



USAID
FROM THE AMERICAN PEOPLE

BACKGROUND PAPER



DEVELOPMENT INNOVATION

LOCAL RESOURCE MOBILIZATION

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Local Resource Mobilization

Introduction

In order for local governments to take advantage of the paradigm shift that is making domestic private investment a new source of long term finance for development projects, they will have to achieve a financial condition satisfactory to the potential providers of capital. Essentially, local governments will have to develop a history of generating an annual surplus of revenues over expenditures. This surplus is then available to cover payments to investors that provide new long term financing to the local government. The extent to which potential private investors are able to clearly see that a local government is managing its finances to create a surplus will have a decisive effect on their willingness to make loans to or buy bonds from them. So, not only must the local government manage its finances well, they must be able to present well maintained budgeting and accounting records to verify their performance.

There are only three ways that a local government can reliably develop a surplus that they can commit to long term debt repayment.

- They can increase their “own source revenues” as currently defined.
- They can reduce their expenditures.
- They can develop new sources of revenue.

In most developing countries, it is easiest to undertake option 1, harder to use option 2, and hardest to do option 3. A realistic strategy is to work on all three options at the same time in order to balance the interests of key stakeholders and achieve the maximum surplus. This paper will explore all three options to show what is involved and how USAID programs can help local governments improve their financial condition, and thus their creditworthiness.

Increasing Own Source Revenue

Local governments in developing countries derive their revenues from two principal sources: A) funds transferred to them from a higher level of government, and B) funds collected and retained in the locality itself.

Funds coming from higher levels of government (national, regional, and/or state/provincial) are referred to as transfer payments. The rules governing the flow of transfer payments are part of the laws on intergovernmental fiscal relations. Transfer payments are typically allocated from a specific revenue source that is controlled by the higher level government (e.g. a national value added tax, income tax, or oil revenues). Transfer payments may be allocated downward on an established formula basis, or an ad hoc basis. Transfer payments may be stable and predictable over time, or they may vary substantially from year to year. Regardless of their characteristics, transfer payments are not “own source revenue” because they are not under the direct control of the local government.

Funds collected and retained in the locality itself are the local government’s own source revenues. In developing countries, it is typical to find that own source revenues are a small (or very small) portion of a local government’s total revenue. This can be due to a variety of factors including: restrictions imposed from higher levels of government on the types of revenue sources available to the local

government and the rates that can be charged; a history or culture of dependency in the relationship of local government to higher levels; local politics that oppose local revenue collection; poor revenue collection technology or effort at the local level; and corruption. Whatever the combination of causes, the result is that local government is usually over dependent on transfer payments and less able to exercise decentralized leadership for development.

What are the types of revenue sources we are talking about? For simplicity, this paper will define local revenue sources into three types: 1) taxes; 2) fees; and 3) user charges.

Taxes are a broad source of revenue that is not linked to any particular service provided by local government. Local taxes vary from country to country but typically include a Property Tax and sometimes one or more Business Taxes and Consumption Taxes. These taxes may or may not vary with the value of the property, business or economic activity.

Fees are a revenue source directly associated with a particular local government service such as registrations, permits, or approvals. They are usually imposed on a per transaction basis, e.g. a fee of a fixed amount to register a property/marriage/birth. They can also be things like school fees or clinic fees, (if these services are run by local government) where the fee is based on a transaction such as provision of a semester of schooling, or a visit to a clinic.

User charges are another revenue source linked to specific services, but unlike most fees, user charges typically vary with the amount of service consumed, e.g. a consumer's water bill will vary with the volume of water used. In some cases, user charges will vary according to the type of consumer, e.g. charges for garbage collection may be different for residential, commercial, and industrial establishments.

The important point about these different types of revenue sources is the degree to which the source of funds is tied to a particular use of funds. There is a continuum. It starts with general taxes, such as the Property Tax, which provide funds that can be used to fund any aspect of the local government budget. It continues with general fees that can also be used across the entire budget even if they are generated by a particular service. Then more specific fees for services, such as schools and clinics, are usually used to fund the operating budgets of these specific services and only if there is a surplus (unlikely) might the fee contribute to the general budget. Finally, user charges are normally dedicated specifically to funding their related service and (even in the unlikely event of a surplus) they are not normally available to support the general budget of the local government, especially if the service is provided by a utility entity with a separate legal identity from the local government that owns/controls it.

These distinctions are important because increasing revenue from the different types of sources will have different impacts on the creditworthiness of a local government. Increases in general revenues from taxes and fees affect overall creditworthiness and enable the local government to commit additional funds to debt repayment on borrowings for any purpose approved by the local government.

Increases in service related revenues from specific fees and user charges affect the creditworthiness of the service in question, and are usually only available to repay debt related to that service.

In fact, the U.S. municipal finance system recognizes this difference with two different types of long term bonds: General Obligation Bonds that pledge all revenue sources of the local government to repayment; and Revenue Bonds that pledge the revenues derived from a specific source (such as the water tariff) to repay the bond.

The first step toward increasing revenue from any source is to analyze current collections and identify the reasons why the local government may be receiving less revenue than they should from the source. Once the reasons for underperformance are understood, appropriate remedies can be devised. This diagnostic will always be case specific, but a few examples will illustrate the kind of issues and remedies that can be expected to emerge. USAID can make an important contribution to increasing own source revenues by funding diagnostic studies for local governments that have shown a willingness to undertake reform measures. Such diagnostics can rely heavily on local analysts and should be linked to local government associations that can effectively disseminate the lessons learned to a wide local government audience.

Property Tax. This tax normally provides a large proportion of a local government's own source revenue, but it is typically an underperforming revenue source. As a result, own source revenue is lower than it should be, and conversely, improvement in property tax yield can have a significant impact on the credit worthiness of the local government. Factors that frequently cause underperformance include:

- Lack of adequate property registration resulting in outdated tax rolls;
- Undervaluation of the properties on the tax roll;
- Poorly managed billing and collection of tax bills; and
- Corruption in the registration, valuation, and billing/collection processes.
- Each of these factors needs to be understood in the context of the specific situation of the local government being diagnosed.

Improving property registration and updating tax rolls (cadastres) is a time consuming, but high revenue impact activity. Employing aerial or satellite imaging, GPS, GIS, and related technology has made it easier to do, but making these techniques sustainable at the local government level requires a significant investment in training and hardware/software. This is fertile ground for public-private partnerships where the two parties share in the increased revenues derived from the effort. At the same time, it will be necessary to address the causes of under-registration such as costly fees (and bribes), time consuming and arbitrary procedures, and lack of legal consequences to non-registration. Political will at the level of local leaders is essential to this effort. Creating the motivation for such leadership is the job of central government incentive programs that effectively reward updated tax rolls (or punish continued lax behavior). Here the judicious use of "challenge grants" or enhanced transfer payments can make a significant difference. (Conversely, reductions in transfer payments to local governments that have increased their property tax yield create a strong disincentive to reform.)

Undervaluation of property already on the tax roll is common in developing countries. Property valuation methods have advanced significantly in the last 20 years, but most

local governments are unaware of this and lack technical staff to apply such methods. Again, this is an opportunity for creative use of public-private partnerships that bring in private sector expertise and professionalism (e.g. certified property appraisers) while sharing the resulting revenue improvements. Overcoming vested interests and ending corrupt practices (bribes for low valuations) will again call for local political leadership, and incentives that will call it forth.

Poorly managed billing and collection of property taxes also contributes to revenue losses. This part of the process is the one most within the immediate control of local leaders. Introduction of proper record keeping, accounting, and managerial supervision can be initiated without costly or complicated technology or expertise. In fact, this is a good place for most local governments to start improving their property tax yield, and it can serve as a litmus test for the willingness of local leaders to undertake essential reforms. The key is usually to get management incentives right so that local tax officials are motivated to improve their performance and hence the tax yield, but opportunities for public-private partnerships in this area are also worth exploring. USAID can play an important role by providing technical assistance in all aspects of property tax improvement, an area of expertise where the U.S. excels.

Business and Consumption Taxes. In a similar vein, analysis of business and consumption taxes (e.g. taxes on value added, sales, hotel stays, alcohol, etc.) should explore why these taxes are underperforming. Are there disincentives to registering businesses or accurately reporting economic activity? Since most local economies in developing countries have a large informal sector, there may be room to expand revenues from business and consumption taxes. However, it is not easy to bring informal businesses into the formal (taxable) sector without harming their often precarious financial viability. Since informal businesses both serve and employ the poor, care should be taken by local governments to avoid actions that seriously reduce or restrict informal economic activity unless there are significant criminal or public safety issues. Unfortunately, recent U.S. local government experience is not likely to be very relevant to dealing sensitively with informal businesses.

General Service Fees. These kinds of fees need to be closely examined to determine if they are actually a useful and appropriate source of revenue. In many cases, such fees create a significant disincentive for people to do things that are in the common good (such as register their property) and thus they “cost” the local government more than they are worth in revenue. They also create opportunities for corruption and diversion of funds if low paid local officials are receiving cash payments that are not well documented and accounted. On the whole, these kind of fees do not usually offer much opportunity to significantly increase own source revenue, although there can be some positive impact to improved accountability measures.

Another possibility worth exploring is the use of e-government systems to put certain routine registration and licensing processes on line. Of course the internet and electronic payment systems in the country need to be adequately developed, but where that is the case, e-government applications can speed up routine administrative services, avoid citizens having to work through middlemen, and reduce corruption and diversion of fee revenue. While e-government systems are more likely to be of benefit to the better educated and wealthy citizens, and to the larger, more sophisticated local governments, they may prove cost effective if they result in a

higher percentage of fees ultimately reaching local government accounts. U.S. local governments are making significant strides in introducing on-line services and can be a resource to developing countries in this regard.

Since general service fees can sometimes create an annoyance factor for local businesses, the competitiveness of the locality may suffer if they are overused. In such cases, it would be preferable to eliminate fees and off-set the loss through improved revenue yield from local property taxes and business taxes that are linked to local economic growth. Again, USAID assistance with analytic studies and technical assistance to review and revise fee systems or introduce on-line systems can be very valuable to local decision makers that are serious about fiscal reform.

Specific Service Fees and User Charges.

Fees and user charges specific to a particular service (e.g. education, health care, water & sewer, building inspection, garbage collection & disposal, markets) should be an important source of revenue to local governments that are responsible for service delivery. Even where services are delivered by a separate legal entity (e.g. a local water utility, or a clinic/hospital), local governments that have been empowered by decentralization often own or control the service delivery entity and are thus responsible for the service.

Services provided by local government have both a “private” and a “public” value. For example, it may be valuable to the public good that all children are educated to a certain level, but the value of education beyond that level may accrue predominantly to the private citizen that receives the additional increment. Determining how the value of a local service is officially perceived (i.e. public/private) is a purely political question, to be decided through a unique combination of central and local politics in every country. To the extent that a local service has a private value, fees or user charges should capture that value and produce revenue to operate the service.

Local services need not depend only, on fees and user charges for funding since their value to the public good may justify some funds/subsidies from general revenues or transfer payments. (However, such funding/subsidization of the service by local budgetary allocations must actually take place if service standards are to remain adequate.) That said, local service fees and user charges are often set very low in developing countries. This, combined with a failure to allocate other funding for service delivery leads to inadequate service levels, rationing, and corruption (e.g. bribes to access services). In order to break out of this all too common situation, local governments need to either (A) allocate a larger share of their budget to the service, or (B) increase revenues from fees/user charges. Assuming that transfer payments can't be influenced by local officials, the ability of a local government to pursue option A requires either an increase in general revenue (discussed above) or a reduction in expenditures (discussed in the next section below).

To increase revenues from local fees/user charges (option B), there are several possibilities:

- Increase the billable use of the service;
- Assure that users are billed fully, and all billings are collected; and
- Increase the level of fees or user charges for the service.

While local government may not be able to increase the total use of some services, such as schools or clinics, they may be able to alter the criteria for whether the use will be billed or not, e.g. lowering the number of free visits to the clinic for each person, or lowering the level at which school fees are imposed. Other services may permit local government to have greater control over usage, e.g. using a local law to require all commercial establishments to utilize the local government's garbage collection and disposal services and outlawing private dumping or incineration. There is also room to examine questions such as: how can more families be connected to in-house water and sewer rather than using free standpipes/latrines? How can more vendors be attracted to official market stalls? Clearly, all of these approaches involve trade offs that are the core of public policy making. USAID analytical assistance to local governments and their associations can provide information and ideas that improve not only revenues but the quality of public policies that most directly affect peoples' daily lives.

Many local governments in developing countries fail to do an adequate job of billing and collecting user charges for services. Water services are a case in point. Water use is often not metered due to a lack of equipment (a good opportunity for USAID to provide high value hardware). Bills based on "estimated use" are prone to errors, disputes, and corruption that systematically lower the level of charges billed to the consumer. Even if usage is properly metered and billed, many local water authorities are unwilling to cut off services to users that fail to pay their bills. Sometimes this is an intergovernmental problem (bills to hospitals or central government buildings) and sometimes it is malfeasance/corruption (bills to businesses or residences of the influential).

When user charges or fees are simply set too low, raising their level requires political will of local leaders. USAID can help local leaders by providing analytical assistance that enables them to understand who really suffers as the result of low fees/charges: the poor majority pays more in bribes and informal service delivery costs than they would under a properly funded service with higher charges but improved access and quality. Technical assistance can help design systems of user charges that are politically acceptable, transparent, and fair. The importance of establishing user charges and fees at a level that permits the adequate funding of a service operation can not be over stressed. Given limited budgets from general revenues and transfer payments, local governments need to collect enough revenue from fees and user charges to operate and maintain its services at an adequate level, and also charge a small additional increment that can be used to repay long term debt that enables the local government to extend its services to a growing population and upgrade their quality (see example in the annex). There is no other alternative that will sustain development, and USAID can play a key role in helping local governments to understand how to cope with this reality.

Reducing Expenditures

If increasing own source revenues does not seem to be a particularly easy thing to do, reducing expenditures is also difficult. Local government budgets are always tight. Local leaders have more ideas about things they would like to do than resources to do them. At the same time, it may be easier to undertake politically difficult measures to increase own source revenues if local leaders can simultaneously demonstrate that

they are bringing their expenditures under control by seriously seeking ways to economize. Certainly, investors that are considering lending money to a local government will want to see evidence of fiscal responsibility, and successfully reducing expenditures is the gold standard for fiscal responsibility.

Local government spending can be classified into two basic types of expenditures: (1) Discretionary; and (2) Non-discretionary. As the names imply, discretionary expenditures are those that are not absolutely required to be made during a budget year, while non-discretionary expenditures are those that must be made. Starting with the latter, non-discretionary expenditures normally involve some kind of legally binding commitment upon the local government. Such commitments include:

- Loan or bond repayment schedules;
- Employment contracts with existing local government staff, either through individual contracts or general rules of employment and compensation;
- User charges for utilities such as power, water, and telecommunications (normally based on the same utilization rate as in the previous year);
- Rental or lease agreements for facilities or equipment if it is not possible to terminate the agreements within the budget year; and
- Contracts with outside service providers such as consultants and construction contractors if it is not possible to terminate them within the budget year.
- There could be others depending on the specific situation of the local government, but these are the major non-discretionary expenditure headings.

Discretionary expenditures can be much more diverse. In essence, they are expenditures for anything that is not absolutely essential to the operations of the local government. But who defines “essential” and how do you know how many staff (i.e. level of employee expenses) are really needed to accomplish the “essential”? Obviously, the line between discretionary and non-discretionary is blurry since it can change as local policy changes (e.g. Is it discretionary or non-discretionary to pay for a security detail to protect the head of a local government?). For simplicity, discretionary expenditures are essentially any expenditure not covered by the five bullets in the paragraph above. Of course changing circumstances may make it essential to hire additional staff, or use more electricity, or rent another dump truck, but the best estimate of discretionary expenditures in any given year is to subtract the non-discretionary items listed above from total expenditures.

Controlling discretionary spending is the obvious first target for reducing overall expenditures. In any given year, it is likely that a local government is doing some amount of discretionary spending, i.e. more than is required by binding legal commitments. Nevertheless, it is not easy to cut back on expenditures that have a history and a constituency that presumes continuation. In cases where there has been an increase in revenues (either own source or transfers), it is somewhat easier to avoid increasing discretionary expenditures, or at least increasing them less than the increase in revenue. Whether restraining increases or actually reducing expenditures, it is essential that local political leaders consult widely with key stakeholders and constituents to explain the reasons for their fiscal restraint, understand concerns, and reach broad consensus on these measures. This is much easier to do if the budget preparation and approval process is participatory by design. Through technical assistance USAID can play a role by helping local governments develop and apply participatory budgeting processes which are common in U.S. local governments.

Participatory budgeting is also important in order to create support for reductions in non-discretionary expenditures over time. While these expenditures are based on legally binding commitments, there are areas where economies may be achieved. Among the easiest are savings on utilities. It may be possible to reduce the local government's electricity bill by installing more energy efficient street lighting and water pumps. It may be possible to reduce water bills through water use awareness campaigns and repair of municipal taps, toilets, and standpipes to reduce wastage. Debt service expenditures should also be scrutinized. It may be possible to reduce debt service costs if they can be refinanced at lower interest rates. In the longer term, it may be possible to restrain the growth of local government staff levels (or even reduce them through attrition) and avoid growing lease expenses by using equipment more efficiently. By creating incentives for cost conscious management of personnel and equipment, local government leaders can, over time, reduce the level of non-discretionary expenditure below the level that would have otherwise prevailed. However, it is often necessary to make investments (e.g. debt refinancing charges, energy efficient measures, or water awareness campaigns) in order to achieve savings. USAID can help local governments with analytic support to examine the trade offs between "business as usual" and making strategic, cost saving investments.

New Revenue Sources

The final way that local governments can generate budget surplus is to "think outside the box" by developing new revenue sources of their own. This could involve design and implementation of new taxes (e.g. a hotel occupancy tax), fees (e.g. a vehicle registration fee), or user charges (e.g. a wastewater disposal surcharge on the volume of water consumed). Naturally, new taxes and charges are not politically popular, so the justification for their use has to be compelling and care must be taken to avoid unintended consequences to the local economy. This argues again for us of a participatory budgeting process that enables key stakeholders to understand the need for increased revenues, and facilitates the formulation of a consensus on any new revenue source proposals. USAID technical assistance can also play a useful role in the design of the new revenue measures themselves.

Not all new sources of revenue involve taxes/fees/charges. Local governments often have assets such as land and buildings that are underutilized or not utilized at all. It may be possible to lease or sell local government properties to produce additional revenue. For example, the local government could wall off unused space in a municipal warehouse and lease it to businesses that need to store products or raw materials. In order to take advantage of such opportunities, local governments will need to catalog their assets and assess their income potential. USAID support for such work would involve using local analysts, and could even be done as the project of a local university under a small USAID grant. This exercise has the added advantage of providing needed information for the local government accounting system which needs to record physical assets and their value.

In order develop any new revenue source; the local government must have the authority to do so. Every country's legal code governing local government is unique. In most countries, local governments can only do those things that they are specifically permitted by law to do. A careful analysis of what can and can not be

done by local governments to develop new revenue sources is essential, and is something that USAID can commission using local expertise. In many countries the central government jealously guards its prerogative to impose taxes or exploit other revenue sources. Local governments will need to lobby the central government very effectively to gain authority to develop new revenue sources. USAID support for associations of local governments can help develop the advocacy skills they need for this effort.

Developing new revenue sources will be an important local political issue. To be effective, local political leaders will need to consult widely with stakeholders before developing proposals for new revenue sources. Unless there is a consensus that new revenues are needed to pursue widely shared priorities there will be negative political consequences. Local governments that have already made the effort to improve the revenue yield of existing sources, and effectively reduced expenditures, will be in a better position to make the case for the development of new revenue sources. Nevertheless, the more democratic and participatory the local governance system is, the more important transparency, consultation, and consensus building will be for the revenue enhancement effort. Providing local government leaders with skill training in conflict resolution and consensus building would be an appropriate way for USAID to assist the revenue enhancement process.

Conclusion

Creating a budgetary surplus is the only way that local governments will be able to repay the long term debt that they need to finance essential development investments such as water supply, sanitation, schools, hospitals/clinics, and roads. The needed surplus can only be achieved by:

- Increasing the yield of existing revenue sources,
- Decreasing expenditures, or
- Developing new sources of revenue.

In addition to the essential political will, local governments will need good management to achieve a surplus. Transparent and effective systems of budgeting and budget management will need to be linked to the local government's accounting system. The budgeting and accounting system will also need to be linked to the revenue collection system so that local government leaders can understand how well actual revenues are meeting projections, how much funding is available, and how well the local government is adhering to its budget.

A well managed local government will be able to effectively engage stakeholders in decisions about fiscal matters. Such engagement is essential to creating a budget surplus, since citizens need to understand why it is important to make the sacrifices entailed in any financial improvement strategy. Local government leaders need to be able to achieve a consensus in their communities on financial priorities, long term investments, and the revenue/expenditure measures needed to realize their communities' development.

USAID programs can help local governments that want to reform and improve their fiscal situation. The preceding sections of this paper suggested a wide variety of interventions that are known to be effective. It is also important for USAID managers to think about how they can appropriately balance "retail" assistance (i.e. direct

assistance to individual local governments) and “wholesale” assistance (i.e. development of intermediaries such as local government associations to assist local governments). In most countries, both types of assistance are needed and a good strategy will be based on the expected results that can be achieved from each in the context of the particular country. One approach that should be actively explored is to help the association of local governments to organize “experience sharing” among their members. Under this scenario, the impact of helping one local government with a particular aspect of fiscal reform can be multiplied by having that local government share their experience and guide/coach many other local governments in the country.

USAID should also focus on the enabling environment created by central government policies, laws, and regulations. A policy dialog with central government is critical to helping local governments improve their finances. By implementing assistance at the local level, USAID is better positioned to understand the important opportunities and constraints that exist in the enabling environment. In particular, it is important for central government to create a set of incentives (both positive and negative) that encourage local government to take the difficult steps that ultimately lead to budget surpluses and thereby access to long term credit for development.

Annex: Public-Private Partnership for Revenue Enhancement

Urban improvement in Guatemala City

Increasing the fiscal and management responsibilities of local governments

Seeking to curb haphazard growth in the late 1980s, the Municipality of Guatemala City wanted to embark upon a long-term urban planning and investment strategy to be called Plan Metropolis 2010. Private sector involvement, improved management efficiency, and municipal revenue enhancement through more systematic tax and licensing fee collection were to be key elements of this strategy. The Plan was seen to be very crucial to coping with the 3 percent annual population growth of the largest metropolis in Central America, with a population exceeding 1.3 million.

Because the municipality had little money, they could not afford to undertake the planning they needed from current revenues. In order to get the planning done, Guatemala City entered into an innovative public-private partnership with an international consulting firm. One of the aspects of the partnership involved setting up and managing a professional building-permit system. Guatemala City realised that such a system is an essential tool to control urban growth as well as a source of municipal revenues from fees. Since the establishment of a good building permit system is rather costly, the problem was how to pre-finance such a project until fee income from building permits were sufficient. The solution was provided by the international consulting firm which brought with it a financial services company who provided a loan of US\$ 250,000 to Guatemala City to get the project started. The loan pre-financed the part of the Metropolitan Plan called the “Urban Growth Control” project. The pre-financing proved a success. The loan (with interest) was repaid within 9 months of commencing the project.

Risk

The financial services company assisted the consulting company in calculating and sharing the project risk that Guatemala City might default on the pre-financing loan. The consulting company and the financial services company agreed on a form of pre-financing whereby both parties shared the financial risk on a fifty-fifty basis. This kind of risk sharing proved essential to making the project work. There were so many unknowns and potential problems that no single for-profit company could bear the risk entirely on its own. (Although this partnership did not involve a USAID DCA partial loan guaranty, the risk sharing approach is similar.)

Revenue Enhancement

Under the Urban Growth Control project, a Guatemalan consulting firm, which is the local affiliate of the international consulting firm, is responsible for improving and managing Guatemala City’s Department for Development and Planning as a public-private partnership. In August 1998, the consultants started off with a team of approximately 40 Guatemalan consultants. The partnership is planned to last at least 10 years.

The consultancy budget was set at US\$ 10 million, to be paid initially from the pre-financing and later from the building permit fees. Once the partnership got underway,

illegal building activities became largely a thing of the past. Almost nobody built a house or an office without a building permit anymore. Under the consultant's management, inspectors keep a watchful eye on the erection of new buildings, and are quick to impose fines if the rules are broken. The city is keeping a careful watch on all future expansion. The new Department for Development and Planning is the most modern in Central America.

Within 6 months of starting up, the fees generated by issuing permits were already a growing source of income for the municipality. In the year 2000 alone, approximately two thousand new permits were issued, of which nearly 40 percent were for high-rise buildings. This meant that Guatemala City earned nearly US\$ 2 million on permits that year. "In the past, annual income from building permits never exceeded US\$300 thousand," says Jorge Mario Solares, Managing Director of the Guatemalan consulting firm. "In those days, the municipality was operating at a loss, for the city's general expenses alone amounted to US\$ 400 thousand a year." For 2001 the fee income was approximately US\$ 3.2 million.

The new permit system is not only enhancing the municipalities "own source revenue", the people of Guatemala City are also profiting from it. Today, the application procedure for a building permit takes 10 days at most. Not so long ago, an applicant had to wait for anything between six months and two years before being informed whether the municipality would approve their building project. Moreover, the application system is becoming fully automated. Architects can leave their blueprints at home: a diskette is all they need.

The consultants are launching similar projects in other cities in Guatemala. Mr. Solares notes that "This method of pre-financing is a positive step for municipalities. Much has changed in Guatemala. Ten years ago the country was not ready for consultancy. But it is now. The politicians believe in long-term planning. Moreover, the projects don't depend on politics. That is important. In February 2001 there was a change of municipal administration [in Guatemala City] with a new political party in charge and different politics and strategies. Although the new administration introduced a number of changes and adjustments, the [Urban Growth Control] project is still going on, with the major difference that instead of 40 persons, it now employs 68, and that the level of provision of services has increased substantially".

Investing in Additional Revenue Enhancement

To facilitate financial management of the Urban Growth Control project, the municipality agreed with their private partner to establish a fiduciary trust. The revenues from issuing building permits are deposited by the municipality into the trust account. Then in 1999, to invest in improvements to the city's cadastre system, the city decided to use the trust to administer a loan from the Central American Bank for Economic Integration (CABEI). Once the trust was ready, CABEI provided US\$3 million to the municipality through a credit line to a local commercial bank that served as trustee. The local bank also serves as the loan administrator and loan guarantor. The contract for the trust was drawn up between CABEI, the local bank and the municipality. CABEI provided the loan to the municipality on the basis of the city's pledge of revenues received from issuing building permits. To make the trust operational, the municipality also opened an account at the local bank with a required

minimum balance of US\$ 500,000. This was considered collateral for the bank's guaranty on the loan (similar to the "subsidy" provided by a USAID Mission for a DCA guaranty). The CABEI loan funded the equipment and services needed to update and improve the city's property tax cadastre. The cadastre project provided the municipality with an immediate additional income of US\$10 million in 2000 (much more than enough to meet the annual debt service on the CABEI loan) with potential future income estimated at approximately US\$30 million per annum.