

Re-engineering Social Funds for Local Governance: The Central American Experience

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In recent years, many social funds in Latin America and other regions have been redefining their goals and strategies to promote good local governance. This trend reflects an emerging consensus that a lasting reduction in poverty requires capable, accountable, and dynamic local governments as well as vibrant and empowered civil societies. The challenge for these social funds is how to apply this new focus to their traditional task of creating small-scale infrastructure and delivering local services.

Social funds in Central America were created in the early 1990s to soften the impact of structural adjustment policies on the poor by financing small-scale investments (mainly infrastructure projects) in poor communities, thus enhancing these communities' access to basic services and generating temporary employment. By the mid-1990s, the funds had shifted their emphasis towards improving access to basic services and infrastructure, particularly in the areas of education, health, water and sanitation, and municipal and community infrastructure. Most of the Latin American funds continued to use centralized methods at the beginning of this new phase, financing and overseeing contracts with third parties or in some cases directly with communities, but largely bypassing local governments. But some funds started to realize that their new mandate called for a more decentralized approach. Even if local governments were unresponsive, captured, or corrupt, the argument went, the solution was to reform them rather than skirt them and thereby undermine their relevance to their own citizens.

This article explores how three social funds in Central America—*Fondo de Inversión Social de Emergencia* (FISE) in Nicaragua, *Fondo Hondureño de Inversión Social* (FHIS) in Honduras, and *Fondo de Inversión Social para el Desarrollo Local* (FISDL) in El Salvador—are meeting the decentralization challenge. In the last few years, all three have partially or radically shifted resources and responsibilities for investment planning, contracting, implementation, and maintenance to local governments. Their strategies for accomplishing this reform have varied. The funds in Honduras and Nicaragua have taken a gradual approach, complementing the efforts of agencies responsible for

decentralization policy in those countries. In El Salvador, in contrast, the national government has transformed the social fund into the lead agency for local development, and pressed for a more radical devolution of responsibilities to local governments.

Fostering a Local Dialogue to Improve Local Investment Planning

As a first step toward decentralization, all three funds started requiring that priority investments arise from municipal investment plans rather than isolated petitions from communities. Further, they put measures in place to ensure that municipal plans were products of genuinely transparent and participatory dialogue between communities and local authorities.

In Honduras and Nicaragua, the absence of statutory guidelines for participatory municipal planning forced FHIS and FISE to develop their own ways to ensure meaningful and participatory planning processes. Evaluations show that the procedures prescribed by the social funds produced plans that were transparent, inclusive, and participatory. But they also showed that local citizens and governments saw the municipal investment plan more as an instrument to get social fund financing than as a tool to plan local development in general. Overcoming this perception is difficult in the absence of statutory guidelines enforced by noninvestment related agencies, but social funds can mitigate this problem by requiring that municipal plans be based on open project menus (even if a social fund only finances certain menu items) and that local governments commit some of their own revenues to pay for these plans (rather than relying only on social funds' resources). In addition, the funds themselves should recognize existing municipal plans (when they meet pre-defined criteria) rather than always demanding a new plan for the social fund.

The two funds' participatory planning methodologies not only improved the quality of municipal investment planning, but also influenced policy. When the agencies responsible for municipal development—the Institute for

Municipal Development in Nicaragua, and the Ministry of the Interior and Justice in Honduras—decided to develop statutory guidelines for participatory municipal planning, they took into account the social funds' experience and their methodologies.¹

The process worked differently in El Salvador since FISDL was the lead agency for local development. There, the social fund focused on making policy rather than devising a specific methodology for participatory planning. It worked with the Consultative Group, a group that had defined the National Strategy for Local Development and that included representatives of national government, the Association of Municipalities, nongovernmental organizations, and the private sector. After more than a year of deliberations and technical studies, the Group agreed on six minimum criteria for participatory planning, including 19 indicators, 26 means for verification, and a range of possible outcomes.²

Competitive Bidding to Create Incentives for Good Municipal Performance

These three Central American social funds have sought to design financing mechanisms based on sound principles for intergovernmental relations. FHIS and FISE established ex-ante municipal allocations based on a formula incorporating population and poverty indicators. FISDL is experimenting with a more radical innovation: a competitive bidding system. In a context where local governments receive significant resources through intergovernmental transfers (6 percent of the national budget) but few mechanisms exist to ensure the good use of those resources, FISDL believes competitive bidding will create incentives for good municipal performance. Specifically, the system was designed to promote these goals:

- **Ensure municipal commitment.** With all municipalities competing for FISDL's funds, proposals with the highest local contributions win.
- **Reward participatory planning, administrative efficiency and transparency.** To participate in the bidding, a local government must have a municipal development plan elaborated on the basis of a municipal participatory planning process, show evidence that it has presented quarterly reports to the national government on the use of transferred resources, demonstrate that it has executed the previous year's national transfers, and produce auditing documents certifying that it makes good use of intergovernmental transfers.
- **Encourage municipalities to invest in high-impact projects.** Before the bidding process, municipalities were mostly investing in isolated, small (less than \$22,000), and low-impact projects. Now, projects seeking FISDL funding must be greater than \$50,000,

a requirement that helps ensure that the projects serve multiple communities and even multiple municipalities.

- **Increase municipal capacities to create alliances with other local governments, the private sector, nongovernmental organizations, and other institutions.**

Another reason for making local contributions the main criteria for winning FISDL funds is to encourage municipalities to reach out to businesses, nongovernmental organizations, and the communities for cash or in-kind contributions. To promote inter-municipal associations, FISDL said that, if all other considerations are equal, a project presented jointly by more than one municipality would be selected over one presented by single local governments.

Between September 2000 and September 2002, FISDL organized eight competitive biddings (*Concurso de Fondos*), in which 203 municipalities (77 percent of the total) sought funding for 371 investment projects. FISDL awarded funding to 248 projects sponsored by 127 municipalities. The total investment budget was about \$46 million, 48.5 percent of which came from local governments, community associations, private businesses, and organizations of Salvadorans in the United States.

Contrary to fears, the process did not discriminate against poorer and smaller municipalities. In fact, 75 percent of the funds were awarded to municipalities in the poorest two quintiles. Some of these municipalities have strong social networks, which allow them to mobilize high levels of support from their communities. What's more, these municipalities generally have shown a greater predisposition than larger and richer municipalities to meet good governance eligibility criteria, which require participatory planning, administrative efficiency, and transparency.

Devolution of the Project Cycle to Build Municipal Capacity for Managing Investment Projects

The acid test of a social fund's commitment to decentralization is how far it goes to shift responsibilities and resources for managing the project cycle—the procedures that govern identification, design, approval, contracting, execution, supervision, and maintenance—to local governments. This has not been easy to accomplish because most local governments have weak managerial capacities.

FHIS and FISE are following a gradual approach, transferring responsibilities according to local governments' capacities and seeking to help municipal development agencies increase their capabilities. FHIS started by devolving all responsibilities to the 20 municipalities with the greatest administrative capacities, as measured by an index. The fund transferred its instruments for project cycle management, such as software for project formulation, and has given municipal teams training and techni-

cal assistance on its standards and procedures. Local governments have applied this know-how not only to FHIS-funded projects, but also to investments funded with their own revenues. FHIS is working closely with the agency that coordinates municipal training (the Ministry of Interior and Justice) to enhance the revenues and capacities of other municipalities with high potential for improvement.

For municipalities with low capacities and low potential for improvement, FHIS is experimenting with the idea of shifting responsibility to associations of municipalities that are supported by nongovernment organizations or government agencies. The fund is testing this approach with the InterMunicipal Council of Lempira Sur, which, supported by the German Technical Cooperation Agency, brings together six of the poorest municipalities in the country. FHIS is studying what alternatives are available for the low-capacity, low-potential municipalities that do not belong to such associations.

Once again, FISDL has chosen a more radical approach. Since 1999, FISDL has shifted all project cycle responsibilities to all local governments, and has set up a support structure of 52 municipal advisors who assist local governments with project management. Municipal advisors spend one day per week in every municipality, working with laptop computers that allow them to connect remotely to the agency's information systems. FISDL has a demand-driven program to build municipal administrative capacities.

Preventive Maintenance Fund to Ensure Sustainability of Local Investments

Social funds have been criticized in the past for failing to ensure that infrastructure they help build is maintained. That was a complicated task since local governments, bypassed in planning and developing projects, often did not accept responsibility for maintaining the resulting infrastructure. The social funds in Nicaragua, Honduras, and El Salvador have addressed this concern not only by working more closely with local governments and user groups, but also by devising innovative institutional mechanisms for maintenance.

In 1997, for instance, Nicaragua's FISE created the Preventive Maintenance Fund (*Fondo de Mantenimiento Preventivo* or FMP), which helps municipalities pay for preventive maintenance of primary schools and health centers. Instead of being a discretionary fund managed by FISE, FMP's funds appear as a specific line in the central government's General Budget approved by Congress; FISE administers the transfer according to transparent rules. Initially limited to FISE's investments, the FMP now can cover all primary schools and health centers in the country.

Before these funds can be released, several conditions must be met:

- Both local governments and communities (the latter through education or health maintenance committees) must provide local counterpart resources. So far, for every dollar provided by the national government, communities and local governments have contributed 27 cents. Extremely poor municipalities receive more co-financing than those that are less poor.
- Local School Councils, Maintenance Committees and local governments, with the support of the Municipal Delegates of the Ministries of Education and Health, must assess their infrastructure and devise a maintenance plan and budget for each facility.
- Each municipality must present an Annual Maintenance Plan, which is based on individual facility maintenance plans and specifies local contributions. Before FISE approves the proposal, local governments must deposit their share in a bank account.

Once these conditions are met, FISE disburses the funds in tranches to local governments, which in turn distribute them among the selected facilities. Community maintenance committees supervised by the local government manage the work. The committees have a strong incentive to perform well since they can receive funds every year only if they are well organized and can show a good track record.

As of 2002, the FMP had funded preventive maintenance on almost 3,000 units; this represents 97 percent of the units built, repaired or expanded with FISE's funds, or 41 percent of the primary health and education network. Since 1997, the FMP has channeled \$3.5 million to communities for preventive maintenance; of this, 80 percent came from the central government through FISE, 10 percent from local governments, and 10 percent from community groups.

Is It Working?

It is too early to make a conclusive assessment about the contribution that FHIS, FISE, and FISDL have made to decentralization in their respective countries. The reform of these funds is still recent, and decentralization policies have gone through significant fluctuations. Their main contribution so far has been to create conditions at the local level that enable the decentralization processes to work well. In particular, the funds have fostered new dialogue between communities and local governments concerning local investment priorities, and they have contributed to institutionalize statutory guidelines for participatory and transparent municipal planning. By transferring funds as well as managerial and technical know-how to municipalities, they have enabled learning by doing, and they have increased municipal capacities to manage infrastructure building. And they have developed institu-

tional mechanisms to guarantee that infrastructure is maintained. They still face the challenge, however, of increasing the involvement of communities beyond the planning stage.

While the balance so far appears to be positive, the lack of a clear and comprehensive policy for decentralization and local development from national governments has made it difficult to establish the proper role of social funds in each country with respect to these issues. A national decentralization policy should include incentives for civic engagement, sector policies that clearly allocate responsibilities, sound legal and fiscal frameworks, and initiatives to build municipal administrative and financial capacities. Without such policies, social funds operate in an institutional vacuum that limits their contribution to processes of good local governance and healthy intergovernmental relations. ▲

Endnotes

- 1 For the municipal planning system of Nicaragua see <http://www.inifom.gob.ni/Documentos/SPM-ILUSTRADA.pdf>.
- 2 For a detailed list of indicators and outcomes, see www.fisdll.gob.sv.