of these relationships since the adoption of the 1949 Constitution, analyze the present relationships, describe the effect of decentralization programs in some other countries for comparative purposes, and analyze in some detail the changes that would follow adoption of the proposed constitutional reform.

The exercise was to suggest a strategy and policy framework for implementing a decentralization program and offer recommendations concerning what could and should be the role of USAID and other donors in assisting with the implementation of decentralization measures. Finally, the Statement of Work asked the contractor to analyze the kinds of decentralization that could be carried out without constitutional or legislative changes, relying solely on administrative actions by the executive branch of the government.

By the time the study began in October 1989, it had become clear that the Reform of Article 170 was not imminent. The Statement of Work, nevertheless, continued to be germane for examining the implications of decentralization efforts in Costa Rica. The present study, therefore, while placing less emphasis on the specific implications of Constitutional Reform, examines the general issue of decentralization in Costa Rica in some detail and offers recommendations on how the GOCR and USAID might proceed.

Section III examines the evolution of the present situation, especially since 1949, in the historical, economic, and cultural context of Costa Rica. Section IV describes the present division of labor between the central government and parastatal institutions and municipal governments. The emphasis is on the way in which essentially local public services and public sector goods are provided at the local level. The concluding Sections draw on the analysis of current government structure, how it came to be, and the kinds of red-flag warning signals one should be conscious of as a basis for recommendations about what is feasible and desirable in pursuing decentralization in Costa Rica. Finally, some programmatic principles and projects are suggested which USAID can evaluate in an effort to encourage and support an efficient decentralization program. Lessons of

experience from other countries that adopted decentralization policies -- specifically Colombia and Indonesia -- are described in Annexes 2 and 3. These lessons may be useful to USAID and the Government of Costa Rica in formulating decentralization policies.

A. The Concept of Decentralization

Decentralization, like beauty, lies largely in the eye of the beholder. There is no single set of conditions that can be identified uniquely as decentralization. Decentralization is a complex issue; and a decentralization program can consist of a wide range of specific, interrelated, and at times conflicting measures. Hence, it is not surprising to find that there is little agreement in Costa Rica today on what decentralization should consist of in terms of specific measures and policies.

There is a growing perception in Costa Rica, however, that the centralization model, which served the country well for several decades following adoption of the 1949 Constitution, has run out of steam and is inappropriate for the challenges of social and economic development during the 1990's and beyond. There is an emerging consensus that centralization of revenues and functions in the central government and autonomous centralized institutions must now, somehow, yield to a process of strengthening local and municipal capacity to deal with many of the public sector services. There is not yet any consensus, however, on just what specific things should be done, how they should be done, and in what sequence they should be undertaken.

This study is an effort to provide some focus to the decentralization dialogue in Costa Rica. It seeks to shift the discussion from an ideological and philosophical framework to pragmatic evaluation of the costs and benefits of specific measures that are available to the authorities.

There is little unanimity among those who support decentralization in Costa Rica regarding the specific content of any reform. In general, however, they hope that decentralization will revitalize the political system and more efficiently mobilize resources for development through some combination of the following arguments:

- Programs at the local level offer an opportunity to involve the citizenry more directly in the process of development in Costa Rica, thus giving them a personal stake in successful programs and projects.
- Because of the general ineffectiveness and inadequacy of local tax programs in Costa Rica, financial resources may be available for development purposes at the local level which heretofore have not been utilized. That is, local revenue generation may increase the size of the budgetary pie available for development rather than simply change the configuration of the pieces.
- Citizens may be more willing to contribute financially to projects that are planned and implemented at the local level, where results are more readily identifiable,

than to be taxed by the central government for programs only dimly understood and implemented far from their localities, with little or no visible value to them.

- Capable local institutions can identify and resolve many issues locally, reducing the demands made on already overtaxed central agencies.
- A kind of grass-roots democracy may be developed, utilizing local government as a training device through which citizens learn skills that will permit them to participate more meaningfully in the governmental processes. There is hope that these skills may be more easily learned and applied at the local level, where inputs and outputs to the system are more readily identifiable and, in fact, influenced by local citizens.
- The validity of these arguments and the ultimate success of decentralization in Costa Rica depend on a variety of variables. One of the critical conditions for success is that the strategies must reflect a clear understanding of the institutional and cultural environment in which they will be implemented. This section seeks to identify some of the components of that environment.

B. Forms of Decentralization

Decentralization can be defined as "the transfer of responsibility for planning, management, and the raising and allocation of resources from the central government and its agencies to field units of government agencies, subordinate units or levels of government, semi-autonomous public authorities or corporations, area-wide, regional or functional authorities, or non-governmental private or voluntary organizations."¹

There are four major forms of administrative decentralization -- (a) deconcentration, (b) delegation, (3) devolution, and (4) privatization and deregulation -- each with different characteristics.

1. Deconcentration

Deconcentration, a principal approach now being discussed in Costa Rica, is often considered the weakest form of decentralization. It is the redistribution of decision-making authority and/or financial and management responsibilities for providing urban services and infrastructure among different levels within the central government. It can merely take the form of shifting work from central government officials in the capital city to those working in regions, provinces or municipalities. But deconcentration also occurs when central ministries create new field offices to extend or carry out their work at the

¹Dennis A. Rondinelli and John R. Nellis, "Assessing Decentralization Policies in Developing Countries: A Case for Cautious Optimism," *Development Policy Review*, Vol. 4, No. 1 (1986): 3:23.

local level, or when national governments create local units of administration. Deconcentration is usually the first cautious step toward decentralization that most highly centralized governments take.

Some degree of decentralization has been achieved even in highly centralized governments by deconcentrating management structure through field administration. The advantages of field administration are that it allows central ministries to focus their activities on the particular conditions and needs of different regions or areas of the country and to obtain the information needed to develop appropriate policies and programs. In countries with poor communications systems, field offices are essential if ministry staff are to interact with local officials and citizens and to coordinate activities at the local level. Field administration brings specialized technical expertise and management capacity to the provincial or local level that may not be available in local governments. When they operate effectively, field offices can extend the coverage of services and facilities and provide access to a larger number of citizens more effectively than if they were provided only from the center.²

The disadvantages of field administration are that field positions are often considered by both ministry officials and field officers to be less desirable posts than those in headquarters. Field officers are often more concerned with being transferred or promoted to a headquarters position than with fulfilling their responsibilities most effectively at the local level. In some countries, field officers lack adequate training, are poorly supervised and lack access to sufficient resources to perform their duties efficiently. Many fail to develop good relationships with their clientele.³ For these and other reasons, central ministry officials in many developing countries are reluctant to transfer authority or resources to field officers, thereby undermining the capacity even of well qualified and highly motivated field staff to perform their functions effectively and expeditiously. Jealousies and conflicts can arise between field officers of national ministries and local officials and political leaders that can delay action or prevent services from being provided at all. Field administrators who are either in conflict with local leaders or who have substantial amounts of resources at their disposal can also weaken well-established capacities for collective action at the local level or prevent those capacities from developing. Often the field units of different ministries pursue their own policies with little coordination among them and sometimes in ignorance of each others' activities. This problem is exacerbated when central ministries and agencies use different geographical boundaries for their field offices. In some cases, field officers must respond to local pressures instead of carrying out central directives.

²Brian C. Smith, Field Administration: An Aspect of Decentralization, London: Routledge and Kegan Paul, 1967.

³Milton J. Esman, "Field Level Organization for Regional Development," in G.S. Cheema (ed) Institutional Dimensions of Regional Development, Singapore: Maruzen Asia, 1981: 13-25.

In any case, subnational units of administration are essential to deconcentrating the authority and resources of central ministries when other forms of decentralization are inappropriate or infeasible.

2. Delegation

Delegation is a somewhat more extensive form of decentralization and one that has long been used in Costa Rica. Through delegation, the central government transfers responsibility for decision-making and administration of public functions to semi-autonomous organizations not wholly controlled by the central government, but ultimately accountable to it. Governments delegate responsibilities when they create public enterprises or corporations, housing authorities, transportation authorities, special service districts, regional development corporations, or special project implementation units. Usually these organizations have a great deal of discretion in decision-making. They may be exempt from constraints on regular civil service personnel. They may be able to charge for their services and may be operated like private corporations, using business practices and procedures.

Such organizations are usually distinguished from regular government agencies by their separate legal identity and corporate structure. They are expected to earn most or all of their revenues from the sale of goods and services, and thus are called "off-budget" organizations in some countries. They are expected to price their goods and services at levels that recover investment, operating and maintenance costs. Thus, they must operate much like private corporations. They usually have a great deal of autonomy in their operations, although in reality governments exercise strong supervision over many of them.⁴

The creation of state enterprises to provide urban services and infrastructure was part of a broader movement during the 1970's, especially in Latin America, to use government controlled corporations to produce a wide range of goods and services.

Public corporations or state-owned enterprises are prevalent in sectors that use or manage natural resources over which the government wishes to maintain control. Public enterprises also operate in sectors in which the private market is weak and in which the government wishes to ensure widespread and reliable service provision. In countries where the government is ideologically opposed to a strong private sector or where the government is suspicious of big businesses, state-owned enterprises have been created to displace or prevent the development of private enterprise. In urban areas, public corporations and state-owned enterprises frequently provide transport, communications, electricity, gas and water services that require large "lumpy" capital investments for which financial resources are usually difficult to obtain through regular government budgets. Private enterprises may not be willing to risk investments in services from which they

⁴Mary M. Shirley, Managing State Owned Enterprises, World Bank Staff Working Paper No. 577, Washington: World Bank, 1983.

may not be able to make an acceptable level of profit and thus leave investment to the public sector. In countries with strong industrial development programs, public corporations were formed to overcome market imperfections and to prevent or alleviate bottlenecks in the provision of urban services and infrastructure required to support industrial expansion.

3. Devolution

A third type of administrative decentralization is devolution. When governments devolve functions, they transfer authority for decision-making, finance and management to autonomous units of local government with corporate status. Devolution involves transferring responsibilities for services to municipalities that elect their own mayors and councils, raise their own revenues, and have independent authority to make investment decisions.

Municipal or local governments play important roles in urban development and can be effective units to which to decentralize financial and management responsibility for providing local services, facilities and infrastructure required to improve the efficiency of urban economies.

The potential advantages of municipal and local governments in urban development are numerous.⁵ A system of local government allows citizens to participate more easily in public activities that affect their economic and social well-being and can elicit stronger support for urban development activities because local residents can see the benefits more easily. Local government officials can often plan and set goals that reflect local conditions and that meet local needs more effectively than those in higher levels of government. Local governments often have an advantage over national and provincial governments in enforcing laws, rules and regulations affecting public welfare and safety and in maintaining law and order on a daily basis. They can more easily maintain urban services and infrastructure because they can monitor deterioration and breakdown. Municipal governments are often more efficient in planning and managing small-scale development projects because they can give these activities closer and more frequent supervision. A strong system of local government is also considered an important element in maintaining the political stability that is necessary for urban economic and social development.⁶

Municipal governments can also play an important "enabling" role that facilitates participation by other public and non-governmental organizations in urban development

⁵J. S. Silverman, P. Crawford, G. Honadle and G. Hansen, AID Assistance to Local Government: Experience and Issues, AID Program Evaluation Discussion Paper No. 17, Washington: U.S. Agency for International Development, 1983.

⁶Milton J. Esman and Norman T. Uphoff, Local Organizations: Intermediaries in Rural Development, Ithaca, NY: Cornell University Press, 1984.

activities and that promotes more efficient urban development decisions. They can create enabling conditions by encouraging informal sector activity in neighborhood service upgrading; by providing secure title to land ownership for those living illegally on urban land to support self-help activities; and by using political processes to review locational decisions such as street paving, water and sewer design, police and fire stations, schools, health centers, and parks, and by working with national planning groups and professional associations to reinforce objectivity in such locational decisions.⁷ Local governments can establish employment centers in low income districts to recruit workers for road and sewer maintenance and other unskilled jobs. They can train police and fire personnel in the organization and supervision of voluntary activities and para-professionals to deliver health and education services in low-income areas.

But in Costa Rica, as in most developing countries, municipal and local governments are among the weakest administrative units and few fulfill their potential. Myriad problems undermine the role of local governments in a decentralized system of urban development. Municipal and local governments in many developing countries lack the skilled personnel to plan and manage service delivery efficiently.

4. Privatization and Deregulation

Finally, the most extensive types of decentralization from the government's perspective are privatization and deregulation approaches to decentralization only recently considered in Costa Rica. Privatization is usually, but not always, accompanied by economic liberalization policies and market decentralization. It allows services to be provided by businesses, community groups, cooperatives, private voluntary associations, individuals, small enterprises in the informal sector and other non-governmental organizations. Goods and services that can be provided on the basis of people's ability to pay -- such as public transportation, electric power, piped water, or housing -- can often be delivered more efficiently and effectively by the private sector than by government.⁸

Deregulation reduces the legal constraints on private participation in services provision or allows competition among private suppliers for services that in the past had been monopolies only because of government restrictions on widespread participation.

Privatization can range in scope from leaving the provision of goods and services entirely to the free market operations to "public-private partnerships." Privatization can take a number of forms such as allowing private sector enterprises to provide services

⁷John D. Montgomery, "The Informal Sector as an Administrative Resource," in D. A. Rondinelli and G. S. Cheema (eds), Urban Services in Developing Countries: Public and Private Roles in Urban Development, London Macmillan, 1988, 89-111.

⁸Gabriel Roth, The Private Provision of Public Services in Developing Countries, New York: Oxford University Press, 1987.

and facilities that had previously been monopolized by the public sector; contracting out the management of public services or facilities; financing public sector programs through the capital market and allowing private organizations to participate; transferring responsibility for providing services and facilities from the public to the private sector through divestiture.

The most frequently found form of privatization in developing countries is contracting by the public sector with private sector organization to provide public services and facilities. Contracting-out can be advantageous for a number of reasons. There is a stronger incentive for private firms to keep costs down, to avoid the bureaucratic problems that plague central and municipal governments, and to experiment with new technology and procedures. Contracting out allows services to be provided or extended without large increases in the number of public employees and without making large capital investments in facilities and equipment. Private contractors can often obtain a higher level of productivity from labor than can civil service systems, they can use part-time labor where appropriate, they can often use less labor intensive methods of service delivery than can municipalities. Private contractors are often free from the severe restrictions on labor practices to which public agencies are subjected because of rigid civil service regulations, and they search out minimum cost approaches to service delivery in order to maximize their profit margins.⁹

Contracting out gives both small and large municipalities the ability to take advantage of economies of scale. By contracting with several suppliers of a service, government can assure continuity of service. Contracting-out also allows governments to take advantage of specialized skills in non-governmental organizations. By contracting competitively for services, governments can determine the true cost of production and thereby eliminate waste. It also permits governments to adjust the size of the program incrementally as demands or needs change.¹⁰

There are also potential disadvantages of using performance contracts.¹¹ To the extent that contracting out displaces public employees it can generate political opposition and hostility by public officials and political groups who benefit from public employment. If contracting procedures are not well designed, supervised and enforced, contracting out can be more expensive than government provision of services because of corruption, the tendency of contractors to maximize their profits, the cost of contract management or the absence of sufficient competition. Contracting can also limit the flexibility of government to respond to emergencies. If too many contractors are used, it limits the opportunity

⁹James Ferris and Elizabeth Graddy, "Contracting Out: For What? With Whom?," Public Administration Review, Vol. 46, No. 4 (1986): 332-344.

¹⁰E. S. Savas, Privatizing the Public Sector, New York: Chatham House Publishers, 1982.

¹¹Ruth H. DeHoog, Contracting Out for Human Services, Albany: State University of New York Press, 1987.

to take advantage of economies of scale. If government regulation of contractors is too stringent it can lead to deficiencies in service provision and if it is too lax there can be insufficient accountability on the part of service providers. Performance contracting can have substantial administrative costs that must be compared to the costs that governments incur in providing services directly.

Thus, performance contracting can be most effective in situations where efficiencies in service provision arise from economies of scale, where greater productivity can be obtained from hired labor or professionals than from the civil service, where contractors can make use of part-time labor or less labor-intensive methods of operation. Private contractors are often free from the severe labor practice restrictions of the civil service regulations and seek minimum cost approaches to service delivery in order to maximize their profits.¹²

Each of these forms of decentralization is somewhat different in its characteristics and the distinctions -- and their policy implications -- must be kept in mind as the dialogue on decentralization evolves in Costa Rica.

¹²James Ferris and Elizabeth Graddy, "Contracting Out: For What? With Whom?," Public Administration Review, Vol. 46, No. 4 (1986): 332-344.

III. CENTRALIZATION AND DECENTRALIZATION IN HISTORICAL CONTEXT

A broad consensus exists among many actors in the Costa Rican political system that the time is ripe for some sort of decentralization of government resources and responsibilities. The current political model is based on a high level of centralization and, although relatively successful for several decades, seems now to have run its course and its negative by-products are increasingly apparent.

But strong historical and cultural influences affect any contemplation of possible decentralization programs in Costa Rica. This section, therefore, traces the historical context in centralization and decentralization policies in Costa Rica as a prelude to discussion of the current situation.

A. Historical Roots of Centralization and Decentralization

The Spanish Legacy. The Spanish colonial political legacy to the New World contains strains of both centralism and decentralization. On the one hand, the dominant colonial experience was that of a strong, centralized executive (the crown) with few limitations other than those imposed by distance and the ruler's own sense of restraint. The power of the crown in the New World was actually greater than that which it enjoyed in Spain, itself, by virtue of the fact that New World colonies were legally considered to be personal possessions of the monarch rather than property of the Spanish nation. In Spain the power of the crown was limited, somewhat, by prerogatives that had been won by various institutions over the centuries. Few such limitations existed in the New World where central power was virtually uncontested. Institutionally, the power of the crown over its New World possessions was exercised by the Council of the Indies, a large bureaucratic structure that concerned itself with regulating in detail even the smallest aspects of life in the New World. The inevitable difficulties that arose as colonial officials applied the rules formulated by a far-away bureaucracy to the reality of local conditions were often resolved by the wide-spread practice of "Obedezco pero no cumplo" (that is, "I acknowledge your right to give this order but I decline to carry it out."). Thus, a strong dose of legalism and unreality characterized relations between the center and the periphery from the beginning of the colonial period.

The strong centralism of the Spanish colonial system was tempered from time to time by a strain of decentralization, in the form of active municipal governments. The importance and role of municipal governments in Latin America has varied a great deal over the centuries. The period of the Spanish conquest of the New World took place on the heels of the successful Christian effort to push the Muslims off the Iberian peninsula. For centuries, Christian strongholds in the north of the peninsula gradually extended south until, in 1492, the final Muslim center of power, Grenada, was defeated. Having thus cleared the peninsula, finally, of a foe they had been battling for centuries and having built in the process a series of institutions readily adaptable to new setting, the Spaniards were uniquely prepared to take on the exploration and conquest of the Americas.

One of the institutions that had developed during the long period of conflict on the Iberian Peninsula was the municipality. It was important to colonize new sections of the frontier that was gradually moving southward and, so, newly established municipalities were given special rights and powers (fueros) to encourage new settlements. The tradition of relatively independent municipalities was carried to the New World and became a strategic consideration for conquistadores who wanted to gain a degree of independence from other representatives of the crown. Thus, one of the first events following Spanish occupation of a new territory was the establishment of a municipality to clothe the conquistadores with an additional level of legitimacy.

Later in the colonial period municipalities simply became ceremonial and honorific organizations. They re-emerged in the Wars of Independence of the early nineteenth century. Open town meetings (cabildos abiertos) were often the rallying points for declarations of freedom from colonial rule.

The Republican Experience. All over Latin America municipalities again sank into oblivion during the republican period when they were overwhelmed in most countries by the tides of centralism. Costa Rica was no exception. Independence was achieved in 1821 and, for two decades, national political life was dominated by lively and strong (some would say disruptive) municipal governments.

This heady experience of municipal prominence ended in 1841 when local power was curtailed by President Braulio Carrillo in the name of national unity. Thought to be an obstacle to the development of a strong national consciousness, municipal governments were actually eliminated until the 1860's, by which time the central government was judged to be strong enough to again permit the existence of subordinate levels of authority. Although various constitutions, including the present, speak of "autonomous" municipal government, that autonomy has always been strictly limited by central government's power to determine the range of municipal activity through enabling legislation and its control of financial resources. Even when seemingly large mandates have been given to municipal governments the strict controls exercised by national ministries, the Controller General's Office and the Legislative Assembly have combined to effectively eliminate any possibility of strength and independence at the local level. The authors of a 1971 study of municipal government in Costa Rica note that because of centuries of dependence and neglect " . . . it should come as no surprise that the municipal structures of government of the nation have not evolved much beyond the administrative stage which must have characterized the institution at its very inception."¹³

As noted in the preceding paragraph, the entire period since the 1860's has been characterized by weak, ineffective municipal governments. However, during the same period, constitutions and enabling legislation have consistently assigned important

¹³Christopher E. Baker, Ronald Fernandez Pinton, and Samuel Z. Stone, Municipal Government in Costa Rica: Its Characteristics and Functions (Associated Colleges of the Midwest Central American Field Program and School of Political Science, University of Costa Rica: San Jose, Costa Rica, March 1971), p. 124.

functions to the municipal institutions that have usually been completely beyond their ability to carry out. The authors of the 1971 study speak of ". . .the haphazard way in which functional attributions have been made by the constitutions and laws of the nation. Little effort to legislate within a practical context rather than in terms of abstract ideals is evidenced in the legal structure related to the municipal system of government. The functions attributed to the municipalities have from the very outset been in their majority very unrealistic. Experience has led to very few modifications."¹⁴ Therefore, up to and including the present time a clear role for municipal governments in the provision of services and programs that is also consistent with available resources and local institutional capabilities has never been articulated. It thus appears that local governments have suffered because the central government has exercised virtually no critical judgement as it has assigned functions to municipalities and it seems likely that some part of municipal government's present negative image is a result of its historic inability to perform functions that were never clearly thought out before they were delegated.

B. Centralization and Decentralization Since 1949

Individuals and institutions that dominated the Costa Rican political system in the period following the 1948 civil war were committed, among other things, to weakening the power of the presidency. One vehicle through which this was to be accomplished was the creation of a series of autonomous agencies organized around the provision of essential services. The new agencies were designed to be technical institutions, guided by objective criteria in program development and implementation, and independent of partisan political control. This process is referred to in Costa Rica as administrative or technical decentralization and resulted in agencies responsible for electricity, water and sewage, housing, social security, tourism, and a number of other services.

Since some of the services assigned to the autonomous agencies had historically been municipal responsibilities, partisans of municipal government in Costa Rica refer to this process as the latest in a series of policy decisions that have seriously weakened and discredited municipal government. The tenor of their remarks leads one to believe that forty-five years or so ago there was a Golden Age of municipal government in Costa Rica in which local institutions were thriving, services were being efficiently provided and that, unfortunately, all of this was brought to a premature end in the changes following the civil war. In reality, there was no Golden Age of municipal government in Costa Rica unless one is willing to apply the term to the chaotic twenty-year period following independence in the early nineteenth century. Certainly, there was no Golden Age in the 1940's. In this regard it is noteworthy that the question of municipal government was debated in the convention that drafted the 1949 Constitution. Participants in the debate characterized the municipal governments of the period in the same terms that are heard today -- painting a picture of weak institutional capabilities, very limited financial resources, and no clear role in the provision of local services. A number of proposals

¹⁴Ibid., p. 123.

made at the time to strengthen municipal governments were rejected by the Constitutional Assembly.

C. Decentralization and the Reforms of the 1960's and 1970's

Several attempts to strengthen local institutions took place in the late 1960's and early 1970's, in part influenced by the Alliance for Progress.

The Municipal Code of 1970. One of the most important changes mandated by the Municipal Code of 1970 was the elimination of a centrally-controlled system of jefes políticos (political chiefs) that had been in place since 1862. The jefe político was a canton-level official, appointed by and responsible to the president. He played a dual role as the official representative of the central government in the canton and also the executive officer responsible for implementing the decisions and actions of the municipal council. In the latter role, his signature was required on all payment vouchers against municipal funds, he prepared the municipal budget for submission to the council, and he supervised all municipal employees. In neither of his roles was he subject to control by the elected municipal council or local citizens. The 1970 Municipal Code eliminated this particular intrusion of the central government into local affairs by transferring all of the jefe político's municipal functions to a municipal executive officer appointed by the municipal council and responsible only to them.

In a similar fashion, the 1970 Municipal Code eliminated another 1862 provision, this time stripping the centrally-appointed provincial governor of his municipal functions, which had included the same power in the provincial capital that the jefes políticos exercised in the cantones. In addition, the governor had a veto power over any municipal council decisions in the province and could oppose budgets and taxes proposed by the local councils.

Creation of IFAM (Institute for Municipal Development and Advice). A further contribution of the Municipal Code of 1970 was the creation of a municipal development institute (IFAM) that was mandated to:

- stimulate municipal coordination (through voluntary means).
- provide financial assistance to municipalities.
- provide technical assistance to municipalities.
- cooperate with municipalities in projects of mutual interest (Código Municipal, Título II, Artículo 19).

As IFAM has developed over the years, it has not entirely avoided the pattern common to similar municipal development institutions in other countries. That is, IFAM is in the incongruous position of being a central government agency trying to promote decentralization. Its executive officers and board of directors are appointed by the

president and, obviously, must be somewhat responsive to whatever ideas a given president may have about the role of municipal governments within the national political framework. IFAM's advocacy of municipal government, therefore, is always tempered by the necessity to reflect current central government priorities. The tendency in most countries, to be avoided in Costa Rica, is for the municipal development institution to become highly centralized, itself, and evolve into simply one more capital city agency to which municipal leaders must go, hats in hand, to seek assistance.

Community Development Associations and DINADECO (National Office for Community Development). An additional product of the Alliance in the early and mid-60's was the encouragement of community development organizations in order to mobilize local communities and neighborhoods for development purposes.¹⁵ In Costa Rica during this period a wide variety of national ministries and public agencies organized local associations through which to implement their projects. Thus, the ministries of Transportation, Public Health, Labor and Social Welfare and institutes for water, sewage, and housing all sponsored separate local associations. The 1967 Law of Community Development and the subsequent creation of DINADECO were attempts to coordinate central government assistance to local communities and to provide a framework for technical assistance and training.

In fact, the local development associations in many areas soon became rivals of municipal government and scarce local resources and leadership were sometimes squandered through senseless competition. The sometimes adversarial relationship is encouraged by two factors:

- Municipal governments often offer most of their services to the capital district of the canton, usually the largest local population center. Outlying districts are often ignored or abandoned, a situation that is aggravated by the proportional representation system used to elect municipal council members. All members are elected at large, which encourages candidates and office holders to cater to the geographic areas containing the largest blocs of voters.
- Members of the national Legislative Assembly use Partidas Especificas (earmarked budget allocations) to reward friends at the local level. When the municipal government is controlled by an opposition political party the Assembly often funds local projects directly to community development associations, avoiding and weakening municipal government in the process.

The community development associations most often function at the district level and, in some ways, fill the gap created by the fact that district councils, authorized in the Municipal Code (Titulo III, Capitulo VIII) and to be named by the respective municipal

¹⁵For a discussion of the early development of community development associations and DINADECO see: Harry Jager Contreras, Las Funciones del Gobierno Local en Costa Rica (unpublished thesis, Escuela de Ciencias Politicas, Universidad de Costa Rica, 1982), pp. 100-103.

council, have never been organized in most cantons.

At the canton level the community development associations send representatives to an Union Cantonal de Asociaciones de Desarrollo Comunal, and at the national level the local associations are represented by the Confederación Nacional de Asociaciones de Desarrollo Comunal. DINADECO is organized within the Ministry of Gobernación and is to facilitate the community development process from the national level and to offer training and technical assistance.

Thus, at every level, the community development structure parallels that of municipal government:

	<u>Municipalities</u>	<u>Community Development</u>
District Level	District Council (not functioning)	Community Development Associations
Canton Level	Municipal Government	Union Cantonal
National Level	Union Nacional de Gobiernos Locales	Confederacion Nacional
National Support Agency	IFAM (autonomous agency)	DINADECO (depends on the Min. of Gobernación)

If one believes community and municipal development to be necessarily interrelated the current separate, uncoordinated, parallel efforts are cause for concern. To some extent the situation in Costa Rica reflects a larger problem among bilateral and multilateral providers of technical assistance and funding. Practitioners of community development have their own vocabulary, techniques, and vision of development which, in theory, should be integrated with a separate series of vocabularies, techniques, and visions espoused by the practitioners of municipal development in the interest of coordinated development at the local level. In fact, the two rarely talk to each other and integrated projects are conspicuous by their absence.

In summary, inhabitants of the geographic area now comprising Costa Rica, at least since the period of the Spanish Conquest, have always been subject to a unitary form of government. Sovereignty, the final power of authoritative decision-making has been lodged firmly in the center, unencumbered by effective claims from other, subordinate levels of government. These traditions of dependency and paternalism will be difficult to modify, even among those who give lip service to the ideas of decentralization and local autonomy. The transfer of responsibility for many local services to central government agencies that occurred in the post-1948 period has further solidified the historical primacy of central government. Successful decentralization,

therefore, will require carefully developed strategies that respond to social, as well as technical, constraints and that provide a sufficiently long time frame to accommodate incremental change.

IV. THE EXISTING PROVISION OF LOCAL GOODS AND SERVICES

At present, centralized control of the provision of local goods and services is pervasive and overwhelming in Costa Rica. Central control is exercised through laws, the control of revenue and funding sources, and through fiscal controls and auditing powers. Municipal authorities have little voice in these matters. As a consequence, citizens find no reason to look to municipal governments in the hope of improving services. It is not surprising, consequently, to find that municipal governments enjoy little prestige or authority. Many argue that there is a corresponding lack of municipal competence to supervise the provision of local goods and services in any event. The self-justifying logic is ineluctable: Municipalities do not have resources or the ability to provide goods and services so centralized institutions provide them; therefore, there is no municipal capability to provide them and centralized agencies must continue to provide local goods and services.

A more detailed description of how centralized control is exercised is instructive. It is a necessary prelude to evaluating the rationale for the existing state of affairs and for questioning whether the focus of responsibility can and should be modified. The Municipal Code provides that municipalities are responsible for administering local services.¹⁶ These services include but are not limited to guaranteeing efficient electrification and communication services, good water and sewerage systems, trash collection, and the maintenance and cleaning of streets and neighboring roads.¹⁷ The municipal authority, however, immediately is hedged by Articles 5 and 6, which preserve the powers of other public administrative entities and recognize the ability to reach responsibility-sharing arrangements with other state entities.¹⁸ Almost all such arrangements, as well as any activities carried out solely by a municipality, moreover, are subject to the approval and vigilance of the Controller General.¹⁹

The most exhaustive existing analysis by a distinguished Costa Rican scholar of the division of powers and responsibilities between local governments and the state is quite clear in asserting the primacy of the central government in all matters touching local governments.²⁰ The way in which general principles (nearly complete local autonomy) are diluted in practice (to preserve centralized state control) is exemplified by the procedures for establishing and changing the charges which are levied for municipal services. The setting of municipal service charges is the prerogative of the Municipal

¹⁶Código Municipal, Ley No. 4574 del 4 de mayo de 1970, Artículo 4.

¹⁷IFAM, Código Municipal Comentado (second edition, 1988), pp. 14-15.

¹⁸Código Municipal, *op cit.*

¹⁹*ibid*, Art. 80 *et passim*.

²⁰Eduardo Ortíz, La Municipalidad en Costa Rica, Instituto de Estudios de Administración Local, Madrid, 1987. See especially Part III pp. 337-440.

Council. The Council, however, does not enjoy much independence in the matter. The legal procedure provides that:²¹

- (a) The Concejo bases the rates (or a proposed change in rates) on a study of the current cost of the service plus 10% (for Municipal development purposes).
- (b) The study usually is done by or under the supervision of IFAM or, in the case of water and sewerage, jointly by IFAM and Acueductos y Alcantarillados (AyA).
- (c) If the Concejo Municipal accepts the study, it forwards the study to the Controller General for approval (to the Servicio Nacional de Electricidad (SNE) in the case of water and sewerage).
- (d) The Controller General (or SNE) analyzes the study.
- (e) If approved, the (new) rates are published in the Gazette and become effective 10 days later.

Non-municipal authorities completely dominate all these procedures. A few examples will convey the flavor of what is involved.

Municipal Budgets. The annual budget prepared by the municipal officials and approved by the elected municipal council (Concejo Municipal) and the Municipal Executive Officer (Ejecutivo Municipal, who is appointed by and responsible to the Concejo) is submitted to the Controller General (Contraloría General). The Contraloría General analyzes the proposed budget and approves it, with or without modifications, or disapproves it.

The analysis and approval by the Contraloría General is not a pro forma exercise. The analysis is detailed, professional, and well done. For example, details can include pronouncements on salary increases and bonuses proposed for secretaries; the denial of authorization to fill existing vacancies on the staff by specific individuals; determination of what kinds of equipment and supplies can be purchased and the prices to be paid; and injunctions to study and propose increases in the charges collected for municipal services such as trash collection and the rents of public market stalls.

The Contraloría General by law is mandated to do the analysis. The process inevitably does take time, however, and it can introduce basic sources of inefficiencies. In one town, for example, the material that had been approved for the repair of a small bridge became less desirable than an alternative kind of material between the time that approval of the Contraloría General was asked for and the time that the project was to

²¹IFAM, Código Municipal Comentado, *op cit*, pp. 163-165.

be executed. The Municipal Executive Officer, however, was proceeding with the less efficient -- but already approved -- technology in the interest of getting the job done and avoiding further paperwork and delay. In this instance, local discretion could have increased efficiency, decreased costs, and speeded up the work.

One is prompted to question whether the detailed control of municipal budgets by the Contraloría General, whatever the historical reasons which conduced it, continues to be necessary and desirable in its present extent. It is the function itself, not how well it is exercised, which is at question.

Trash Collection and Treatment. In Costa Rica, 76 of the 81 municipalities provide trash collection and waste treatment services. Most of them (64) do it directly; a few (12), including some of the larger municipalities, do it by contracting private firms to provide the service.²² The service is far less efficient than it should be in most instances. Indeed, recent IFAM estimates are that barely half of the 1,500 metric tons of daily waste products produced nationally are even collected. Only a fraction of that is treated. Most is simply dumped into open landfills. Trash collection and treatment typically constitutes the single largest deficit item in municipal budgets and, a related matter, produces the highest amounts of overdue, uncollected, and uncollectible charges for any municipal services. An examination of how the service is provided and regulated suggests why, in large part, these conditions exist.

Trash must be collected whether or not the citizen pays the municipal trash collection fee. There are evident public health considerations involved. An example of the experience of one of the larger municipalities in providing trash collection, however, illustrates some of the basic problems that affect most communities. This is one of the 12 communities which for many years has contracted a private firm to provide the service. In the past decade, the urban population has grown as has the number of households that must be served. Population growth also has led to construction near a landfill long used for trash disposal and the Ministry of Health has proscribed its continued use. This has made it necessary for the trash to be transported to a temporary landfill much farther away.

The combination of larger amounts of trash plus the higher cost of transportation and disposal requires renegotiation of the contract with the trash firm. This requires the approval of the Contraloría General. As of late November 1989, approval had not been granted and the trash firm, after many years of providing the service, intended to cease its operations and cut short its losses upon expiration of the present contract.

In order to increase the fees charged or amounts paid for trash collection, a study of current costs must be done. The study, which is relatively simple and straightforward, usually is done by IFAM or by Municipal employees under the supervision of IFAM. (Exceptionally, the trash firm itself may do the study; but without the imprimatur of

²²IFAM, Plan de Decentralización Territorial y Fortalecimiento Municipal, January 1990, p. 20.

IFAM, it is likely to encounter increased scrutiny by the Controller General.)

If the Concejo Municipal approves the study and the suggested new rates, it sends the study and recommendations to the Contraloría General. The Contraloría then re-does the study in its entirety -- from primary data collection to analysis -- and stipulates the new rates. Not only is there an obvious duplication of effort; but approval itself is by no means automatic. Rates are supposed to be reviewed annually and revised as necessary in order to ensure that complete cost recovery is always achieved.²³ The procedure is so onerous and the political recrimination of voters in response to rate increases is so distasteful to the Concejo, however, that annual revisions in fact are the exception rather than the rule.²⁴ The result, as noted above, is that trash collection usually is the largest deficit item in a municipal budget.²⁵

An important matter related to trash collection is the availability of trash collection trucks. IFAM has been doing an excellent job of analyzing equipment needs, assessing the municipal creditworthiness to borrow for equipment purchases and, subject to the Controller General's approval, financing equipment purchases. The shortage of equipment, nevertheless, is a chronic, serious and continuing problem for almost all municipalities.

Water and Sewerage. Forty-six municipalities are responsible for providing their own water and sewerage services. The procedure for establishing and revising rates is similar to that for other municipal services except that, as noted above, IFAM and AyA do the analysis and SNE approves or disapproves the rate recommendations.²⁶ In the other municipalities in the San José Greater Metropolitan Area for which AyA directly provides water and sewerage services, costs are continually monitored by AyA and rate revisions are requested from SNE annually.

In addition to the duplication of analysis, two other difficulties sometimes intrude in financing and delivering these services. The service has become so bad in some municipalities that health is seriously at risk. Major new investments are needed to replace -- not just repair -- aqueducts. In two small municipalities, however, we were told that the municipality was not judged creditworthy to finance new aqueducts because, in large part, they were not charging enough to recover even existing costs and, further, that even these understated charges were not actually collected as a rule. "We can't

²³Código Municipal, op cit, Art. 89.

²⁴The exception seems to be in the northern region of Guanacaste, where IFAM's only regional office does initiate annual reviews.

²⁵Several of the Councilmen in one of the larger municipalities actually thought that it was the role of IFAM to study and approve trash collection rates, a sad measure of the breach between intent, law, and practice.

²⁶IFAM, Código Municipal Comentado, op cit, p. 166.

charge or collect for such bad service." At the same time, it is clear that the service cannot be improved unless more is charged and collected.²⁷ Again, a self-defeating and self-justifying continuum.

There are two additional complications in the San José Greater Metropolitan Area. A relatively minor one, in principle, is that rate recommendations must be approved by the Concejo Económico (composed of interested Ministers, the President of the Central Bank, and a Vice President of the Republic) before being forwarded to the SNE.²⁸ This intrudes some momentary political considerations into what otherwise would be purely a technical analysis, with the result that rates have been changed on an average of about every 2 years during the past 8 years instead of annually as stipulated in the Law.

The second complication is a technical one and is more serious. The revised tariff should cover costs and provide at least a 4.5% return on average net revalued assets.²⁹ This practice is followed by AyA. The Municipalities in the area which calculate their own tariffs, however, generally value investment assets at historical rather than replacement costs. The predictable result is that rates are too low and the services are threatened with a cumulative deterioration.

A long list of other local services which in many countries are the province of local authorities is reserved to centralized authorities in Costa Rica despite the putative assignment of responsibilities to municipalities. These include anything involving taxes and licenses, both of which must be approved by the General Assembly (the Legislature). (This is a still more rigid, time consuming and difficult process than the involvement of the Controller General.) It is worth examining the principal sources of municipal revenues in order to get a feeling for how detailed is the control of minutiae by central authorities.

Municipal Revenues. Municipal revenues amount to less than 2% of total public sector tax revenues in Costa Rica.³⁰ The property tax (impuesto territorial), licenses, and service charges together generate more than 75% of municipal revenues. The property tax is by far the most important of these. Table 1 lists the principal revenue sources by

²⁷Studies in Asia and Africa as well as in South America consistently show that people are willing and able to pay significantly higher prices for reliable services of good quality.

²⁸Ley Constitutiva, Reformado y Anexos (1986): Instituto Costarricense de Acueductos y Alcantarillados, Ley 2726.

²⁹This was a requirement introduced in a World Bank loan in 1982 and wisely has become accepted practice in AyA.

³⁰ IFAM, Plan de Decentralización Territorial Y Fortalecimiento Municipal, op cit, p.23.

order of importance in 1986. The property tax accounted for 24.9% of municipal revenues in 1986, for example. In 1988 it amounted to 31.2% of municipal revenues and, in 1989, preliminary estimates are that the property tax will constitute about 35% of total municipal revenues.³¹ Table 1 also makes clear that for most municipalities a broad array of taxes individually provide relatively small amounts of income.

TABLE 1
PRINCIPAL SOURCE OF MUNICIPAL REVENUES
1986 (Percent of Total)

<u>Percent</u>	<u>Source</u>
24.9	Property tax
13.6	License fees
8.1	Trash collection fees
5.5	Street vendors and street stalls
5.3	Construction taxes
4.6	Liquor taxes
4.5	Street cleaning taxes
3.6	Municipal stamp taxes
1.8	Road Taxes
1.8	Entertainment taxes
0.4	Profit tax on public festivals
0.3	Cemetery fees
0.3	Parking fees
0.1	Tax on cement sales
----- 74.8%	TOTAL

Source: Contraloría General de la Republica, Memoria Annual 1986; and IFAM, Principales Tributos que Proveen Ingresos a las Municipalidades, 1989.

Indeed, the administrative cost of collecting many of the local taxes, when compared to the potential revenues, argues strongly that a revision and simplification of the municipal revenue system is in order. A 1977 study showed that there were more than 40 municipal taxes, 9 of which provided 94% of tax revenues.³² A part of the explanation of the inefficiency of collecting what have become nuisance taxes rather than significant sources of revenue is that, as in many countries, the tax is stated in the law as an absolute amount. Inflation and rising prices over time reduce the real value of the absolute amounts to token charges.

³¹ ibid.

³² ibid., pp. 50-51. IFAM has initiated a project to simplify and improve the revenue capacity of the municipal tax system. The project should be encouraged and supported.

It now is time to review and, in all likelihood, substantially modify the property tax. The administration of the tax is unnecessarily complicated and inefficient, with the result that the yield of the tax is much less than it could and should be.

The property tax is assessed on the total value of all real property, including personal goods as well as real estate and construction.³³ Six central government agencies are involved in the administration of the tax.³⁴ The Dirección General de Tributación Directa is responsible for maintaining the register of tax payers, calculating the tax, and issuing the tax bills and payment receipts. The Central Bank has the duty of actually receiving the tax payments; the National Treasury is charged with legal custody of the payments; and the National Accounting Office has the task of checking the tax amounts received. All of these activities, in turn, are under the overall supervision and control of the Controller General and the General Banking Auditor.

The administration of the tax is further encumbered by legal definitions of how the revenue is to be distributed between the Central Government, the Municipality of San Jose, and the other municipalities. Finally, certain percentages are earmarked for specific purposes, principally for local Boards of Education and for IFAM.

The main shortcoming of the administration of the property tax is that the tax roles (catastros) are incomplete and out of date; and evasion and avoidance of the tax probably is significant. The percentage of the net tax revenues, after earmarked deductions, which goes to the Central Government is relatively small (8.6%); and the division of responsibilities between six central governmental institutions dilutes the accountability of each one. The incentive to maintain current and complete tax roles is weakened and the revenues available to the municipalities is significantly less than the revenue potential.

Local responsibility for administration of the property tax may provide a powerful motive to maintain updated tax roles and to realize fuller collection of the amounts due. A simplification of the administration of the property tax by making it a purely local matter is well worth study.³⁵

³³ Ley No. 4340 of 30 May 1969 and modifications.

³⁴ IFAM, Principales Tributos. . ., op cit, pp. 6-10.

³⁵ Most of the historical reasons that argued in favor of central administration of the property tax now appear moot. The possibility of detecting property owned by one person in more than one municipality can be ensured by means of simple computer programs. More basically at issue, however, is whether such measures to minimize tax avoidance and tax evasion are relevant to a program designed to promote local municipal autonomy. The property tax in many countries is reserved to municipalities as a matter solely of concern to the municipality itself. The rationale for central government administration and supervision of this tax should be examined in any decentralization program.

Specific Central-Government Budgetary Allocations to Local Institutions (Partidas Especificas). A major source of local revenues consists of partidas especificas. These are special grants obtained by legislators and must be used for the specific purpose for which they are granted. Access to the pork barrel is a prerogative jealously guarded by legislators and the proficiency with which legislators obtain these grants is a major measure of their effectiveness in the eyes of their constituency.³⁶ This uncoordinated, even haphazard, method of allocating scarce resources is unavoidably inefficient.

Community Development Associations. The inescapable inefficiency of the partidas especificas is exaggerated by the role which Community Development Associations play in Costa Rica. These are local groups of citizens who join together to promote community development projects. Established by law in 1967, there now are over 1,000 of them throughout the country.³⁷ Some, indeed probably most, of them do commendable work and undoubtedly enlist the personal work, participation and active concern of citizens who otherwise might choose not to become involved in community projects.

There are, nevertheless, some shortcomings inherent in the system of Community Development Associations that warrant a reconsideration of the system itself in any decentralization process. The first of these is the role of the Direccion Nacional de Desarrollo de la Comunidad (DINADECO), which nominally administers the local associations and represents them before other government institutions. DINADECO is an entity of the Executive Branch of government. The historical need for DINADECO may well have become largely superfluous. As it is now organized, DINADECO is isolated from the formal structures of municipal development, and its functions need to be integrated with those of other local development programs.

The much more serious question which is raised by the local associations, however, concerns their funding and relationship to the local government. Even if not controlled by the Concejo Municipal, it clearly is necessary that the activities of the Community Development Associations be coordinated with those of the municipal governments. In practice, the record is quite mixed.

The relationships between the Concejo and the local development associations are excellent in some municipalities; quite the contrary in others. In the best of cases, the Concejo and the Ejecutivo Municipal consult regularly with the development associations,

³⁶ The flavor of this was conveyed in an interview, in October 1989, with a former deputy (diputado: Congressman) who is running for election a second time in the February 1990 elections. (Legislators cannot serve more than one term consecutively.) When asked what he had done for his constituency during his earlier term which would justify his election again, four years later, his first response was that he had managed to get 200 partidas especificas approved. Rumbo, October 10, 1989, pp. 14-15.

³⁷ Ley sobre el desarrollo de la comunidad, Ley No. 3859 of 7 April 1967.

coordinate their work with municipal work programs, support their requirements for funding, and contribute municipal materials and equipment to assist their projects. These commendable examples usually occur in municipalities where the Concejo is dominated by members of the same political party that is in control of the executive and legislature at the national level.

In other cases, however, the Concejo has little to do with the Community Development Associations: there is minimal coordination, cooperation or support. In the worst of cases, legislators establish and support the local development associations with partidas específicas as a way of avoiding dealing with the Concejo. It is almost as though the Community Development Associations constitute a semblance of a municipal shadow government. Local development associations receive the limited partidas específicas at the expense of there being few funds left for the municipal government.

This is an inefficient way of allocating scarce revenues for local municipal projects and services. Where the local constituents, the Concejo and the Community Development Associations all agree on their priorities and where these priorities also are consistent with inter-municipal and regional priorities, the allocation of revenues under the system would be no worse than the partidas específicas system. In almost no instance is this ideal situation likely to exist. The result must be, predictably, a less efficient allocation of revenues.

It is not argued that the Community Development Associations are not good nor that they should be curtailed. It is suggested that the means through which they are funded should be reexamined and that their activities should be coordinated with local (and regional) units of government.

In summary, then, the potential for more effective local development in Costa Rica is limited by the following factors:

1. On the one hand, most municipal governments do not now provide for systematic participation by the community in local decision-making and implementation, and have little capacity to mobilize the population to support development activities.
2. On the other hand, many community organizations such as development associations, committees of parents, and church groups are found in these same municipalities. They tend, however, to focus on relatively narrow concerns and are not linked to municipal government activities and those that affect the larger community.

The challenge is to preserve the vitality and participatory characteristics of the more successful community associations and, at the same time, link them more effectively to the larger vision of local development that is, in theory, entrusted to (but not yet developed by) municipal governments.

One reasonable way to respond to the challenge would be to actually organize the District Councils authorized in the Municipal Code (Article 64). The code specifically charges these councils with the following responsibilities:

- to serve as links between municipal governments and local communities
- to serve as organizations with which municipal governments can collaborate
- to monitor municipal operations that are carried out within the district and to report to the municipal executive on how they could be better performed.

In other words, District Councils seemed to have been designed specifically to fill the gaps identified above. The fact that these councils are already authorized in the Municipal Code and can, therefore, be implemented without further enabling legislation is a powerful argument to encourage their establishment.

Other Local Services. It is perhaps fitting to close this section by pointing out that even the rents paid by the operators of stalls in the local public market are controlled by the Central Government.³⁸ The latest revision of the rent control law provides that a municipal rent adjustment commission, composed of two Municipal councilmen and two stall renters, will agree on the schedule of rents for periods of five years; the contracts will be reexamined and new rent schedules agreed to for each 5 years.³⁹

Even if the five-year contract provides for some annual increase in rents, there is no way that a 5-year prediction can correctly foresee what the level of rents should be. The result is that public markets, which well might be judged to be a matter almost solely of local concern, are regulated by national statutes in a manner which has to be inefficient.⁴⁰

Certain highlights emerge from this selective review of the provision of local public goods and services.

- Central Government institutions have nearly complete control of almost all local public sector goods and services.

³⁸ Ley No. 2420 of 14 September 1959, revised by Ley No. 6890 of 14 September 1983.

³⁹ Ley No. 7027 published in the Gazette No. 78 of 25 April 1986.

⁴⁰ There is some evidence that this continues to be the case in most municipalities not because of any continuing national interest but, more likely, as a matter of lethargy which inhibits the legislators from reconsidering the system. That evidence is that the IDB, as a condition of a loan to build new local public markets, required that the rents be revised annually. The legislature granted an exemption from the 5-year Public Market Law. In one municipality, the old and the new public markets are both being used simultaneously.

- In addition to exercising control through the physical delivery of goods and services, significant additional controls are exercised through fiscal control and audit authority over municipal revenues, budgets and expenditures.
- Some inefficiencies in the centralized system have become increasingly apparent. There is a presumption that some municipalities now could deliver some goods and services more efficiently than presently is done.
- Particularly troublesome and controversial is the role of Community Development Associations. Often there is a lack of coordination with municipal officials. In all cases, there is a worrisome competition to receive the partidas específicas from the legislators.

It should not be surprising to learn that the centralization model of the state has absorbed a growing percentage of the labor force and that the state has become less of a positive element in economic growth. Public sector employment has grown rather consistently over the past decade and now accounts for about 20% of total employment (see Table 2). At the same time, real wages in the public sector declined by 20.9% between 1979 and 1985 and by 2.4% in the private sector.⁴¹ During the period 1979 through 1987, private fixed investment increased 54.4% in real terms; public sector investment by 18.3%.⁴² During the period 1975 through 1987, real GDP at market prices grew at a 3-year average of 2.6% per year.⁴³ While the GDP growth includes the disaster years of the 1979-1982 crisis, the average annual real growth rate since the 1982 recovery through 1987 is estimated to be about 4.3%. It can and should be quite a bit higher.

⁴¹ ibid, Table 2.4.

⁴² Ministry of Planning and the Central Bank of Costa Rica, as reproduced in Table 9.4, World Bank, Costa Rica: Economic Memorandum, October 1988.

⁴³ ibid.

TABLE 2
 AVERAGE PUBLIC SECTOR EMPLOYMENT
 (Percentage of Total)

	<u>Percentage</u>
1976, 1979-80	18.2
1981-1983	18.7
1984-1986	19.5

Source: Ministry of Planning; Central Bank of Costa Rica

These statistics when taken together offer a powerful warning. They show that the public sector has been growing in size while becoming a drag on the economy. Almost the entire central government budget revenues (some 95%) are absorbed by recurrent expenditures. At the same time, open unemployment is about as low (some 5%) as is possible without provoking inflationary rises in costs and prices. The implication seems clear that continued economic development and growth must depend on a shift of reliance and resources from the central government to the more productive private sector and perhaps, to some extent, to municipalities.

Finally, before concluding this review of the present division of responsibilities and authority between centralized agencies and municipal authorities, it may be useful to elaborate briefly on the earlier observation that decentralization is a complex subject. Decentralization is a topic that embraces many dimensions.

To illustrate this, let us conceive of a scale of possibilities ranging from "complete centralization" to "complete local autonomy." There are many sets of variables (choices) that will determine where a particular decentralization program is placed on this scale. For example:

- Different concepts of decentralization are appropriate depending on the good or service involved and on the characteristics of the society. One useful classification of types of decentralization described in detail in Section II of this report distinguishes among deconcentration, delegation, devolution, and privatization (deregulation).⁴⁴

⁴⁴Dennis A. Rondinelli and John R. Nellis, "Assessing Decentralization Policies in Developing Countries: A Case for Cautious Optimism," Development Policy Review, Vol. 4, No. 1 (1986), pp. 3-23.

- The appropriate approach will depend also on the good or service involved and on the municipality involved. A recent Central American conference held in Tegucigalpa, Honduras, for example, listed over a dozen specific types of local goods and services, each meriting a somewhat different treatment.⁴⁵
- It often is useful to distinguish among forms of decentralization according to whether the primary thrust of decentralization is to promote urban development, municipal development, or community development. They are not the same thing.
- Again, it is necessary to examine whether the basic motive of decentralization is to promote participatory democracy by the local community or primarily to promote efficiency in the delivery of goods and services.⁴⁶
- Each of the principle elements of a decentralization program involves political, fiscal, and administrative dimensions as well.⁴⁷
- Implicit in every decentralization measure is the provision for the sources and uses of the necessary funding - local taxes, central government taxes, grants, user charges, partial subsidies, for example.

Depending on the alternatives selected, the implementation of decentralization measures may require constitutional changes, statutory changes in laws, or only administrative changes.

The list of pertinent considerations to be aware of in a decentralization program could be extended, but this partial listing serves to show its inherent complexity. Conceptually the above (partial) listing produces an action matrix with 12,960 cells. To extend the list would invite overkill to illustrate the point that it is hardly surprising to find that there does not yet exist a broad consensus in Costa Rica on just what a decentralization program should consist of, how it should be implemented, and in what time frames.

⁴⁵October 18-20, 1989, sponsored by USAID/Honduras and RHUDO/CA.

⁴⁶It can be argued that efficiency is an eventual prerequisite of accomplishing participatory democracy. Otherwise, inefficiency will engender disillusionment and disgust with the participatory effort itself.

⁴⁷IFAM, Plan de Decentralization..., op cit, p. 60 et passim.

V. STRATEGIES FOR DECENTRALIZATION

ARTICLE 170

The protocol reform of Article 170 of the constitution would transfer to municipalities 10% of the central government ordinary budget revenue. This would be done under an 8-year period - 2% initially and an additional 2% each biennium until the total reached 10%.

The potential advantages of the proposed Reform of Article 170 are (1) an increase in participatory democracy and (2) an increase in the efficiency of delivering local public sector goods and services.

1. The long history of diminished local responsibility for managing local affairs has brought local government into disrepute. Citizens correctly perceive that money, power, decisions, and authority are centralized in central government entities. This distances the individual from his government and produces a sense that the individual is powerless to affect local matters that directly concern him.

2. A corollary perception is that municipal governments are correspondingly inept and, in many cases, corrupt. Members of the Municipal are regarded as self-serving or as interested in using membership in the Concejo as a spring board to national politics. They are of the municipality, pathetically, few Concejo members stand for reelection because the position is unrewarding.

3. The proposed reform of Article 170 could change this. It could generate an enthusiasm to participate in local affairs, to elect better local officials, and to hold them accountable to their constituency.

4. Local citizens and local officials should be more knowledgeable than central government officials about local needs, problems, and priorities. This could lead to a better choice of investment projects, project designs more suitable to local conditions, and more efficient delivery of goods and services.

5. All of this, in turn, could change attitudes about the duty and "justice" of paying local taxes. Tax evasion and tax avoidance should decrease if the local taxpayer feels that his taxes are being well used for his benefit. This attitudinal change can be reinforced by off-year municipal elections and the popular election of a mayor.

There are three main kinds of reservations about the proposed Reform of Article 170. They have to do with costs and affordability, legislative and bureaucratic interests, and technical and administrative complications.

1. Costs and affordability. The Reform would involve a loss of central government revenues and a substantial investment in training and upgrading municipal government. The economic payoff in increased efficiency cannot be fully realized for some time. In its present fiscal condition, the Government of Costa Rica cannot afford,

without tremendous sacrifice, to forgo these revenues nor to make the attendant investment at this time. Recognition that there may be some loss in efficiency - increased costs - with interim learning period which municipal governments will need reinforces the Government of Costa Rica's doubts about the feasibility of the proposed reform in the short run. The short run of political expediency can easily be prolonged into a very long run indeed. (It is largely for this reason that this report recommends more realistic measures that can promote decentralization even without the reform.)

2. Legislative and Bureaucratic Interests. Legislative change in Costa Rica often is a lengthy, divisive, and torturous process. The difficulties of legislative changes to implement the proposed Reform would exaggerate these conflicts in two basic ways: (a) Legislators would need to vote to decrease their own powers in a number of ways. Legislators are not prone to do this. And (b) it is conceptually impossible to devise a formula to distribute revenues among municipalities in a manner that will benefit equally every municipality. Equity and social goals will tend to be combined with revenue objectives and endlessly prolong debate and disagreement.

Decentralization also would involve diminished power and authority--and employment and budgets--for central government entities. Central government officials will be loath to surrender power and authority. Decentralization may be used instead by central government officials to rationalize the need for greater centralized efforts to coordinate, plan, train, and provide technical assistance to local government until local government is indeed deemed (by central government officials) to be competent to manage its own affairs. This can take forever.

3. Technical and Administrative Complications. The relative scarcity of well trained and experienced technical and administrative personnel in government can be used to argue that they should not be dispersed. There can be economies from specialization in a centralized system that are diluted by decentralization. The unavoidable interim learning period and temporary reduced efficiency in delivering goods and services can be strong motivations for delaying decentralization.

The potential advantages of decentralization are persuasive. The reputed drawbacks are largely self-serving objections from those with vested interests in maintaining the status quo. Nevertheless, they are daunting political realities. The convincing and decisive argument for decentralization, however, is that centralization no longer works as well as it formerly did. The real choice is between decentralization a predictable growth of administrative inefficiency and economic stagnation. These observations lead to several of the recommendations of this report.

- Decentralization should be pursued using primarily executive rather than legislative measures at the outset.
- Priority should be given to enhancing local own-source revenues.
- Training and technical assistance should be emphasized.

- Decentralization should be reviewed as an incremental and gradual undertaking.
- IFAM, central government entities, and autonomous institutions should become advisors available to local governments rather than authorities making local decisions.

DECONCENTRATION OF CENTRAL GOVERNMENT MINISTRIES

Discussions of decentralization in Costa Rica now tend to focus on deconcentration, that is, on creating regional offices of central government agencies to coordinate and develop resources for local development. Some lip-service is paid to the idea of devolution, but enthusiasm for this alternative is tempered by the negative image most national leaders have of the managerial and technical capabilities of municipal officials. This, in turn, leads them to discount the potential of local institutions as viable units of governance and development.

Although it is true, at present, that most municipalities lack strong and dynamic leadership, this is partly a reflection of the fact that weak and ineffective institutions have difficulty attracting well-trained personnel. Costa Rican leaders are in danger of being trapped in a self-fulfilling prophecy. As long as municipal governments are left in a weak position, they cannot attract strong leaders and managers, and therefore, they cannot be trusted with new functions.

It is quite likely, however, that if stronger, clearer, authority is granted to municipal governments, if more financial resources are made available for local governments to engage in development activities, and if a strong commitment is made to training and technical assistance programs for local officials, they can develop stronger managerial capabilities and municipal governments can begin attracting more skilled leaders.

The probability that in such a case improvements in local capabilities would be gradual reinforces the idea expressed elsewhere in this report that decentralization in Costa Rica can be implemented most successfully in incremental fashion.

However, implementation of a strong program of devolution in Costa Rica will inevitably require something of a leap of faith--a willingness to believe that local institutions will respond to the challenge of greater self-governance, of greater control over local resources and of the opportunity to take the initiative in pursuing development goals. In this sense, devolution may seem to be a high risk alternative to simply deconcentrating central government agencies. But the potential payoff--in terms of political support, more widespread economic development, and the development of more widespread managerial capacity--can also be high. The power of devolution is that it has the potential to increase significantly the resources available for development.

If devolution is successful, it can create new financial resources and develop more human resources than would be possible simply by restructuring central government agencies.

In this regard, political leaders in Costa Rica should recognize that whatever the benefits of deconcentration--and there are many--it alone can never completely unlock the latent resources existing at the local level. Central government officials have only limited capacity to mobilize local resources and generate the commitment that comes from the sense of local control over community activities.

REFORM OF STATE STRUCTURE

The broad administrative and legal reforms now being contemplated by COREC will require extensive political and administrative support. Experience with such wide-ranging reforms in other countries suggest that the ability of the government of Costa Rica to implement COREC's (Comisión Consultativa de Reforma del Estado) recommendations will depend on the existence of, or the ability to create, appropriate political, administrative, organizational and behavioral conditions that allow decisions to be made and implemented by local governments, private organizations and cooperative associations.

A review of decentralization policies in more than 25 developing countries for the World Bank found four sets of conditions that are necessary to implement the types of wide-ranging structural reforms that COREC will recommend for Costa Rica.⁴⁸

- Political Conditions -- In order for decentralization policies to be effective, strong political commitment and support must come from national leaders for the transfer of planning, decision-making and managerial authority to field agencies and lower levels of administration, or to the private sector.⁴⁹

Political leaders must be willing to accept the participation in planning and management of local organizations that are outside of the direct control of the central government or the dominant political party. Support of and commitment to decentralization must also come from line agencies of the central bureaucracy and central government officials must be willing to transfer functions previously performed by them to local organizations.

Decentralization usually requires strong administrative and technical capacity within central government agencies and ministries to carry out national development

⁴⁸Dennis A. Rondinelli, John R. Nellis and G. Shabbir Cheema, Decentralization in Developing Countries: A Review of Recent Experience, World Bank Staffing Working Paper No. 581, Washington: World Bank, 1983.

⁴⁹Dennis A. Rondinelli and John R. Nellis, "Assessing Decentralization Policies in Developing Countries: A Case for Cautious Optimism," Development Policy Review, Vol. 4, No. 1 (1986): 3-23.

functions and to support -- with adequate planning, programming, logistical, personnel and budget resources -- their field agencies and lower levels of government in performing decentralized functions. Finally, effective channels of political participation and representation must be developed that reinforce and support decentralized planning and administration and that allow rural people, especially the poor, to express their needs and demands and to press claims for national and local development resources.

Even in a decentralized system of urban service provision and management, central government agencies and ministries must play an important supporting role by providing financial assistance, technical assistance, assuring some degree of equity in the distribution of goods and services, and providing guidelines and support for urban development programs. The role of the central government in a decentralized system, however, must shift from directly providing and maintaining services and infrastructure to strengthening and support local governments and private organizations.

- Organizational and Administrative Conditions -- Organizational factors conducive to decentralization include the appropriate allocation of planning and administrative functions among levels of government and local organizations, with each set of functions suited to the existing or potential decision-making capabilities of each level of organization. Decentralization requires laws, regulations and directives that clearly outline the relationships among different levels of government and administration, the allocation of functions among organizational units, the roles and duties of officials at each level and of cooperative and private organizations, and their limitations and constraints.

Decentralization must be supported by flexible legal arrangements, based on performance criteria, for reallocation of local governments change over time. Clearly defined and relatively uncomplicated planning and management procedures for eliciting participation of local leaders and citizens and for obtaining the cooperation or consent of beneficiaries in urban development activities are also needed.

Success in decentralizing service provision depends on the ability of the central government to reorient the activities of public servants from controlling activities role to facilitating the activities of others. The role of central government ministries and agencies must change from that of being the primary service provider to that of being one of many service providers. But governments still retain a crucial role in assisting local governments, facilitating self-help activities and supporting private enterprises engaged in urban development.

- Behavioral Conditions -- Behavioral and psychological conditions supporting decentralization include appropriate attitudes and behavior of central and lower level government officials toward the decentralization of service provision and maintenance, and a willingness on their part to share authority and accept participation in public decision making.

Effective means must be found of overcoming the resistance, or getting the cooperation, of local elites and community leaders in decentralized service provision and maintenance. Appropriate incentives must be created to elicit the support of those whose participation is needed to make decentralization work effectively. A minimal level of trust and respect must be created between local organizations and government officials.

The success of decentralization depends on a mutual recognition that each is capable of performing certain functions and participating effectively in various aspects of financing and managing urban development activities. Strong leadership must be developed within local organizations and private enterprises that will allow them to deal effectively with local and central governments.

Resource Conditions -- Finally, financial and human resource conditions required for decentralization include sufficient authority for local units of administration or government, cooperative and private organization or government, cooperative and private organizations to raise or obtain adequate financial resources to acquire the equipment, supplies, personnel and facilities needed to carry out decentralized responsibilities.

Experience with decentralization efforts in other countries suggest that programs are more likely to be successful if initially they are rather modest rather than all-encompassing in scope.⁵⁰ Programs need lengthy periods of gestation, testing, training and technical assistance. It is not necessarily paradoxical, therefore, to find that the first stages of decentralization often require close supervision; and supervision and training are necessary not only for local government units but also in order to modify the procedures and mindset of the centralized institutions which inevitably must be involved. Given these lessons, the following policy and programmatic recommendations are suggested to guide USAID's programs in Costa Rica.

Lessons of Experience with Decentralization. Research on decentralization experience in more than two dozen countries undertaken for the World Bank indicates a number of lessons that should be reflected in AID policy dialogue and project and program design in Costa Rica.⁵¹

⁵⁰ Dennis A. Rondinelli, John R. Nellis and G. Shabbir Cheema, Decentralization in Developing Countries: A Review of Recent Experience. World Bank Staff Working Paper No. 581, Washington, D.C., (1983).

⁵¹Dennis A. Rondinelli, John R. Nellis and G. Shabbir Cheema, Decentralization in Developing Countries: A Review of Recent Experience. World Bank Staffing Working Paper No. 581, Washington: World Bank, 1983.

- Small-scale programs designed for limited impact are likely to generate more positive and durable results than large-scale, sweeping organizational reforms. Programs should, therefore, be planned initially on a small scale and expanded incrementally.
- Complex schemes and procedures for decentralization are unlikely to be implemented effectively; and therefore, decentralization programs should be kept simple, flexible and appropriate to the capacities of local organizations.
- Decentralization requires a lengthy period of gestation before its benefits will be realized, and programs must therefore be planned for the long term. Because decentralization often goes against the grain of tradition and custom and against the interests of some groups whose support is important for its success, it cannot be implemented without conflict. Successful decentralization programs often require a long period of testing during which political support and commitment must be mobilized.
- Decentralization programs in which the first stages are closely supervised efforts to teach local organizations how to handle new responsibilities will be more successful than those that transfer large numbers of tasks of great responsibilities all at once. Programs should therefore be planned tutorially.
- Decentralization programs that include a component for training central administrators, local officials, and leaders of local organizations will be more likely to have a positive effect than those that do not.
- Decentralization programs that transfer adequate financial resources and the authority to mobilize resources locally, as well as powers and responsibilities, will be more successful than those that merely call for consultation with or participation of local officials and private organizations.

RECOMMENDATIONS

Municipal Finances. In a very real sense, finance lies at the core of any decentralization program in Costa Rica. A reexamination of the source of municipal revenues already has been identified as a necessary early effort.⁵² One model that has been used successfully in other countries is the technique of Municipal Management Assessment. Application of the methodology would be much easier and faster in Costa

⁵²IFAM, Plan de Decentralization. . ., *op cit*, pp. 50-53.

Rica than in most other countries because of the rich sources of data which already are available.⁵³

Because of this, the financial analysis can and should be more profound in Costa Rica than generally is feasible elsewhere. In addition to a routine analysis of the sources and uses of actual and potential municipal revenues, the examination should address the appropriations of existing administrative and legislative procedures as well.⁵⁴ It is recommended that USAID support this effort.

Among the financial arrangements for decentralizing urban services and infrastructure that Costa Rican, policy analysts should consider are:⁵⁵

- Self-financing and cost recovery, which can be achieved through user charges, betterment levies and land readjustment programs. User charges can be levied for those services or infrastructure for which there are direct relationships among the costs of providing the services, the amount charged for the services, and the amount of services received. Betterment levies are taxes for those services for which there is some direct relationship between providing the service and improvements in the value of property owned by the beneficiaries. The costs of providing services are recovered by taxing surplus value created by public improvements on or near private property. Land readjustment programs -- whereby land owners pool their property for service improvements and contribute a sufficient amount of land to compensate government for the cost of the improvements -- may also be useful in recovering the costs of servicing urban land that is likely to be developed in the near future.
- Co-financing is an arrangement through which the users participate in providing services or maintaining a facility, and thereby reduce the overall costs to a level lower than if the services or infrastructure were provided entirely by government. Local non-tax community resources can often be mobilized for co-financing through exchange of services or labor of beneficiaries in return for extension of services or infrastructure by local governments. Fiestas, community fairs, and the solicitation of ad hoc contributions and donations have been used to raise funds for self-help service provision. Some communities have created small-scale

⁵³For example, the Annual Reports of the Controller General, the Controller General's analysis of annual municipal budgets, and the quadrennial publication by IFAM of a Basic Information (Informacion Basica) document for each municipality in the country.

⁵⁴See also, below, the discussion of the recent specific application of the Municipal Management Assessment methodology to water and sewerage projects.

⁵⁵Dennis A. Rondinelli, Decentralizing Urban Development Programs: Concepts and Guidelines for Analysis. Washington: U.S. Agency for International Development, Office of Housing and Urban Programs, 1989.

productive activities to raise funds for services and for infrastructure construction and maintenance.

- Expansion of local general revenues is another means of financing urban services and facilities. Property taxes and other indirect charges must be used to pay for those services that are of value to the community as a whole, but for which the costs are not linked directly to specific beneficiaries or users.
- Intergovernmental transfers provide loans or grants to local governments from national general revenue sources, or earmark funds from specific revenue sources such as tax charges, import duties, fees and fines, amusement or entertainment taxes or lotteries for urban infrastructure and services.
- Authorization of municipal borrowing and the mobilization of either national or local government resources (through loan guarantees or subsidized credit) for borrowing by individuals to obtain services from private providers are other means of financing urban development activities.
- Employment generating service provision arrangements -- that is, the use of service provision and infrastructure construction programs that employ the labor of community residents and beneficiaries to increase their incomes sufficiently to allow them to purchase services to pay the costs -- are a means of expanding effective demand for public goods.
- Cost reduction measures through the modification or elimination of public regulations that artificially increase the price of public goods and services or that obstruct private sector provision of services and facilities are also a source of additional financial resources for urban development.

Experience in other developing countries indicates that if municipal services are to be improved, the financial capacity of municipal governments to deliver services and construct and maintain infrastructure efficiently must be greatly expanded. In Costa Rica, the central government can strengthen municipal government's financial capacity to provide infrastructure and services by:⁵⁶

- Expanding taxing and revenue raising authority for municipalities, allowing them to raise taxes from a wider variety of local sources and to use a greater number of tax instruments.
- Creating special funds for urban infrastructure and service development that can be used to finance costly capital investments that can be replenished from national revenue sources such as customs, excise or import taxes or regularly budgetary assignments that are set aside from line agency budgets.

⁵⁶Dennis A. Rondinelli, "Extending Urban Services in Developing Countries," Public Administration and Development, Vol. 6, No. 1 (1986).

- Expanding statutory payments to local governments from fixed percentages of recurrent revenues of central government budgets as unrestricted grants, thus giving municipal administrations more flexibility to meet local needs and demands.
- Providing technical assistance and training to local officials in improving tax administration and collection procedures and increasing revenues from existing sources.
- Allowing municipal governments to draw loans from national development banks or credit authorities to provide services and facilities for which users can be charged and which generate revenue that can be used to repay the loans.
- Strengthening the property taxing powers of municipal governments and improving their capacity to do tax values more accurately and fairly, and collect revenues, do mapping, keep and maintain records, and assess property more effectively.
- Standardizing and improving intergovernmental transfers and allocating funds from the national government to municipal governments more effectively so that revenues reach them in a timely manner.
- Allowing municipal governments, or expanding their authority, to engage in public enterprise for services not offered by the private sector, and relaxing restrictions on their pricing policies and ceilings on the profits of such enterprises.
- Expanding the authority of municipal governments to levy preferential land use and business taxes to stimulate desirable economic activities and to guide the physical patterns of urban development.

The current structure of municipal government in Costa Rica does not provide for the strong local political leadership that is necessary to make decentralization effective.

The Municipal Code calls for municipal power to be shared by an elected council and an appointed municipal executive. The council, once organized, elects one of its own to be council president for a one-year period. The system seems to reflect some of the characteristics of city manager government in the United States--a weak political executive and a supposedly non-political administrator. Such a system even in the United States works best in homogeneous communities where the appointed administrator is supported by strong community consensus about the scope and content of municipal policy. The system does not function well in communities characterized by serious economic and social divisions and where local policy is controversial. Such an environment demands a strong political executive who can forge programs based on a political mandate and mobilize support for them.

It is likely that increased municipal responsibilities and resources in Costa Rica will not be accompanied by a local consensus on how to use them. Controversial, tough decisions will be forced on local leaders and municipalities will require strong mayors with an electoral mandate.

Transition Team Conference on Decentralization. The newly elected government has endorsed decentralization as an integral part of its intended program.⁵⁷ In view of the complexity of the subject matter, however, it would be advisable to invite to a conference in San Jose, as soon as possible and preferably during or immediately following the work of the transition team, the principal officials who expect to be involved in designing and implementing decentralization programs. The potential exists thereby to save much time by promoting the decentralization dialogue -- a search for consensus on goals, programs, language, and techniques.

The timing would be particularly propitious because the bipartisan report of the Comisión Consultativa de Reforma del Estado (COREC) is due to be published in May 1990. One of the seven main themes in the Report is to cover the topic, "Centralización, sectorialización, regionalización y descentralización financiera y territorial." It is intended that, once the COREC Report is issued, COREC will be reconstituted as a Presidential Commission for State Reform. An early conference could benefit from and considerably contribute to these efforts.

The proposed conference also could be instrumental in defining the training needs, at both the national and local levels, which will be integral to the success of decentralization efforts.

In addition to discussing general issues of decentralization, the conference should develop an appropriate set of criteria for allocating functions among levels of government and between the public and private sectors. In the public sector, there are six criteria frequently used to allocate functions among levels of government and among administrative jurisdictions. These criteria, derived from experience in the United States, may be generic enough to be applicable in Costa Rica as well.⁵⁸

- The governmental jurisdiction responsible for providing any service should be large enough so that the benefits from the service remain primarily within the jurisdiction. Neither the benefits from the service nor the problems of failing to provide it should "spill over" into other jurisdictions.
- The unit of government should be large enough to permit realization of economies of scale if relevant.
- The unit of government carrying on a function should have a geographic area of jurisdictional adequate for effective performance.

⁵⁷Partido Unidad Social Cristiana, Programa de Gobierno, 1990-1994, (October 31, 1989), pp. 62-63.

⁵⁸Advisory Commission on Intergovernmental Relations, U.S. (ACIR) Performance of Urban Functions: Local and Area-wide, (Washington: ACIR, 1963) p. 41.

- The unit of government should have the legal and administrative ability to perform services assigned to it or be capable of acquiring those abilities with training and technical assistance.
- The performance of functions by a unit of government should remain controllable by and accessible to its residents.
- Functions should be assigned to that level of government which maximizes the conditions and opportunities for active citizen participation and still permits adequate performance.

Municipal Involvement in Capital Development Projects. A productive procedure to promote a gradualist approach to decentralization is to take advantage of possibilities to involve local governments in larger regional and national projects. This has been done successfully for projects in education, health, agriculture, natural resource management, and transportation in several countries. Among the most immediately relevant possibilities in Costa Rica are:

- Selection of municipalities to participate in the proposed solid waste disposal program.
- The design and implementation of a Watershed Management Program.

A Watershed Management Program. A number of separate events are coming together to make imminent the prospects for a successful watershed management program in Costa Rica.⁵⁹ At the same time the IDB is proceeding with the preparation of a major waste treatment and water and sewerage project, principally for the San José Greater Metropolitan Area. Among the many agencies which are involved (for example, on the Secretaría Técnica de Cuencas) is IFAM.

Basically, the project would encourage municipalities to prepare projects, with the technical assistance of experts listed by the STC as qualified. When approved by the STC, the projects could be financed through IFAM. The project envisages the possibility of financing a broad range of local services -- potable water, upgrading and maintenance of local roads, sewerage and solid waste treatment, sanitary landfills.

The (combined) project holds the promise of providing municipal governments with significant opportunities to assume greater control over their own affairs. Early on, however, several questions must be addressed. Of particular relevance to this study are the (initial list of) municipalities which are to participate, pricing policies and loan terms, and the basic role of IFAM itself.

See especially the Concept Paper, "Concepts for a proposed USAID Supported National Watershed Project for Natural Resource Conservation in Costa Rica through a Sectoral Approach in Cooperation with Municipalities," by Enrique M. Barrau, September 1, 1989.

It is recommended that all municipalities be invited to participate and that the selection of those which do participate in the program at the outset be based on the creditworthiness and municipal management assessments referred to earlier. This procedure has the dual advantage of beginning to emphasize local freedom of choice and, at the same time, maximizing the probability that the projects will be successful from the start.

Pricing policies and lending terms could pose a major problem. The policies of AyA and IFAM, for example, should be made consistent and economically sound. IFAM at present lends to municipalities for as little as 6% for up to 20 years with a grace period of up to 3 years for water, sewerage, and solid waste projects. These are negative charges in real terms and cannot be the basis for a significant and replicable national long-term program.

The role of IFAM in the program also raises some fundamental questions of a more general nature about IFAM itself.

IFAM. IFAM is the premiere municipal advisory agency in Latin America and has performed many valuable functions over the years. For the most part, it has done them with outstanding professionalism. The way in which it has operated, however, is not suitable to the new role that it can and should have in a program of decentralization. There are 4 major organizational and operational issues that need early resolution.

Partly as a branch of the Executive in a highly centralized system and partly by the default of local autonomy and municipal capabilities, IFAM itself has been highly centralized and has acted more as a paternalistic sponsor than as an advisor to municipalities. However appropriate this may have been until now -- and it has been largely appropriate as well as efficient -- it is inappropriate to the role which IFAM should have in a decentralized system. IFAM should concentrate on responding to municipal requests for technical assistance. In the future, this technical assistance will be increasingly for project preparation as the municipalities acquire the capability to handle many local functions on their own.

An early step in this change of attitude and function should be serious consideration of a much more extensive deconcentration of IFAM offices, at least to the regional level. It will take time before IFAM can relinquish policy-making or significant financial authority to regional offices; but it can begin with deconcentration of its offices at least for a regional level. An IFAM technician living in San José does not know the communities in his geographic area as the people in the regional office in Guanacasti, for example, know local problems. The level of understanding and trust are quite different. This became apparent in the RTI study team's discussions and visits to several regions.

IFAM will need to develop a capability for the economic evaluation of projects in order to be able to advise municipalities on capital investment projects. Until now, IFAM has financed relatively small projects for which a sophisticated economic analysis

would not be warranted. Simple tests of creditworthiness and financial analysis were sufficient. This will be inappropriate if, as expected, municipalities increasingly seek financing for larger capital development projects. IFAM will have to develop an economic analysis capability.

Finally, the role of IFAM as a financing agent should be rethought. As ever larger amounts of money become involved in financing capital projects, the dangers grow that there can be a conflict of interest between IFAM's role as (a) an advisor assisting municipalities to prepare projects and IFAM's role as (b) a source of approving and financing those projects. As an advisor, IFAM could well continue to represent municipalities -- at their request -- as financial agent. It might be wise at this point, however, to contemplate separating loan approval and loan administration. One possibility that has worked well in other countries is to utilize the banking system under the supervision of the Central Bank or conceivably together with the Ministry of Planning. In any event, IFAM should be alert to the potential conflict of interest that its new role is likely to create and early considerations should be given to avoid those conflicts of interest.

ANNEX 1

TERMS OF REFERENCE

As requested by the Statement of Work, the RTI team focused on seven principal elements:

- 1) A concise assessment of the relationship between the principal institutions of the Central Government and the municipalities and local development associations;
- 2) A description of the present division of labor between the central government and parastatal institutions and the municipal governments with respect to their legal, financial and administrative roles in providing basic goods and services as well as an assessment of their primary strengths and weaknesses;
- 3) A comparative analysis of the legal, financial, political, institutional, and administrative consequences of decentralization reforms adopted in such countries as Columbia and Bolivia, and recommendations on policies or actions to be taken to minimize the potential impediments that might adversely affect the successful implementation of the Coast Rican process;
- 4) An analysis of the major legal, financial, political, institutional, and administrative changes which are expected to occur following the adoption of the proposed constitutional reform and its regulatory law, and a listing of the critical issues which may be expected to arise in implementing the transfer of power, responsibilities, and resources from the central government to the local municipal governments;
- 5) A recommended policy framework and implementation strategy to systematically deal with the key policy and implementation issues posed by the proposed decentralization reform,
- 6) Recommendations on possible opportunities for USAID and other donors to assist in the decentralization process, including helping to furnish priority technical assistance and training in specific identified areas of need;
- 7) An analysis of the feasibility of a decentralization process which could be administratively mandated by the executive branch of the government under present law, without a constitutional change.

ANNEX 2

CASE STUDY: DECENTRALIZATION EXPERIENCE IN COLOMBIA

I. INTRODUCTION AND OVERVIEW

The decentralization process that is currently taking shape in The Republic of Colombia represents a major shift from the centralist tradition that has characterized the country for over a century. Until very recently, Colombia was caught in a tug of war between proponents of centralization and decentralization, the outcome of which seemed very much in favor of the centralists. The central government and its agencies not only controlled all the public revenues, but also supplanted regional and local governments in the provision of services such as primary education, health, housing and water and sewerage that were local in nature.

However, increasing national budget deficits and a growing concern about the erosion of local governments' role in the provision of services led to political movements for more "decentralization". From the growing concern about the steady decay of departmental and local institutions, policy makers seriously examined the respective functions and responsibilities of the three levels of government. A series of reforms instituted by the Betancour government in 1986, and continued by the present administration, represent a historic turning point in fiscal and institutional development in Colombia.

The public sector in Colombia is a three-tier system consisting of national department and local governments. The country is divided into 23 departments each of which is administered by a governor who is centrally appointed. Bogota, the capital of Colombia, also has departmental status. These departments are further divided into 1009 local government units know as "municipios". These local government units are of enormous diversity in terms of demographic characteristics, economic base, natural resources, fiscal and managerial capacity. This diversity is clearly visible in Tables 1 and 2.

TABLE 1
CLASSIFICATION OF MUNICIPALITIES BY POPULATION SIZE

<u>Population</u>	<u>Number of Municipalities</u>
800000 & +	4
100- 700000	22
30- 99999	41
12- 29999	84
< 12000	<u>858</u>
TOTAL	1009 ===

SOURCE: DANE 85 Population Census, DNP.

TABLE 2
 FINANCIAL SITUATION ASSESSMENT: 1988
 COMPOSITION OF REVENUES\EXPENDITURES
 BY MUNICIPAL SIZE

REVENUES	6000 - 12000	30000 - 50000	50000 - 100000	100000 - 500000	> 500000
Property Tax	8.6%	6.5%	10.0%	12.1%	4.5%
Industry & Commerce	2.3%	4.6%	7.2%	18.3%	25.4%
Vehicle Tax	0.2%	1.2%	1.1%	1.9%	1.2%
Valorization	0.2%	1.4%	0.7%	0.5%	1.1%
Royalties	1.8%	1.9%	0.9%	3.3%	0.0%
TOTAL OWN SOURCE	13.1%	15.6%	19.9%	36.1%	32.2%
Dept. Transfers	1.7%	0.9%	1.2%	2.6%	0.5%
National IVA					
Transfers	73.0%	65.9%	57.4%	31.8%	17.0%
Internal Credit	1.0%	2.5%	2.5%	10.2%	27.8%
Other	11.2%	15.1%	19.0%	19.3%	22.5%
TOTAL SHARED REVENUES	86.9%	84.4%	80.1%	63.9%	67.8%
TOTAL REVENUES	100.0%	100.0%	100.0%	100.0%	100.0%

EXPENDITURES					
Current	51.7%	55.8%	53.4%	58.4%	39.3%
Debt Service	2.4%	4.1%	4.6%	10.4%	10.6%
TOTAL CURRENT	54.1%	59.9%	58.0%	68.8%	49.9%
Investment	45.9%	40.1%	42.0%	31.2%	50.1%
TOTAL EXPENDITURES	100.0%	100.0%	100.0%	100.0%	100.0%

II. DECENTRALIZATION AND INSTITUTIONAL CHANGES

A. Fiscal Reforms Since 1983

The decentralization process was set in motion with a series of legislative measures of which the fiscal package was the first. The fiscal decentralization process was set in motion by law 14, promulgated in 1983. It sought to strengthen local government finances by conceding greater revenue raising authority and responsibility to local governments. This was followed by law 12 of 1986 that provided for transfer of increasing shares of the value added tax to local governments. In 1987, Decree 77 mandated that some public services be transferred to local governments, certain central governments agencies be abolished and responsibilities among different levels of government and among central agencies be realigned before 1993.

The original objectives of the decentralization reforms were ambitious: local government finances were to be strengthened by the enabling legislation to increase their own resources as well by the provision of additional transfers. The provision of public services was to be based on real needs and be provided more efficiently. Simultaneously, the national government was to be relieved of the burden of financing local services.

The passage of Laws 14 and 12 intended to strengthen the local fiscal base and enable "municipios" to use this expanded fiscal base to the fullest. The short term impact of Law 14 on municipal revenues was substantial until 1985 when they fell in real terms reflecting the decline in the property and commerce and industry tax. Many municipalities failed to take advantage of their ability to establish their own rates. In the face of slow property revaluations and relevant price adjustments, this revenue source is fast becoming a drag on municipal revenues. The poor managerial and administrative capability and the lack of any significant support from the departmental or national governments explain some of the implementation difficulties with regard to the commerce and industry tax.

Fiscal performance in municipal finance in Colombia demonstrates the overwhelming dominance of the largest cities, four of which together accounted for nearly 60% of all municipal taxes with less than 30% being generated among the nearly 1000 "small" municipalities. Of all municipal taxes, the industry and commerce tax is especially concentrated in the larger cities but is a more important source of revenue in all groups of municipalities than the property tax. A further characterization that is manifest in Colombian municipal finance is that taxes constitute a more important share and transfers a less important role, in the largest cities. Smaller municipalities, however, are more dependent on transfers. Against a panorama such as this, the principal objective of Law 12 looked to strengthening the finances of the smaller municipalities. Law 12 sought to give smaller municipalities more resources and to encourage fiscal effort: improving the efficiency of the local sector by both reducing the number of national agencies working at the local level and redirecting local funds to investments rather than recurrent expenditures.

The law of 1975 distributed 27% of the national sales tax collections to municipalities in accordance with demographic size. In 1983 when the sales tax was expanded to a value added tax, the basic procedure was maintained for 25% of the IVA (Impuesto al Valor Agregado) collections, although it updated the population basis. In addition, the national territories were granted an additional 1.5% with at least 30% of this to be directed to municipal investments. By 1985, the amounts diverted were 30% for municipalities between 100,000 and 500,000 and 50% for those over 500,000.

In terms of increasing financial resources available to municipalities, it appears that law 12 has achieved its objectives. However, this very success has also increased and accentuated the dependence that small municipalities have on the central government. Law 14 had little success particularly with respect to decreasing the reliance of smaller municipalities. The initial increases to local revenues have long since faded away in the face of a slow reassessment program and the inadequacy of inflation adjustments with respect to the property tax base.

Because the IVA transfer amounts to little more than a flat per capita grant, it does little to correct the wide disparities that exist between municipalities based on the heterogeneous resource base open to them. Some of the smaller municipios are barely able to survive even on the transfer, let alone take on added responsibilities conferred to them by law. Similarly, there exist municipios that are much better off and better organized to undertake adequate planning and where the results of the increased IVA transfer have become apparent in the provision of service delivery.

Larger municipalities do not appear to have great potential for increasing their revenues despite Law 14. One reason for this pessimism is that there is no incentive to do so. Another reason for the skepticism with respect to revenue potential from local taxes is the obvious political sensitivity of such a measure as observed in the cadastre fiasco in Bogota where the new valuations were deferred for up to a year and the methodology subject to examination. The difficulty of increasing revenues from such taxes even in nominal terms may make it difficult to expand local revenues.

B. Political Reforms and Community Participation

In order to make local governments more responsive to the needs of the community they serve and to strengthen the country's democratic process, a law promulgating the national election of mayors was passed in 1986. To further bolster the role of the community, a decree of 1986 created "comunas" with their representative organ called the "junta administradora" within municipalities to serve as an instrument for communicating initiatives and viewpoints from grassroots organization to the mayor's office. Furthermore, through a process called "consulta popular", local communities can now question specific actions or decisions of the local government.

This process of devolving authority to the local community also extends to increased control over resources and responsibilities. An important objective is to delegate greater decision making authority to the mayors in the provision of basic public

services and in planning and implementing productive and infrastructure investments within a national policy framework.

To this end, a decree passed in 1987 specifies the public services that are to be transferred to the domain of local authorities by 1992 and a calendar of activities transferring responsibilities from central government agencies to municipalities. The services to be transferred include water and sewerage, solid waste disposal, construction, operation and maintenance of markets and slaughter houses, operation and maintenance of schools, athletic facilities and parks, urban and rural feeder roads, transport terminals, bridges and river ports; provision of agricultural extension and operation and maintenance of health posts.

The implementation effort of this process has centered to date on those sectors with more immediate deadlines. In January of this year, water and sewerage responsibilities were transferred to local authorities. In education, local governments are starting to assume responsibilities for school maintenance and construction. Work is just starting in the health and road sector where implementation is somewhat behind schedule. In the health sector, several critical policy decisions need to be made for the transfer of responsibilities. These include decisions on policies and mechanisms on cost sharing for construction, equipping and operating local hospitals; on ensuring recurrent funding for all primary health care facilities; on formulating a pragmatic and manageable user charge policy for primary health care facilities and on appropriate co-financing schemes between the National Hospital Fund (FNH) and the Regional Health Service (SSS) offices.

Progress is considerably slower in the agricultural sector where the principal actors are drawing up policies and co-financing arrangements that were to have passed to the Rural Integrated Development Fund by the end of last year. The role of each level of government and the division of responsibilities between them need to be in place by 1992.

C. Management Capability and Regional Disparities

The lack of management capability at the local level, especially within smaller municipalities, has been a cause for concern. Institutional and management strengthening is critical not only for obtaining successful implementation of the decentralization process but also for obtaining synergetic results in local economic development. In executing the policies and implementing reform, perhaps one of the most overwhelming hurdles to the decentralization process, has been the immense diversity between the different "municipios" and regions. This diversity precludes the government from adopting standardized training and technical assistance programs and policies throughout the country. The real challenge lies in a pragmatic, flexible and situational approach to technical assistance and training and other management support programs to address the enormous diversity among municipalities.

The transfer of responsibility for the provision of public service has been effective for all municipalities, and legally municipalities have been treated as a homogeneous

group in the decentralization laws. However, administrative structures differ widely among municipalities. This fact has given rise to a complex matrix of requirements that call for very innovative approaches.

In this respect, training is key to the institutional building and management strengthening. The National School of Public Administration (ESAP) has so far focused on explaining different aspects of the decentralization process and the fiscal reform measures. What has been missing is a strategy to provide training in practical skills for financial management, budgeting, accounting and especially criteria for establishing priorities for expenditures and investment projects.

A coherent training plan and a strategic action plan that take into account regional and institutional differences is a top priority. It is also well known that ESAP cannot address the entire gamut of training needs, nor does it have the capability to undertake such a program on a national scale. It is, therefore, in the interests of the local governments that the role of the private sector be considered.

D. Strategic Action Plans and Critical Areas for Improving Results

The heterogeneity of municipalities, especially those with below 100,000 inhabitants, will require long term institutional strengthening in terms of technical assistance and training. In this process, it will be necessary to employ the people available at regional and departmental level who are more familiar with the local circumstances and whose intervention could have effective synergetic effects. It will take years before the smaller municipalities are able to take charge of the responsibilities that have been devolved to them.

Most municipalities are going to require assistance in the effective use of the financing options open to them. They also require technical assistance in various aspects of the project cycle for implementing multi-year rolling investment programs. Given the great diversity that exists, the role of intermediary agencies capable of providing technical assistance and training at the departmental level cannot be overstressed.

Considerable attention also needs to be given to financial management and budgeting, organizational development, human resource development and strategic and urban planning. The strategy for a successful implementation has to include, but not be limited to, adequate guidelines for policy implementation; clear definition of roles and responsibilities, especially at departmental and regional level; and an adequate system to monitor the trends and consequences of the fiscal effects of decentralization.

Greater efficiency in the provision of public services through decentralization will be achieved by improved local financial performance. Although most of the smaller municipalities are still dependent on central government transfers, additional measures to improve the local financial base and collection need to be formulated.

The final area that requires a coherent policy is cost recovery through user charges. As local governments assume responsibility for providing services at local level, this issue becomes important.

E. Relevance of Colombian Experience for Costa Rica

The Colombian decentralization efforts since the major initiatives of 1983, 1986, and 1987, indicate some of the cautionary expectations that can be anticipated in Costa Rica's decentralization program.

- Legislative change can be a necessary condition for some decentralization measures. It cannot be a sufficient condition.
- Increased municipal revenues must accompany improved local responsibility for the provision of public sector goods and services. Increased revenues will be a necessary, but not a sufficient condition to accomplish decentralization in Costa Rica.
- As in Colombia, a necessary and sufficient condition for decentralization in Costa Rica will be to strengthen local management and decision-making capabilities.

The Colombian experience also shows that the process of increasing own-source revenues is unavoidable time consuming. Continued heavy reliance in central government financial support Costa Rica can be diminished only gradually. In particular, the ability to increase property tax revenues is likely to be an incremental process over an extended period of time in both Colombia and Costa Rica.

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ANNEX 3

CASE STUDY: DECENTRALIZATION EXPERIENCE IN INDONESIA

I. COUNTRY SITUATION AND DECENTRALIZATION

Into the foreseeable future, Indonesia will experience rapid and accelerating urban growth. By the end of this century, an estimated 36% of all Indonesians, or 76 million persons, will be living in cities, compared to 22% or 33 million persons in 1980. The country's urban population is expanding annually at 4.3%, or more than twice the overall growth rate.

National investment in urban development has been unable to keep pace with the increased demand for new services or the costs of operating and maintaining existing infrastructure and services. As a result, over half of the urban residents do not have access to piped water, and over two-thirds lack adequate sanitation facilities. The expected increase in the urban population will only compound these problems, contributing to even greater deficits in infrastructure and services, unless additional revenues are mobilized for urban investments, and these investments are made more efficiently.

The GOI's investment in the urban sector began in earnest during Repelita II (1974-1979), with an average annual expenditure of 263 billion R. Under Repelita III (1980-1984), substantially increased earnings from oil revenues enabled the GOI to expand its urban investments, nearly doubling its yearly expenditures to 500 billion R. Throughout this period, capacity at the local government level to plan and carry out urban projects remained weak; thus, the GOI played a dominant role not only in funding urban development, but in the planning and approval of local projects as well. Over the Repelita III period, the percentage of municipal revenues coming through GOI grants rose from 69% to 75%, with a top-down, central-government-controlled planning and approval process firmly entrenched.

This heavy dependence by municipalities on central government revenues served as a disincentive for improving local resource mobilization, and allowed for distortions in the allocation of urban expenditures. Local governments that may have wanted to operate more independently or undertake more ambitious development programs were hampered by GOI controls on the one hand, and the lack of alternative funding sources (e.g., loans) on the other.

Despite the substantial increase in the GOI's urban expenditures between Repelitas II and III, these investments were inadequate to meet increasing needs, in part because of the absorptive capacity of government at both the local and national levels. The problems associated with limited implementation and O&M capacity at the central and local levels were compounded by a lack of systematic planning and coordination among the key national agencies. As evidence of having reached the urban sector's absorptive capacity, commonly there were budget carry-overs of 30-35% from one year to the next in the programs of Directorate General Cipta Karya, the principal agency concerned with urban infrastructure.

By the end of Repelita III, some attempts were made to begin decentralizing the planning and implementation of urban activities, but these efforts were confined to only the country's largest cities. However, as a result of this process, an Institute for Urban Policy Analysis (IUPA) was created under the Ministry of Finance's chairmanship. Ultimately, the IUPA's initiatives in decentralization and coordination became the basis for the GOI's more recent policy changes in the urban sector.

The main impetus for decentralization, however, has been the sharp decline in the country's oil revenues since the mid-1980s, exacerbated by a fall in other commodity prices as well. As a result, the GOI has experienced severe budget cuts starting in 1986, with a growing gap between resources and investment needs.

During Repelita IV (1985-1989), the World Bank estimated that an annual investment of 900 billion R (1986 prices) was needed in the urban sector to meet reasonable growth needs and overcome service shortages at minimum service levels. In FY 1985/86, however, the total public expenditure on infrastructure, operations and maintenance amounted to only 470 billion R, or just over half of the estimated need. Continued budget austerity has meant that the GOI can not complete some on-going projects or initiate new ones.

This resource gap has caused the GOI to embark of a broad policy agenda of shifting responsibility for the planning, financing and management of urban development to municipal governments, with concomitant programs to build local management capacity and enhance local resource mobilization. This GOI-adopted decentralization program is supported by a World Bank urban sector loan, and comprises four principal policy and programmatic areas:

- Local resource mobilization including measures to enhance tax collections and user fees, and to improve local revenue administration;
- Urban development financing mechanisms including the establishment of a loan fund for local governments and enterprises, and development of criteria and guidelines for the allocation of GOI grants;
- Planning and programming including strengthening of decentralized planning procedures, development of planning guidelines, and formulation of medium-term urban development and expenditure programs; and,
- Institutional and manpower development through technical assistance and training.

The various components of the GOI's decentralization program are discussed in detail in the following section.

II. LOCAL GOVERNMENT ROLE

1. Structural Characteristics

(a.) Overview

Provision of urban services in Indonesia forms an integral part of the overall system of the four-tier levels of government. The 27 provinces form the first level (Dati I or Tingkat I) regions and each province is further divided into second level (Dati II or Tingkat II) units consisting of 292 regencies (Kabupatens) plus 54 municipalities (Kotamadayas). The regencies closest U.S. counterpart is the county as each regency essentially covers the areas not incorporated in one of the 54 municipalities. Jakarta (DKI) is a special case having the status of a province. The second level regions are in turn subdivided into 3500 third level units known as districts (Kecamatan) while these again are subdivided into 64000 fourth level villages (Desa). In the large urban areas there are further divisions into Rukun Warga (RW) and Rukun Tetangga (RT). The latter, which each consist of 150 families, are the smallest urban administrative units.

(b.) Regional Government Organization

Regional administration at province and local levels comprise separate legislative and executive branches. The executive arm consists of Governors for provinces, Mayor (Walikota) for kotamadya and Bupatis for the kabupaten. They are all appointed by the Minister for Home Affairs. The legislative arms are the "people's representative councils" and consist of mainly of elected representatives. Provincial governments generally are not greatly involved in the direct provision of urban services (except for Jakarta DKI), although in certain cases they do provide some financial assistance. They are, however, responsible for overseeing all the work of the municipalities and counties. As urban services expand to numerous settlements in the province, the provincial authorities can be expected to assume a greater role in guiding, assisting and evaluating urban plans and programs.

2. Service Provision Responsibilities

The real responsibility for most urban services lies at the municipal/ county level. Responsibilities are shared with a number of central government agencies. Public Works (Dina P.U.) generally is the most important, being concerned with roads, drainage, sewerage, public works and parks. In some localities, it is responsible for solid waste service (although there is often a separate enterprise). Where a neighborhood improvement program has been undertaken, a separate KIP (Kampung Improvement Program) unit is established. Sanitation and rural water supplies are sometimes provided through the Health Department. Markets and water supply are generally run as local enterprises as in Semarang, although water supply may be under the temporary control of the Directorate General of Housing, Building and Planning (Cipta Karya) or organized as a local section. Urban public transport is provided in most cities by the private sector excepting Jakarta and some four other cities.

Village governments and community groups play an important role at the very local level. In addition to the heads of the administrative areas, village associations (Lembaga Kemajuan Masyarakat Desa) play an important role in neighborhood life. Besides maintaining access roads and footpaths, cleaning drainage channels, house to house collection of solid waste, managing public water standpipes, these local groups have the responsibility for planning and implementing the village development programs (Inpres Desa programs) and in some cases are actively involved in setting local priorities for KIP layouts as occurs in Semarang. In many smaller urban communities, the bulk of urban services such as drainage, waste disposal and footpaths have been provided on an informal basis through self-help (golong-royong) programs.

The allocation of responsibilities for local services between the Central Government provincial-level offices (Kanwils) and the local authorities (through sections) is not completely clear cut; both kinds of agencies may be involved in a particular geographic or functional service area.

Indonesian Law (notably Law 5 of 1974) makes a distinction between those services which are provided directly by central government agencies, which are termed "deconcentrated" services, and those which are, or better said, which should be provided by the local government, termed "decentralized" services. (See Exhibit 1). Most elements of urban infrastructure (water supply, local roads, sanitation, solid waste) fall in the latter category. The law also refers to the provision of urban services by a third means, namely, "co-administration" (tugas pembantuan); defined as "the execution of services by local government under the direction of central government". To a large extent this third approach is a fair description of the means of provision of nearly every significant service provided by the local government. Most of the urban services noted in the decentralized category are in fact implemented in the style of co-administration.

3. Planning and Coordination at Local Level

Heads of regional administration exercise a dual role. Not only are they leaders of the executive branch of the "autonomous regional governments"; they also are local representatives of the President, acting for this purpose in a "deconcentrated" capacity. This deconcentration role requires heads in the region to exercise a general oversight of all government functions within the area and in particular to coordinate the work of all central and regional government agencies. To this end heads of the Kanwils, though subordinate in their executive capacity to the central sectoral departments, are for coordination purposes subject to the authority of the regional heads. They are, nonetheless, financially, technically and administratively responsible to the central government department.

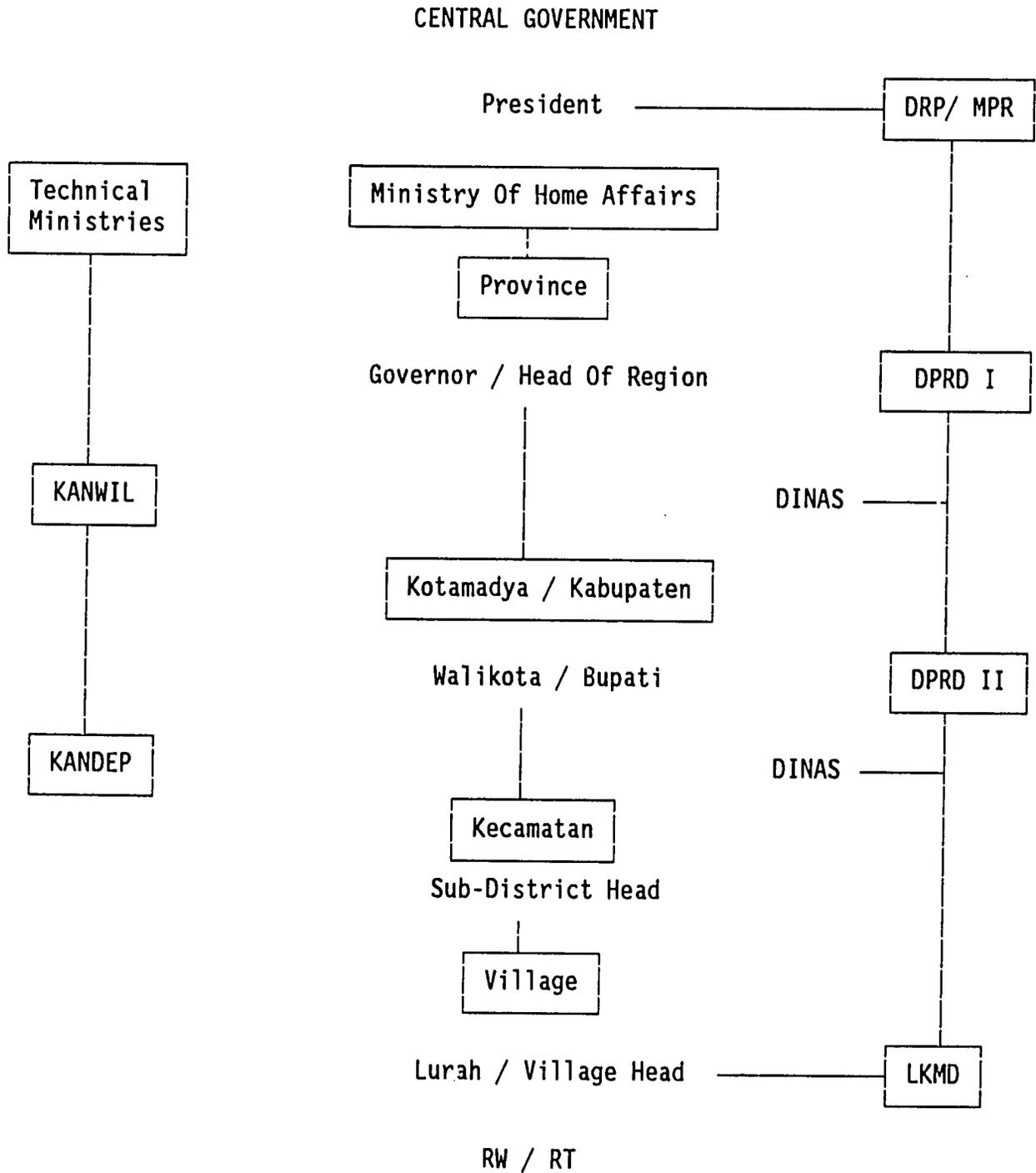
An important role in the coordination of central and local government programs is exercised by (Regional Development Planning Boards) BAPPEDA that are established in every province and second level administration. As a planning service to regional heads, these boards fall under the jurisdiction of the Ministry of Home Affairs. These planning boards have both annual and long term planning functions in relation to local and regional development programs. Each year they prepare schedules of development

project proposals in all service areas for execution by both the Kanwils and the local Dinas organization, for approval by the regional heads and submission to the Central Government. These programs are the basis for central government financial allocation both for sectoral department development projects and for central government grants. For the purpose of the urban services program, the planning boards play a potentially important function to define the local needs and priorities.

EXHIBIT 1

DECONCENTRATION

DECENTRALIZATION



SOURCE: Intergovernmental Financial Relationships in Indonesia, N. Devas, June 1987

Longer term development planning is attempted through the medium of five-year plans coincident with the national five-year plans. These programs being undertaken in some 350 cities through the Integrated Urban Infrastructure Development Program (IUIDP), which include, inter alia, five year rolling investment plans identifying projects, financing sources and capital costs of each project. (See discussion in next section.)

Responsibility for technical aspects is largely vested in the Ministry of Public works. The Directorate General for Housing, Building and Planning (DIPPTA Karya) deals with water supply, sanitation and sewerage, solid waste, kampung improvement etc; the Directorate General for Roads (Bina Marga) is responsible for national highways including those through urban areas; and the Directorate General for Irrigation and Water Resources (Dengairan) is responsible in urban areas for major drainage. The technical and financial implications of operation and maintenance is the responsibility of local government and has been given less consideration. Through an IBRD Urban Loan Program, such a study has commenced to determine ways and means on improving operation and maintenance of urban services.

Mid-term priorities for investments are established by the National Planning Agency (BAPPENAS), in the five year plans. It also reviews and approves specific projects and programs proposed each year by the sectoral departments and the plans prepared by the provincial and local agencies. The Ministry of Finance through the Directorate General for Internal Monetary Affairs monitors and has oversight of local government finances and loan schemes. The Directorate General for Budget authorizes all central government payments and a third Dg audits local governments. Finally the Directorate General for Taxation is responsible for the collection of certain assigned revenues and supervises the local property tax.

4. Municipal Finances

(a.) Overview

The financing sources for local governments comprise the following:

i. Central Government Grants

These grants form the bulk of all development expenditures undertaken in the municipalities and counties and also support routine expenditures covering personnel costs and a proportion of operation and maintenance.

Development expenditures financed from the National Budget (APBN) come through various channels. The DIP (Daftar Islan Proyek) were the most important and linked to sectoral program. These funds financed the so called "deconcentrated services". These DIP grants have declined in recent years while the INPRES "block and categorical/specific" grants have increased. It is not entirely clear whether this change stems from the financial constraints the GOI is experiencing or whether it signals a fundamental change in government policy. Nevertheless, the shift does show an implicit recognition of the priority of local government expenditure. The most important aspects of the different grants is considered below:

- The largest grant -- the Subsidi Daerah Otonomi (SDO) covers basically wages and salaries of staff that are appointed centrally. This allocation is based on the number of officials in each region. Although the better part is destined to salary and wages, a smaller proportion (ganjaran) is assigned to operation and maintenance. The size of the latter portion is determined by the Ministry of Home Affairs.
- "Block" grants (INPRES II) are allocated on a per capita basis for the second level governments, while the village level municipal and county (Desa) receives a grant on probata basis per village. These grants, although they contain elements of local choice, are subject to national guidelines and are commonly referred to as "guided" (Diarhkan).
- The "specific" or "categorical" INPRES II grants are earmarked for roads, bridges, education, regreening and reforestation. These "directed" (Ditetapkan) grants are to ensure the equal distribution of minimum education and health services. However, the per capita criterion falls short of the regional equity issue and the criteria for these grants are currently under revision.

ii. Assigned Revenues

These are a shared revenue base with provinces and local government. The most important of these assigned revenues is the property tax (PBB) and include royalties on forestry, mining and gasoline. The latter are not a significant

source. Provincial governments receive 40% of royalties collected from their regions while municipalities receive 20%, the rest going to central government coffers.

iii. Own Source Revenues

These consist of local taxes, user charges, profits from local municipal enterprises, departmental revenues (Dinas-daerah) and other miscellaneous revenues. Although municipalities receive most of their revenues from user charges, they also impose over a 100 taxes. Most of these are regressive in nature. A draft proposal is being formulated for eliminating most of these. This is discussed in the following section on the efforts being undertaken to strengthen local government finances. (See IIC, 2bi.)

iv. Borrowing

Municipal governments have borrowed very little over the past years. This is due in part to the assistance they receive from GOI and also because of the approval required from MHA. A further reason is the debt ceiling established at 15 percent of total development revenues. Currently the debt service ratio is under revision and the central government is contemplating increasing it to 30%.

(b.) Analysis of Revenues And Expenditures

For municipal governments only 11 percent of their budget comes from local revenue sources. Of this, charges contribute the largest share (5.2%), with the main sources being markets, hospital charges, building permits. Local taxes only contribute 2.2%, of which the main sources are taxes on entertainment, hotels/restaurants, and street lighting. Assigned revenues contribute 5.2%, most of which comes from the property tax (PBB). (See Tables 1 and 2.)

LOCAL GOVERNMENT FINANCE
REPUBLIC OF INDONESIA
FINANCIAL SITUATION ASSESSMENT OF MUNICIPALITIES
(Rp. Millions)

	1979-1980	1983-1984
Routine Revenues ^{1/}		
Balance B/F	10,700	10,800
Local Taxes	21,500	45,200
Charges	46,100	105,800
Regional Enterprises	1,900	3,100
Other	27,000	63,900
Central Gov. (SDO)	188,500	452,500
Total Routine Revenues	295,700	681,300
Development Revenues		
INPRES	274,400	1,102,900
Transfers from Prov.	10,200	20,400
IPEDA	49,900	109,400
Loans & Dev Income	40,100	126,400
Current Account Surplus		
Total Dev. Revenues	374,600	1,359,100
Total Revenues	670,300	2,040,400
Routine Expenditures		
Personnel	193,447	443,998
Materials	26,056	65,897
Subsidies to Regional E.	813	1,394
O & M	12,014	25,764
Debt Service	1,426	4,711
Other	49,302	116,986
Total R. Expenditures	283,058	658,750
Development Expenditures		
Investments	376,800	1,356,100
Total Expenditures	659,858	2,014,850
Current Account Surplus	12,642	22,550
Surplus / Deficit	10,442	25,550

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1/ Figures shown are estimated total receipts and expenditures based on
Typically delay in published data is around 2 years.

LOCAL GOVERNMENT FINANCE
REPUBLIC OF INDONESIA
FINANCIAL SITUATION ASSESSMENT OF MUNICIPALITIES
(Rp. Millions)

	1979-1980	1983-1984
ROUTINE REVENUES		
Balance B/F	1.6%	0.5%
Local Taxes	3.2%	2.2%
Charges	6.9%	5.2%
Regional Enterprises	0.3%	0.2%
Other	4.0%	3.1%
Central Gov. (SDO)	28.1%	22.2%
Total Routine Revenues	44.1%	33.4%
Development Revenues		
INPRES	40.9%	54.1%
Transfers from Prov.	1.5%	1.0%
IPEDA	7.4%	5.4%
Loans & Dev Income 1/	6.0%	6.2%
Total Dev. Revenues	55.8%	66.7%
Routine Expenditures		
Personnel	29.3%	22.0%
Materials	3.9%	3.3%
Subsidies to Regional E.	0.1%	0.1%
O & M	1.8%	1.3%
Debt Service	0.2%	0.2%
Other	7.5%	5.8%
Total R. Expenditures	42.8%	32.7%
Development Expenditures		
Investments	57.1%	67.3%

1/ Loans amounted to Rp. 40,100 and 25,700 in 1979/80 and 1983/84.
This constitutes roughly 1.3% of total revenues in 1983/84

Local authorities borrow about 6.5% of their budget if development income (soft loans) are included. Most of the remainder -- about 77.3% comes from central government grants which includes 1 percent from provincial governments. Of this, 22 percent is constituted by the SDO, while 54.3% is channeled into development either through "block" or "specific" grants.

Development revenues rose steadily from 56% in FY 1979/80 to 67% in FY 1983/84. This pattern reflects the influence of the INPRES program which rose substantially over the period.

Routine expenditures account for 32.7% in FY 1983/84. Of this personnel expenditures account for 22% of total expenditures, followed by materials while O & M accounted for only 1.3% of total development costs. This is very low by international standards. Annual average growth rates for municipalities over the same period, show that expenditures grew at a faster rate than the Gross Domestic Product in both routine and development expenditures. While routine expenditures grew at 23.5% and development expenditures averaged 37.7%, the gross domestic product averaged 23.2%.

5. The Question of Decentralization

Indonesia is a unitary state, but the pace and spread of development and the vast size and diversity of the country has meant that more initiative and responsibility for implementation of local services must be devolved to lower level of local authorities, but under central guidance on policy and resource allocations. This proposition is universally accepted and agreed to; but a major area of discussion within the government is how rapidly this process of devolution can proceed. This question is particularly relevant in the case of urban services where the scope for devolution may be greater, since the managerial and technical capacity of the kotamadya, especially the larger ones, is often superior to that of the kabupaten. About 35% of all government spending is made by the provincial and tingkat II authorities, compared with a 36% average for all other regionally incurred expenditures. The discussion has become more urgent since it has become apparent that central government funds are likely to be relatively less important in financing urban services than in the past.

The view of the Ministry of Home Affairs, which is responsible for the administration and staffing of local administration, is that the devolution to local administrations of the "decentralized" services already identified in the law should be quickly implemented and that the powers be accompanied by the allocation of grant funds directly to the local level instead of being implemented through the budgets of sectoral departments. These Departments would provide policy guidance on technical matters, and technical assistance to local administrations. The view of some sectoral Departments is that, while in agreement with decentralization as a long term goal, due to weaknesses in local capability to plan and manage, to staffing limitations, and to the danger of inefficient use of funds by local administrations, sectoral agencies should continue to fund and implement local programs until these matters can be resolved. These are all legitimate concerns, and an important task for the government is to explore the suitability of various services for local implementation and the rate at which

selected services might be devolved, and what other measures including changes in administration, funding, staffing and training are required.

III. PRESENT POLICY AND PROGRAM EFFORTS

1. Overview

The recent decline in oil prices have severely limited the GOI's ability to maintain the past level of substantial financial support to sustain the momentum of urban development in recent years. Although the recent decline in Central Government revenues has served as catalyst for reform, the need for adopting different and innovative financing mechanisms has been recognized for sometime.

A draft statement of Policies for Urban Development prepared recently stresses the need that more initiative and responsibility for implementation of local services be devolved to lower levels. These policies encompass strengthening local government financial management particularly with respect to local resource mobilization, budgeting, improved O & M; changes in urban infrastructure financing and improved planning and programming of multi-year urban investments.

The key elements in the strategy of local resource mobilization focus on the implementation of a new property tax (PBB, effective in January 1986); a draft law to improve the structure of local taxes, pilot efforts to improve tax administration and financial management in 6 cities and that would eventually be extended to some 90 areas and the development of national water tariff guidelines for water enterprises (PDAMs).

In the future financing of urban infrastructure investments, due to a limited availability of grants, the government is taking steps to set up a consolidated revolving loan fund and specific proposals for a comprehensive reform of the central-local grant system. Taken together, these policy changes should represent a significant shift from Central to Local government.

Several initiatives to improve the planning and programming process in conjunction with the fiscal reforms described above have already begun. Of particular significance, is the system of Integrated Urban Infrastructure Development Program (IUIDP) that was introduced in 1985 and covers some 350 cities. Its major objectives are to implement an integrated planning approach, issue guidelines defining investment policy and criteria, as well as the functional responsibilities of central, provincial and kotamadya authorities.

It is important to note that while these intergovernmental reforms and proposals reflect a significant commitment to strengthen the role of local government in the provision, financing and delivery of urban services, it will not be in place in the immediate future.

2. Local Resource Mobilization

In order to develop local government responsibility for providing urban infrastructure services, various efforts are either being undertaken or contemplated to strengthen their capability to mobilize resources and optimize the use of funds.

(a.) Property Tax Reform (Pajak Bumi dan Bangunan, PBB)

The Law on Land and Building Tax (Law 12 of 1985) was passed on December 27, 1985 and became effective on January 1 1986. This new tax represents a significant departure from IPEDA because it simplifies the rate structure and broadens the tax base (change from annual rental value to capital market value). Its other innovative features impact the administration and enforcement of the new law where incentives for evasion are reduced and penalties for non payments included.

The revenue potential of the new property tax looks promising. According to World Bank estimates, receipts could be increased from Rp. 243 million in 1986/87 to over Rp. 1000 billion within the next five years. It is estimated that by having 95 percent of the property registered, having properties valued at 90 percent of their true market values, collecting 85% of all the assessed taxes, property tax revenues could reach over Rp. 2400 billion by 1995, more than 14 times the present value. Should this target be reached, these assigned revenues could compensate for the declining contributions from the Central Government.

The distribution criterion differs from the previous IPEDA allocation. The new property tax allocates about 65% of its revenue to Level II governments, 16% to Level I, 10% to the Central Government and 9% to cover collection costs. This allocation differs from the old IPEDA system which allocated 70% to local governments, 10% to provincial governments, 10% as Kotamadya/Kabupaten equity contribution to the regional development banks and 10% to cover collection costs. Another fundamental difference between the old and new law refers to its use. Unlike the old IPEDA law that stipulated that the tax be used for the development budget, the new law gives local governments considerable more discretion over its use; between 10% and 50% need be allocated to the development budget. From a financial management perspective, the use of 50-90% in the routine budget may have varying consequences depending on its use. This will be examined in greater detail in the following section.

(b.) Increasing Local Taxes

Local governments levy nearly 100 taxes. However, few of these taxes are individually very important in local government finances and constitute less than 10 percent of total revenues. A three pronged strategy, either currently being implemented or in the process of implementation, focuses on:

i. Improving Tax Administration

Local tax administration is deficient in three broad areas of registration of taxpayers, assessment of tax liabilities and collection of revenues. In an attempt to remedy some of these administrative deficiencies, a new tax registration, assessment and collection system is being introduced on a pilot basis in 6 cities (five kotamadya and one urbanized kabupaten) and is expected to be replicated to 90 other areas. This also includes the reorganization of the local tax offices (Dinas Pendapatan Daerah, DIPENDA). Under the pilot program, a standardized organizational system will be used in all localities. However, it is too early to assess the impact of this program.

ii. Draft Reform Of the Local Tax System

A draft proposal is pending approval. It is aimed at eliminating the less productive taxes to reduce the distortions and misallocations caused by such taxes; mitigate the administrative and cost burden; and reorient principal employee efforts on the more productive ones.

When enacted the law would eliminate all except the following taxes. Taxes on motor vehicle and transfer duties that would still be retained at provincial level. Local Dati II would retain tax on non-motorized vehicles, entertainment tax, restaurant and hotel tax, business tax, street lighting and the advertisement tax.

In addition to the proposed elimination of many unproductive taxes, the draft law is also contemplating the introduction of two new taxes for the Level II governments. These are the gasoline tax and the betterment levy tax. The gasoline tax is to be levied on consumption of fuel and is progressive in nature. Some estimates on this tax consider that a one percent surcharge would generate roughly Rp. 15 billion while a three percent levy would produce the equivalent of total local taxes currently being generated. On all basic criteria for a tax - efficiency, equity, ease of administration and collection, this tax measures favorably.

The betterment levy tax, which is used in many South American countries, was introduced in DKI Jakarta where it is called Payak Khusus. However, it appears to have had administrative problems in its initial implementation; no revenues were budgeted for the last fiscal year. Another variation of this tax has been introduced in Bali. This is the land development tax that has been used in countries like Taiwan and Korea. GOI is studying the possibility of introducing one of these variations under the IBRD Urban Sector Loan Project.

(c.) User Charges

User charges levied either by service departments of local governments (DINAS) or local enterprises (Perusahaan Daerah) constitute an important source of local revenues (18% in Bandung in 1983/84). The most significant user charges are those for water supply (PDAMs), as well as charges for markets, solid waste collection and disposal, parking, bus stations, taxi stands and building permits.

A number of technical assistance efforts to improve cost recovery and administration are currently being carried out. As has been mentioned earlier, efforts to improve the structure and procedure of local revenue offices, are being carried out in 6 cities. Improved planning and financial programming has been introduced in kotamadya Surabaya while a financial management study is being undertaken in Bandung, Semarang, Surakarta, Pandgang and Ujung. An Operation and Maintenance Study on City Infrastructure is also being carried out in the cities mentioned above. The objective is to better identify and measure the cost of services provided. Additionally, under the World Bank Urban Sector Loan, similar efforts will be directed specifically at Water Enterprises. The aim is to make these entities self sustaining financially and also to improve their management practices particularly in accounting, tariff structure.

(d.) Other Financing Sources

Due to limited availability of Central Government funds, two cost sharing mechanisms are currently being contemplated: the formulation for specific proposals for reform on the Central-Local Grant System and the establishment of a consolidated revolving loan fund -the Regional Development Account.

Both these initiatives are being contemplated under the Urban Sector Loan Program. It is anticipated that the instruments for improvement of the Central-Local Grant System will be prepared by 1989. The RDA is considered a precursor to the Regional Government Development Fund. It will be established as an Account at the Ministry of Finance and its function will be to lend to local governments for capital investments in infrastructure, equipment and provide facilities for bridge financing needs. The lending terms and conditions would be structures to ensure consistent treatment of all local governments as well as the financial viability of the RDA.

3. Integrated Urban Infrastructure Development Program (IUIDP)

The GOI (initially through its Directorate Cipta Karya, DGCK) but with increasing support from other Central Government ministries (Finance and Public Works) has initiated an improved planning and programming process for urban investments. The basic approach is that the Level II governments would take the lead, with the assistance of the sectoral agencies, in preparing:

- medium term 5 year investment rolling plans, identifying the needs spatially and by sector;
- an operation and maintenance plan and program a multi-year budget;
- a financing plan with a mix of loans, grants, own source revenues and cost recovery measures.

Provincial governments would provide guidance and assistance as well as review the multi-year investment plans. This function would be headed by BAPPEDA with

coordinated technical inputs from other departments. The Central Government's role would be limited to setting standards, providing financing mechanisms, guidance on the planning process to provincial governments and technical assistance where necessary, and training local staff in planning, implementation and O&M procedures.

A major program of training and technical assistance has been launched to support implementation of the change, with the assistance from UNDP/UNCHS, IBRD and ADB as well as other bilateral donors.

Managed properly this process could offer integrated infrastructure planning based on rational technical criteria and standards. It would improve the previously fragmented coordination between the various levels of government and also focus better on the estimation and provision for the hitherto neglected operation and maintenance of urban infrastructure investments. Much of its success will undoubtedly depend on the transfer of technology to level II governments and a "buy in" from respective local counterparts.

4. Training and Technical Assistance

In order to rationalize planning for the development of staff involved in urban development, particularly at Levels I and II, GOI proposes to carry out a comprehensive review of existing conditions and future needs. Because of the primary role of the Ministry of Home affairs in local government administration, the Secretariat General of MHA plans to commission a study that would form the basis to amend policy and procedures in order to strengthen local authorities' capacity over the medium to long term to undertake their responsibilities. While the primary focus would be on Level II authorities, the capacity and structure of supporting agencies of central and provincial government would also be examined.

With the advent of the Integrated Urban Infrastructure Development Program and the need to devolve authority to local government, the need to provide a broad spectrum of high impact; relevant management and technical level training, is clear. Furthermore, due to the increased emphasis on cross sectoral integrated urban development project, local government personnel particularly at management level require a much wider range of technical and managerial expertise. As has been mentioned earlier on, some of this training and technical assistance is already in place.

IV. CURRENT POLICY AND PROGRAM LIMITATIONS

Although the policy and program efforts currently underway encompass a broad agenda, there are significant areas recognized by the GOI and the donor community in which additional, major effort is required. For the most part, these areas represent implementation issues rather than matters of broad policy concern, although some policy changes will be required if there is to be successful implementation of some decentralization strategies. In this section we discuss the major areas in which either additional policy attention must be focused, or additional attention to implementation must be paid, or both. Four major concerns are addressed:

- Planning process strategy for focusing local investments on the economically most productive alternatives;
- Policy and legislative reforms to improve local, own-source revenue generation;
- Policy and programmatic efforts to insure the most efficient use of local resources; and
- Capital resource availability to support additional local investments.

1. Local Investment Planning

As the preceding section described, the GOI already has initiated a major effort to reorient the local development investment programming and financing process (IUIDP). Its present focus is on integrating the programming and financing for all local public works investments covered by the umbrella of Ministry of Public Works responsibilities (roads, water, sanitation, drainage, and related other infrastructure). This effort, supported by IBRD urban sector loan financing and UNCHS-financed technical assistance, is operational in several larger cities and is in process of being extended to a much larger number of cities. Although the program already has an ambitious agenda, there are several areas in which it could be enhanced to increase its impact on local development.

First, the focus of the present effort is more on programming and financing local investments rather than on identifying the economically most productive investments. This is not to say that consultants presently working with provincial and local government officials are not addressing the issue of priority determination, but rather to say that developing a process for identifying which investments would be the most productive is not the main focus. Rather, there may be a tendency to take local investment priorities as given and to focus on evaluating those priorities from the point of view of integrating all possible funding sources in order to determine a financially feasible set of investments. This observation is not so much a criticism of the program, but rather an observation that its present focus does not encompass the entire spectrum of investment planning issues.

For example, it does not appear that sufficient attention is being paid presently, at the initial planning stage, of determining what types of investments should be considered by a local government from the point of view of contributing the most to local economic development. Virtually all local governments in Indonesia can catalogue a long list of public works infrastructure needs, but the planning mechanisms for evaluating which of these needs are more likely to generate local employment and other economic activity are not likely to be in place. For example, in one municipality (Sukabumi), local officials are able to identify the need for transportation investments to improve the linkages between rural, agricultural production centers and the urban center in order to increase the value of the urban center as a market and processing center. However, an overall planning process is lacking for identifying other investments to

stimulate the local economy and establishing priorities among these alternatives as an input into the integrated programming and financing process being established by the IUIDP program.

This issue is not unknown to the GOI and its advisors. For example, Ministry of Home Affairs officials reflect the concern that investment priorities in the near term for local governments should be focused mainly on economically attractive alternatives -- those that will have the greatest direct impact on employment generation and stimulation of local economic activity. In addition, participants in the IUIDP program also stress that it is not a complete planning tool, but rather is most valuable at the investment programming and financing stage of analysis.

A second concern, recognized by all, is that the IUIDP process does not include all development investments but is focused on the subset that is within the Ministry of Public Works responsibilities. Health and other more social investments as well as some types of direct economic production investments such as market facilities or agroprocessing facilities and warehouses are presently not included (although basic infrastructure support such as water and sewer connections to these facilities is included). This limitation is presently a technical one based on the program being housed principally within Public Works rather than a conceptual one. There already is agreement that the process should be extended to include all local capital investments.

A final concern is a practical implementation concern. The resources presently available to the IUIDP process simply do not permit rapid expansion to the full range of local governments in Indonesia. In particular, the implementation approach is to focus present attention on larger cities (typically above 500,000 in population) and to institutionalize the process at the provincial level with the intent that provincial staff, once trained, will extend the training to municipal level staff. While it is impossible to do everything at once, the present focus tends to leave middle-size and secondary cities (less than 500,000 in population) out of the process.

2. Local Resource Mobilization

The local revenue generation programs presently underway are at a very early stage of development. The one major policy reform already adopted, conversion of the traditional land tax (IPEDA) into a property tax (PBB) based on the capital value of land and buildings, is only this year showing significant increased collections. As noted in the preceding section, it has the potential for increasing total property tax collections by as much as 14 times and the municipal share by as much as 12 times. For the large cities that already have the capacity to develop relatively sophisticated tax maps and assessment processes, the reform can have major effects. For the smaller municipalities, it will take some years before the full effects can be felt.

Smaller municipalities are coping with the changes with intermediate approaches to establishing the capital value of land and buildings. For example, municipalities may establish a simple classification system with as few as five categories ranging from expensive, commercial property to unserviced residential, and place an estimated (as

opposed to assessed) average value on each of these five categories. This allows the municipality to begin collecting the potentially higher taxes before they develop a more sophisticated tax mapping and valuation process.

Aside from the resources required to develop a registration and valuation process to take full advantage of the law, the major policy concern for the property tax is its continued status as a central government tax with a major return to the local level rather than as a local tax. Opinion is divided in the government over whether it should be 100% local versus the present 65% municipal, 25% provincial and 10% national. However, there is support for converting it to a strictly local tax, based on the argument that even with the return of a major share of the tax, local governments have less incentive to collect the full possibilities than if it were perceived as their own local revenue.

In addition to the property tax reform, local governments will have to have additional revenue sources beyond those presently allowed if they are to meet long term goals for assumption of additional development responsibilities. As noted in the preceding section, use of betterment levies and a local fuels tax are among those being given primary consideration. Of the two, the fuel tax has the best prospects for additional revenue generation in the short-run because it is more easily administered. Betterment levies typically take a much more sophisticated administrative capacity.

Finally, as with initiatives to improve investment programming and financing, local resource mobilization efforts are in the early implementation stage with extensive effort required to reach all local governments. Ministry of Home Affairs, which has the major technical assistance and training responsibility for developing local administrative capacity, only now is in the process for contracting for consultants to extend the pilot program to train in local resource mobilization from six cities to ninety-three additional.

3. Local Expenditure Management

Although the natural focus in a program to increase local responsibilities for economic development is to enhance the ability to generate additional revenues, at least an equal focus on managing the efficiency of expenditures is necessary also. Not only have local governments historically been dependent in general on the central government for investment funds, but routine or current budget expenditures also have been principally funded by the central government. Municipal employees, for example, are primarily funded by central and provincial resources. Under these conditions, there have been few financial or administrative incentives for municipalities to focus attention on limiting expenditures or operating efficiently. Such controls as exist are mainly those exercised by the central government in its review of municipal budgets. This is not to say that municipal governments are inherently inefficient, but only that there is little incentive to be concerned with the cost of routine or current expenditures and no particular program at the central level for assisting municipalities in developing performance improvement programs. This concern may be even more important in the future as local revenues from the PBB increase. The previous land tax (IPEDA) revenue share for municipalities was restricted to use for investment purposes, whereas

now up to 90% percent of the PBB revenue share may be used for routine expenditures. This loosening has a good motive in encouraging increased municipal attention to operation and maintenance. However, it also could have the negative effect of further decreasing incentives to efficient management.

4. Capital Resource Availability to Local Governments

Even under optimistic scenarios, measures to improve local resource mobilization through taxes, user charges and other levies are not expected to enable municipalities to generate sufficient surpluses to meet investment needs on a direct payment (pay as you go) basis. Without funds available for borrowing, a significant investment deficit will remain at the local level.

Presently, municipalities are not permitted to access credit through the private market either by borrowing directly from private financial institutions or by issuing some form of revenue bonds. Nor in the short term are financial institutions or other sources of private capital likely to perceive municipalities as good credit risks or good targets for investment capital. In the short-run, some form of government-sponsored loan facility seems essential. Present proposals focus on the creation of a development loan fund or account, with some discussion about whether it should use existing institutions such as the Regional Development Banks or should create a new entity, such as the proposed Regional Development Account.

If the RDA is established, or a functional equivalent, present capitalization plans include two sources. First are the repayments of existing central government loans to municipalities. Second are funds presently committed under IBRD urban sector loans and central government budget commitments. The first source involves 100 billion R outstanding municipal loans and another 100 billion R in local enterprise loans. The second source adds approximately 84 billion R, about two-thirds of which is already committed to projects in Jakarta and other large cities. Based on the present repayment schedule for outstanding loans, the best estimate of committed present capitalization for a loan fund for a first year of operation is about 100 billion R or approximately 60 million \$US. This amount could easily be absorbed by a few large cities.

V. RELEVANCE OF INDONESIAN EXPERIENCE FOR COSTA RICA

What should be clear from the preceding report is that the GOI has embarked on an ambitious reform of its policies and programs in the urban sector. Through the adoption of broad centralization policies, the fundamental relationships between various levels of government may be altered. The catalysts to these changes have been the need to improve resource mobilization and to more efficiently utilize these resources in order to meet the existing and growing demand for urban services.

Implementation of these policies and programs will take many years, and it will not be until the end of this century that the impact of these changes will be noted.

The observations based on the Colombian decentralization experience all can be repeated based on the Indonesian experience. In addition, however, the Indonesian experience places some other problems in even sharper focus than does the Colombian program. Those which are especially relevant for Costa Rica include:

- The potential eventually to increase property tax revenues, if well administered by local governments, can be dramatic indeed. The increases were 14 fold in Indonesia. Given these results in a country as highly centralized as Indonesia should motivate the Government of Costa Rica to rethink the reform of its property tax system.
- Costa Ricans can learn from Indonesia the great advantages in simplifying the local tax structure. The Government of Indonesia will eventually eliminate many of the more than 100 local taxes that product little revenue.
- Indonesia explicitly recognizes the need for economic analysis of projects in any program of increased local capital investments. This will be necessary in Costa Rica as well.
- The Indonesian experience emphasizes that, in part because the development of true autonomy and financial independence is essentially a prolonged undertaking, municipalities will continue to require for some time a financial mix of grants, loans, cost-recovery user charges, and own-source revenues. It will be important in Costa Rica to plan consistently toward changing the mix to reduce the prominence of central government grants as rapidly as possible.
- Indonesia places more importance than does the Colombian program on Regional Development Planning Boards and on the harmonization of responsibilities and relationships between local government and institutions at other levels of government. The success of such efforts in Costa Rica can be a significant measure of the resolution of conflicting tendencies to promote local autonomy and to preserve central government control.

LIST OF ACRONYMS

ACIR	Advisory Commission on Intergovernmental Relations
AyA	Acueductos y Alcantarillados
COREC	Comisión Consultiva sobre la Reforma del Estado
DINADECO	Dirección Nacional de Desarrollo de la Comunidad (National Office for Community Development)
ESAP	Escuela Superior de Administración Pública (National School of Public Administration)
FNH	National Hospital Fund
IDB	Inter-American Development Bank
IFAM	Instituto de Fomento y Asesoría Municipal (Institute for Municipal Development and Advice)
IVA	Impuesto al Valor Agregado (Value Added Tax)
GDP	Gross Domestic Product
GOCR	Government of Costa Rica
RTI	Research Triangle Institute
SNE	Servicio Nacional de Electricidad
SSS	Regional Health Service
STC	Secretaría Técnica de Cuenacas
USAID	U.S. Agency for International Development