

Document of  
The World Bank

Report No.: 21536 NI

PROJECT APPRAISAL DOCUMENT  
ON A  
PROPOSED CREDIT  
IN THE AMOUNT OF SDR22.0 MILLION (US\$28.7 MILLION EQUIVALENT)  
TO THE  
REPUBLIC OF NICARAGUA  
FOR A  
SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT  
FEBRUARY 21, 2001

Environmentally and Socially Sustainable Development  
Central America Country Management Unit  
Latin America and Caribbean Region

## CURRENCY EQUIVALENTS

(Exchange Rate Effective February 2001)

Currency Unit = Cordobas

Cordoba 1 = US\$0.08

US\$1 = 12.90C

## FISCAL YEAR

July 1 June 30

## ABBREVIATIONS AND ACRONYMS

ADR	Alternative Dispute Resolution
AMUNIC	Nicaraguan Association of Municipalities ( <i>Asociación de Municipios Nicaraguenses</i> )
CAM	Municipal Environmental Commission ( <i>Comisión Ambiental Municipal</i> )
CBA	Atlantic Biological Corridor ( <i>Corredor Biológico del Atlántico</i> )
CAS	Country Assistance Strategy
CDM	Municipal Development Committee ( <i>Comite de Desarrollo Municipal</i> )
CSD	Decentralization Sector Commission ( <i>Comisión Sectorial para la Descentralización</i> )
DIRAC	Alternative Conflict Resolution Office ( <i>Dirección de Resolución Alternativa de Conflictos</i> )
DGAF (MARENA)	General Administrative Financial Office ( <i>Dirección General Administrativa Financiera</i> )
CG	Central Government
DANIDA	Danish Agency for International Development
EIA	Environmental Impact Assessment
EMP	Environmental Management Plan
FODES	Decentralization Strengthening Project (financed by GTZ and implemented by CSD)
FONAFIFO	National Forestry Financing Fund ( <i>Fondo Nacional de Financiamiento Forestal</i> )
FAM	Municipal Environmental Facility ( <i>Facilidad Ambiental Municipal</i> )
FAN	National Environmental Fund ( <i>Fondo Ambiental Nacional</i> )
FINNIDA	Finnish Agency for International Development
FISE	Social Emergency Fund ( <i>Fondo de Inversión Social de Emergencia</i> )
FONDEM	Municipal Development Fund ( <i>Fondo de Desarrollo Municipal</i> )
GDO	Operations Management Department ( <i>Gerencia de Operaciones</i> ) of INIFOM
GEF	Global Environment Facility
GTZ	German Agency for Technical Cooperation ( <i>Gesellschaft für Technische Zusammenarbeit</i> )
IDR	Institute for Rural Development ( <i>Instituto de Desarrollo Rural</i> )
INIFOM	Nicaraguan Institute for Municipal Development ( <i>Instituto Nicaragüense de Fomento Municipal</i> )
IDA	International Development Association
LED	Local Economic Development
LACI	Loan Administration Change Initiative
LG	Local Government (municipal and regional governments)
MARENA	Ministry of Environment and Natural Resources ( <i>Ministerio del Ambiente y Recursos Naturales</i> )
MHCP	Ministry of Finance ( <i>Ministerio de Hacienda y Crédito Público</i> )
MPP	Micro Participatory Planning ( <i>Micro-Planificación Participativa</i> )
PANIF	Environmental Program Nicaragua-Finland (financed by FINNIDA)
PASMA	Environmental Sector Support Program ( <i>Programa de Apoyo al Sector Ambiental</i> )
PIU	Project Implementation Unit
PMR	Project Management Report
PPF	Project Preparation Facility
PRODEMU	Municipal Development Project (financed by DANIDA)
PROTIERRA	Rural Municipalities Project (ongoing World Bank-financed project)
SINIA	National Environmental Information System of Nicaragua ( <i>Sistema Nacional de Información Ambiental de Nicaragua</i> )
SOE	Statement of Expenses
UNCDF	United Nations Capital Development Fund
UTI	Institutional Technical Unit ( <i>Unidad Técnica Institucional</i> ) in INIFOM

Vice President:	David de Ferranti
Country Manager/Director:	Donna Dowsett-Coirolo
Sector Manager/Director:	John Redwood
Task Team Leader/Task Manager:	Maurizio Guadagni

**NICARAGUA**  
**SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**

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MAP(S)  
IBRD 31119

NICARAGUA  
SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT

**Project Appraisal Document**

Latin America and Caribbean Region  
LCSER

<b>Date:</b> February 21, 2001 <b>Country Manager/Director:</b> D-M Dowsett-Coirolo <b>Project ID:</b> P055823  <b>Lending Instrument:</b> Specific Investment Loan (SIL)	<b>Team Leader:</b> Maurizio Guadagni <b>Sector Manager/Director:</b> John Redwood <b>Sector(s):</b> BD - Decentralization, BI - Institutional Development <b>Theme(s):</b> Rural Development <b>Poverty Targeted Intervention:</b> N
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**Project Financing Data**  
 Loan     Credit     Grant     Guarantee     Other:

**For Loans/Credits/Others:**  
**Amount (US\$m):** 28.7

**Proposed Terms:** Standard Credit  
**Grace period (years):** 10  
**Commitment fee:** 0.5%

**Years to maturity:** 40  
**Service charge:** 0.75%

Financing Plan:	Source	Local	Foreign	Total
BORROWER		3.00	0.00	3.00
IDA		24.80	3.90	28.70
LOCAL GOVTS. (PROV., DISTRICT, CITY) OF BORROWING COUNTRY		4.00	0.00	4.00
U.N. CAPITAL DEVELOPMENT FUND		4.40	0.60	5.00
<b>Total:</b>		36.20	4.50	40.70

**Borrower:** THE GOVERNMENT OF NICARAGUA

**Responsible agency:** INIFOM AND MARENA

**Implementing agencies:** Nicaraguan Institute for Municipal Development (INIFOM) and Ministry of Natural Resources (MARENA)

**Address:** INIFOM, Camino para la Refineria, entrada los Arcos, Managua. MARENA, Km. 12 ½ Carretera Norte Apdo. 5123-1631, Managua, Nicaragua

**Contact Person:** Dr. Jose' Rizo, President of INIFOM; Dr. Roberto Stadthagen, Minister of MARENA

**Tel:** 505-266-6413, 505-263-2835

**Fax:** 505-266-6336, 505-263-2157

**Email:** Presidencia de INIFOM <prinifom@tmx.com.ni>, dgamarena@tmx.com.ni

**Estimated disbursements ( Bank FY/US\$m):**

FY	2002	2003	2004	2005				
Annual	6.00	11.10	8.00	3.60				
Cumulative	6.00	17.10	25.10	28.70				

**Project implementation period:** 2001-2004

**Expected effectiveness date:** 06/30/2001    **Expected closing date:** 12/30/2004



## A. Project Development Objective

### 1. Project development objective: (see Annex 1)

The project development objective is to improve the performance of rural municipalities, by building their capacity in three major areas in which municipal governments can make a critical contribution to sustainable rural development:

- (a) the provision of local public infrastructure and the delivery of municipal services;
- (b) the protection of the environment and the sustainable management of natural resources; and
- (c) the promotion of local economic development.

The project would seek to build municipal capacity by strengthening their planning, administration, monitoring, and evaluation. The project would foster not only the organizational efficiency of municipal governments, but also their legitimacy, accountability and transparency, enabling greater community participation in municipal development planning and management.

The project would build on the experience of the ongoing Nicaragua - Rural Municipalities Project (PROTIERRA,) enhancing its design on the basis of the lessons learned during implementation (a comparison between the ongoing operation and the new proposed project is available in section D.3 on lessons learned.)

Specifically, the new project would support the institutional development of rural municipalities through:

- the development and piloting of a decentralized municipal financing system, including technical assistance and training to municipalities, and the strengthening of the Nicaraguan Institute for Municipal Development (INIFOM), the central government institution responsible for support and supervision of municipal authorities; and
- strengthening of municipal environmental management, through decentralization of environmental responsibilities, the development of an environmental information system, and the establishment of a Municipal Environmental Facility.

### 2. Key performance indicators: (see Annex 1)

Measuring municipal performance is a difficult task, and there is little practical experience in this field in Nicaragua. Meaningful and locally relevant indicators must first emerge from the *planning* process of each municipality. These indicators should measure the effort and achievements of the municipality against the development and service delivery targets agreed with local communities and other stakeholders within the frame of the municipal planning process. The project therefore would assist municipalities to develop performance indicators and citizen satisfaction measures as *tools for reporting* against their strategic plans.

As checklists to aid in the development of accurate and useful reporting measures for each municipality, the following categories of indicators of municipal performance (indicators of the Project's *outcomes/impact*) would be used:

- *Municipal services delivery indicators* would track actual vs. planned improvements in coverage, quality and cost-effectiveness of municipal services. The percentage of completion of the 5 year Municipal Development Plan would reach at least a 15 percent per year, on average, among the 40 target municipalities. Under the ongoing project in 2000, the first year that this indicator was measured, it reached 10 percent (the optimal: annual implementation of a five year plan should be 20 percent.)
- *Municipal environmental management* would track municipal performance in (i) enforcing local environmental policies; (ii) establishing and strengthening of municipal environmental commissions; (iii) promoting the use of environmental information at the municipal level; and (iv) utilizing environmental criteria in municipal planning.
- *Local governance indicators* would track municipal performance in (i) promoting community

involvement and participation in local decision-making; (ii) increasing tax revenue of target municipalities from the current \$9.5 million to \$12.5 million; and (ii) increasing the perception of accountability and transparency of municipal administration. The share of population consulted by the municipality would increase from 60 percent to 75 percent. (These estimations are based on the experience of the ongoing project. Prior to project implementation, only 38 percent of rural inhabitants of León and Chinandega polled in a 1995 survey said they were consulted by municipal governments on issues that affected them. After four years of project implementation, a 1999 survey of a similar sample population revealed that 68 percent indicated that their elected official consulted them on issues affecting their livelihoods.)

- Indicators of *performance of INIFOM* would track institutional performance in terms of (i) perception of beneficiaries, as revealed by regular surveys of municipal staff and other municipal actors; (ii) number of INIFOM staff de-concentrated to departmental offices (from the current 40% to 45% by project completion); (iii) ratio of technical and professional staff versus administrative and directive staff (from the current 15% to 25% by project completion), and (iv) subjectively, on the basis of technical contribution to the national policy debate on municipal development.

## **B. Strategic Context**

**1. Sector-related Country Assistance Strategy (CAS) goal supported by the project:** (see Annex 1)

**Document number:** 17496 - IDA/R 98-32; IFC/R 98-44

**Date of latest CAS discussion:** 04/8/98

The project is consistent with both the CAS core themes and the areas of concentration of IDA's assistance to Nicaragua, through:

- (i) the focus on the development of rural areas, where poverty is concentrated;
- (ii) the contribution to the development of municipal/rural infrastructure and local services delivery;
- (iii) the recognition that environmental protection must be an integral part of any sustainable approach to rural development, and its contribution to local level natural resources management; and
- (iv) the support to municipal capacity building and the establishment of inter-governmental partnership between the State and the municipalities, as key conditions for further advancement of the national decentralization process.

The project is also consistent with the findings of the Nicaragua Poverty Assessment, currently being finalized. The following findings are relevant to the proposed project:

- (i) poverty in Nicaragua is concentrated in rural areas, where economic growth and the prospects of poverty alleviation depend on few agricultural commodities, characterized by volatile international prices;
- (ii) aid flows bias government spending towards new investments, and lead to under-funding of maintenance and operations expenditures;
- (iii) a common feature of rural poverty is the marginality and sense of exclusion felt by the poor; and
- (iv) service delivery mechanisms need to be results-driven, rather than supply-driven.

Rural municipalities could play an important role in all of the above aspects. Because of their geographical distribution, municipalities are in a favorable position to provide operation and maintenance, particularly to small investments. In addition, by promoting participation and inclusion of the poor in the local political and social life, they can coordinate the demand for services and induce important behavioral and cultural changes.

By integrating poverty and environmental management concerns and addressing them within the unifying institutional framework of municipal development, the project is also consistent with the Regional Environmental Strategy which aims to integrate environmental concerns into all poverty alleviation and economic development efforts.

## **2. Main sector issues and Government strategy:**

Nicaragua has two autonomous regions (North and South Atlantic Autonomous Regions, namely RAAN and RAAS), 15 departments and 150 municipalities. Recently, the municipality of Managua has been

divided into three separate municipalities. The term Local Governments (LGs) refers to both municipalities and the governments of the two autonomous regions of the Atlantic. Municipal assemblies and mayors are elected for a 4-year term of office. Municipal populations range from 270 in San Juan del Norte (RAAS) to 930,000 in Managua (before the separation), with an average population size of 29,600.

Existing legislation (the Municipal Laws 40 and 261) assigns a broad range of responsibilities to municipalities, both as "own" and "shared" mandates. However, most municipalities do not have the *capacity* to carry out all of these responsibilities (capacity is used in its broad sense, which refers to both *technical* and *fiscal* capacity.) Small, rural, and remote municipalities tend to have less fiscal and technical capacity than large and more urban municipalities, even when fiscal capacity is measured in per capita terms. As a consequence, different municipalities have assumed their legal responsibilities at different levels, often leading to confusion in the division of responsibilities between central and municipal governments.

The Central Government (CG) has been supporting municipalities with several programs which seek a partnership with municipal governments, and support them with both technical and financial assistance. For instance, through the Social Investment Fund (FISE), the Government is developing municipal capacity to provide social infrastructure and the delivery of social services demanded by communities. The Institute for Rural Development (IDR, in its Spanish acronym) is another example where a governmental program is developing a partnership with municipalities in the area of local economic development.

The current system of municipal support is still missing two essential mechanisms to: (i) develop a partnership between central and local governments in environmental protection and natural resources management; and (ii) improve the capacity of local governments to develop their own policies, allowing local choices to be made. The latter requires a system of support to municipalities which is not sector specific.

**Municipal Development.** There is an ongoing discussion on the most appropriate modalities to support municipal governments across the sectors. The "*municipalista*" position considers that the major bottleneck to municipal development in Nicaragua is the absence of a regular system of municipal transfers to address the disparity between municipal responsibilities and fiscal capacities (the so-called "vertical fiscal imbalances"). This position points to the need for fiscal transfers, an automatic mechanism to transfer a fixed percentage of national income to municipalities with no *a priori* controls (to avoid the risk of political interference). Fiscal transfers to municipalities are required by the 1995 Constitution. Others caution that municipalities should increase their capacity *before* receiving fiscal transfers. They tend to be concerned about the risks associated with such transfers, including (i) limited municipal technical capacity; (ii) disincentives to municipal efforts for local revenue generation; and (iii) the reduction of governmental flexibility to steer macroeconomic stabilization.

The discussion raises two major policy questions: (i) the issue of municipal capacity and how to create/strengthen it, and (ii) the issue of how much central government support and supervision of municipalities is required, and through which mechanisms this should be provided. Many agree that the issue in Nicaragua is not whether or not to have fiscal transfers or decentralization as such but the strengthening of the *inter-governmental relations* between central-level public administration and municipalities. For this, an improvement in both central and local governments is needed.

**Environmental Management.** Nicaragua is rich in natural resources and one of the most biologically diverse countries in Central America. Although 18.2 percent of Nicaragua's land area is included in protected areas, natural resources exploitation is still a problem. The effects are clear: the country has suffered from extreme deforestation at the rapidly advancing agricultural frontier, agro-industrial water pollution, and soil erosion. The trend in natural resources exploitation is a result of poor environmental management. According to the latest state reform legislation, the central government should limit its role to the design of regulatory and other policies, leaving most of the implementation responsibilities to other actors: LGs, civil society, private sector, and Judicial Power. In 1998, Nicaragua approved the State Modernization Law (Law 290) with the objective of reorganizing competencies and procedures of the

Executive Power. This law set both "de-concentration" and "decentralization" of environmental management as policy priorities under the Ministry of Environment and Natural Resource's (MARENA) new mandate\*. Since 1998, MARENA initiated the de-concentration of functions to its Departmental Delegations. However, local actors, and particularly municipal governments, have been playing a limited role in implementing environmental policies, due, in part, to limited capacity and lack of incentives from the central government. Traditionally the Government, and MARENA in particular, addressed environmental problems using command and control policies that in many cases created the wrong incentives. MARENA is aware of the need to develop new mechanisms to create a constructive dialogue and collaboration with the local level and with communities. However, currently there are limited incentives for partnership between the central government and municipalities on environmental management.

\* Although at times used interchangeably, de-concentration and decentralization differ significantly. Under *de-concentrated* arrangements, a central body delegates technical autonomy to a regional body to carry out limited jurisdiction over part of the territory. The regional body is dependent on the central body since it does not have a legal status or its own source of revenue. Under a *decentralized* arrangement, instead, the regional body is autonomous from the central body, since the regional body represents, through local elections, a local constituency, and it has its own source of revenue, such as local taxes.

### **3. Sector issues to be addressed by the project and strategic choices:**

The project would pilot a fiscal transfer facility, and a conditional matching-grant mechanism for environmental protection. The pilot fiscal transfer facility would promote *learning-by-doing*, where both investment resources and technical assistance would be provided to municipal governments. In other words, it would build capacity *through* direct implementation of municipal activities. The project would gradually enable municipalities to face the responsibilities entrusted to them by the Municipal Law, while providing a balance of financial incentives and technical assistance for capacity building purposes.

The decision to combine the two separate issues described above in one single project - multi-sector and environmental municipal support - was based on the need for both issues to be addressed under a comprehensive framework. Although separating these components under two separate projects would likely have involved less ambitious implementation arrangements, the proposed approach would promote the acceptance of environmental management as an integral aspect of municipal responsibilities.

To balance the increased complexity of such a comprehensive approach, it was decided not to expand significantly the project's area of action from that supported under the ongoing project, but rather to concentrate on those municipalities for which some strengthening/assistance has already been provided and to include only a limited number of additional municipalities. The criteria to select the project area were the following: (i) to continue to work in the same municipalities where the ongoing project has been implemented to build on the existing experience and institutional capacity; (ii) to work in municipalities where both project components could be implemented; and (iii) to add contiguous groups of municipalities, possibly departments. See Chapter D.1 on Project Alternatives for further details. A list of covered municipalities is available in Annex 2.

The project would address the variation of capacity among municipalities (*horizontal* imbalances) rather than the disparity between municipal responsibilities and capacities (*vertical* imbalances.) This decision was made because vertical imbalances are difficult to assess in the current situation, where responsibilities are unclear. Conversely, horizontal imbalances are relatively simple to measure. For instance, the variations of fiscal revenue among municipalities represents an easily accessible and reliable indicator of fiscal capacity (the per capita fiscal capacity of Nicaraguan municipalities ranges between \$0.6 to \$60 per year, with an average of \$11). The project would not aim to achieve a comprehensive strategy on decentralization, including commitment to a sustainable fiscal transfer policy. Rather, the proposed project would pilot mechanisms to strengthen municipal capacity.

To address the issue of inadequate inter-governmental relations, the project would not limit its objectives to those of developing municipal governments. Instead, it would focus on the development of both central and local level institutions. The project would thus support also the institutional development of the two central level agencies involved in project implementation: INIFOM and MARENA. See also Chapter D.1 on Project Rationale.

### C. Project Description Summary

**1. Project components** (see Annex 2 for a detailed description and Annex 3 for a detailed cost breakdown):

The proposed project would include two distinct components:

- A "Municipal Development" component executed by INIFOM, and
- A "Municipal Environmental Management" component executed by MARENA.

The INIFOM-executed "Municipal Development" Component would include four sub-components: (a) decentralized financing; (b) strengthening of municipal institutions; (c) strengthening of INIFOM; and (d) evaluation and policy development.

The MARENA-executed "Municipal Environmental Management" Component would include three sub-components: (a) decentralization of environmental management; (b) environmental information systems; and (c) municipal environmental facility (FAM).

Component	Sector	Indicative Costs (US\$M)	% of Total	Bank-financing (US\$M)	% of Bank-financing
1. - MUNICIPAL DEVELOPMENT	Institutional Development		0.0		0.0
1.A - Decentralized Financing - Municipal Development Fund (FONDEM)	Decentralization	16.73	41.1	11.00	38.3
1.B. - Strengthening Municipalities	Institutional Development	7.84	19.3	4.37	15.2
1.C. - Strengthening of INIFOM	Institutional Development	3.29	8.1	3.12	10.9
1. D - Evaluation and Policy Development	Institutional Development	1.09	2.7	0.98	3.4
2. MUNICIPAL ENVIRONMENTAL MANAGEMENT	Environmental Institutions		0.0		0.0
2.A. - Decentralization of Environmental Management	Environmental Institutions	5.16	12.7	3.77	13.1
2.B. - Environmental Information System	Environmental Institutions	1.77	4.3	1.61	5.6
2.C. - Municipal Environmental Facility (FAM)	Decentralization	4.82	11.8	3.85	13.4
<b>Total Project Costs</b>		<b>40.70</b>	<b>100.0</b>	<b>28.70</b>	<b>100.0</b>
<b>Total Financing Required</b>		<b>40.70</b>	<b>100.0</b>	<b>28.70</b>	<b>100.0</b>

**Implementation period.** The project would be implemented over a period of three years (2001-2004). This limited implementation period was selected to reduce the risks to the project of significant policy changes after the next Presidential and General Assembly elections. The three year period would provide "bridge" financing which might be followed by a follow-up if commitment to project objectives is sustained after the transition. However, longer-term assistance will be required to fully achieve the sustainability of project interventions.

## **2. Key policy and institutional reforms supported by the project:**

The project would support the development of national policies on municipal strengthening and decentralization. In particular, it would support the development of: (i) a national fiscal transfer policy, including incentives for municipal environmental management (FONDEM and FAM); and (ii) a municipal planning and financial management policy. Within this framework, the project would promote the development of the following legislation:

- Municipal Budget Law;
- Municipal Administrative Career Law; and
- National Cadastre Law.

The project would not attempt to achieve a comprehensive decentralization strategy but rather to build momentum from the bottom-up that would promote an agreement on a workable model.

The project would also support the institutional reforms of INIFOM and MARENA to implement the Law for the Reform of the Executive Power (Law 290) and the Organic Law of INIFOM (Law 347).

As for municipal environmental management, the project would concentrate on the implementation of the existing legal framework rather than on its revision.

## **3. Benefits and target population:**

**Benefits.** The proposed project would have an impact at three levels: community, municipal and Central Government. At the *community* level, the expected benefits are: (i) services provision focused on community priorities; (ii) improved natural resources management and environmental sustainability; (iii) increased community organization and involvement in municipal management; (iv) greater accountability of municipal authorities to their constituencies; and (v) greater access to government services of the most rural, isolated, and poor communities, and reduced sense of marginality. A biannual survey similar to the one recently carried out to evaluate the effects and potential sustainability of the ongoing project would be carried out every two years to assess the increase in community organization and community perception of municipal performance.

At the *Municipal level*, the main expected benefits are (i) improved local governance and greater coordination among public and private agencies and civil society; (ii) increased local revenue generation, and financial capacity; (iii) increased administrative capacity for service delivery, including environmental services; (iv) increased ability to identify, and respond to, local service demand, particularly from rural communities; and (v) increased natural resources management capacity. Annual surveys and audits would be used to assess benefits at this level.

At the *Central Government level*, the project would improve the capacity of INIFOM and MARENA to provide services for municipalities, thereby enhancing the system of intergovernmental relations. Specifically, the project would improve managerial and administrative capacities of INIFOM and MARENA. Annual surveys would also provide feedback on the municipal perception of the performances of INIFOM and MARENA.

**Target population.** The final target population are rural communities, both in the countryside and in small rural towns. Following the positive example of the ongoing project, poverty targeting would be based on two mechanisms. *First*, inter-municipal targeting would be effected through the formula used to allocate FONDEM and FAM funds among municipalities. *Second*, intra-municipal poverty targeting

would be supported through the participatory planning procedure to be adopted by municipal governments. In developing techniques for intra-municipal targeting, the project would build on the positive experience of the ongoing project, whose results in this respect were significant (see the "Evaluation of Effects and Potential Sustainability of the Protierra project"). The new project would further improve mechanisms for participation in the municipal planning system through their institutionalization in municipal activities.

The formula to distribute FONDEM transfers would be substantially different from the one utilized by the ongoing project, which is based on "indicators of need" such as poverty and population. The new formula would instead use two separate windows: 60 percent of the funds would be distributed with a fiscal equalization objective, while the remaining 40 percent would be distributed as an incentive to improve municipal revenue performance (local tax effort). According to initial simulations (which INIFOM is still negotiating with the Association of Municipalities, AMUNIC, and the General Assembly), the equalization window would bring all targeted municipalities to a minimum per capita total revenue of around \$9 (below the average per capita municipal revenue of the 151 municipalities of Nicaragua, which is around \$11). This formula would distribute most funds to the fiscally weaker municipalities. Although fiscal weakness and poverty are different sets of indicators, they have a strong positive correlation. As a result, the correlation between the ratio of people below the poverty line and the FONDEM per-capita transfers would be even higher than in the ongoing project (33 percent versus 31 percent.) See Attachment 1 of Annex 2 for more details on the proposed FONDEM design.

Participatory municipal planning would develop specific mechanisms to foster indigenous communities and women's organizations to contribute in the process.

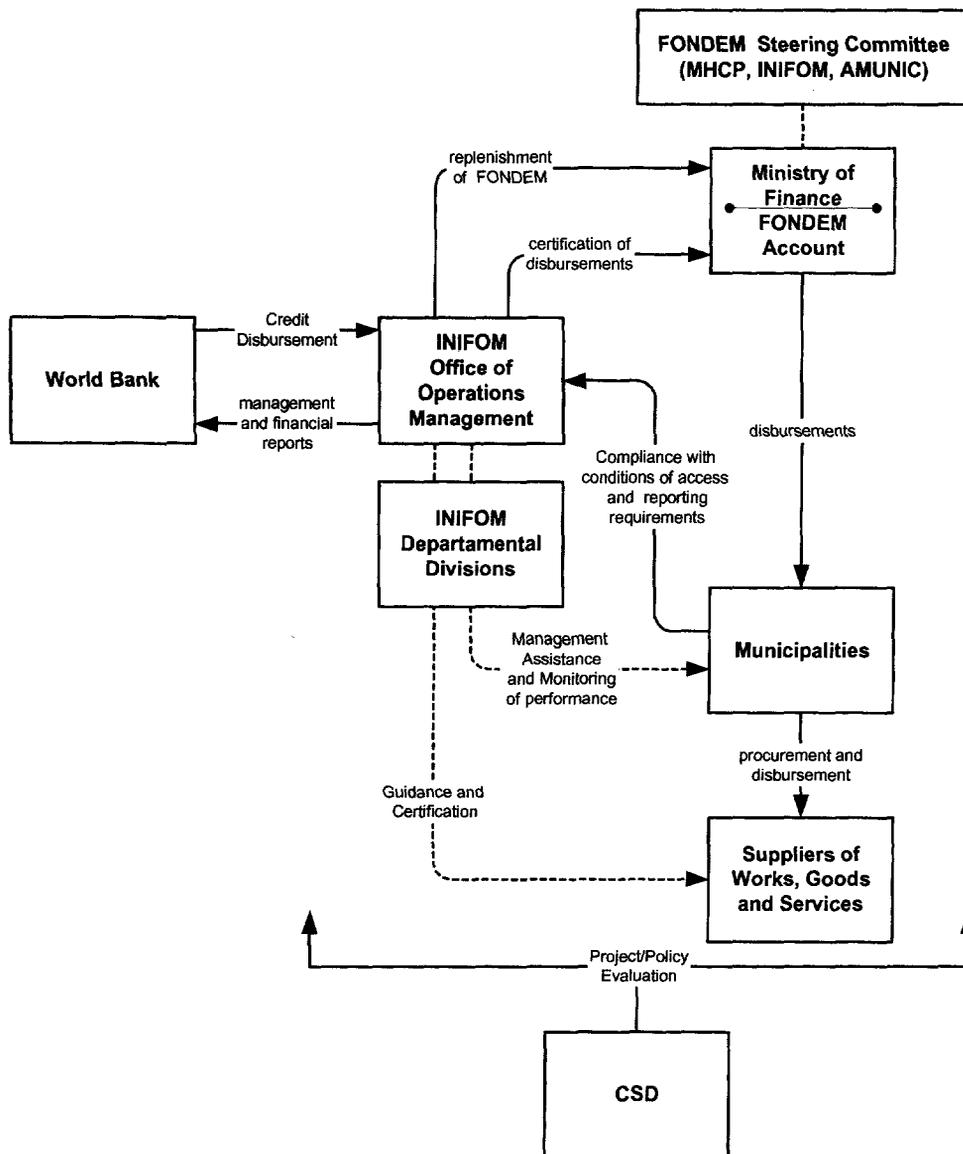
#### **4. Institutional and implementation arrangements:**

A key feature in the design of the institutional arrangements for implementation of this project, is the choice *not* to establish separate Project Implementation Units within the two executing agencies (INIFOM and MARENA). Instead, the line departments of INIFOM and MARENA would execute the two project components. Besides aiming to promote the institutional sustainability of the project's activities, this choice is also dictated, in the case of the "Municipal Development" component, by an explicit attempt to facilitate a strategic restructuring of INIFOM.

Given that environmental and municipal affairs cut across all sectors, the coordination among INIFOM, MARENA, and other governmental agencies is essential. An example is the coordination that is required between FISE and INIFOM. This coordination will be achieved through: (i) an inter-institutional agreement which clarifies specific responsibilities and complementarities, and defines mechanisms for coordination and collaboration; (ii) FISE's participation in the INIFOM Steering Committee; (iii) INIFOM's participation in the FISE steering committee; and (iv) the activity of an inter-institutional working group to address specific technical aspects. Finally, recently FISE became a member of the Decentralization Sector Commission (CSD, its acronym in Spanish). Annex 14 elaborates on the potential complementarity of INIFOM and FISE.

#### The INIFOM-executed Municipal Development Component

The institutional arrangements for implementation of the "Municipal Development" component of the project would reflect two circuits of: (1) *financial* assistance and (2) *technical* assistance. (See diagram below.)



The **financial assistance** circuit refers to the operation of FONDEM, which would be managed by INIFOM, under the guidance and supervision of an Inter-Institutional Committee composed of representatives of the Ministry of Finance, INIFOM, AMUNIC, and the Municipal Committee of the National Assembly. With respect to the operational aspects of the FONDEM, the project's execution and implementation responsibilities would be distributed as follows.

- (a) INIFOM would be responsible for: (i) requesting the disbursement of IDA's credit replenishing the FONDEM and producing the required management and financial reports (quarterly Project Management Reports (PMR), and annual financial statements) on its operations; (ii) communicating to participating municipalities the respective annual planning ceilings, based on the FONDEM resource allocation formula; (iii) establishing the conditions of access to the FONDEM (e.g. permissible uses and procedural requirements) and ensuring compliance with FONDEM requirements and applicable regulations; (iv) reviewing and approving the Municipalities' financial

reports, and processing the quarterly transfer of FONDEM resources, requested by Municipalities to INIFOM and transferred through the Ministry of Finance into municipal FONDEM accounts; (v) establishing, and extending to municipalities, appropriate tools, controls and procedures for financial management, and monitoring the physical and financial progress of all FONDEM-financed activities; (vi) effecting random inspections to assess municipal performance in the implementation of FONDEM-financed activities; and (vii) contracting external audits of the FONDEM-financed activities. (See Annex 2 Attachment 1 for FONDEM detailed description.)

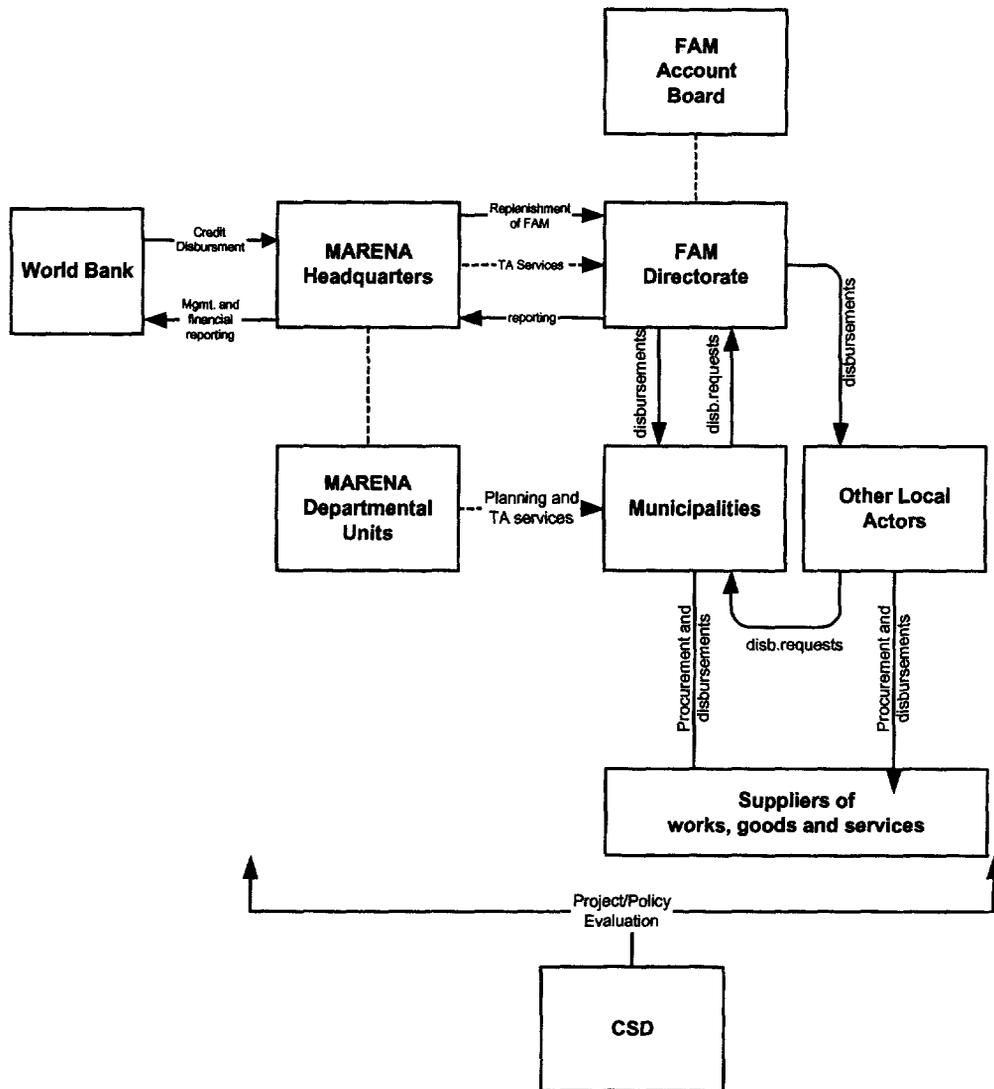
- (b) The Ministry of Finance would be a cooperating agency, responsible for making disbursements of FONDEM resources to participating municipalities, according to their quarterly financial program submissions certified by INIFOM. Funds from the project Special Account would be transferred by INIFOM to the Ministry of Finance on a quarterly basis, into a separate bank account.
- (c) Municipalities would be the implementing agencies of FONDEM, responsible for: (i) complying with all conditions of access to the FONDEM, including the adoption and implementation of participatory planning, and financial management procedures; (ii) reflecting all FONDEM-supported activities in the annual budget approved by the Municipal Council; (iii) submitting quarterly financial programs and disbursement requests to INIFOM for review; (iv) procuring all works, goods and services financed from FONDEM resources; (v) maintaining separate bank accounts, project records, and monitoring systems of the FONDEM-supported activities; and (vi) providing INIFOM with timely physical and financial reports of all FONDEM financed activities.

The **technical assistance** responsibilities for the Municipal Development Component are distributed as follows.

- (a) INIFOM would be responsible for: (i) assisting participating municipalities in the development and adoption of an appropriate and participatory municipal planning technology; (ii) assessing, informing and responding to the municipal demand for services and systems that improve local resources mobilization, internal organization and local personnel management; (iii) promoting and certifying potential suppliers of technical assistance services to the municipal sector, from the public, private and non-profit sectors; (iv) providing, through its departmental divisions, a wide range of management assistance services, particularly to smaller and weaker municipalities, including appropriate guidance in the selection, contracting and supervision of suppliers of technical services.
- (b) INIFOM would also be responsible for contracting technical assistance to support its own restructuring efforts. Specifically, INIFOM would be responsible for the selection and evaluation of management consultants, and implementation of adopted policies (such as personnel management, financial management and procurement, etc.).
- (c) The Decentralization Sector Commission (CSD) would be a cooperating agency, responsible for: (i) designing and implementing a system of external, policy-oriented, evaluation of key project activities. This evaluation system would comprise a baseline study against which to evaluate project impact; and (ii) communicating and disseminating lessons learned in order to translate them into the development of decentralization policy papers and draft legislation and regulations (see Annex 13.)

#### The MARENA-executed Municipal Environment Component

The diagram below summarizes the institutional arrangements for implementation of the "Municipal Environmental Management " component of the project. The diagram reflects both financial and technical assistance circuits between MARENA and external beneficiaries.



The **financial assistance** refers to the Municipal Environmental Facility (FAM), earmarked to finance environmental management activities identified, selected and prioritized within the framework of the municipal planning process.

- (a) MARENA, through the Decentralization Office, would be the agency responsible for the execution of this project component. In particular it would be responsible for: (i) requesting the disbursement of IDA's credit, replenishing the FAM and producing the required management and financial reports; (ii) providing, through the relevant line departments, technical assistance to the FAM Technical Unit for the review and approval of project proposals submitted by participating municipalities; and (iii) monitoring, through its Regional Delegates, the implementation of FAM-supported municipal projects and the environmental impact of municipal investments.
- (b) The FAM Technical Unit would draw on the capacity of the existing Small Projects Technical Unit financed by the Danish Agency for International Cooperation (DANIDA). This Technical Unit would be responsible for: (i) appraising all project proposals for FAM support and recommending their approval by the FAM Committee; (ii) managing the FAM account and disbursing the resources to municipalities; (iii) monitoring the FAM operations and providing MARENA with the required management and financial reports; and (iv) acting as an executive secretariat for the FAM Committee.

- (c) The FAM Committee would steer and supervise FAM activities. The Committee would be composed of representatives of MARENA (chairperson), INIFOM and AMUNIC, and would be responsible for: (i) setting the FAM policy, including conditions of access and implementation and reporting procedures, and monitoring its implementation, as detailed in the MARENA operational manual (as defined in Section 3.01 c. i. of the Development Credit Agreement); and (ii) approving all municipal requests for financial support, upon the recommendation of the FAM Technical Unit.
- (d) Municipalities would be the implementing agencies of the FAM-financed projects. Municipal authorities would be responsible for: (i) complying with conditions of access to FAM, such as creating Municipal Environmental commissions (CAM) as multi-actor, specialized bodies, with consultative functions and the responsibility to recommend municipal environmental actions; (ii) building up a minimum capacity for local environmental management; (iii) certifying and submitting all funding disbursement requests to the FAM Technical Unit; (iv) monitoring the implementation of all FAM projects and providing the FAM Technical Unit the required quarterly financial and physical progress reports.

Local promoters of environmental management activities, belonging to the private or community sectors would be able to participate as co-executors with municipal governments in FAM projects, but always under the Municipalities' supervision and approval.

The **technical assistance** responsibilities for the Municipal Environmental Management Component are distributed as follows.

- (a) MARENA would be responsible for: (i) assisting participating municipalities in the development and adoption of land use plans; (ii) assessing, informing and responding to the municipal demand for services and systems that improve environmental and natural resources management; (iii) providing, through its departmental divisions, a wide range of environmental management assistance services, including appropriate guidance in the selection, contracting and supervision of suppliers of technical services.
- (b) MARENA would contract consultants for the development of the National Environmental Information System (SINIA), and coordinate with other relevant government agencies.
- (c) MARENA would also be responsible for its own institutional development efforts. Specifically, MARENA would select and evaluate management consultants, and implement adopted policies (such as personnel management, financial management and procurement, etc.).

## **D. Project Rationale**

### **1. Project alternatives considered and reasons for rejection:**

**The rationale of project area selection.** Project coverage was selected on the basis of institutional criteria, considering the pilot nature of the project, and the limited institutional capacity of INIFOM and MARENA. As a consequence, the criteria to select the project area were the following: (i) to continue to work in the same municipalities where the ongoing project has been implemented to build on the existing experience and institutional capacity; (ii) to work in municipalities where both project components could be implemented; and (iii) to add contiguous groups of municipalities, possibly departments. Working with contiguous municipalities would facilitate exchanges and horizontal learning among municipalities, encourage the creation of association of municipalities; and facilitate the articulation between municipalities and the de-concentrated agencies at department level.

Although the ongoing project is covering the Atlantic region under the MARENA executed Mesoamerican Biological corridor, the project team decided to withhold interventions in this area because the Inter-American Development Bank (IADB) just completed the preparation of the "Atlantic Coast Local Development Program". The IADB program will invest an approximate US\$9.3 million to strengthen the capacity of Atlantic Coast institutions to manage the regional sustainable development. Specifically, the IADB-financed program intends to develop the institutional capacity of communities, municipal and regional governments in the Atlantic Coast. As this objective is similar to the proposed project, the team decided to avoid duplication of efforts.

On the basis of the above criteria, the project preparation team decided to concentrate project activities in 40 municipalities: the 32 municipalities currently covered by the ongoing project, and 8 new municipalities in the department of Chontales. This department does not represent a significant increase in institutional effort since the INIFOM field office in Juigalpa, Chontales, has already been strengthened under the ongoing project. (For a list of municipalities, see Annex 2.)

Although the project area was not selected on the basis of poverty criteria, the average poverty level in the project area is slightly higher than the national average (for poverty targeting within the project area, see the chapter C.3 on target population.)

In exceptional circumstances, project coverage could be modified during implementation. One of these circumstances could be an emergency, similar to what occurred as a result of Hurricane Mitch in November 1998. If the proposed municipalities found it more difficult than expected to comply with FAM and FONDEM conditions of access, the possibility of expanding the project area could be considered to avoid delays in disbursements. Any modification of project coverage would, however, require the mutual agreement of the Borrower and IDA.

**The rationale of the project's support to INIFOM.** Considering its current institutional weakness and the mixed performance record, questions have been raised on the strategic value of an organization like INIFOM. The alternative to support another existing, strong institution -- such as FISE-- was discarded because an articulated system of inter-governmental relationships requires a multi-sector institution, dedicated to policy development on municipal issues. FISE is an implementing institution. (For an explanation of the complementary roles of FISE and INIFOM see Annex 14). Still, a strong policy management capacity of the central government is critical for successful decentralization reforms.

The Organic Law of INIFOM supports the development of a central institution to assist municipalities. Such Law has clarified the formerly unclear (half government, half municipal) nature of INIFOM and brought the Institute closer to what elsewhere would be a "Ministry of Local Governments". The Nicaraguan association of municipalities (AMUNIC) has welcomed this change and has been a firm supporter of the legislation, repeatedly expressing the interest of its members in a stronger INIFOM as their main interlocutor when dealing with the central Government.

The strategic relevance of INIFOM is evident considering that the majority of Nicaraguan municipalities (and the target beneficiaries of this project) are small, weak and mostly rural. These municipalities can benefit more from a direct and intense assistance from a central government agency like INIFOM, than their larger/urban counterparts. This is what this project aims to do, through the strengthening of INIFOM and the implementation of the FONDEM.

With respect to the provision of technical assistance, INIFOM will need to strike a realistic balance between a supply and a demand-driven approach to capacity building in small and rural municipalities. The premise is that INIFOM should perform an overall regulatory function. For example, INIFOM should be responsible for setting the conditions of access to the resources of the FONDEM. Having set such conditions, INIFOM should also provide (develop and be ready to extend) to municipalities the tools (procedures and systems) to comply with them. However, as long as municipalities do comply with the required conditions, they should be free to do what they consider appropriate, including the use of FONDEM resources to purchase technical assistance services and contract private and non-profit providers.

**Decentralized versus de-concentrated approach.** The project chooses to strengthen municipalities as an institutional strategy for rural development and poverty alleviation. This approach is different from a program that delivers rural development through central line agencies or directly through community groups, or, as it is often the case, through a combination of the two. By contrast, this project would strengthen the autonomous capacity of municipalities to design and implement locally-relevant development policies, developing the capacity of municipal authorities to be involved in the *definition*, and not only in the *implementation*, of poverty alleviation programs.

**Rationale of FONDEM and FAM.** FONDEM responds to the need for improving the current system of fiscal transfers, through a pilot case. FONDEM would not attempt to tackle the *vertical* fiscal imbalance, but rather the *horizontal* fiscal imbalances. (While "vertical imbalances" refer to the discrepancy between municipal responsibilities and capacity, "horizontal imbalances" refer to the difference of capacity across municipalities.) This is consistent with Art. 177 of the Constitution (as amended in 2000), which established the central government's obligation to allocate a percentage of the General Budget of the Republic to the municipalities, giving priority in the distribution formula to those municipalities with lower fiscal capacity. The FONDEM would effect *regular* and *transparent* (formula-based) transfers of funds to municipalities for the financing of a broad range of activities prioritized through a municipal participatory planning process and reflected in the annual municipal budget. The general-purpose grants financed under FONDEM would be complementary to the earmarked/conditional funds provided under FAM as well as to other earmarked funds (such as FISE, IDR, and other). See Attachment 1 of Annex 2 for more details on FONDEM.

**2. Major related projects financed by the Bank and/or other development agencies (completed, ongoing and planned).**

Sector Issue	Project	Latest Supervision (PSR) Ratings (Bank-financed projects only)	
		Implementation Progress (IP)	Development Objective (DO)
<b>Bank-financed</b>			
Development of rural municipalities	Rural Municipalities Project (PROTIERRA), approved FY97	S	S
Support of environment and land use plan for the Atlantic Region to consolidate the Nicaraguan portion on the Mesoamerican Biological Corridor	Atlantic Biological Corridor (GEF), approved FY98)	S	HS
Provide technical assistance for state modernization	Institutional Development Credit	S	S
Provides small-scale infrastructure, mainly in education, health, and water supply and sanitation	Third Social Investment Fund Project (FISE), approved FY99)	HS	S
Strengthen local capacity and develops alternatives to address long-term forestry issues.	Sustainable Forestry Investment Promotion Project, approved FY99	S	S
Increase and diversify agricultural output and exports, while preserving the country's natural resource base	Agricultural Technology and Technical Education Program, approved FY01		
<b>Other development agencies</b>			
Strengthening of the decentralization process through the Sectoral Decentralization Commission (CSD)	Fortalecimiento a la Descentralizacion (FODES-GTZ)		
Develop local institutions in the Atlantic Coast	Atlantic Region Development Project (IDB-FISE)		
Municipal Development in Las Segovias	PRODEMU - DANIDA		
Local Environmental Management	PANIF - FINNIDA		
Rural Development in Leon and Chinandega	PROCHILEON (IDR)		
Municipal Development and support to decentralization	United Nations Capital Development Fund (UNCDF)		
Develop municipal cadastres and improve municipal revenue generation	System of Cadastre (SISCAT) UNDP-DANIDA		

IP/DO Ratings: HS (Highly Satisfactory), S (Satisfactory), U (Unsatisfactory), HU (Highly Unsatisfactory)

The relationships and complementarities between INIFOM and the **Social Investment Fund (FISE)** are detailed under the institutional analysis summarized in Annex 14.

The project to be financed by the **United Nation Capital Development Fund (UNCDF)**, currently under preparation, would be an operation parallel to the proposed IDA project. If approved, this project would provide a \$5.0 million grant to pilot the FONDEM (\$3 million) and provide technical assistance to both municipalities and INIFOM. The experience of UNCDF in Local Development Funds constitutes an important technical contribution of this institution.

### 3. Lessons learned and reflected in the project design:

The main lessons reflected in project design were learned during the implementation of the ongoing project (Credit No. 2918-NI). A series of evaluations of the ongoing project were summarized in the report "Local Governments and Sustainable Rural Development" (Latin America and Caribbean Region Sustainable Development Working Paper No. 11, December 2000). The Working Paper concludes that the ongoing project helped reduce marginalization of poor communities, created infrastructure and local institutional capacity considered essential for long-term poverty alleviation, and contributed directly to improving quality of life through emergency reconstruction measures. However, the prospects for sustainability of specific project interventions are mixed. Potential sustainability at the local level is good due to significant gains in institutional development at the municipal level, but potential sustainability of interventions at the central government level is less likely because of unsatisfactory institutional development within INIFOM. This situation is not unusual: experience from other countries shows that it is difficult to strengthen national government institutions responsible for building and maintaining multisectoral relationships with sub-national governments.

INIFOM recognizes that these deficiencies hinder the overall sustainability of the system of intergovernmental relationships on which the project is based, and is taking positive steps to address key problems. The following table summarizes the differences between the ongoing project and the proposed operation, designed in part to address the conclusions of the 1999 evaluation of the ongoing project.

	<b>Ongoing Rural Municipalities Project</b>	<b>Proposed Second Rural Municipal Development Project</b>
<b>Project Management</b>	Project Implementation Units in INIFOM and MARENA	Consultants hired under the ongoing project would be responsible for the performances of the whole institution (not only "the project") and they would be placed directly within the line units of INIFOM and MARENA to build capacity within those units. The project would also finance salary increases for permanent staff
<b>Municipal Development Fund</b>	One single fund managed by INIFOM and often not part of the municipal budget	<ul style="list-style-type: none"> <li>• Clear separation between the equalization and the incentive facilities</li> <li>• Flow of funds through the Ministry of Hacienda, similar to fiscal transfers.</li> <li>• Municipal Development Fund is part of the municipal budget</li> </ul>
<b>Environmental Municipal Fund</b>	Non existent	Created under the National Environmental Fund
<b>Municipal Focus</b>	Environmental management component focused to improve national legal framework	Municipal Environmental Management Component would focus on implementing existing legislation at municipal level
<b>Technical assistance to Municipalities</b>	Mostly contracted by INIFOM	Certified and trained by INIFOM, but mostly hired by the municipalities themselves
<b>Local Economic Development</b>	Financing of credit allowed	Financing of credit NOT allowed (as specified in the INIFOM and MARENA Operational Manuals)
<b>Policy implications of Evaluation</b>	Carried out by INIFOM (with IDA support)	Carried out by the Sectoral Commission for Decentralization (CSD)

An important lesson learned from the implementation of the ongoing project concerns municipal action for promotion of **local economic development** (LED). This is an area where the main challenge is in the design of innovative, yet transparent, institutional arrangements that allow municipal government to respond to strong pressures from their constituency and play an active role in promotion of local economic activity.

Under the ongoing project, municipal personnel, in cooperation with beneficiary communities, were given the flexibility to identify and design small income-generating sub-projects. Local identification and design resulted in most cases in revolving funds for investments in poultry, livestock and basic grain production, which were managed and technically supported by local NGOs, acting as Funds Administrators. The nature of investments was rather uniform, although results were mixed. This was due to the following: (i) municipal governments, as other government agencies, are not in a good position to provide – and recuperate – credit; (ii) municipal personnel often do not have the appropriate technical skills for evaluating and monitoring investment proposals; and (iii) fund administrators do not have a financial stake in the outcome of sub-project investments.

The experience of the ongoing project shows that municipalities tend to get directly involved in fixing the problem, instead of seeking collaboration with other actors. For instance, the private sector may be better positioned to provide financial services, but municipalities rarely seek their collaboration. Municipalities often consider "participation" as the collaboration with communities and civil society, but do not consider the private sector as a viable ally.

Nonetheless, municipalities have a potentially important role to play in LED. Their comparative advantage is in the local coordination of public, private and civil society actors. That is, municipal governments should help to mobilize human, financial and information resources to increase private investment and economic activity rather than directly providing these resources. The typical market failures that, if overcome, can promote rural-urban linkages are in:

- (a) information; e.g., generation and dissemination of up-to-date market information on goods and services, including labor, skills available locally etc;
- (b) stable and dependable business environment, e.g., through enforcement of contracts that encourage sub-contracting by urban-based firms, enforcement of law, order, and security;
- (c) economic infrastructure, including telecommunications.

Following the lessons with LED under the ongoing project, credit for productive subprojects would no longer be eligible. By excluding credit, municipalities would have an incentive to forge constructive relationships with private sector providers for this purpose.

The experience of the ongoing project has also shown that without specific incentives, municipalities tend to under-invest in **environmental protection and natural resources management** as opposed to local infrastructure. Therefore, the proposed project introduced an earmarked facility (the Municipal Environmental Facility, or FAM) to create a financial incentive for municipalities to be more active in this area.

The main lesson learned with respect to **project management** relates to the experience on individual consultant performance evaluation. The system developed has already achieved important results and reduced the influence of non-technical factors in consultant evaluations.

Finally, important lessons were learned with respect to **monitoring and evaluation**. Since these two activities are extremely challenging in a decentralized project, the preparation team decided to separate their management between two different institutions. While *INIFOM's Gerencia de Monitoreo* would be responsible for monitoring, the Sectoral Commission for Decentralization (CSD) would be responsible for evaluation. The new institutional set-up would reduce complexity and also increase the credibility of evaluation results. See annex 13 for more details.

#### 4. Indications of borrower commitment and ownership:

Current borrower commitment to the project is evident. Both MARENA and INIFOM understand this project as an essential component of their corporate strategy. INIFOM in particular has already taken advantage of the preliminary discussions about this project to launch a major initiative of internal programmatic and organizational restructuring. Other demonstrations of borrower commitment are the inclusion of the project in the GON program presented at the Consultative Group meeting in May 2000, the approval of the Organic Law of INIFOM as fulfillment of a pre-condition for this project's preparation, repeated requests from the President's Office, and the Government's requests for a Preparation Finding Facility (PPF) advance of US\$1.5 million, which was signed on January 8, 2001.

#### 5. Value added of Bank support in this project:

IDA adds value through its extensive experience in the areas of local development, natural resources management, and local capacity building, both inside and outside Nicaragua. The specific regional experience in demand-driven Rural Investment Funds and biodiversity conservation was critical from the beginning of the ongoing project. The value-added of IDA support includes the availability of in-house natural resources management expertise, the ability to mobilize global experts with long experience in the field, technical support for preparation, supervision capacity, and development of linkages with other sources of expertise and funding. Finally, IDA adds value in cross-sector and donor coordination.

### E. Summary Project Analysis (Detailed assessments are in the project file, see Annex 8)

#### 1. Economic (see Annex 4):

- Cost benefit NPV=US\$ million; ERR = % (see Annex 4)
- Cost effectiveness
- Other (specify)

The institutional nature of the proposed project makes it difficult to quantify expected benefits. Although the local investments financed by the project are a means to achieve institutional and policy change, rather than ends unto themselves, they would produce quantifiable benefits. To determine the potential economic benefits of the proposed project, the economic benefits of local investments made under the ongoing project were quantified. The analysis was based on a stratified sample drawn from the experience of the ongoing project, although the results are based on assumptions about future financing. The resulting weighted average Internal Rate of Return is 24%. However the sampling error is significantly high and the 95% confidence interval is between 6% and 54%.

#### 2. Financial (see Annex 4 and Annex 5):

NPV=US\$ million; FRR = % (see Annex 4)

na

#### Fiscal Impact:

The fiscal impact on the national budget during the three years of project implementation would be positive. Project financing of the FONDEM pilot (totaling \$11 million in three years) would reduce the Government's need for budgetary allocations to finance fiscal transfers.

#### 3. Technical:

Choice of technology for all local investments financed under this project would be selected through the municipal participatory planning process. During this process, technical options would be assessed in relation to the level of available budget ceilings, the ability of municipalities and communities to contribute to the capital cost and to meet the operation and maintenance costs. Appropriate procedures for projects' preparation for financing under the FONDEM and FAM would be specified in specific INIFOM and MARENA operational manuals. In the case of environmental investments, appropriate technical packages for each item in the "menu" of the FAM would be specified and technical agents

either from MARENA or from MARENA-certified intermediaries, would provide technical support for their implementation.

#### **4. Institutional:**

##### 4.1 Executing agencies:

A comprehensive institutional analysis of MARENA and INIFOM was carried out during project preparation. The findings revealed that neither of the two institutions would be able to implement project activities without proper technical assistance and training. Based on this finding, adequate project financing was assigned to support the two institutions (see Section C4 on Institutional Arrangements and Annex 14 on Institutional Capacity Assessment.)

##### 4.2 Project management:

See section C4 on Institutional Arrangements and Annex 14 on the Institutional Capacity Assessment.

##### 4.3 Procurement issues:

An assessment of the procurement capacity of INIFOM and MARENA has been carried out. A plan proposing specific actions to be addressed before effectiveness has been discussed with the Government and has been agreed upon during negotiations. (See Annex 6 for details.)

Under the ongoing project, both INIFOM and MARENA established Implementing Units (PIUs) which have a procurement and financial management capacity. The proposed project would mainstream these PIUs in their respective institutions. The procurement consultant currently hired by the INIFOM-PIU would be integrated into the INIFOM Administration and Finance Department, handling the IDA credit at the same time as other administrative responsibilities of the institution. In MARENA, the procurement consultant would not be immediately integrated, but rather, the consultant would strengthen MARENA by training its permanent staff on IDA requirements.

##### 4.4 Financial management issues:

The project financial management (FM) assessment concluded that INIFOM and MARENA do not have yet in place a system satisfying IDA's financial management requirements. Action plans in this area were agreed upon with each institution, as explained in Annex 6. Substantial completion of the FM action plans would be a condition of effectiveness.

MARENA and INIFOM would maintain adequate financial management systems, compatible with Project Management Reports (PMR) as required by IDA under the Loan Administration Change Initiative (LACI). The financial management system would include internal control systems, reliable records and report of project assets, accounting, financial reporting, reconciliation of project records with the Special Account statements, monitoring of physical progress of agreed project indicators, procurement management, and auditing systems to ensure the provision of accurate and timely information to the World Bank regarding project resources and expenditures, in accordance with: (i) the Financial Accounting, Reporting, and Auditing Handbook (World Bank, 1995); (ii) the Bank's Operational Policy (OP) and Bank Procedure (BP) 10.02 dated July 1996; and (iii) the revised Bank financial management standards to comply with OP and BP 10.02, dated August 1997.

MARENA and INIFOM would maintain separate project accounts, retain strict financial controls, review and approve disbursements of funds to the municipalities under the FAM and FONDEM, ensure that the municipalities keep separate bank account and records for the FAM and FONDEM funded activities, consolidate quarterly financial and progress reports submitted by the municipalities, conduct annual project reviews, including contracting of a firm for the audit of the project financial statements, as well as preparing periodic reports on performance against agreed monitoring indicators. (See Annex 6 for details.)

**5. Environmental:** Environmental Category: B (Partial Assessment)

5.1 Summarize the steps undertaken for environmental assessment and EMP preparation (including consultation and disclosure) and the significant issues and their treatment emerging from this analysis.

The project is expected to have a positive environmental impact. However, the demand-driven aspects of the project may pose modest environmental risks at the subproject level. Following the experience of the ongoing project and similar projects which finance many small subprojects (such as FISE), the project would execute an environmental screening mechanism and create the institutional capacity to carry out the screening, propose and implement effective mitigation measures where appropriate, and monitor the effectiveness of these procedures. The mechanisms and procedures would be outlined in the two Project's Operational Manuals (one for INIFOM and one for MARENA) which will be finalized before project effectiveness. (See Annex 2 for typology of projects to be financed under FONDEM and FAM, and Annex 12 for the Environmental Analysis and Mitigation Measures).

5.2 What are the main features of the EMP and are they adequate?

Given the potentially positive environmental impact, an EMP is not applicable.

5.3 For Category A and B projects, timeline and status of EA:

Date of receipt of final draft: January 29, 2001

An Environmental Analysis (EA) was finalized in August 2000. The EA is based upon the findings of the ongoing Rural Municipalities Project and a detailed project cycle (potential environmental risks and mitigation measures) to be followed by the targeted municipalities in the implementation of subprojects. (See Annex 12).

5.4 How have stakeholders been consulted at the stage of (a) environmental screening and (b) draft EA report on the environmental impacts and proposed environment management plan? Describe mechanisms of consultation that were used and which groups were consulted?

Selected NGOs, among which the association of Nicaraguan Municipalities (AMUNIC), MARENA and INIFOM staff, and other donors were consulted during project preparation. On-going consultations would be held during project implementation as part of the municipal participatory planning and budgeting process.

5.5 What mechanisms have been established to monitor and evaluate the impact of the project on the environment? Do the indicators reflect the objectives and results of the EMP?

Some types of sub-projects to be financed through FONDEM and FAM may pose environmental risks. Although these risks are minor, all subproject proposals would be subject to an environmental review process. The INIFOM and MARENA Operational Manuals would specify a "negative list" of subprojects which cannot be financed by the Credit (see Annex 12 for details).

**6. Social:**

6.1 Summarize key social issues relevant to the project objectives, and specify the project's social development outcomes.

The project would support decentralization and local governance by promoting a process of democratization and participation at the municipal level. Through participatory planning, the project would increase transparency in the allocation of municipal resources and would contribute to reduce the

sense of marginality and exclusion that is common among the poor (as reported in the Nicaragua Poverty Assessment.)

Key social issues are: (a) effectiveness in the use of municipal resources and fiscal transfers; (b) responsiveness and accountability of municipal governments to their communities and constituencies; (c) citizen's empowerment and responsibility with regard to the public domain; (d) services delivery mechanisms that are results-driven rather than supply-driven; (e) environmental protection as an integral part of rural development; (e) gender imbalance in municipal decision making processes and the inclusion of procedures to enhance more balanced participatory mechanisms and more equitable outcomes; and (f) presence in the area of the project of the Sutiava indigenous peoples (see below.)

Key expected social development outcomes are: (a) better quality of life and better governance as measured by a combination of accountability and responsiveness from the part of municipal governments; (b) citizen empowerment; and (c) more equitable participatory processes and outcomes for men and women in their gender roles.

Indigenous Peoples. The project developed a specific action plan to enhance the capacity of the Sutiavas to articulate demands which can be addressed by the municipal government of Leon. The number of the Sutiava population is uncertain because the definition of who is Sutiava is unclear. In fact, the majority live in an urban area and speak only Spanish. As a result, most residents of the Sutiavas neighborhood share the same cultural values and identity and are considered Sutiavas, even though they do not share the same ethnic background. This has made their number vary from 35,000 to 53,000, with 71 percent urban and 29 percent rural.

The Sutiavas have their own organizational structure, based on an elderly council (*Consejo de Ancianos*) and its executive branch, the *Directiva de la Comunidad*. The elderly council is not part of the municipal government but it has a strong community influence. However, the relationship between the *Consejo de Ancianos* and the municipal government has at times been conflictive. One of the objectives of the proposed project is to make possible, through participatory decision making, the reconciliation between Sutiavas organizations and the Municipality of Leon. The project will strengthen the Sutiava group by providing them with technical assistance and training (as identified in the INIFOM and MARENA Operational Manuals) in order to train such group in management of local projects and community participation. Guidelines to ensure the participation of indigenous group representatives in the planning, programming, budgeting and monitoring of the FONDEM and FAM subprojects will be outlined in the INIFOM and MARENA operational manual. (see Annex 11 for a Summary of the Social Assessment)

## 6.2 Participatory Approach: How are key stakeholders participating in the project?

Preparation. The project stakeholders' views, expectations and values with respect to local governments, provision of local services, and involvement in community life, have been sought through two beneficiary assessments and one gender assessment undertaken during the last two years, and several workshops and community meetings held in a sample of municipalities as part of the supervision process of the ongoing project. The proposed project's design is based largely on results developed during this process. Additionally, a social assessment was prepared during the design phase, including an analysis of the extension in which the ongoing project was able to reach the Sutiavas and a participatory action plan designed to promote their inclusion as beneficiaries but also as part of decision making processes.

Municipal governments with representation from all political parties have been strongly involved during preparation through AMUNIC. The final beneficiaries of the project - residents who will benefit from more effective municipal governments - will also be consulted through a base line study that will be conducted as a condition of effectiveness of the project. Considering the different types of municipalities involved, the views expressed by the project's beneficiaries would guide the design of specific tools to promote civil engagement. Key indicators will be assessed two years after effectiveness to monitor the project's performance, provide adjustments and speed the expected outcomes.

Specific mechanisms to consult the Sutiavas have been set up during preparation. The result of this

process resulted in the design of both special activities aimed at strengthening their organization and specific monitoring indicators to measure project performance.

Implementation. Under project design, the funds available to municipal government through FAM and FONDEM would be allocated through participatory planning. Monitoring shall also be participatory and will include beneficiaries' views.

6.3 How does the project involve consultations or collaboration with NGOs or other civil society organizations?

The concept guiding the project is that municipal strengthening intrinsically implies civil engagement. Thereby, a key project goal is to strengthen municipal capacity for planning, budgeting, implementing and enforcing policies through the involvement of all main local actors, including residents, interest groups, NGOs that are active in the area, community groups and local institutions.

An action plan to address the specific situation of the Sutiavas was designed through consultation with community members and leaders. The project also include actions to promote more balanced participation of all citizens, regardless of their gender roles.

6.4 What institutional arrangements have been provided to ensure the project achieves its social development outcomes?

FAM and FONDEM conditions of access are the main incentive for municipalities to adopt improved planning and administrative procedures. Monitoring through beneficiaries' evaluation would ensure social development outcomes.

The action plan for the Sutiavas includes monitoring indicators that are part of project monitoring and evaluation. Exclusion of indigenous peoples would be addressed with the technical assistance provided to the Municipality of Leon.

6.5 How will the project monitor performance in terms of social development outcomes?

A base-line study would be conducted as a condition of effectiveness. The base-line study would assess two aspects: the relationship between beneficiaries and local governments from the view point of the former; and governance issues from the view point of municipal staff and local political representatives.

An assessment of the Sutiavas has been prepared, and suggested monitoring indicators to measure their participation have been developed. During project implementation, specific assessment with this group would be conducted to evaluate whether the objectives of the action plan are reached and whether additional measures are needed.

## 7. Safeguard Policies:

7.1 Do any of the following safeguard policies apply to the project?

Policy	Applicability
Environmental Assessment (OP 4.01, BP 4.01, GP 4.01)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Natural habitats (OP 4.04, BP 4.04, GP 4.04)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Forestry (OP 4.36, GP 4.36)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Pest Management (OP 4.09)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Cultural Property (OPN 11.03)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Indigenous Peoples (OD 4.20)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Involuntary Resettlement (OD 4.30)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Safety of Dams (OP 4.37, BP 4.37)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Projects in International Waters (OP 7.50, BP 7.50, GP 7.50)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Projects in Disputed Areas (OP 7.60, BP 7.60, GP 7.60)	<input type="radio"/> Yes <input checked="" type="radio"/> No

7.2 Describe provisions made by the project to ensure compliance with applicable safeguard policies.

See environmental analysis and mitigation plan described in Annex 12.

## F. Sustainability and Risks

### 1. Sustainability:

Through the ongoing project, target municipalities have experienced significant gains in their sustainability. Nonetheless, institutional sustainability of the proposed project interventions would depend upon a stronger commitment to decentralization and a significant increase in municipal tax generation. Environmental sustainability would depend upon improved coordination between municipal and central governments in natural resources management and environmental protection.

The experience of the ongoing project demonstrated that promoting lasting improvements at level of central agencies is more challenging than at municipal level. The project aims to strengthen municipalities to create a bottom-up demand of services from INIFOM and MARENA, thereby increasing the potential sustainability of these two institutions.

### 2. Critical Risks (reflecting the failure of critical assumptions found in the fourth column of Annex 1):

Risk	Risk Rating	Risk Mitigation Measure
<b>From Outputs to Objective</b>		
Correct and stable macro-economic incentive structure	M	
Political stability and support to decentralization and municipalities through national elections	S	Reduction of implementation period to three years
<b>From Components to Outputs</b>		
Constructive political relationships between municipalities and CG	H	Technical assistance to the CSD to provoke a technical discussion between the two governmental levels
Effective management and leadership of INIFOM and MARENA	H	Technical assistance and capacity building to both institutions. Limited project area.
Commitment to NRM and environmental protection	M	Awareness campaign
Inter-institutional coordination	S	Clear definition of INIFOM and MARENA roles
Capacity and commitment of municipalities to build synergies with CG, civil society, and private sector.	S	FAM and FONDEM constitute a specific incentive to synergies
<b>Overall Risk Rating</b>	S	

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

The project faces three levels of risks. At the *central level*, support for decentralization and municipal development is not entirely unanimous. With this in mind, project scope was reduced, and the project

does not aim to achieve a comprehensive decentralization strategy but rather to build momentum from the bottom-up that would promote an agreement on a workable model. To address the risk of changing political support, the project team undertook a participatory project preparation to build constituencies at different levels: within municipalities and particularly their association (AMUNIC), with the General Assembly, and among the civil society. In addition, the differentiation between the two aspects of sustainability at the local level - institutional and environmental - and the implementation by two central level institutions (INIFOM and MARENA) would help build broader support for the project.

At the *municipal level*, similar risks exist in terms of political support. If support for decentralization increases, and substantial fiscal transfers are implemented, the project may face a reduced support from municipalities who would otherwise receive unconditional resources. Although this scenario is unlikely, the role that INIFOM plays within the GON policy dialogue would in any event reduce this risk.

At the *community level*, the ongoing project demonstrates that a purely demand-driven approach may be affected by lack of technical capacity. To address this risk, both INIFOM and MARENA developed a new emphasis on intergovernmental relationships and shared responsibilities, which would significantly increase the emphasis on participatory investment design. A system of cross monitoring would be pivotal to reducing the risk that shared responsibility would potentially dilute specific municipal responsibilities.

### **3. Possible Controversial Aspects:**

None

## **G. Main Credit Conditions**

### **1. Effectiveness Condition**

- Completion of a baseline study satisfactory to IDA
- Compliance with either A or B disbursement conditions, as specified under paragraph G.2.

### **2. Other [classify according to covenant types used in the Legal Agreements.]**

Disbursement conditions:

- A.** Before the "Municipal Development Component" implemented by INIFOM could disburse, the following conditions should be satisfied:
- (i) the INIFOM Operational Manual, comprising FONDEM Manual and INIFOM Institutional Implementation Plan, has been submitted to and approved by IDA;
  - (ii) the procurement system submitted and approved by IDA and a financial management system has been established; and
  - (iii) the INIFOM Subsidiary Agreement has been entered into and a copy of it has been submitted to the Association; and
- B.** Before the "Municipal Environmental Management Component" implemented by MARENA could disburse, the following conditions should be satisfied:
- (i) the FAM committee has been satisfactorily created;
  - (ii) the MARENA Operational Manual, comprising FAM Manual and MARENA Institutional Implementation Plan, has been submitted to and approved by IDA; and
  - (iii) the procurement system submitted to and approved by IDA and a financial management system has been established.

## **H. Readiness for Implementation**

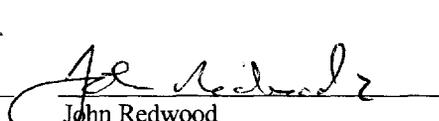
1. a) The engineering design documents for the first year's activities are complete and ready for the start of project implementation.

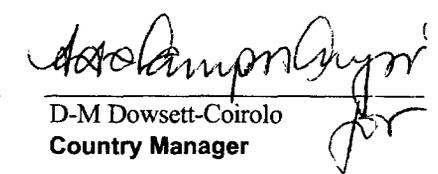
- 1. b) Not applicable.
- 2. The procurement documents for the first year's activities are complete and ready for the start of project implementation.
- 3. The Project Implementation Plan has been appraised and found to be realistic and of satisfactory quality.
- 4. The following items are lacking and are discussed under loan conditions (Section G):
  - Operational Manuals for INIFOM and MARENA. A draft of both manuals has been reviewed and found to be realistic and of satisfactory quality
  - Implementation of an action plan for procurement and financial management.
 Both Operational Manuals and action plan are effectiveness conditions

**I. Compliance with Bank Policies**

- 1. This project complies with all applicable Bank policies.
- 2. The following exceptions to Bank policies are recommended for approval. The project complies with all other applicable Bank policies.

  
 \_\_\_\_\_  
 Maurizio Guadagni  
 Team Leader

  
 \_\_\_\_\_  
 John Redwood  
 Sector Manager

  
 \_\_\_\_\_  
 D-M Dowsett-Coirolo  
 Country Manager

## Annex 1: Project Design Summary

### NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT

Hierarchy of Objectives	Key Performance Indicators	Monitoring & Evaluation	Critical Assumptions
<b>Sector-related CAS Goal:</b> Sustainable rural poverty alleviation.	<b>Sector Indicators:</b> Improvement in life quality indicators as specified by rural communities; Reduced perception of exclusion of the rural poor.	<b>Sector/ country reports:</b> Living standard measurement survey (LSMS); Nicaragua - Qualitative Poverty and Exclusion Study (Similar to 2000 survey).	<b>(from Goal to Bank Mission)</b> Political and macroeconomic stability
<b>Project Development Objective:</b> Improve municipal capacity in service delivery, environmental management, and local development coordination	<b>Outcome / Impact Indicators:</b> 1. Improved local governance indicators in 40 project municipalities: (a) community involvement and participation in local decision-making (32 municipalities of PROTIERRA 1 from 68% to 80 %, 8 new municipalities from 30% to 60%); (b) perception of transparency of municipal officers by the general public increased (from 50% to 70%); and (c) increasing tax revenue of target municipalities from the current \$9.5 million to \$12.5 million;	<b>Project reports:</b> Baseline, mid-term and completion surveys INIFOM and municipal monitoring systems Survey of the <i>Instituto de Estudios Nicaragüenses</i>	<b>(from Objective to Goal)</b> Correct and stable macro-economic incentive structure Political support to decentralization and municipal development Effective management and leadership of INIFOM Timely and coordinated implementation of FISE

2. Actual vs. planned improvement in coverage, quality and cost effectiveness of: (a) municipal services; (b) municipal infrastructure; (c) local natural resources management; and (d) local economic development (Because municipal services are different for each municipality and because the focus of the project is to assist municipalities to identify and define their local needs, it is impossible to aggregate municipal performance results for specific indicators at the project level. Therefore, the evaluation of the municipal performance would be based on individual Municipal Development Plans.)

3. Implementation of at least 15% per year of the 5 year Municipal Development Plan including environmental management aspects;

4. The difference between urban/rural investments ratio and population ratio is inferior to 20% in 90% of municipalities;

	<p>5. Improved institutional performance of INIFOM in terms of: (a) perception of beneficiaries, as revealed by regular surveys of municipal staff and other municipal actors; (b) number of INIFOM staff de-concentrated to departmental offices (from the current 40% to 45%); (c) ratio of technical and professional staff versus administrative and directive staff (from 15% to 25%), (d) subjectively, on the basis of technical contribution to the national policy debate on municipal development; and, (e) allocation and productive efficiency of LG and CG compared and measure in relative terms;</p> <p>6. Improved municipal natural resource and urban environmental management: (a) Municipal land use plans approved in at least 60% of target municipalities: (b) at least 10 municipalities contribute to the management of protected areas in their territory; (c) 90% of Municipal Environmental Commission (CAM) established and 60% active with participation of public and private municipal entities; (d) EIA performed and consulted for 100% of investment projects; and, (e) 60% agricultural and industrial producer are aware of their responsibilities and environmental duties.</p>	<p>National Environmental Information System (SINIA)</p>	<p>Effective management and leadership of MARENA</p>
<p><b>Output from each Component:</b></p>	<p><b>Output Indicators:</b></p>	<p><b>Project reports:</b></p>	<p><b>(from Outputs to Objective)</b></p>

<p><b>Municipal Development</b> 1.1 Municipal Development Financing Mechanism developed and piloted in targeted municipalities</p>	<p>1.1a Average annual US\$4 per capita is transferred through FONDEM to municipalities; 1.1b Municipal real estate tax collection increased by 20%; 1.1c 90% of municipal development committees, as a participatory planning platform, established and meeting regularly; 1.1d 100% of FONDEM and FAM subprojects pass environmental screening;</p>	<p>INIFOM Monitoring System (SAFIN)</p>	<p>Constructive political relationships between LG and CG</p>
<p>1.2 Municipal planning and management improved</p>	<p>1.2a Municipal Development Plans (MDP): 95% prepared and 70% being implemented with participation of communities, civil society and 30% with private sector; 1.2b Multi-actor Municipal Development Committees (CDM)/Municipal Planning Commissions (COPLAM) established by Municipal Ordinances and operational; 1.2c Participation of civil society and COPLAM in budget planning in 80% of targeted municipalities; 1.2d Budget commissions established and consulted on budget decisions; 1.2e Municipalities implement improved personnel management systems; 1.2f Municipal Staff trained and equipped with improved accounting, financial reporting, investment projects cycle and Municipal Information System (SIM) systems.</p>	<p>INIFOM Monitoring System Municipal staff survey</p>	<p>Appropriate municipal fiscal policy.  Inter-institutional coordination, specifically: among different CG institutions (INIFOM, MARENA, FISE, IDR, MAG-FOR).</p>

1.3 INIFOM management improved	<p>1.3a Improved perception of beneficiaries;</p> <p>1.3b Number of INIFOM staff de-concentrated to departmental offices (from the current 40% to 45%);</p> <p>1.3c Ratio of technical staff versus administrative staff increase from current 15% to 25% at project completion;</p> <p>1.3d INIFOM technical contribution to the national policy debate on municipal development.</p>	<p>INIFOM Monitoring System</p> <p>Municipal staff survey</p>	Capacity and commitment of municipalities to build a partnership with CG and civil society, and private sector.
1.4 Policy Evaluation & dissemination mechanism established and operational	<p>1.4a Annual evaluation studies completed in a timely manner;</p> <p>1.4b Workshops carried out with high level participation and good press coverage;</p> <p>1.4c CSD meets quarterly.</p>	<p>INIFOM Monitoring System</p>	Awareness of NRM and environmental issues
<b>Decentralization of Environmental Management</b>	<p>2.1a Municipalities enforce and apply 80% of decentralized environmental norms and instruments;</p> <p>2.1b Basic technical environmental capacity achieved in each municipality;</p> <p>2.1c Fifty natural resource management conflicts resolved with alternative conflict resolution mechanisms;</p> <p>2.1d Technical assistance to the municipality of Leon and to Suitiva organization carried out.</p>	<p>National Environmental Information System</p> <p>Institutional analysis of MARENA</p>	Sustainable intensification of agricultural production Commitment of CG to sound environmental management
2.1 Municipal technical capacity for environmental management increased			
2.2 National Environmental Information system established and operational	<p>2.2a Data base, meta data, networks, Estelí regional node, training/user manuals and user centers established;</p> <p>2.2b All of MDP incorporate environmental information and planning;</p>	<p>National Environmental Information System</p>	Pro-active collaboration among MARENA, INIFOM, and Municipalities

2.3 Environmental investments are identified and funded	2.3 Environmental subprojects: (a) at least 1 subproject per year in 80% of participating municipalities; (b) at least 100 implemented subprojects; (c) average transfer of \$1.5 per capita per year; (d) all subprojects pass environmental screening.	FAM Monitoring system	Municipalities demand environmental investments
<b>Project Components / Sub-components:</b> Decentralized financing system (FONDEM) Municipal Strengthening  INIFOM strengthening Evaluation and policy development Municipal environmental management  Environmental information system  Municipal Environmental Facility	<b>Inputs: (budget for each component)</b> \$11.00 M  \$4.37 M  \$3.12 M \$0.98 M  \$3.77 M  \$1.61 M  \$3.85 M	<b>Project reports:</b>  Project reports	<b>(from Components to Outputs)</b> Political will at both local and central level INIFOM capacity and other agency's coordination Political will at central level CSD institutional strength  Sustained commitment of local government. MARENA's capacity Coordination among different agencies Awareness of environmental issues at local level Municipalities demand for environmental investments

**Annex 2: Detailed Project Description**  
**NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**

The proposed project includes two distinct major components:

- A "*Municipal Development*" component executed by INIFOM
- A "*Municipal Environmental Management*" component executed by MARENA

While different inputs, activities and outputs apply to the two components, they both contribute to the same development objective of *improved municipal performance* for rural development. The *municipal perspective* provides the unifying frame for the two components. However, the two components require different design in terms of funding instruments and institutional. The experience of the ongoing project has clearly shown that without dedicated financial incentives and access to specialist technical advice, municipalities tend to under-invest in environmental management as opposed to local infrastructure.

#	Municipality	Project Area			
		Level of Poverty	Population (2000, estimates)	Number of Poor <sup>^</sup>	Number of Extreme Poor <sup>^</sup>
1	Achuapa	Medium	15,286	9,860	4,018
2	Acoyapa*	High	19,571	11,264	5,634
3	Chichigalpa	Low	47,638	19,978	6,169
4	Chinandega	Low	135,678	55,212	17,394
5	Cinco Pinos	Medium	7,211	4,618	1,758
6	Comalapa*	Extreme	12,682	8,554	4,668
7	Corinto	Low	19,913	5,179	1,073
8	El Almendro	High	13,674	8,309	3,862
9	El Castillo	Extreme	11,265	7,332	3,985
10	El Jicaral	Medium	11,634	7,509	2,915
11	El Rama (And El Ayote)	High	72,516	30,819	14,471
12	El Realejo	Low	9,453	4,424	1,452
13	El Sauce	Medium	29,901	18,429	7,405
14	El Viejo	Medium	80,054	44,519	17,899
15	Juigalpa* (and Cuapa)	Low	64,658	26,385	11,046
16	La Libertad*	High	11,377	6,942	3,574
17	La Paz Centro	Low	31,890	16,393	5,972
18	Larreynaga-Malpaisillo	Low	34,544	20,082	7,443
19	Leon	Low	187,258	67,393	20,892
20	Morrito	High	7,063	4,206	2,076
21	Muelle De Los B Ueyes	Medium	26,955	14,590	6,575
22	Nagarote	Low	33,851	14,394	4,071
23	Nueva Guinea	High	91,883	56,800	26,479
24	Posoltega	Medium	17,773	11,010	4,524
25	Puerto Morazan	Medium	13,228	7,988	3,214
26	Quezalguaque	Low	8,989	5,325	1,944
27	San Carlos	High	33,309	19,874	9,991
28	San Francisco Del Norte	Medium	6,932	4,551	1,858
29	San Juan Del Norte	High	314	181	87
30	San Miguelito	Extreme	15,690	9,980	5,368
31	San Pedro De Lovago*	Medium	8,260	4,340	1,990
32	San Pedro Del Norte	Medium	4,693	3,227	1,406
33	Santa Rosa Del Peñon	Medium	10,583	6,960	2,952
34	Santo Domingo*	Extreme	14,541	8,986	4,686
35	Santo Tomas Chontales	Medium	18,545	9,082	4,015
36	Santo Tomas Del Norte*	Medium	7,869	7,988	3,214
37	Somotillo	Medium	28,712	17,473	6,858
38	Telica	Medium	26,407	15,569	6,124
39	Villa Sandino* (and El Coral)	High	30,539	14,044	6,640
40	Villanueva	Medium	25,899	16,784	7,100
<b>TOTAL PROJECT AREA</b>			<b>1,248,239</b>	<b>626,553</b>	<b>252,802</b>
TOTAL COUNTRY			5,014,184	2,225,293	909,571
Project Coverage			25%	28%	28%

\* Eight new municipalities of the department of Chontales

<sup>^</sup> Nicaragua Poverty Map (2000)

## **By Component:**

### **Project Component 1 - US\$28.95 million**

This component would include four sub-components: (a) decentralized financing; (b) strengthening of municipal institutions; (c) strengthening of INIFOM; and (d) evaluation and policy development.

#### Sub-component 1 (a) Decentralized Financing

##### *Activity 1 (a) (i) The Municipal Development Fund (FONDEM)*

The project would support the establishment of a Municipal Development Fund (FONDEM, *Fondo de Desarrollo Municipal*). The FONDEM is just one (currently missing) component of a well developed municipal finances system. Designed as a "general-purpose grant" mechanism, the FONDEM aims to complement existing municipal own-source revenue and various ongoing programs with negotiated, purpose-specific transfers (one of them supported by another project sub-component, the Municipal Environmental Facility). The specific features of the FONDEM would be covered in the Operational Manual and are summarized in Attachment 1 of this annex.

##### *Activity 1 (a) (ii). Local Revenue Generation*

In addition to the establishment of the FONDEM, the project would strengthen municipal capacity to generate local, own-source revenue through better assessment and collection of local taxes and fees. To this effect the project would assist INIFOM in:

- The revision of the legal framework of local government finances and the drafting of appropriate policy, legal and regulatory texts; and
- The development and extension to all municipalities participating in the project of: (i) improved systems and manuals of local fiscal administration, (ii) standards and procedures for financially sustainable delivery of municipal services, and (iii) the system for land and property registration/Cadastral (*Sistema de Catastro, SISCAT*)

#### Sub-component 1 (b) Strengthening of Municipal Institutions

This sub-component would contribute to strengthen municipal institutions, by providing assistance in three complementary areas: (i) municipal planning, (ii) municipal organization and management, and (iii) municipal supervision and monitoring.

##### *Activity 1 (b) (i) Municipal Planning System*

The first activity would be to develop and extend an improved municipal planning system. Drawing on the experience accumulated by the ongoing project, as well as other relevant efforts (most notably the PRODEMU-DANIDA experience with municipal strategic planning in the "Las Segovias" region and the work of PADCO-USAID on municipal "budgets by programs"), such system would define and link, within an annual cycle of statutory planning tasks and deadlines:

- A *strategic planning* exercise including the set up of multiple stakeholders around municipal objectives and the elaboration of related operational plans and indicators;
- The preparation and review of a multi-annual "rolling" municipal *investment* program; and
- The preparation and approval of an *annual budget* "by programs".

Institutions and techniques for community participation in local planning and decision-making would be refined and adopted, based also on the INIFOM-PROTIERRA and FISE experience with "participatory micro-planning" (MPP). Also, based on efforts already initiated under the ongoing project, departmental forums/workshops for coordination of municipal plans with the sectoral programs of both government agencies and NGOs would be set up and strengthened.

### **Activity 2 (b) (ii) Municipal Organization and Management**

This activity would develop and extend municipal organization and management systems, covering both the internal aspects of organizational structures, work planning and personnel management and the "external" aspects of efficient delivery of services. This is an area where considerable experience has already been accumulated by INIFOM, often with help from external assistance. Nevertheless, simplification, focus and innovation in capacity building approaches and techniques are required. It is also an area where existing municipal capacities differ widely. To allow the necessarily differentiated approach to capacity building a classification of municipalities in 4 categories (A to D) of decreasing administrative capacity is being developed by INIFOM. Based on such classification, the project would therefore support INIFOM to: (i) service and complement selectively the existing manuals and guidelines for municipal administration and services delivery management, focusing on the linkages between the improved municipal planning system and internal organizational and personnel management changes; and (ii) develop financial and other incentives for municipalities to demand capacity building services and create a network of certified suppliers of such services, including universities, training institutions, and public and private sector consultants. Specific emphasis would be provided to:

- financial management and internal controls. Specifically (i) budgeting, (ii) accounting, and (iii) auditing; and
- management of municipal personnel, and specifically selection, remuneration, performance evaluation, and removal. This would be regulated by the Municipal Administrative Career Law;

### **Activity 1 (b) (iii) Municipal Supervision and Monitoring Systems**

This activity would develop and extend municipal supervision and monitoring systems. Here the project would help INIFOM and participating municipalities to:

- monitor inputs, process, results and impact of the Municipal Strengthening Program;
- facilitate technical improvement and transparency in municipal administration; and
- manage municipal information.

There are two principle objectives in strengthening INIFOM and municipalities' capacity for monitoring and managing information. These are to: (i) improve the existing system to allow monitoring at the municipal level; and (ii) provide target municipalities with the instruments for using technical information and thus improve the efficiency and transparency of municipal management.

The basis for the development of this activity is the existing information systems which consists of: The "*Sistema Información Gerencial del Proyecto*" (SIGP) (developed under the ongoing project), the "*Sistema de Catastro Municipal*" (SISCAT) the "*Sistema de Recaudación Municipal*" (SISREC) "*Sistema de Información Financiera*" (SAFIN) and other initiatives developed by INIFOM and other projects that have been working at the municipal level. The goal is to improve, expand, and integrate all these sub-systems.

The municipal monitoring and management system would consist of the following subsystems:

(i) Monitoring and Financial Management. The goal is to develop and implement a subsystem integrated by the Budget, Treasury and Accounting, in the management of resource administration by the municipality. This system aims to consolidate the summary of information collected in the monitoring of municipal finance; (ii) Monitoring of Procurement and Physical Management; (iii) Municipal Information System and Planning Cycles, linking the database of subprojects (this includes the National Environmental Information System being developed by MARENA under the other component of this project), with socio-demographics, economic and environmental information at the municipal level, which supports the process of planning for the municipalities; and (iv) a feasibility analysis for the development of a system that would allow systematization and monitoring of management of the municipal planning cycle.

The resulting database would collect, organize and publish on the internet, in addition to other appropriate fora, municipal information which increase the knowledge of policies and laws in relation to municipal functions and experience. The principal beneficiaries of this component are municipalities, governmental institutions, National Assembly, civil society, and the general public.

### Sub-component 1 (c) Strengthening of INIFOM

The INIFOM "Organic Law", strengthens the identity of the Institute as the main national organization responsible for articulating the State support to municipalities. INIFOM has autonomously initiated a process of (a) re-definition of its *core activities* and (b) re-design of its *organizational structure*. This process is centered on the formulation of a broad "Municipal Strengthening Program" (PFM) which INIFOM aims to develop as its *main corporate program* and as *the unifying framework* for all INIFOM-executed external assistance to the municipalities.

The project recognizes the strategic importance of this process. In fact, project preparation has already been fully integrated within the INIFOM restructuring initiative and has brought several donors together to support it, specifically DANIDA, GTZ, UNDP, UNCDF. The project is therefore explicitly designed to (i) to assist in the implementation of selected major components of the INIFOM Municipal Strengthening Program and (ii) to facilitate the corporate restructuring of the Institute.

All the project-supported municipal strengthening activities listed in the preceding paragraph are parts of the INIFOM corporate program currently being developed (called *Plan de Fortalecimiento Municipal*). In addition, the project would provide a mix of technical and management consulting services, financial incentives and minor equipment to support:

- INIFOM's organizational restructuring at both central and regional/departmental levels, including personnel selection, remuneration, motivation, redeployment and performance evaluation;
- Monitoring of INIFOM performance and business practices, through periodical client (municipalities) and staff surveys;
- Strengthening of INIFOM's administrative and financial management capacity; and
- Strengthening of INIFOM's capacity to monitor and evaluate municipal performance,

Since the execution of this component presented serious difficulties in the ongoing project, three major improvements would be introduced: (i) increased coordination among various donors; (ii) the proposed project would finance international technical assistance to support INIFOM's efforts, and (iii) activities related to evaluation and policy development would be separated from monitoring and would be implemented by the Sectoral Commission for Decentralization.

The sub-component would finance (i) technical assistance, by way of individual consultants and consulting firms, (ii) recurrent costs to operate INIFOM, comprising also of salary increase for existing staff; (iii) equipment, such as vehicles and information technology (computers, etc.); (iv) training; and (v) minor works to improve existing offices, particularly in the covered departments.

### Sub-component 1 (d) Evaluation and Policy Development

The experience of the ongoing project demonstrated that monitoring decentralized and disperse intervention is complex. Nonetheless, the ongoing project already achieved several important steps. It has supported:

- a decentralized project management information system which is mostly maintained by the municipalities;
- annual surveys where municipal officers anonymously express their opinion on institutional performances of INIFOM and MARENA;
- biannual survey of final beneficiaries (rural communities) on the performances of municipal governments;
- periodical survey of INIFOM staff about the perception of institution and management performances.

One of the main challenges for the proposed project is to improve data quality of such systems, and utilize them to design national policies. Because of the difficulty of transforming the data provided by the monitoring system into technical evaluations which could produce a policy discussion, it was decided to separate monitoring from evaluation, and assign the latter to a different institution. On the basis of this, the Sectoral Decentralization Commission (CSD) would be responsible for designing and

implementing a system of external evaluation and policy development. This is an activity in which their technical secretariat has already developed a significant capacity (with support from the German Technical Cooperation. See [www.csd.gob.ni](http://www.csd.gob.ni)). The CSD would evaluate the project's impact for the design of a national decentralization policy. The Logical Framework (in Annex 1) would serve as a basis for both evaluation and monitoring of the project. See annex 13 for more details on this sub-component.

**Project Component 2 - US\$11.74 million**

This component would include three sub-components: (a) decentralization of environmental management, (b) environmental information systems, and (c) Environmental Municipal Facility.

**Sub-component 2 (a) Decentralization of environmental management**

This sub-component would strengthen the capacity of target municipal governments to more effectively implement their environmental functions. The sub-component would provide training and technical assistance to MARENA and the target municipalities to operate in a context of more decentralized environmental policy implementation. It is expected that this would increase the role of municipalities in the implementation of environmental policies, and also strengthen the accountability of MARENA to local constituencies. This would complement MARENA de-concentration effort (supported by DANIDA and FINNIDA).

To improve the capacity of municipalities to formulate, implement, monitor, and evaluate environmental policies and enforce environmental legislation, the sub-component would support the following activities.

*Activity 2 (a) (i) Improving the municipal legal framework*

According to national legislation, municipal governments have the competence to regulate the protection of the environment and to manage natural resources within their geographical jurisdiction. However, most of the municipalities do not count with the appropriate instruments and capacity. The sub-component would support MARENA to draft legal and technical norms in agreement with municipalities. Among other technical assistance inputs, this activity would finance permanent staff to be assigned to the specific departments of MARENA to cover existing capacity gaps.

*Activity 2 (a) (ii) De-concentration of MARENA*

The activity would support the Departmental Delegations of MARENA (only in part supported by DANIDA and FINNIDA) to improve MARENA's capacity of coordinating with municipalities. The activity would provide technical assistance and training for MARENA officials in different aspects of decentralized environmental management, covering both general issues of local environmental management and specific technical, institutional, and legal aspects. Given the modest level of experience in Nicaragua with decentralized environmental management, some training would focus on familiarizing Nicaraguan officials with similar experiences in other parts of the world.

*Activity 2 (a) (iii) Municipal environmental planning*

The activity would finance training and technical assistance to develop municipal environmental plans. The municipal environmental plans would be coordinated with the Nicaragua Environmental Plan (PANIC) recently updated in 2000. The central element to institutionalizing municipal environmental management involves the creation or strengthening of municipal environmental commission (CAMs). The activity would also provide equipment and technical assistance to the Sutiavas indigenous group in order to train such group in environmental management and participation in municipal planning.

*Activity 2 (a) (iv) Environmental awareness*

Supporting specific environmental educational campaigns to increase environmental awareness addressed to economic agents that affect the environment, through (i) technical assistance to these economic agents on environmental beneficial technologies and clean production, (ii) public dissemination campaigns and agreements between the municipalities and private entities to achieve improved environmental management.

#### ***Activity 2 (a) (v) Conflict Resolution Program***

This activity would seek to strengthen the role of municipalities in Nicaragua's formal and informal Alternative Dispute Resolution (ADR) mechanisms. It would provide technical assistance and training for policy development, institutional strengthening, dissemination, and pilot municipal ADR centers. The activity would focus on enhancing the effectiveness of ADR institutions as a means for resolving environmental policy issues as well as local conflicts over natural resource use and access. Specifically, the activity would finance: (i) Policy development to produce and disseminate manuals to clarify the administrative and ADR channels for resolution of natural resource and environmental disputes; (ii) Institutional strengthening to the Environmental Attorney Office (*Procuraduría Ambiental*) on Alternative Conflict Resolution. It would also support the creation of a body of ADR specialists in the country whose focus would be on assisting in the resolution of national and environmental conflicts at municipal level; and (iii) Dissemination to broaden the base of government officials, private sector representatives and civil society actors who understand the purpose and appropriate use of ADR mechanisms. Target audiences would include representatives of key government agencies involved in natural resource management, local officials, civil society organizations, indigenous groups and private sector leaders. As part of the dissemination strategy, the activity would build on Nicaragua's important tradition of using community-level negotiations and mediation to resolve conflicts over natural resources by supporting development of case studies on key recent dispute resolution efforts focusing on natural resources.

The sub-component would finance (i) technical assistance, in form of both individual consultants and consulting firms, (ii) recurrent costs to operate MARENA, comprising of salary increase for existing staff; (iii) minimal equipment; (iv) training; and (v) minor works to improve existing offices, particularly in the covered departments.

#### **Sub-component 2 (b) Environmental Information systems**

This sub-component would finance the establishment of the National Environmental Information System of Nicaragua (*Sistema Nacional de Información Ambiental de Nicaragua*, SINIA). The SINIA would provide access to all data and information related to the environment and natural resources existing in different governmental and non-governmental organizations. Although the SINIA would be an electronic network, it would also be responsible for the collection of data and the dissemination of information in non-electronic form. The electronic network would have a distributed architecture with electronic nodes in all the participating organizations.

The SINIA would be based on standards and operational rules to facilitate the integration and analysis of data and information, in order to generate information products for a variety of users. In general, the development of the SINIA would be done utilizing the physical infrastructure that is already present. Following is a description of the different activities that would be carried out under this component.

#### ***Activity 2 (b) (i) SINIA Administration***

This activity would finance a small SINIA Coordination Office, which would be responsible for managing all activities under this sub-component. The SINIA Coordination Office would be part of the Planning Division of MARENA and would be constituted by a small number of MARENA staff (financed with decreasing share as recurrent/operating costs of the project): a Coordinator, and a few technical specialists (webmaster, a metadata specialist, a database specialist, a system administrator, and a technical assistant). The technical staff would be responsible for the implementation and maintenance of the whole network and would provide assistance to all participating institutions as needed, including training.

#### ***Activity 2 (b) (ii) SINIA Design***

The design of the SINIA would be carried out during the first six months of the project. The design would be based on several studies that have been carried out recently or are being carried out during the project preparation phase. An international consultant would be hired to address data standardization issues.

*Activity 2 (b) (iii) SINIA Promotion and Dissemination of Information.*

The activity would finance: (i) Development of Educational Materials and Training. Technical training would be provided to the staff at each of the participating nodes in the network. The training would be on system administration, metadata development, database management systems, and other special areas as needed. Technical training of users would also take place to insure that they are proficient at using the basic information tools provided by the SINIA. Decision-makers would also be trained on how to use information products in the decision making process; (ii) Establishing Public Access Centers. Public Access Centers would provide computer terminals to access the SINIA, as well as printed information on certain topics and programs. Each center would be staffed with one specialist who would provide individual training and advise users on request. (iii). Outreach Activities. The activity would finance two publications: the SINIA monthly bulletin, and the bi-annual State of the Environment.

*Activity 2 (b) (iv) SINIA Infrastructure*

This activity would finance the development of the physical infrastructure of the SINIA. Specifically, the activity would finance: (i) Equipment for the SINIA: one server, one large image printer, and one scanner and an Internet access system; (ii) Operation and Maintenance of Regional Nodes. Regional Nodes are expected to play a key role in the decentralization and de-concentration process. They are the main mechanism by which MARENA interacts with local communities. Currently, MARENA has one Regional Node in the Central Region in Nicaragua. This node has been very successful, and the concept would be replicated in the project area.

*Activity 2 (b) (v) Content Development*

This activity would develop a System of Environmental Indicators and Information Products and Tools for Decision-Making. This activity, with the help of a national and an international consultant over a period of three years, would identify the environmental indicators of importance at the local and national levels. These indicators would be prioritized, and utilized in a progressive manner. Information products and tools for decision-making would be provided at the municipal level.

Sub-component 2 (c) Municipal Environmental Facility (FAM)

This sub-component would finance a Municipal Environmental Facility (*Facilidad Ambiental Municipal*, FAM) to provide a financial incentive for local actors, and particularly municipalities, to increase their engagement in local environmental management activities and investments. The specific features of the FAM would be covered in the Operational Manual and are summarized in Attachment 2 of this annex.

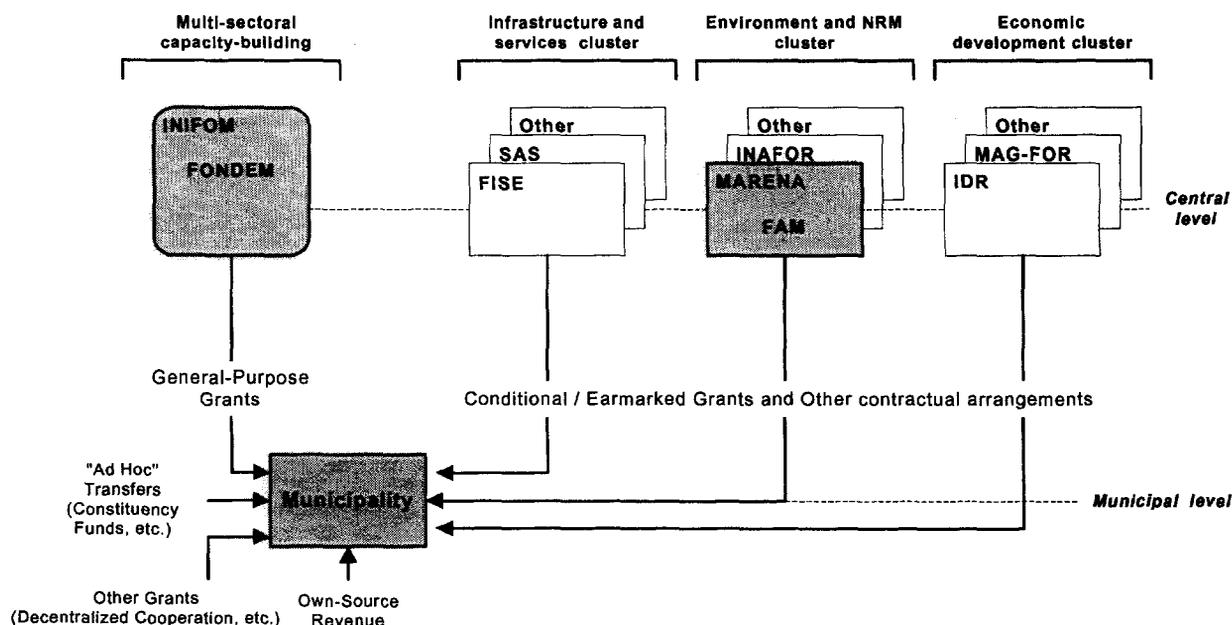
## Attachment 1 of Annex 2 The Municipal Development Fund (FONDEM)

This attachment summarizes the main features of the Municipal Development Fund (FONDEM). A detailed definition of FONDEM regulations is the main objective of the pilot, and would be developed during project implementation. These details would be specified in the FONDEM Operational Manual, whose acceptance by IDA is a condition of disbursement of the Municipal Development Component.

### Concept and Justification of FONDEM

FONDEM responds to the need for improving the current system of fiscal transfers, through a pilot case. The current Nicaraguan system of intergovernmental transfers is weak: the distributions and supervision arrangements of the current fiscal transfers are still under definition. The current level of fiscal transfers -- equivalent to less than one percent of the general budget of the Republic -- is relatively low by international and regional standards. It is however difficult to quantify the fiscal gap between responsibilities and fiscal resources of municipalities (vertical fiscal imbalances), because of the unclear separation of responsibilities between central and municipal governments. However, the fiscal differences across municipalities (horizontal fiscal imbalances) are easily quantifiable and substantial. FONDEM would not attempt to address the *horizontal* fiscal imbalances rather than the *vertical* fiscal imbalance. This is consistent with Art. 177 of the 1995 National Constitution, which gives priority to those municipalities with lower fiscal capacity.

Managed by INIFOM, the FONDEM would effect *regular* and *transparent* (formula-based) transfers of funds to municipalities for the financing of a broad range of activities prioritized through a municipal participatory planning process and reflected in the annual municipal budget. The general-purpose grants financed under FONDEM would be complementary to the earmarked funds provided under FAM as well as to other earmarked funds (such as FISE, IDR, and other), as graphically shown in the following graphic.



FONDEM main objectives are to:

- Foster autonomy in the design of local policies for municipal development and poverty reduction.
- Support municipal institutional development, especially strategic investment planning, programming and budgeting, to ensure local policy implementation.

- Strengthen participatory local investment planning, independently of financial sources and sectors.
- Complement the existing municipal financial mechanisms of the Central Government that, through inter-institutional agreements, support national policies for sustainable development and poverty alleviation.

In particular, FONDEM would pilot a system of fiscal transfers which is financially and politically viable, and hence would provide inputs for policy development on municipal fiscal transfers. Specifically, the technical improvements to the system of fiscal transfers aims to:

- Achieve a more economically efficient determination of the pool of resources and a more equitable distribution formula.
- Promote a better articulation between the objectives of the system (i.e., inter-jurisdictional fiscal equalization and incentives for local tax effort) and the actual design of the distribution formula.
- Strengthen local institutional capacity in general and financial management in particular, as means for a more effective implementation of a municipal policy for local development and local poverty reduction.

### **Magnitude and Distribution of FONDEM Resources**

The FONDEM annual transfers would be relatively modest, in the order of US\$4 per capita. This would (i) correspond to sustainable fiscal transfers of 3-5% of domestic income, well within the regional range (ii) be comparable to similar transfers effected by other Bank-supported demand-driven funds in the region (US\$3-6) and (iii) be significantly below the level of transfers of existing sectoral / earmarked grants programs (e.g. FISE).

Two broad objectives have been identified as part of FONDEM's concept: (i) attain fiscal horizontal equalization across those municipalities below a minimal standard of per capita income; and (ii) encourage local revenue mobilization. FONDEM would allocate 60% of its resources for its fiscal equalization policy goal and 40% to encourage local revenue mobilization. The distribution of FONDEM resources would be done via formula with two main policy objectives:

- Fiscal Equalization.** The objective of fiscal equalization is a compensation to close the gap between a set standard and the *potential* per capita revenue of the particular municipality, so that the horizontal imbalance across municipalities is eliminated for those that fall below the standard. The magnitude of the compensation is determined as the difference between the standard and the fiscal *potential* of the particular municipality. Note that it is not the difference between the standard and their *actual* revenue performance, so that poor performance would not be rewarded. For those municipalities whose fiscal potential (or fiscal capacity) is greater than the minimum standard, there would be no need, or justification, for a compensation. Given the substantial differences across municipalities they have been grouped in three categories, with a different standard for each group. In other words, the objective would be to ensure that all municipalities in each group are in principle equipped with no less than the standard of minimum fiscal capacity for that category.
- Local Revenue Mobilization.** As mentioned above, the second policy objective of FONDEM is to encourage local revenue mobilization (i.e., *tax effort*). Forty percent of FONDEM resources are allocated to this end. Specifically, the relative revenue performance of the property tax is used as the indicator of local *tax effort*. Revenue performance is measured as the taxes *actually* collected as a proportion of the minimum *potential* that might be collected. The transfers for tax effort have a ceiling to avoid that potentially a few municipalities, due to an exceptional performance, might take over a disproportional amount of the total pool of resources allocated to this goal. This need has been identified as a result testing the formula with actual data. Simulations and sensitivity analysis are currently being carried out to fine tune the formula for the distribution of FONDEM resources.

*Fiscal Potential.* The fiscal capacity of the local governments is measured in terms of the minimum potential of the property tax, which is common to all local governments and is also a good indicator of the potential generation of other local taxes.

### **Use of FONDEM Resources**

The FONDEM is meant to support the entire range of municipal responsibilities for local development. Up to 20% of the FONDEM resources may be used to cover the increase in administrative costs that municipalities would face to manage these transfers. The FONDEM Operation Manual, to be provided to participating municipalities at the outset of the program implementation, would define in detail eligible expenditures under this category and the related reporting requirements that municipalities would need to comply with. Not less than 80% of FONDEM resources shall be used by recipient municipalities to finance, in full or in part, the cost of preparing and implementing local investment projects, including the design, construction, rehabilitation, and repair of: (a) local infrastructure, (b) environment protection works and natural resource management activities and (c) activities to promote local economic development. The following is an indicative list of the activities and projects to which FONDEM resources may be applied. A separate detailed "negative list" would be covered in the Operational Manual. The negative list would contain (among other): purchase of land, credit or other financial operations, opening of new roads, construction or reconstruction of dams, supply of guns or illegal drugs, and activities of any type classifiable as category A for environmental purposes pursuant to Annex B of the IDA's December 1998 policy document titled Good Practices (GP) 4.01.

Subprojects financed by both the FONDEM and FAM must undergo an environmental screening or checklist procedure at the time of project approval. The procedure is a similar scheme used by MARENA which classifies projects in three categories. The FONDEM Operational Manual would include a checklist of basic project characteristics, environmental analysis classification requirements, and required processes. The procedure is a similar scheme used by MARENA which classifies projects in three categories. The Operational Manual would include a checklist of basic project characteristics, environmental analysis classification requirements, and required processes. (See also Annex 12 for Environmental Analysis and Mitigation Plan).

#### **Typology of FONDEM-Financed Activities**

<i>Economic Infrastructure</i>
<ul style="list-style-type: none"> <li>● Transmission and Distribution networks for Rural Electrification</li> <li>● Power Supply and Distribution systems: (i) Street lighting; (ii) Low Voltage Local Distribution Networks and grid expansion; (iii) off-network, back-up and emergency power plants</li> <li>● Transport Infrastructure: (i) Rehabilitation and spot improvement of Rural Roads; (ii) Urban streets and sidewalks; (iii) Bridges, crosswalks and fords; (iv) Transport Terminals (Passengers and Cargo); (v) Bus Stops; (vi) Roads and Street Signs and Traffic Signaling</li> </ul>
<i>Social Infrastructure</i>
<ul style="list-style-type: none"> <li>● Public Health and Hygiene such as: (i) Collection and disposal of solid wastes; (ii) Storm water drainage systems; (iii) Health Posts and Health Centers; (iv) Market facilities; (v) Slaughterhouses; (vi) Public Lavatories (vii) Cemeteries</li> <li>● Water Supply and Sanitation systems: (i) Dikes, source improvements, and reservoirs; (ii) Wells and Water Treatment plants (iii) water distribution systems; (iv) Piped sewage collection and disposal systems; (v) Wastewater treatment plants; (vi) Latrines and septic tanks.</li> <li>● Education, Tourism , Culture and Sport Facilities: (i) Training centers; (ii) Sport fields and facilities; (iii) Museums, Public Libraries, and public Exhibitions facilities; (iv) Tourist facilities; (v) Public Parks, Playgrounds, Gardens and Public Squares</li> <li>● Administrative Infrastructure: (i) Municipal office facilities; (ii) Community Centers</li> <li>● Other social facilities and programs: (i) Nurseries; (ii) Nutrition centers; (iii) Social Emergency response schemes</li> </ul>
<i>Environmental protection and Natural Resources Management</i>

<ul style="list-style-type: none"> <li>● Soil and water conservation works</li> <li>● Reforestation and tree nurseries</li> <li>● Water head works and source protection</li> <li>● Water pollution control</li> <li>● Illegal logging control facilities</li> <li>● Ecological Parks and Ecotourism</li> </ul>
<p><i>Local Economic Development promotion</i></p>
<ul style="list-style-type: none"> <li>● Market information and facilitation services</li> <li>● Local Fairs and exhibitions</li> <li>● Support to technical assistance and business promotion services</li> <li>● Primary and Secondary Connections of Micro-Irrigation schemes</li> <li>● Vocational training workshops</li> <li>● Agricultural Storage and Processing Facilities</li> </ul>
<p><i>Institutional Development</i></p>
<ul style="list-style-type: none"> <li>● Technical design of subprojects</li> <li>● Technical assistance and training</li> </ul>

FONDEM resources would need to be matched by locally generated funds, at a variable rate, depending on projects' types and municipal/beneficiaries capacities. If and when necessary, municipalities can in turn choose to use FONDEM resources to co-finance purpose-specific matching grants programs that address local priorities, such as funds from the Municipal Environmental Fund (FAM), FISE and/or others.

*Local Economic Development (LED).* Municipalities could also use FONDEM resources to promote LED. However, municipalities would not be allowed to provide credit for productive activities (as it is the case in the ongoing project). If municipal action in this area were to go beyond the traditional provision of local economic infrastructure, considerable capacity building and experimentation would be needed. For most Nicaraguan municipalities, participation is limited to engaging communities and civil society; however, private sector engagement still represents a challenge. Stimulating LED could focus on the creation of : (i) involving the private sector in the municipal participatory participatory planning process; (ii) municipal development plans which incorporate LED priorities; (iii) information flows on market conditions and opportunities; and (iii) instruments and incentives to mobilize productive investments and increase local economic activity.

The FONDEM would create incentives for Municipalities to plan, in collaboration with private, other public and community actors, and develop and implement LED strategies. The municipal planning process would incorporate a LED strategy covering of the following four areas: (i) economic infrastructure investments, not limited to transport infrastructure but extending to stalls for trade fairs and markets; (ii) administrative and regulatory reform priorities such as zoning, licensing, and transaction costs; (iii) flow of information and publicity to facilitate networking among local and external firms; and (iv) specific interventions such as tax breaks, use of public land, incentives to create a local chamber of commerce, etc.

The following are some practical examples of products within the four areas described above that were drawn from Nicaragua and other countries: (i) parking areas with basic sanitation and other services at crossroads of main transportation routes and local access roads, to encourage local-external commerce; (ii) business service windows with information, applications and status updates available on construction permits, business licenses and local tax rules/payments; (iii) facilitating competitive assessments for local business clusters or small and medium enterprises, and providing connections with NGOs, donors and central government agencies to improve standards, take advantage of technical assistance or cooperate with other area enterprises to gain access to markets or equipment, for example; (iv) economic maps with local businesses, structure of production, transportation routes; providing public land rent-free for a limited time for the privately financed construction of storage or processing facilities.

### **FONDEM Access Conditions**

All selected municipalities would be eligible to access FONDEM resources. However, in order to create an incentive for performance and promote accountability, municipalities would have to meet the following two access condition. Legal representatives of selected municipalities would sign a legal binding agreement (which would have to be approved by the Municipal Council) detailing that the municipal government would agree to:

- (i) establish a *participatory planning, programming, and budgeting system* (as specified in the manual for municipal planning); and
- (ii) introduce an *administrative system*, comprising an internal control system, and accounting system, comprising of a financial and physical reporting system. This would cover at least to: (i) open an account in a commercial bank exclusively for the management of FONDEM resources; (ii) report to the Central Government (i.e., INIFOM) on the executed and estimated budget (revenues and expenditures) on a quarterly basis; (iii) develop a minimal procurement capacity; (iv) allow external auditing of FONDEM municipal accounts by a private firm authorized by the General Controller offices (*Contraloría General de la República*) and acceptable to IDA; and (vi) provide to INIFOM all financial and physical information on the implementation of activities financed even in part by FONDEM.

### **Administration of FONDEM**

An inter-institutional commission, denominated as the Transfers Commission, has been recently created to provide oversight to municipal finances and the policies to administer FONDEM. The Transfers Commission is comprised by representatives of the Finance Ministry, INIFOM, the Association of Municipalities (AMUNIC) and a representative of the municipal commission of the General Assembly. The Transfer Commission would be presided by the representative of the Finance Ministry. This Commission would oversee both FONDEM and the national fiscal transfers system (i.e., the transfers from the Central Government to the municipalities).

In compliance with the function of overseeing the municipal finances, INIFOM would keep up-to-date the municipal database and would provide the Finance Ministry with the relevant information. The Finance Ministry would incorporate the information provided by INIFOM to the distribution formula.

## **Attachment 2 of Annex 2 The Municipal Environmental Facility (FAM)**

### **Background and Justification**

The experience of the ongoing project illustrates that, given the choice, most municipalities focus their spending on local infrastructure development, a traditional area of their concern and where they have a comparative advantage. Also, given appropriate institutional arrangements, municipalities have an interest in supporting local economic development initiatives, strongly demanded by their constituency. Without incentives, however, municipalities tend to under invest in environmental management initiatives. The Municipal Environmental Facility (*Facilidad Ambiental Municipal*, FAM) would provide a financial incentive to municipalities for environmental investments. The FAM would also strengthen links between MARENA and municipal governments.

The FAM would be designed as a conditional matching fund. It would finance earmarked matching-grants to stimulate municipal governments to develop local environmental initiatives and assume greater responsibilities in the implementation of national environmental policies. Municipalities would be required to make an up-front cash, in-kind, or labor contribution of a specified share of project costs (20% or higher according to the investment type and municipal classification). Technical assistance would be contracted by municipalities to assist municipalities in the design and implementation of environmental investments.

Municipal government would have to meet minimum environmental capacity criteria to gain access to funds for environmental subprojects through FAM. Most of the larger municipalities and a handful of smaller municipalities already meet these basic requirements. In other cases, the project would contribute to create such capacity. In some cases the magnitude of municipal environmental activities would not justify the creation of a permanent environmental unit in each municipality. In these cases, the project would favor the creation of a joint environmental unit serving more than one municipality.

### **Magnitude and Distribution of FAM Resources**

The FAM would make available to municipalities an average of US\$1.5 per capita per year for environmental investments. All 40 municipalities in the project area would be eligible for FAM financing. Only 40% of total annual FAM budget would be distributed equally to all participating municipalities based on an *environmental needs indicator* to be defined in the FAM Operational Manual (part of the MARENA Operational Manual). The remaining 60% would be available to all participating municipalities which would compete on the basis of the quality of their proposals and efficiency. Further explanations will be detailed in the FAM Operational Manual, to be provided to participating municipalities at the outset of the program implementation.

### **Use of FAM Resources**

The FAM is meant to support the entire range of municipal responsibilities for environmental local management. As in the case of FONDEM, up to 20% of the FAM resources may be used to cover the increase in administrative costs that municipalities would face. The FAM Operation Manual would define in detail eligible expenditures under this category and the related municipal reporting requirements. Not less than 80% of FAM resources shall be used by recipient municipalities to finance, in full or in part, the cost of preparing and implementing local environmental investment subprojects.

As in FONDEM, subprojects financed under FAM must undergo an environmental screening or checklist procedure at the time of project approval. The FAM Operational Manual would include a checklist of basic project characteristics, environmental analysis classification requirements, and required processes. (See also Annex 12 for Environmental Analysis and Mitigation Plan). The FAM **negative list** would build on the FONDEM negative list (described in Attachment 1 of this annex), adding all those investments which are not directed to local environmental management.

Requirements for FAM Eligibility. The MARENA Operational Manual would detail a set of subproject eligibility criteria, based on the following. Subprojects must be:

- (i) identified within framework of municipal participatory planning, and incorporated under the Municipal Investment Plan;
- (ii) intended to produce an environmental benefit, both local or global.
- (iii) requested by the Municipal Government (although its execution could be outsourced);
- (iv) co-financed by direct executors at least 20% of total investment requirements (monetary or in-kind contributions);
- (v) presented with a financial application and a project profile that would justify and identify the nature of the proposal, environmental and social impact, financial investments and an execution timeline, along with co-financing specifics and implementing agency information.

The FAM would finance those investments which are specifically target for local environmental management. Below is a sample list of projects that could be financed under the FAM depending on the local demand as revealed by the local participatory planning process.

### Typology of FAM-Financed Activities

<i>Brown environmental subprojects</i>
<ul style="list-style-type: none"> <li>● Clean Technologies such as: (i) pollution control; (ii) industrial decontamination; (iii) water treatment systems for coffee mills and cheese production facilities; (iv) and methane gas production</li> <li>● Facilities and Environment Programs: (i) institutional development, such as rehabilitation of municipal environmental offices, technical assistance and equipment for municipal technical units; (ii) technical assistance to Municipal Environmental Commissions and Municipal Technical Units; (iii) municipal ecological brigades; (iv) environmental awareness and education campaigns</li> </ul>
<i>Green environmental subprojects</i>
<ul style="list-style-type: none"> <li>● Natural Resources Management: (i) soil erosion control, (ii) prevention and control of forest fires; (iii) reforestation and tree nurseries, (iv) municipal natural protected areas management or administration; (v) watershed management, particularly for the supply of drinking water</li> <li>● Environmental Economic Activities: (i) sustainable use of wild flora and fauna, including fisheries; (ii) ecotourism; and (iii) sustainable forest use</li> </ul>
<i>Environmental institutional development subprojects</i>
<ul style="list-style-type: none"> <li>● Technical design of environmental subprojects</li> <li>● Environmental technical assistance and training</li> <li>● Institutional development of the Municipal Environmental Commissions (CAMs)</li> </ul>

### FAM Administration

The FAM would be managed by MARENA, through the unit for small projects created by DANIDA. An independent Board of Directors would be responsible for defining and supervising FAM policies. The Board of Directors would be composed of two representatives from MARENA, one from INIFOM, and one from AMUNIC.

**Annex 3: Estimated Project Costs**  
**NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**

<b>Project Cost By Component</b>	<b>Local US \$million</b>	<b>Foreign US \$million</b>	<b>Total US \$million</b>
<b>A. MUNICIPAL DEVELOPMENT</b>	0.00	0.00	0.00
1. Decentralized Financing (FONDEM)	16.32	0.00	16.32
2. Municipal Strengthening	6.11	1.39	7.50
3. INIFOM's Institutional Strengthening	2.15	0.93	3.08
4. Evaluation and Policy Development	0.70	0.30	1.00
<b>B. MUNICIPAL ENVIRONMENTAL MANAGEMENT</b>	0.00	0.00	0.00
1. Decentralization of Environmental Management	4.02	0.89	4.91
2. Environmental Information System (SINIA)	1.02	0.65	1.67
3. Municipal Environmental Fund (FAM)	4.58	0.00	4.58
<b>Total Baseline Cost</b>	34.90	4.16	39.06
<b>Physical Contingencies</b>	1.05	0.22	1.27
<b>Price Contingencies</b>	0.25	0.12	0.37
<b>Total Project Costs</b>	36.20	4.50	40.70
<b>Total Financing Required</b>	36.20	4.50	40.70

<sup>1</sup> Identifiable taxes and duties are 0 (US\$m) and the total project cost, net of taxes, is 40.7 (US\$m). Therefore, the project cost sharing ratio is 70.52% of total project cost net of taxes.

## Annex 4

### NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT SUMMARY OF ECONOMIC ANALYSIS

The economic analysis was based on the quantification of the expected costs and benefits of local investments - or subprojects - to be financed by FONDEM and FAM. The analysis was based on a stratified sample drawn from the experience of the ongoing project, basing the results on assumptions about future financing.

**Sample selection.** The range of the subprojects financed under the ongoing project is large and diverse. The ongoing project implemented more than 950 economic and social infrastructure, productive, environmental and institutional development subprojects. Previous analysis demonstrated the economic results vary greatly, from extremely profitable to complete failures. Therefore particular attention was given to the selection of a representative sample of subprojects.

To improve sample representativeness without excessively increasing its size (and consequent costs), the sample was stratified on the basis of four investment categories (see Table 1). In addition, each category was separated into two strata according to the evaluation of the monitoring system maintained by municipalities. According to this system, each subproject is classified as highly satisfactory (HS), satisfactory (S), unsatisfactory (U), and highly unsatisfactory (HU). Each strata provided a minimal sample of two subprojects, to allow an estimation of variability. In September 2000 (moment of the sample selection), the ongoing project had implemented 933 subprojects. Of these, 352 had been completed at least one year before (on or before September 1999). The sample was selected from this universe of 352 subprojects, thus guaranteeing that all sampled subprojects had been under operation for at least one year.

**Table 1-4 - Sample Stratification**

Investment Category	Number of HS and S subprojects		Sample		Number of HU and U subprojects		Sample		Total Universe (US, S, U, HU)	Total Sample	
Economic infrastructure	145	5	3%	5	2	40%	150	7	5%		
Environmental Projects	41	2	5%	2	2	100%	43	4	9%		
Social Infrastructure	9	3	33%	2	2	100%	11	5	45%		
Productive Investments	142	4	3%	6	2	33%	148	6	4%		
<b>Total</b>	<b>337</b>	<b>14</b>	<b>4%</b>	<b>15</b>	<b>8</b>	<b>53%</b>	<b>352</b>	<b>22</b>	<b>6%</b>		

A team visited each subproject in the selected sample and collected information on costs and benefits and calculated the Economic Internal Rate of Return and Net Present Value for the 22 sampled subprojects. The economic analysis of sampled subprojects was based on the following assumptions:

- Discount Rate: 12%
- Shadow price of labor and land: 100% of market price;
- Shadow Price of tradable: 130% of market price;

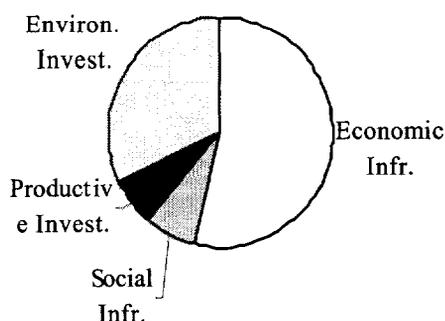
**Table 2-4 - Results of the Economic Analysis in the Sampled Subprojects**

#	Subproject	Location	Category	Economic Internal Rate of Return (EIRR)	Net Present Value (US\$ '000)
1	Rural Electrification	Santa Teresa de Tolap	Ec. Infr	-6%	-5,879
2	Rural Electrification	El Comejen	Ec. Infr	24%	6,718
3	Rural Road Rehab.	Rio Chiquito	Ec. Infr	40%	149,055
4	Rural Road Rehab.	Nagarote - La Trinidad	Ec. Infr	84%	513,086
5	Bridge	La Cuitanga	Ec. Infr	12%	143
6	Rural Road Rehab.	Lagartillo-Pajarito	Ec. Infr	Negative	-2,248
7	Rural Road Rehab.	Lagartillo-Guanacaste	Ec. Infr	Negative	-14,223
8	Pine	San Pedro	Environ.	9%	-316
9	Pine	San Francisco	Environ.	9%	-316
10	Forestry	Santo Tomas	Environ.	12%	26
11	Silvopastoril	El Castillo	Environ.	17%	99
12	Silvopastoril	El Limonal	Productive	57%	26,777
13	Irrigation	Jicaral	Productive	9.1	-5
14	Productive	La Paz Viejo	Productive	Negative	-26,351
15	Silvopastoril	El Bonete	Productive	Negative	-55,986
16	Chicken Production	Malpaisillo	Productive	Negative	-3,378
17	Chicken Production	Telica	Productive	Negative	-8,892
18	Health center	Copaltepe	Soc. Infr.	-2%	-3,099
19	Nursery	Posoltega	Soc. Infr.	88%	947
20	Water supply	San Martin, El Sauce	Soc. Infr.	59%	133
21	Latrines	Somotillo	Soc. Infr.	Negative	-14,223
22	Water supply	La Mesa	Soc. Infr.	Negative	-14,223

The analysis revealed that subprojects classified as unsatisfactory or below (less than 5% of cases), present serious design or implementation problems. In all of those cases there were minimal benefits, and the rate of return was highly negative. There were also two cases of subproject with a slightly negative Economic Internal Rate of Return (EIRR) even though the municipal monitoring system classified them as satisfactory. EIRR of satisfactory and highly satisfactory subproject ranged between -6% and 88%. This high variability of results caused a high sampling error.

In calculating the average resulting from weighting the results of the sample, future demand was estimated to change in comparison to the ongoing project. It was assumed that FISE would finance a larger share of the social infrastructure, while the decision that financing of credit would not be followed would curb the demand for productive subprojects. Additionally, separate financing for environmental subproject under the Municipal Environmental Facility (FAM) would increase demand for environmental subprojects. On the basis of these assumptions, *future* demand was estimated with the following relative share.

**Graphic 1-4. Estimation of future demand share for local investments**



**Table 3-4 - Summary Results of the Economic Analysis**

Investment Category	Economic Internal Rate of Return (%)	95% Confidence Interval (%)		Net Present Value (US\$ '000)	95% Confidence Interval (US\$ '000)	
		Lower	Upper		Lower	Upper
Economic Infrastructure	31.1	-0.2	62.5	71,535	-351,888	494,958
Social Infrastructure	20.4	-10.7	51.6	21,273	-31,976	74,523
Productive Investments	18.7	-18.7	56.0	-20,548	-1,004,041	59,308
Environmental Investments	18.5	-13.8	50.8	-57	-578	464
<b>Weighted average</b>	<b>22.7</b>	<b>10.5</b>	<b>34.8</b>	<b>19,537</b>	<b>-78,578</b>	<b>117,544</b>

The estimated Economic Internal Rate of Return for the investments in municipal subprojects (FONDEM and FAM sub-components) which resulted from the above analysis is quite satisfactory: the average of 23% is significantly higher than the discount rate, and also the lower Confidence Interval is slightly lower than the discount rate (12%). The Net Present Value is, however, slightly more problematic: although the weighted average for one subproject is almost \$20,000, the confidence interval is extremely broad, with a lower value significantly negative: -\$78,600. This is a consequence of the high variability of results in the sample and consequent high sampling errors.

#### **Institutional Development**

The above analysis did not consider investments in institutional development, such as technical assistance and training. Although the major expected gains of the proposed project are in terms of institutional development, to quantify the return of such investments is extremely difficult. Therefore the preparation team carried out a sensitivity analysis which considered two hypothetical scenarios:

- the institutional development would produce no benefit. In this scenario, the Economic Rate of Return of the whole project, comprising the cost for investments in technical assistance and training, would still be slightly positive (weighted average EIRR=5.7%); and
- the institutional development benefits were estimated on the basis of the amount of resources managed by municipal governments. Considering that the 40 municipalities covered by the project manage around US\$16 million per year, a conservative estimate increased efficiency of 8.8% after project completion would produce an EIRR equal to the opportunity cost of capital (12%).

Neither of the two scenarios attempted to quantify institutional development benefits at community level. Nonetheless, participatory implementation of local investments is expected to foster the creation of social capital thus reducing transaction costs. However, transaction costs reduction has been quantified only in few anecdotal examples, without a statistical significance, thus the team decided to not account for such benefits.

Finally, there is a last benefit expected from the participatory planning exercise which was not quantified: the complementarity among subprojects. Within the framework of a sound municipal planning, the many small investments financed by FONDEM, FAM, municipal taxes, and other financing sources, are expected to produce significant synergy, thus increasing the benefit of each investment alone. Again, given the difficulty in quantifying such benefits, they were not accounted for.

**Cost-Effectiveness Analysis.** The Evaluation of Effects and Potential Sustainability of the ongoing project analyzed cost-effectiveness of subprojects. The analysis quantified the unitary costs of municipalities in implementing small-scale infrastructure projects as compared to other central government agencies.

The analysis confronted significant methodological problems in defining the comparators because even the most simple infrastructure (as in the case of latrines) was found to be difficult to compare. This is mainly due to the difficulty of defining *quality* in *quantitative* terms. In fact, the technical design of municipal investments is very flexible and does not follow any specific standard. In addition, record keeping is very poor at municipal level.

Findings from the cost-effectiveness analysis show that the efficiency of the project's decentralized mechanism is comparable to that of the most efficient central level institutions, sometimes slightly higher. The decentralized mechanism has the additional benefit of building local capacity through a learning-by-doing methodology. Building local capacity is essential for increasing the participation of rural communities (often poor and isolated) in their own development.

**Annex 5: Financial Summary**  
**NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**  
**Years Ending**

	<b>IMPLEMENTATION PERIOD</b>						
	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>	<b>Year 6</b>	<b>Year 7</b>
<b>Total Financing Required</b>							
<b>Project Costs</b>							
Investment Costs	10.1	11.9	8.6	3.9	0.0	0.0	0.0
Recurrent Costs	1.0	2.1	2.0	1.1	0.0	0.0	0.0
<b>Total Project Costs</b>	11.1	14.0	10.6	5.0	0.0	0.0	0.0
<b>Total Financing</b>	11.1	14.0	10.6	5.0	0.0	0.0	0.0
<b>Financing</b>							
IBRD/IDA	6.7	10.8	7.6	3.6	0.0	0.0	0.0
Government	0.2	0.9	1.5	0.4	0.0	0.0	0.0
Central	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Provincial	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Co-financiers	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Municipalities	0.8	1.3	1.1	0.8	0.0	0.0	0.0
Others	3.4	1.0	0.4	0.2	0.0	0.0	0.0
<b>Total Project Financing</b>	11.1	14.0	10.6	5.0	0.0	0.0	0.0

**Main assumptions:**

## **Annex 6: Procurement and Disbursement Arrangements**

### **NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**

#### **Procurement**

Procurement of goods financed by IDA under the project would be carried out in accordance with the Bank's *Guidelines: Procurement under IBRD Loans and IDA Credits*, published in January 1995 (revised January/August 1996, September 1997 and January 1999). Consultant services would be procured in accordance with the *Guidelines: Selection and Employment of Consultants by World Bank Borrowers* published in January 1997 (revised in September 1997 and January 1999), and the provisions stipulated in the Credit Agreement.

#### **Assessment of agency's capacity to implement procurement**

An assessment of the capacity of INIFOM and MARENA to conduct procurement indicated in the project design has been completed. A corrective plan that proposes specific actions to be addressed before Credit Effectiveness has been agreed upon with the Government. This action plan includes:

- Adoption of the Code of Ethics (Decree 124-99 published on December 10, 1999) by employees of INIFOM and MARENA.
- Integration of current INIFOM-PIU with INIFOM's structure.
- Recruitment or reallocation of administrative staff in MARENA, in particular a procurement and a disbursement specialist, to work with PIU staff.
- Specific procurement training to municipalities on national procurement law.
- Preparation of chapter on procurement and disbursements in the Operations Manuals for INIFOM and MARENA (comprising FONDEM and FAM), describing clearly the procedures, methodologies, coordinating arrangements and control mechanisms.
- Adoption of a personnel management system in INIFOM and MARENA for its restructured organization, including viable performance appraisals and a scheduled compensation improvement plan, would be a condition to access IDA financing for salaries.

The ongoing project has created a capacity within MARENA and INIFOM to conduct procurement of goods, works and consultant services in accordance with the Bank's guidelines. This capacity is concentrated in the Project Implementing Units (PIUs) but under the proposed projects INIFOM's PIU would be transferred to the institution in an effort to institutionalize this capacity. However, pursuit of the decentralization strategy would also require the implementation of procurement at and below the municipal level, as vehicles of capacity building. Government agencies and IDA will need to agree on the application of suitable community-based procurement procedures for municipal and community subprojects under the Municipal Development Fund (FONDEM) and Municipal Environmental Facility (FAM). The subproject procurement procedures would be designed to be consistent with the Government's recently passed Public Procurement Law (Law 323) dated January 2000. Based on the thresholds set in Law 323 for different procurement procedures and the average size of the subprojects, it is expected that procurement in most of the subprojects would be carried out under shopping procedures. The average size of individual subprojects is expected to be below US\$25,000. The average in the ongoing project is US\$20,000.

As a pilot within the FONDEM resources transfer mechanism, and to help accelerate implementation of the new Public Procurement Law, the project proposes to support and monitor financing of fiscal transfers to municipalities with an ex-post procedures review mechanism. Municipalities that might be allowed to use this pilot funding would need to show a stronger capacity in planning, procurement administration and managing their resources in order to qualify for the somewhat expanded procurement authorities. This financing procedure would be an incentive for other municipalities to improve administratively and be able to qualify for this program. To implement this approach and support a more rapid application of the new Public Procurement Law at the municipal level, the Government and IDA will

agree on the specific procedures to be followed (e.g., Shopping and/or community-based procedures). A suitable procurement audit mechanism will also be formulated within the INIFOM / Municipal Operations Manual to assure that the pilot funds transfers will be used for: (i) eligible investments, and (ii) in a manner satisfying IDA procurement requirements.

Procurement activities would be carried out as follows:

- (a) Municipal Development component (US\$28.9 m). INIFOM through its Administrative and Operations Departments would carry out procurement activities to support decentralization and institutional strengthening of INIFOM. INIFOM units would also coordinate the transfer of funds to municipalities to finance subprojects and would train and monitor INIFOM's central and field administrative staff, which would support and oversee the implementation of program procurement at the municipal and community levels. Municipalities would have management responsibilities for implementing the subprojects, including procurement of, as appropriate, consultant services, materials, works and supervision activities, processing of associated contract payment documentation, reporting, and the maintenance of related records.
- (b) Municipal Environmental Management component (US\$11.7 m.). MARENA would carry out procurement activities for this component using existing, experienced staff. FAM subprojects would be implemented directly by the municipalities, under supervision of INIFOM and MARENA. The existing PIU would initially carry out all procurement and it would also train procurement staff hired by MARENA which would help institutionalize improved procurement procedures within MARENA's administrative departments. PIU and the augmented staff would also coordinate and supervise procurement actions for the subprojects where procurement activities are carried out directly by municipalities. Municipalities would be responsible for procurement under FAM-funded subprojects and administration and record-keeping responsibilities related thereto.

### **Procurement methods (Table A)**

Procurement methods are described below and their estimated amounts are summarized in Table A. Threshold estimated contract values defining applicable procurement methods are indicated in Table B.

#### Procurement of Works

The Project would finance small civil works for remodeling of several office buildings estimated to cost in total US\$144,000. The contracts would be procured under lump-sum, fixed price contracts awarded on the basis of quotations obtained from at least three qualified domestic contractors in response to a written invitation. The invitation shall include a detailed description of the works, including basic specifications, the required completion date, a basic form of agreement acceptable to IDA, and relevant drawings, where applicable. The award shall be made to the contractor who offers the lowest price quotation for the required work, and who has the experience and resources to complete the contract successfully. Standard documents for this procedure would be agreed before the first invitation is issued.

#### Procurement of Goods

Goods to be procured under the project include computers, printers, videos, publications, promotional material, vehicles, communications and office equipment and furniture. To the extent practicable, goods would be grouped in packages of US\$150,000 or more that would be procured through ICB procedures. NCB is not contemplated but, if any, goods that are estimated to cost more than US\$25,000 per contract up to US\$150,000 would be procured under NCB procedures. Publications, promotional materials, office equipment and furniture, etc., estimated to cost less than US\$25,000 per contract would be procured using Shopping procedures based on a model Request For Quotations satisfactory to the Association, up to an aggregate amount of US\$500,000.

#### Selection of Consultant Services and Training

Consulting services include technical assistance, studies and provision of staff and program training. Most of these services are expected to be carried out by consulting firms. These services are required to: (i) support decentralization and training activities of INIFOM and MARENA, (ii) improve the legal framework of local government financing, (iii) strengthen municipalities' capacities in administration and management of subprojects, preparation of annual plans and budgets, manuals, (iv) establish integrated information systems, comprising an environmental information system and a municipal system, (v) establish an evaluation and policy development system, (vi) provide technical assistance to decentralize environmental management; and supervise and monitor municipalities, comprising procurement and financial audit, in the implementation of FONDEM and FAM subprojects. Individual consultants would be hired for capacity building, and for specialized services and training.

#### a) Firms

Consultant services carried out by a firm would be hired using QCBS procedures, in accordance with consultants' guidelines, as indicated in the procurement schedule.

#### b) Individuals

Individual consultants would be used for two main objectives and would be selected in accordance with the provisions of paragraphs 5.1 through 5.3 of Chapter 5 of the Consultant Guidelines. The *first* objective would be to maintain the capacity created during the ongoing project. There is currently a group of more than 30 individual consultants who are supporting the regular staff of INIFOM and MARENA in carrying out their activities. This group of consultants developed a significant set of skills on municipal development and decentralized environmental management. Such skills are rare in Nicaragua, and one important objective of the proposed project is not to lose the already developed capacity. Although it is expected that some of these individual would be hired as permanent staff by the two institutions, for most of them the change from individual consultant to permanent staff would significantly reduce their remuneration, and would be therefore difficult to accept. Although incentives such as job stability could be important in the electoral period during project implementation, it is expected that most would maintain their consultant status. Therefore some 50% of the proposed allocation for individual consultants would be used to assure the continuity of already hired consultants. This implies that most of these individual consultants' contracts would be for a long period, possibly more than one year. Existing termination clauses would be maintained, together with the already created performance evaluation system.

The *second* objective of individual consultants is to have access to specialized advisory services and provision of training for specific topics where there is limited availability of consulting firms. For example, monitoring and evaluation of decentralized projects is particularly complex, and little experience has been developed in the Central America region. Since the capacity of consulting firms is insufficient, the project would utilize the remaining 50% of the proposed allocation to hire individual consultants. However, the operational manual would define selection criteria, together with a comprehensive consultant management aspects such as objective and technical evaluation of results.

#### Subprojects

Subproject financing would be implemented under the following two funds:

a) The Municipal Development Fund (FONDEM) under the Municipal Development component consists of grants to finance subprojects proposed by municipalities. These subprojects cannot be defined in advance as they would be demand-driven. A Negative List would be included in the FONDEM Operational Manual. The manual would describe in detail selection criteria, the process for identifying, developing and approving subprojects, and applicable procurement procedures. The average cost of a subproject is expected to be below US\$25,000. A subproject could consist of goods, works or services, or a combination of the three.

b) Municipal Environmental Facility (FAM) under the Municipal Environmental Management component

would provide grants to finance municipal environmental projects which meet IDA-approved criteria. Somewhat differently from FONDEM, MARENA has developed a "positive list" of local environmental investments which would be specified in the approved MARENA Operational Manual.

**Procurement for subprojects would be done by target municipalities following national procurement procedures.** Because of their small value, it is expected the majority of subproject inputs would be procured under the national procedures using Shopping-equivalent procedures. In exceptional cases, where the estimated subproject contract would exceed the National Procurement procedures Shopping-equivalent category, NCB or comparable procedures as agreed by IDA would be applied. Procedures to be used by the municipalities and/or the direct community beneficiaries would incorporate community-based concepts, where appropriate, and would be agreed to by IDA and included in the Operations Manuals prepared prior to Credit Effectiveness.

### Operating Costs

Operating Costs comprise expenditures for incremental costs associated with the implementation of the Project, such as: (i) operation and maintenance of vehicles, repairs, fuel and spare parts; (ii) office equipment and computer maintenance; (iii) office supplies, rentals and office facilities and utilities associated with INIFOM, MARENA and their regional offices involved in project implementation; (v) transportation costs, travel and per diem cost for technical staff to carry out training, supervisory and monitoring activities, as previously approved by IDA and (vi) salaries of INIFOM and MARENA staff. The salaries would be financed only after the responsible institutions will have developed and made operational a system of personnel management comprising of a selection, remuneration policy and performance evaluation acceptable to IDA has been made operational.

### **Prior review thresholds**

The prior review thresholds are summarized in Table B.

Bank's prior review would be required for a) All ICB; b) the first two contracts under NCB and National Shopping-equivalent procedures; and d) contracts with individuals consultants above \$50,000, and for consultant firms above \$100,000. Contract amendments which would exceed these levels would likewise be subject to prior reviews. Prior reviews for procurements implemented under the municipal funds (FONDEM and FAM) would have review procedures as specified in the approved Operational Manuals. In addition to prior reviews of designated procurement actions, annual INIFOM and MARENA Operating Plans and budgets, including their procurement plan updates, as appropriate, would be reviewed and approved by IDA.

### **Procurement Plan**

INIFOM and MARENA have initiated the preparation of an indicative Procurement Plan which shall be discussed at negotiations. A detailed Procurement Plan is expected by April 2001. Annual Procurement Plan updates would also be submitted to and reviewed by the Bank as part of the Annual Operations Plan approval process.

### **Frequency of Procurement Supervision**

In addition to indicated prior reviews, it is recommended that a full project launch mission be implemented and an extended procurement supervision mission be effected within the first six months of Credit Effectiveness to ensure administration preparedness and functioning. Full procurement missions should be conducted thereafter at midyear on an six-month basis to monitor progress and carry out post reviews of procurement actions. Such post-review field analyses would assess the efficacy and relevance of procurement audits (See below.)

### **Procurement Audits**

It has been agreed that procurement audits of the subprojects would be carried out, along with the financial audit of the project. Such audits would cover a sample of not less than 10 percent of contracts signed and subprojects funded during the prior year. TORs would be reviewed and approved by IDA by negotiations.

**Procurement methods (Table A)**

**Table A: Project Costs by Procurement Arrangements**  
(US\$ million equivalent)

Expenditure Category	Procurement Method <sup>1</sup>			N.B.F.	Total Cost
	ICB	NCB	Other <sup>2</sup>		
<b>1. Works</b>	0.00 (0.00)	0.00 (0.00)	0.14 (0.10)	0.00 (0.00)	0.14 (0.10)
<b>2. Goods</b>	1.10 (1.00)	0.00 (0.00)	0.59 (0.44)	0.00 (0.00)	1.69 (1.44)
<b>3. Services Including training</b>	0.00 (0.00)	0.00 (0.00)	9.60 (7.31)	0.00 (0.00)	9.60 (7.31)
<b>4. Subprojects</b>	0.00 (0.00)	0.00 (0.00)	21.54 (14.85)	0.00 (0.00)	21.54 (14.85)
<b>5. Operating Costs</b>	0.00 (0.00)	0.00 (0.00)	6.23 (3.50)	0.00 (0.00)	6.23 (3.50)
<b>6. PPF</b>	0.00 (0.00)	0.00 (0.00)	1.50 (1.50)	0.00 (0.00)	1.50 (1.50)
<b>Total</b>	1.10 (1.00)	0.00 (0.00)	39.60 (27.70)	0.00 (0.00)	40.70 (28.70)

<sup>1/</sup> Figures in parenthesis are the amounts to be financed by the IDA Credit. All costs include contingencies

<sup>2/</sup> Includes civil works and goods to be procured through national shopping, consulting services, services of contracted staff of the project management office, training, technical assistance services, and operating costs related to managing the project.

**Table A1: Consultant Selection Arrangements (optional)**  
(US\$ million equivalent)

Consultant Services Expenditure Category	Selection Method							Total Cost <sup>1</sup>
	QCBS	QBS	SFB	LCS	CQ	Other	N.B.F.	
<b>A. Firms</b>	4.95 (3.08)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	4.95 (3.08)
<b>B. Individuals</b>	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	3.68 (3.33)	0.00 (0.00)	3.68 (3.33)
<b>Total</b>	4.95 (3.08)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	3.68 (3.33)	0.00 (0.00)	8.63 (6.41)

1\ Including contingencies

Note: QCBS = Quality- and Cost-Based Selection  
 QBS = Quality-based Selection  
 SFB = Selection under a Fixed Budget  
 LCS = Least-Cost Selection  
 CQ = Selection Based on Consultants' Qualifications  
 Other = Selection of individual consultants (per Section V of Consultants Guidelines), Commercial Practices, etc.

N.B.F. = Not Bank-financed

Figures in parenthesis are the amounts to be financed by the Bank Credit.

Prior review thresholds (Table B)

**Table B: Thresholds for Procurement Methods and Prior Review <sup>1</sup>**

<b>Expenditure Category</b>	<b>Contract Value Threshold (US\$ thousands)</b>	<b>Procurement Method</b>	<b>Contracts Subject to Prior Review (US\$ millions)</b>
<b>1. Works</b>	<150	Lump-sum fixed price contracts	None
<b>2. Goods</b>	>150 25-150 < 25	ICB NCB Shopping	All First two* First two*
<b>3. Services</b>			
<b>a) Firms</b>	>100 <100	QCBS QCBS	All Only TORs and budget
<b>b) Individuals</b>	>50 <50	Consultant Guidelines, Chapter 5, para 5.1	All TORs and terms of employment
<b>4. Training</b>	N/A	N/A	None
<b>5. Subprojects</b>	>50 <50	Municipal and community procurement according to Operational Manual	None
<b>6. Operating Costs</b>	N/A	N/A	None

**Total value of contracts subject to prior review:**

**Overall Procurement Risk Assessment**

**High**

**Frequency of procurement supervision missions proposed:** One every 6 months (includes special procurement supervision for post-review/audits)

\* For INIFOM and MARENA

<sup>1</sup> Thresholds generally differ by country and project. Consult OD 11.04 "Review of Procurement Documentation" and contact the Regional Procurement Adviser for guidance.

## **Disbursement**

### **Allocation of credit proceeds (Table C)**

<b>Expenditure Category</b>	<b>Amount in US\$million</b>	<b>Financing Percentage</b>
<b>1. Works</b>		
a) Municipal Development	0.05	80%
b) Municipal Environmental Management	0.05	80%
<b>2. Goods</b>		
a) Municipal Development	0.60	100% FE/ 85% LE
b) Municipal Environmental Management	0.60	100% FE/ 85% LE
<b>3. Consultant Services and Training</b>		
a) Municipal Development	4.80	100%
b) Municipal Environmental Management	2.15	100%
<b>4. Subprojects</b>		
a) FONDEM	11.00	100% of INIFOM's share
b) FAM	3.30	100% of MARENA's share
<b>5. Operating Costs</b>		
a) Municipal Development	2.20	80% up to an aggregate of US\$1.0 m, 60% up to US\$2.0 m., and 40% thereafter
b) Municipal Environmental Management	1.20	80% up to an aggregate of US\$0.8 m, 60% up to US\$1.0 m., and 40% thereafter
<b>6. PPF</b>	1.50	100%
<b>7. Unallocated</b>	1.25	
<b>Total Credit Amount</b>	<b>28.70</b>	

### **Financial Management Responsibility**

Both INIFOM and MARENA would be responsible for the implementation and maintenance of a financial management system of their respective components, to efficiently manage the Project's funds and timely prepare the Project Management Reports (PMR). The financial management system would include policies, norms and procedures for Planning, Budget, Procurement, Accounting, Reporting, and Auditing, to ensure the provision of accurate and timely information to the IDA, regarding Project funds resources and expenditures, as required by OP/10.02. The system will provide information on physical performance, according to Project's out-put and indicators included in Annex 1.

Although the UTI established within INIFOM under the ongoing Rural Municipalities Project has the capacity to comply with IDA's financial management requirements - except generating PMR - INIFOM's Administration and Finance Department (*Gerencia de Administracion y Finanzas - GAF*) does not have this capability. INIFOM is currently undergoing a process of organizational change to institutionalize the UTI into its line departments. As part of the change process, a consultant would be hired to evaluate and revise staff qualifications and responsibilities. Additionally, as recommended during the financial management assessment carried out for this project's preparation, an external audit of the INIFOM internal controls would be conducted. Recommendations from these two evaluations would have to be implemented within the frame of the Institute's organizational re-engineering and through the enactment of a specific action plan. This action plan has already been agreed upon and includes key actions to: (a) restructure the INIFOM budget control and accounting system, to meet INIFOM's and its clients' needs; (b) improve the INIFOM's accounting software; (c) up-grade and complete the accounting and monitoring systems of the municipalities; (d) establish modalities and schedule for incorporation of the

temporary special financial management unit (SFMU) corresponding to the current UTI Finance and Administration Unit, within the INIFOM's new organizational structure; (e) update the administrative procedures manual; (f) draft an operating manual for the management of FONDEM; (g) improve the INIFOM's monitoring system; and (h) hire external auditors.

MARENA is facing a similar situation. The General Directorate for Finance and Administration (DAGF) does not have the capability to implement the project according to IDA requirements. The institution needs to strengthen the financial areas, including planning, budgeting and accounting systems, as well as to improve the system for physical and financial monitoring of its annual projects implementation plans. The DAGF does not have experience in procurement of goods and services in accordance with IDA requirements, nor has a procurement specialist or division. The PIU established within MARENA under the first phase of the Rural Municipalities Project would therefore assist MARENA by hiring and training the staff assigned to the project financial management. Until an accounting system that meets MARENA's and its clients' needs, is implemented, the PIU's accounting system would continue to be used, with some improvements, for the accounting of the proposed project.

Action plans have been agreed with both institutions, which provide the necessary guidelines to ensure that by project effectiveness an adequate financial management system, internal controls, monitoring systems, and trained staff, are in place to achieve the certification of the project's financial management system under the Bank's Loan Administration Change Initiative (LACI), and in accordance with (i) the Financial Accounting, Reporting, and Auditing Handbook (World Bank, 1995); (ii) the Bank's Operational Policy (OP) and Bank Procedure (BP) 10.02 dated July 1996; and (iii) the revised Bank financial management standards to comply with OP and BP 10.02, dated August 1997.

#### **Use of statements of expenditures (SOEs):**

IDA and the Borrower have agreed that if by project effectiveness MARENA and INIFOM have not implemented a PMR compliant system, but has in place a financial system that meets minimum IDA requirements, the traditional disbursement procedures will be used for the first two quarters of project implementation, in accordance with the guidelines set in the Disbursement Procedures Handbook. The assessment of the institutions' readiness for disbursements under SOEs or PMRs will be independently one of each other. The institutions for post-review and audit purposes will maintain SOEs documentation.

#### **Use of Project Management Reports (PMRs)**

By the end of the second quarter of project implementation, or earlier if the institutions are compliant and request transition to a full Project Management Report (PMR) system, the PMRs would serve as disbursement requests. Transition to PMR will be subject to the satisfactory results of new financial management and procurement assessments. Once the borrower becomes PMR compliant, disbursements would be in accordance with guidelines set in the Loan Administration Change Initiative (LACI) Implementation Handbook. Each institution would submit separate withdrawal applications, and would be supported by a PMR or such other documents and evidence as IDA may request. PMRs should be submitted within 45 days from the preceding quarter. Upon receipt of each application for withdrawal, IDA, on behalf of the Borrower, shall withdraw from the credit account and deposit into the Special Accounts an amount equal to the lesser: (a) the amount requested; and (b) the amount the IDA has determined, based on the PMR accompanying the application, is required to be deposited in order to finance eligible expenditures during the six month period following the date of the report, but in no case should exceed 20% of the total loan and grant funds, without prior authorization from the Loan department. MARENA and INIFOM would be responsible for preparing withdrawal applications and the related PMRs. All supporting documentation authenticating the expenditures reported in the PMRs would be maintained by MARENA, INIFOM, and the municipalities and made available for review by independent auditors and by the Bank supervision missions. Direct Payments and Special Commitments should be clearly identified in the PMRs, as applicable, shall include the documentation required for these types of payments.

**Special account:**

Two Separate Special Accounts in US Dollars will be established at a commercial bank in Nicaragua, provided that this (these) bank(s) meet World Bank requirements. MARENA and INIFOM would be responsible for submitting appropriate disbursement applications to request the transfer of funds to the Special Accounts. One special account for the component to be executed by MARENA, and one Special Account for the component to be executed by INIFOM. The authorized allocation(s) to the Special Accounts, for Non-PMR disbursements will be set at a level sufficient to cover approximately four months of estimated expenditures eligible for financing by the Bank, up to a maximum authorized allocation of US\$1.0m for MARENA, US\$2.5m for INIFOM.

**Disbursement Procedures**

Replenishments of funds will be made on evidence of satisfactory utilization of the previous advance(s) as evidenced by the documentation submitted in support of disbursement applications. Deposits into the Special Accounts and their replenishments, up to the Authorized Allocations will be made initially on the basis of Applications for Withdrawals (Form 1903) accompanied with the supporting and other documentation specified in the Disbursement Handbook. Withdrawal applications will be fully documented, except for expenditures under contracts costing less than US\$150,000 equivalent for goods, and US\$100,000 and US\$50,000 equivalent for consulting firms and individual consultants, respectively, in which cases disbursements would be made against certified statement of expenditures (SOEs).

Given the rural and disperse nature of the Municipalities receiving documentation on funds under the FAM and FONDEM funded activities, funds advanced to the municipalities may be outstanding for a period up to 90 days.

**Auditing Arrangements**

MARENA and INIFOM would contract external auditors, acceptable to the Association, to carry out an annual financial audit of the project, as required by OP/BP 10.02. The auditor will be selected according with the Bank's "Guidelines for the Selection and Employment of consultants by the World Bank Borrowers" dated January 1997, revised in September 1997 and January 1999. The auditors should be hired at project inception, to cover the whole period of project implementation, to perform three annual audits and one final audit at project closing. INIFOM would contract external auditors to carry out annual financial audits of the municipalities for the FAM and FONDEM funded activities. The project financial statements, the Special Accounts, SOEs (if applicable), the PMRs, and procurement procedures, central level and municipalities will be audited at the end of each fiscal year during project implementation. An audited report of the project financial statements, along with the audited financial statements of the municipalities, will be submitted to the Bank within 120 days of the close of the project's financial year. The "Guidelines and Terms of Reference for Audits of Projects with Financing by the World Bank in the Latin American and the Caribbean Region" should be followed by MARENA and INIFOM in preparing the terms of reference for the audit and these guidelines should be provided to the selected auditors. The audit terms of reference and short list of audit reports will be cleared by the Bank's Regional Financial Management Department (LCOAA).

**Annex 7: Project Processing Schedule**  
**NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**

<b>Project Schedule</b>	<b>Planned</b>	<b>Actual</b>
Time taken to prepare the project (months)	17	19
First Bank mission (identification)	10/20/99	01/20/2000
Appraisal mission departure	08/20/2000	10/15/2000
Negotiations	11/25/2000	01/22/2001
Planned Date of Effectiveness	03/01/2001	06/01/2001

**Prepared by:**

Nicaraguan Institute for Municipal Development (INIFOM) and Ministry of Natural Resources (MARENA)

**Preparation assistance:**

PHRD: TF025621 and TF026314

**Bank staff who worked on the project included:**

<b>Name</b>	<b>Speciality</b>
Maurizio Guadagni	Rural Development Specialist
Gabriela Boyer	Environmental Specialist
Leonardo Romeo	Institutional Expert
Valeria Pena	Social Scientist
Douglas Graham	Biodiversity specialist
Mark Austin	Project Management
Lisa Taber	Economist
Teresa Roncal	Procurement Analyst
Juan Pablo Ruiz	Decentralization of Environmental Financing
Hernando Garzon	Municipal Finance Specialist
David Kaimovitz	Natural Resources Management Specialist
Mariangeles Sabella	Country Lawyer
Luz Zeron	Financial Management Specialist
Francis Kenefick	Procurement Consultant
Radha Seshagiri	Research Associate
Vincent Abreu	Environmental Information Specialist

**Annex 8: Documents in the Project File\***  
**NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**

**A. Project Implementation Plan**

1. INIFOM. *Plan de Fortalecimiento Municipal*
2. MARENA. *Borrador del Plan de Implementacion Institucional*

**B. Bank Staff Assessments**

1. Pena, Valeria. Social Assessment
2. Roncal, Teresa, and Francis Kennefik. Procurement Assessment of INIFOM and MARENA

**C. Other**

1. Abreu, Vincent, 2000, *El Sistema Nacional de Información Ambiental de Nicaragua (SINIA): Evaluación Rápida*;
2. Boyer, Gabriela. Environmental Analysis;
3. Fernández, Milton; 2000, "*Informe Consultoría. Preparación de un Plan para la Elaboración de la Estrategia para adaptar las Operaciones del Segundo Proyecto de Municipalidades Rurales a las Necesidades Locales de la RAAS en Forma Participativa*;
4. Fernández, Milton; 2000, "*Informe de Análisis Documental. Evaluación Rápida. Capacidad Institucional de las Delegaciones Territoriales del Ministerio del Ambiente y los Recursos Naturales de la República de Nicaragua (MARENA)*", MARENA;
5. Garzon, Hernando. *Diseño del FONDEM*;
6. Gutierrez, Ivan, and Ivan Salinas. *Diseño del Fondo Ambiental Municipal*;
7. MARENA - DGCTOC; 2000, "*Evaluación Rápida. Capacidad Institucional de las Delegaciones Territoriales*";
8. MARENA. *Estrategia de MARENA para la descentralización de las funciones operativas de protección del medio ambiente y uso sostenible de los recursos naturales*. Borrador para discusión interna en la DGCT, Febrero, 1999;
9. MARENA. *Plan Operativo Anual Institucional 1999*, MARENA, Managua, Febrero de 1999;
10. *Ministerio de Hacienda y Crédito Público. Presupuesto General de la República 1995, 1996, 1997, 1998, 1999 y 2000*;
11. Parra, José. *Análisis Institucional de MARENA*;
12. Romeo, Leonardo. *Análisis Institucional del componente Desarrollo Municipal*;
13. Romeo, Leonardo. *El Sistema de Planificación Municipal*;
14. Roncal, teresa. *Project Costs Tables*.
15. Zeron, Luz. *Financial Management Assessment and Action Plan of INIFOM and MARENA*.

\*Including electronic files

**Annex 9: Statement of Loans and Credits**  
**NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT**  
20-Sep-2000

Project ID	FY	Purpose	Original Amount in US\$ Millions				Cancel.	Undisb.	Difference between expected and actual disbursements*	
			IBRD	IDA	SF	GEF			Orig	Frm Rev'd
P064915	2000	AG TECHN & RURAL EDU	0.00	23.63			0.00	23.27	0.65	0.00
P040197	1999	FISE III	0.00	45.00			0.00	18.50	-3.34	0.00
P052080	1999	FORESTRY	0.00	9.00			0.00	7.00	2.07	0.00
P035080	1995	INSTITUTIONAL DEV CR	0.00	23.00			0.00	0.20	0.24	0.00
P049296	2000	NI ECONOMIC MANAGEMENT TAC	0.00	20.90			0.00	19.23	-0.80	0.00
P007783	1995	NI/Basic Education Project	0.00	47.20			0.00	1.95	-8.76	5.26
P035753	1998	NI/HEALTH SECT II	0.00	24.00			0.00	17.41	4.13	0.00
P050613	2000	NI/SECOND BASIC EDUCATION PROJECT	0.00	52.50			0.00	41.42	-10.00	0.00
P056087	2000	Pension and Financial Market Reform TA	0.00	8.00			0.00	7.48	0.00	0.00
P007788	1996	ROADS REHAB & MAINT	0.00	25.00			0.00	0.03	1.60	0.00
P007790	1997	RURAL MUNICIPALITIES	0.00	30.00			0.00	2.25	-4.37	0.00
P055853	2000	TELECOMMUNIC. REFORM	0.00	15.90			0.00	10.30	3.40	0.00
P053705	1998	TRANSPORT II	0.00	47.40			0.00	25.36	-5.31	0.00
<b>Total:</b>			0.00	371.53			0.00	174.40	-20.49	5.26

**NICARAGUA**  
**STATEMENT OF IFC's**  
**Held and Disbursed Portfolio**  
20-Sep-2000  
In Millions US Dollars

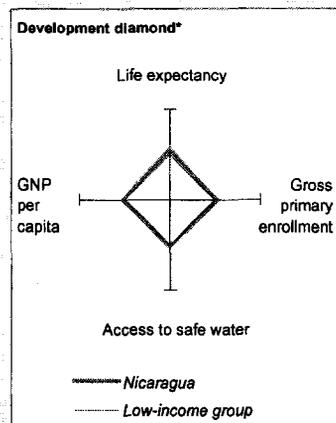
FY Approval	Company	Committed				Disbursed			
		IFC				IFC			
		Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
2000	Finarca	2.00	0.60	0.00	0.00	1.67	0.00	0.00	0.00
1998	Frutan	2.00	1.00	0.00	0.00	1.00	0.64	0.00	0.00
1998	La Colonia	4.00	0.00	0.50	0.00	2.00	0.00	0.50	0.00
1999	SEF Dicegsa	1.00	0.00	0.00	0.00	1.00	0.00	0.00	0.00
<b>Total Portfolio:</b>		9.00	1.60	0.50	0.00	5.67	0.64	0.50	0.00

FY Approval	Company	Approvals Pending Commitment			
		Loan	Equity	Quasi	Partic
<b>Total Pending Commitment:</b>		0.00	0.00	0.00	0.00

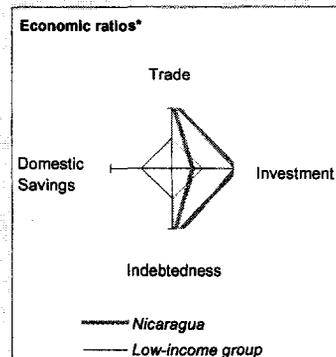
## Annex 10: Country at a Glance

### NICARAGUA: SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT

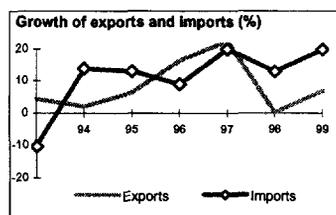
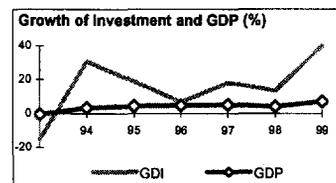
POVERTY and SOCIAL	Latin America & Carib.		
	Nicaragua	Latin America & Carib.	Low-income
<b>1999:</b>			
Population, mid-year (millions)	4.9	509	2,417
GNP per capita (Atlas method, US\$)	430	3,840	410
GNP (Atlas method, US\$ billions)	2.1	1,955	988
<b>Average annual growth, 1993-99</b>			
Population (%)	2.7	1.6	1.9
Labor force (%)	4.0	2.5	2.3
<b>Most recent estimate (latest year available, 1993-99)</b>			
Poverty (% of population below national poverty line)	48	..	..
Urban population (% of total population)	56	75	31
Life expectancy at birth (years)	66	70	60
Infant mortality (per 1,000 live births)	40	31	77
Child malnutrition (% of children under 5)	20	8	43
Access to improved water source (% of population)	67	75	64
Illiteracy (% of population age 15+)	20	12	39
Gross primary enrollment (% of school-age population)	101	113	96
Male	100	..	102
Female	102	..	86



KEY ECONOMIC RATIOS and LONG-TERM TRENDS	1979				1989				1998				1999			
	1979-89	1989-99	1998	1999	1979-89	1989-99	1998	1999	1979-89	1989-99	1998	1999	1979-89	1989-99	1998	1999
GDP (US\$ billions)	1.6	1.0	2.1	2.3	1.6	1.0	2.1	2.3	1.6	1.0	2.1	2.3	1.6	1.0	2.1	2.3
Gross domestic investment/GDP	-5.7	27.5	33.4	42.4	-5.7	27.5	33.4	42.4	-5.7	27.5	33.4	42.4	-5.7	27.5	33.4	42.4
Exports of goods and services/GDP	42.0	32.5	35.8	33.6	42.0	32.5	35.8	33.6	42.0	32.5	35.8	33.6	42.0	32.5	35.8	33.6
Gross domestic savings/GDP	8.2	-5.2	-8.6	-12.6	8.2	-5.2	-8.6	-12.6	8.2	-5.2	-8.6	-12.6	8.2	-5.2	-8.6	-12.6
Gross national savings/GDP	-0.9	-26.1	-5.7	-7.2	-0.9	-26.1	-5.7	-7.2	-0.9	-26.1	-5.7	-7.2	-0.9	-26.1	-5.7	-7.2
Current account balance/GDP	2.5	-53.2	-29.4	-36.9	2.5	-53.2	-29.4	-36.9	2.5	-53.2	-29.4	-36.9	2.5	-53.2	-29.4	-36.9
Interest payments/GDP	2.3	0.2	4.0	5.2	2.3	0.2	4.0	5.2	2.3	0.2	4.0	5.2	2.3	0.2	4.0	5.2
Total debt/GDP	97.8	952.5	280.7	281.0	97.8	952.5	280.7	281.0	97.8	952.5	280.7	281.0	97.8	952.5	280.7	281.0
Total debt service/exports	8.9	3.3	23.2	27.6	8.9	3.3	23.2	27.6	8.9	3.3	23.2	27.6	8.9	3.3	23.2	27.6
Present value of debt/GDP	..	..	246.4	..	..	..	246.4	..	..	..	246.4	..	..	..	246.4	..
Present value of debt/exports	..	..	484.1	..	..	..	484.1	..	..	..	484.1	..	..	..	484.1	..
<b>(average annual growth)</b>																
GDP	-1.0	2.8	4.1	7.0	-1.0	2.8	4.1	7.0	-1.0	2.8	4.1	7.0	-1.0	2.8	4.1	7.0
GNP per capita	-4.4	2.2	6.4	4.6	-4.4	2.2	6.4	4.6	-4.4	2.2	6.4	4.6	-4.4	2.2	6.4	4.6
Exports of goods and services	-7.4	7.9	0.2	6.7	-7.4	7.9	0.2	6.7	-7.4	7.9	0.2	6.7	-7.4	7.9	0.2	6.7



STRUCTURE of the ECONOMY	1979				1989				1998				1999			
	1979-89	1989-99	1998	1999	1979-89	1989-99	1998	1999	1979-89	1989-99	1998	1999	1979-89	1989-99	1998	1999
<b>(% of GDP)</b>																
Agriculture	28.3	32.0	33.0	31.6	28.3	32.0	33.0	31.6	28.3	32.0	33.0	31.6	28.3	32.0	33.0	31.6
Industry	28.6	22.3	21.6	22.8	28.6	22.3	21.6	22.8	28.6	22.3	21.6	22.8	28.6	22.3	21.6	22.8
Manufacturing	24.6	17.6	15.1	14.4	24.6	17.6	15.1	14.4	24.6	17.6	15.1	14.4	24.6	17.6	15.1	14.4
Services	43.1	45.7	45.4	45.7	43.1	45.7	45.4	45.7	43.1	45.7	45.4	45.7	43.1	45.7	45.4	45.7
Private consumption	74.0	78.5	92.4	94.4	74.0	78.5	92.4	94.4	74.0	78.5	92.4	94.4	74.0	78.5	92.4	94.4
General government consumption	17.9	26.7	16.3	18.2	17.9	26.7	16.3	18.2	17.9	26.7	16.3	18.2	17.9	26.7	16.3	18.2
Imports of goods and services	28.1	65.2	77.9	88.7	28.1	65.2	77.9	88.7	28.1	65.2	77.9	88.7	28.1	65.2	77.9	88.7
<b>(average annual growth)</b>																
Agriculture	-2.6	4.7	3.5	4.8	-2.6	4.7	3.5	4.8	-2.6	4.7	3.5	4.8	-2.6	4.7	3.5	4.8
Industry	-0.7	3.4	5.1	12.6	-0.7	3.4	5.1	12.6	-0.7	3.4	5.1	12.6	-0.7	3.4	5.1	12.6
Manufacturing	-1.4	1.4	2.1	3.3	-1.4	1.4	2.1	3.3	-1.4	1.4	2.1	3.3	-1.4	1.4	2.1	3.3
Services	-0.4	1.3	3.7	4.5	-0.4	1.3	3.7	4.5	-0.4	1.3	3.7	4.5	-0.4	1.3	3.7	4.5
Private consumption	-3.5	4.5	10.4	5.6	-3.5	4.5	10.4	5.6	-3.5	4.5	10.4	5.6	-3.5	4.5	10.4	5.6
General government consumption	7.3	-3.0	0.1	9.6	7.3	-3.0	0.1	9.6	7.3	-3.0	0.1	9.6	7.3	-3.0	0.1	9.6
Gross domestic investment	-3.0	10.0	13.5	39.8	-3.0	10.0	13.5	39.8	-3.0	10.0	13.5	39.8	-3.0	10.0	13.5	39.8
Imports of goods and services	-0.6	9.0	12.9	19.8	-0.6	9.0	12.9	19.8	-0.6	9.0	12.9	19.8	-0.6	9.0	12.9	19.8
Gross national product	-1.6	5.1	9.3	7.3	-1.6	5.1	9.3	7.3	-1.6	5.1	9.3	7.3	-1.6	5.1	9.3	7.3

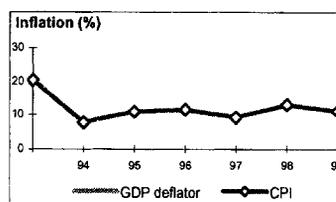


Note: 1999 data are preliminary estimates.

\* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

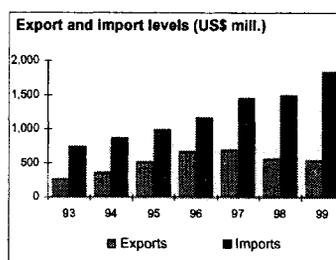
## PRICES and GOVERNMENT FINANCE

	1979	1989	1998	1999
<b>Domestic prices</b> (% change)				
Consumer prices	48.1	4,709.3	13.0	11.2
Implicit GDP deflator	31.7	4,709.3	13.0	11.2
<b>Government finance</b> (% of GDP, includes current grants)				
Current revenue	..	..	26.2	25.1
Current budget balance	..	..	5.0	5.4
Overall surplus/deficit	..	..	-4.8	-11.7



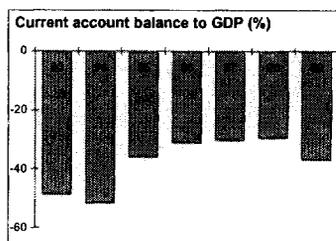
## TRADE

	1979	1989	1998	1999
<i>(US\$ millions)</i>				
Total exports (fob)	567	311	573	544
Coffee	159	90	173	135
Shrimp and lobster	22	11	79	86
Manufactures	118	48	125	109
Total imports (cif)	360	615	1,492	1,846
Food	78	90	357	441
Fuel and energy	76	94	144	161
Capital goods	46	200	452	597
Export price index (1995=100)	65	78	90	83
Import price index (1995=100)	56	81	112	109
Terms of trade (1995=100)	116	97	81	76



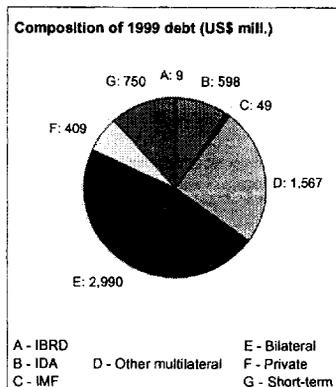
## BALANCE of PAYMENTS

	1979	1989	1998	1999
<i>(US\$ millions)</i>				
Exports of goods and services	623	333	830	839
Imports of goods and services	511	667	1,517	1,800
Resource balance	112	-334	-687	-961
Net income	-73	-205	-170	-176
Net current transfers	0	0	232	300
Current account balance	39	-539	-626	-837
Financing items (net)	-42	471	620	955
Changes in net reserves	3	68	6	-118
<b>Memo:</b>				
Reserves including gold (US\$ millions)	156	164	357	510
Conversion rate (DEC, local/US\$)	1.85E-9	3.02E-3	10.6	11.8



## EXTERNAL DEBT and RESOURCE FLOWS

	1979	1989	1998	1999
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	1,533	9,651	5,968	6,372
IBRD	85	221	15	9
IDA	23	60	487	598
Total debt service	56	11	251	321
IBRD	8	0	11	7
IDA	0	0	4	5
Composition of net resource flows				
Official grants	45	173	345	310
Official creditors	99	570	187	135
Private creditors	-5	11	-13	18
Foreign direct investment	3	0	184	143
Portfolio equity	0	0	0	0
World Bank program				
Commitments	0	0	238	91
Disbursements	8	0	105	120
Principal repayments	4	0	10	7
Net flows	5	0	95	114
Interest payments	5	0	5	5
Net transfers	0	0	90	108



**Additional  
Annex 11**

**Summary of Social Assessment**

**Key Findings and Recommendations**

**Background**

1. Poverty. Comparing the 1993 and the 1998 Living Standard Measurement Survey (LSMS) results, the Poverty Assessment shows that poverty and extreme poverty remain overwhelmingly rural. The rural population represents 46 percent of the national population; about 69 percent of this population was living in poverty in 1998, compared to 31 percent of the urban population. Not only there were more poor in rural areas, but the depth of their poverty was greater. In general, the rural poor are almost three times further from the poverty line than the urban poor. Comparing the two LSMS, coverage of basic services has generally increased, with gains in schooling, and health care. Nevertheless, large gaps in access remain, with the rural population clearly lagging behind the urban.
2. Municipalities plays an important role improving the quality of life of residents, helping to close the gap with urban areas, and promoting a more inclusive pattern of development. However, the prevalence of several and often non compatible legislation defining this role has made accountability, responsiveness, and responsibility leaves important issues still pending.

**Social Assessment Rationale**

3. Objective. The objective of this social assessment is to ensure that the proposed project contribute to poverty alleviation and at the same time strengthen social cohesion and reduce potential adverse social impact.
4. Organization of the social assessment. The social assessment has been structured in two phases. The first phase was based on a desk review of quantitative beneficiary surveys, analysis of qualitative information, and reports of participatory consultation carried out with direct and indirect beneficiaries and institutional stakeholders. The second phase shall be based on a base line study to be conducted as a condition of effectiveness, with residents in the area of influence of the new project. This annex summarizes key results from the desk review and includes the main features of the base line.
5. First phase. During the implementation of the ongoing Rural Municipalities Project, several analysis were prepared to evaluate project results in reaching the poor as well as the strengthening of the institutional capacity of municipalities. These analyses are useful for two reasons: *first*, since 32 of the 40 municipalities proposed under the new project are covered under the ongoing project, it provides information about a large sub-set of the potential population of the proposed project; *second*, and more important, they demonstrate the potential capacity of municipal governments to create a socially inclusive decision-making processes reducing social conflicts.
6. This assessment is also based on a recent base-line study conducted by the Central American University (CASC/UCA) for the Municipal Development Project (PRODEMU/DANIDA) in twenty six municipalities in the region of Las Segovias (Ortega Hegg, et al., 1999. *Estudio de Línea de Base de 26 Municipios de Las Segovias*. Centro de Análisis Cultural/DANIDA). Although this region would not be covered by the proposed project, the study provides a relevant analysis on the role of municipal governments. Results are based on twenty six surveys, including 950 variables and on 130 semi-structured interviews with mayors and staff of municipal governments. Its aim is to understand participatory and democratic aspects of local decision making, and the role local governments play in promoting local development.
7. Second phase: base-line. The base-line for the second phase of the social assessment shall support the monitoring and evaluation system of the proposed project. It would help provide quantitative dimensions of outcomes and outputs such as improved governance and better well being of the poor.

The base line shall have the following characteristics:

*Sample.* The sample shall be selected in two stages. First, it shall be based on a random selection of municipalities, stratified by population size, governing political party, newly incorporated by the new project or already incorporated by the ongoing project and being or not head of a department (*cabecera departamental*). The second stage shall be a random selection of households within the selected municipalities.

*Household Interviews.* In single headed households, the head shall be the one providing the information to the survey. In half of the sampled conjugal households, the female co-head shall answer the questionnaire and in the other half, the male co-head shall answer the questionnaire.

#### **Key finding from the ongoing project**

8. Two beneficiary Assessments were conducted in 1998 and 1999 to evaluate the INIFOM implemented rural municipalities development component. The following are the key results on the social impact of the project:

There is evidence that the project strengthened municipal governments:

- (i) Municipalities are better equipped. They have improved transportation routes which facilitates access to remote communities. Some also have access to the internet: a significant achievement considering that before the project a few of them did not have even a telephone connection;
- (ii) staff is more professional and trained on both technical and administrative aspects;
- (iii) cost-effectiveness and economic analyses demonstrate the contribution of the project in terms of reducing poverty and improving public services, particularly in the aftermath of Hurricane Mitch;
- (iv) by increasing local revenue generation of municipalities, the project increased their financial sustainability and also stimulated the relationship between municipal government and taxpayers;
- (v) the participatory planning supported by the project fostered the culture of consultation between municipal governments and rural communities
- (vi) *formal* links between local governments and communities were enhanced. The 1999 survey of 1,200 rural dwellers living in the 32 municipalities covered by the project demonstrated that 76 percent of those who benefited were informed about the project through formal *asambleas comarcales*, whereas only 23 percent were informed through informal conversation. The role of the local media or even religious organizations in disseminating information related to the project was statistically irrelevant.
- (vii) Participation is a self-reinforcing mechanism. Those who participated in one instance have a tendency to participate in another instances. Indeed, one third of the direct beneficiaries of the ongoing project, participates also in other groups or associations.

Although working with municipal governments yields several benefits, there are also some risks. The most recognizable risk is political partiality. The municipal participatory planning supported by the ongoing project was successful in reducing this risk. The survey of 1,200 rural dwellers living in the 32 municipalities covered by the project examined the *perception* of political partiality. Only 5.2 percent of households have the perception that the project is primarily benefiting the "political friends of the mayor", while 42.2 percent believe that it is benefiting the whole community. Predictably, direct beneficiaries have a more positive view than indirect beneficiaries (see nest table for details).

**Answers to the question "Who Does Protierra Benefit?"**

	<i>Respondents (percent)</i>		
	<i>Direct beneficiaries</i>	<i>Indirect beneficiaries</i>	<i>Total</i>
The whole community	40.9	43.8	42.2
The richest	9.3	11.7	10.5
The poorest	41.9	23.1	32.1
Political friends of the mayor	1.9	8.3	5.2
Other and no answer	6.0	13.1	10.0

*Source: September 1999 Survey*

**Key findings for Las Segovias**

9. The study conducted by the Central American University (CASC/UCA) for the Municipal Development Project (PRODEMU/DANIDA) has shown important results about municipalities which can be useful for the proposed project. Among them:

Participation. Attitude regarding participation is ambiguous. Although 96 percent of the surveyed agree that participation is the only way to solve problems, more than 50 percent consider participation not viable in Nicaragua. Accordingly, about two thirds of those interviewed evaluate that the mayor is the sole decision maker, often disregarding the role of municipal councils.

Municipal councils. Ninety six percent of the interviewed have a positive evaluation of the potential role of the municipal council, particularly as an instrument for *conflict negotiations*. However, less than half of them have agreed on how to organize the relationship between the council and the mayor.

Fatalism. Organizational and governmental leaders display a religious and traditional vision about the world, in which destiny and God takes a large share of responsibilities: 71 percent of those interviewed believe that God governs the world, 77 percent that socioeconomic differences are natural and thus inevitable and that to plan the future is worthless because at the end God's will prevails. Surprisingly, when the sample is desegregated between civil and governmental leaders, the latter show slight but consistent greater adherence to traditional thinking than the former. More than civil leaders, governmental leaders believe that God governs world affairs (75 percent in contrast with 60 percent); that socioeconomic differences are natural (80 percent in contrast with 68 percent); and that planning is a futile exercise because the future belongs to God (71 percent in contrast with 63 percent). Accordingly, civil leaders are slightly more open to participatory decision making than governmental leaders; they are also slightly more critical of municipal governments. Less often than governmental leaders (41 percent), civil leaders (26 percent) consider civil organizations and associations as trouble makers because of their strong allegiance to a political party. Less often than governmental leaders (69 percent), civil leaders (only 20 percent) consider that municipal decision making is independent from institutions that represent the rich.

**Key Findings from the Nicaragua - Qualitative Poverty and Exclusion Study (2000)**

10. Although this study covers the entire country and its findings do not necessarily refer to the proposed project area, they are useful to better understand the poor. The poor see poverty as natural, or at least, there is nothing much that can be done against the fate of being poor. One of them declared that "the power of the rich has been transmitted through generations, and so has deprivation: We have been poor for generations." For the population, governmental institutions do not work for the poor and in general they question how financial resources are managed. They also question decision-making process which they consider biased with regard to the selection beneficiaries of basic services, and inefficient with regard to the allocation of physical and human assets to make effective basic services.

11. For the poor, to be poor is to live under high levels of ill being (*es estar mal*). One of characteristics of ill being is to be excluded, to be left apart. Being excluded means to be affected by unemployment and economic crisis, but it also means to be affected by precarious social services. Access to services is also felt as empowerment, a right that has been recognized and can be shown with pride.

12. For the poor, the existence of a variety of organizations and networks does not mean that they function as social capital. There is awareness that participation in social networks secure benefits and sometimes with cynicism this is translated as "*it is not what you know, it is whom you know*" that matters. Not often are they aware that networking might function as social capital by reducing transaction costs; on the contrary, they are fearsome that it might increase their degree of indebtedness.

### **Recommendations**

13. The social assessment validates the project design in its proposal to focus on increasing governance capacity at the municipal level. It also validates: (a) the importance of using a participatory decision-making process on how to plan municipal investments and activities; (b) the importance of increasing participation in budgeting; and (c) having a participatory planning system as a requirement for accessing both FAm and FONDEM. Other specific recommendations:

- (a) To achieve sustainability of the whole system of government, it is necessary to develop institutions at all levels, community, municipal, regional and national.
- (b) Because of decentralized implementation, monitoring needs to include indicators that reflect changes and impacts at the municipal level. The innovative feature of the project demands strong accountability in this area.
- (c) Local participation is not sufficient to guarantee more accountable governments but it is an essential part of good governance. The project should assist municipalities in this regard since this is a new practice in the country.
- (d) Because municipalities are very diverse, the project should be flexible to promote incentives and mechanism to different types of municipalities.
- (e) The project should continue to work in the three municipalities of the RAAS which are covered under the ongoing project: El Rama, Muelles de los Bueyes and Nueva Guinea. These three municipalities do not share some important characteristics of the Atlantic Region, and indeed they are *de facto* part of a department called Zelaya Central, whose official recognition is underway.
- (f) The expansion to the remaining eight municipalities in the RAAS is not advisable because these municipalities are already covered by a recently approved project financed by IDB and implemented by FISE. The project has a considerable financing for development of regional and municipal governments (total project cost is US\$11 million, with US\$8.5 million of IDB Credit). Thus INIFOM and MARENA should look for opportunities to collaborate with FISE in the Atlantic Region, rather than risking overlapping with it.
- (g) Given that the proposed project area covers the municipality of Leon, where the Sutiavas indigenous people are located, the following attachment describes findings and recommendations for project action in this specific municipality.

#### **Attachment 1 to Annex 11: Sutiavas Indigenous People**

Background. The Sutiava indigenous group live in the municipality of León, located in Pacific region of Nicaragua approximately 90 kilometers from Managua, in an area covered by the proposed project. Before the Spanish domination, the Sutiavas were a people belonging to the sociocultural sphere of the Maribios, speaking Taplaneca- Yopi, a language original of the Guerrero state in Mexico Idiáquez, (Marco Membreno, 1998. *La estructura de las Comunidades Étnicas Managua*). During the Spanish period, the Sutiava community received from the Crown, as their land, an area comprised of all the municipality of Leon, in addition to Quezalguaque and Telica, in the same department, and Chichigalpa, in the department of Chinandega, approximately 537 square kilometers. Since 1902, the group settled in an urban neighborhood of the city of Leon. However, the Sutiavas occupy a heterogeneous territory that is bigger than that neighborhood, living in some middle class residential area but also in *asentamientos* without service infrastructure (some created as a consequence of Mitch Hurricane) and in some rural

areas of the municipality of Leon.

The number of the Sutiava population is uncertain because the definition of who is Sutiava is unclear. In fact, the majority lives in an urban area and speaks only Spanish. As a result, most residents of the Sutiavas neighborhood share the same cultural values and identity and are considered by the Sutiavas and by themselves as Sutiavas, even though they do not share the same ethnic background. This has made their number vary from 35,000 to 53,000, with 71 percent urban and 29 percent rural.

In general, the urban population is well covered by the school system, with some attending private Sutiava schools. However, in the 40 rural communities where they live, only one has primary and secondary school. For instance, in Los Barzones and in Trohilo, about 35 percent of children do not attend schools. In twelve communities, comprising 700 children, there is only one preschool, maintained by the communities themselves. In eleven communities there is no school at all. Although this situation is common to most rural communities, the Sutiavas are deeply critical for the lack of quality of multi-grade classrooms and teaching. The same trend prevails regarding access to health services. The urban Sutiavas have reasonable access to them - there is a Medical School located in Leon - and in the Surtiava community in Leon there is a health center with three physicians, one nurse and two *para medicos*. However, in rural areas, the Sutiavas have access only to one health center located in PoneLOYA, with two physicians, one in Trohilo, one in Abagasca central, and one in La Gallina, with one physician each. The rest of the communities depends on sporadic visits from the Ministry of Health personnel and from the efforts of their own traditional medicine.

Organization. According to an indigenous interviewed for the social assessment, "*en realidad, una forma de gobierno no tenemos; pero si tenemos una rebeldía para enfrentar que nosotros creemos estar mal*" (in fact, we do not have a format of govern. What we have is a rebellious way to challenge what we believe is wrong). Three organizations are crucial to understand how they are organized: the *Consejo de Ancianos*, the *Junta Directiva* and the *Fundación Xochil Acatl*, usually managed by women. Each two years, the community vote for the *Junta Directiva*. The vote is universal and secret and extended to all adult Sutiavas and all those who live in the community but might not belong to the same ethnic group. In general, the Junta act as a neighborhood association.

Relation with the municipality of Leon. The Sutiavas describes as good their relationship with the municipal government, stressing that their rights are not entirely disregarded - on the contrary, there is an attitude of respect towards them, with one municipal counsel being himself a Sutiava. However, they do not feel they participate in any aspect of municipal decision making processes and do not feel the municipality is particularly responsive to their specific demands. There is no formal mechanism to assure their participation which, when it comes, is occasional and unstructured. Moreover, there is a feeling they are consulted only when the solution is obvious and easy, or when their labor is needed, rather than for more complex questions, that have more impacts.

Relation with the ongoing project. According to the views manifested by members of *Junta Directiva*, their perception is that the project do not sufficiently understand community needs. They oppose one subproject (the electrification of the *Comarca Trohilo*, which they found not providing electricity for most) and they favor another subproject (the rehabilitation of the *Puente Capulín -Trohilo* project). Both projects were visited during the beneficiary assessments and improvements in terms of communication and ownership were discussed with local authorities. In part, the problems mentioned by the Sutiavas, which are real, had taken to the new design of the proposed project.

Demands. The Sutiavas ask to be recognized in their specificity by the municipal decision making processes. However, to be met, this demand needs to be accompanied by investments in their community. Investments are needed for both physical infrastructure and capacity building to articulate priorities. Other Sutiava demands do not differ from those of other poor: (a) access to financial services; (b) technical assistance for productive activities, from producing to marketing; (c) maintenance of roads; (d) health centers located at a close distance; and (d) an education system to improve quality in multi-grade classrooms.

Environment. Two attitudes prevail regarding the environment. First, among urban Sutiavas the attitude very often takes to environment degradation: this resource belongs to everyone and to nobody and thus it belongs to oneself; to use it one does not need permission. Among the rural indigenous who still can cultivate the land, conservation is a priority that they know how to care for; among the landless and new fisherman, the attitude tends to be similar to those living in towns, pragmatic but shortsighted. The perception of the Sutiavas is that they do not know about the existence of environmental regulations, and they consider it important to receive information as well as capacity building.

### **Recommendations**

The social assessment based on numerous participatory evaluations carried out with municipal governments and beneficiaries of the ongoing project since 1995 validates the project design in its proposal to focus on increasing governance capacity at the municipal level. It also validates: (a) the importance of using the decision making process on how to allocate fiscal transfers as training on good governance; (b) the importance of moving to participatory budgeting from participatory programming; and (c) the importance of having public involvement as a requirement for accessing the municipal fund. Specifically:

The ongoing project has shown that to request participation in the allocation of funds may become a formal procedure that does not guarantee ownership of the project and participation for the Sutiavas. The FAM and FONDEM operational manuals would include specific guidelines to assure the participation of Sutiava indigenous group representatives in the planning, programming, budgeting and monitoring of FAM and FONDEM. Special funds would be provided for their capacity building, training and small community equipment. The monitoring and evaluation system would include the following indicators: (i) improved evaluation of the proposed project when compared to the ongoing project; (ii) defined rules on decision making processes under FAM and FONDEM; and (iii) sponsor training workshop on community management.

**Additional  
Annex 12**

**Summary of Environmental Analysis and Mitigation Plan**

The Municipal Environmental Facility under the proposed project is designed as a vehicle for local governments to improve their environmental capacity. Through the municipal participatory process promoted by the local government, these projects would be included in the municipal development plan and municipal investment plan (Spanish acronym PIM). In essence, the local government would be responsible for overall approval of the projects in the PIM even if implementation is maybe carried out through different mechanisms -- direct implementation, contracting, and delegation.

The project would ensure proper environmental screening of subprojects and enforcement measures, to prevent certain types of infrastructure subprojects from producing negative effects on the environment. The MARENA Operational Manual would specify key environmental criteria and screening and enforcement procedures to be followed.

Sub-project categories to be financed through a decentralized financing facility (Municipal Development Fund, FONDEM) and a municipal environmental facility (FAM) may pose environmental risks. Based on specific criteria for different subproject types, each subproject proposal presented by the community associations would include a simple environmental assessment in the form of a "checklist", following a standard format. For standard subproject types environmental screening at the subproject approval stage would be the responsibility of the municipal government. The criteria used for decision making would be a short environmental review, an assessment instrument in which investments are likely to have minimal impacts but should be reviewed with a simple and standardized checklist. The review process would follow similar procedures that are already required by General Division of Environmental Quality of MARENA and are currently followed by municipalities. Sub-projects would fall under two categories, depending on their impact. Category 1 would not require a special study; and Category 2 would require an environmental review which would be designed by a municipal employee with the assistance of MARENA Regional Delegates when appropriate. Category 3 which would require a detailed environmental impact assessment would not be allowed to receive financing under the FONDEM or FAM

Under the ongoing Rural Municipalities Project the environmental review of subprojects is carried out by the Municipal Technical Unit (MTU) for all projects and by the MTU and MARENA for projects greater than US\$50,000. At the municipal-level technical unit staff review preliminary proposals against predetermined inclusion and exclusion criteria and ascertain the proposal's coherence, and are checked against municipal environmental and land use plans. Those that pass this stage are required to complete a simple form which describes project activities, geographic location of each activity and the presence of sensitive areas (rivers, protected areas, forests, etc) and how subproject interventions would be maintained following subproject completion.

Prior to the project's mid-term evaluation, the project followed the procedures to meet requirements. MARENA delegates often signed off on projects without careful review or analysis; the MTU often lacked the technical expertise to prepare a thorough assessment. In addition, Environmental and Land Use Plans were not operational. To address this problem, an environmental specialist was assigned per department of coverage area to assist the MTU and coordinate with the appropriate MARENA delegations. The presence of an environmental specialist at the municipal level improved consideration of mitigation measures in environmentally risky projects (infrastructure, for the most part) and increased demand for environmental projects. Local environmental priorities were included in the Municipal Development Plans.

The Second Rural Municipal Development Project would involve a similar review process with the exception that environmental expertise at the municipal level would be present from the beginning. In addition, MARENA delegates would be supported financially by municipal funds (via the Second Rural

Municipal Development Project) to assist with screening of subprojects financed by FONDEM and FAM. (See Annex 2: **Project Description**).

### Targeting

Subprojects would surge from grassroots or institutional (Municipal Environmental Commissions, or Municipal Civic Committee) demands specific to the environmental problems of a target municipality. The Commissions ensure that subprojects match the environmental priorities firmned by the municipality in its Municipal Investment Plan and recommend to the Mayor's Office and Municipality Council to consider them as eligible for the FAM. Screening for FONDEM-financed projects would follow the screening process followed under the on-going project.

### Promotion

Under the FONDEM, environmental issues would be taken into account by applying screening procedures, raising awareness through technical staff in the municipal government, training and capacity building, local MARENA delegates, NGOs and other organizations, and through the FAM itself.

### Project Formulation, Appraisal, and Approval

Project formulation may be undertaken at the municipal level including but not limited to local NGOs, the Municipal Environmental Commission, the private sector, a local community group or a trade union. Details and requirements for implementation of subprojects at the municipal level would be outlined in the MARENA's Operational Manual. A typology of projects that may be financed by both FAM and FONDEM, is available in Attachment 2 of Annex 2.

A thorough formulation process ensures that these proposals meet all eligibility and application criteria and would be ready for appraisal. Negative and positive environmental impacts for the subprojects financed by both funds are identified, and alternative sites and/or designs and mitigation measures introduced. The analysis would be included and form the criteria of the project proposal. At this point, as standard practice, and abiding by Nicaraguan environmental regulations, MARENA Delegates at the regional level would be assigned funds by MARENA (via the proposed Second Rural Development Project) to undertake initial environmental reviews or limited EA.

### Table 1. Types of Environmental Analysis Required by MARENA

The MARENA and INIFOM Operational Manuals will include a checklist to classify subprojects into two categories. There will be no projects financed by the FONDEM or FAM that fall under Category III (environmental impact assessment) and will require and environmental impact assessment.

<b>Category of Environmental Impact A</b> detailed checklist of decision making criteria on environmental categorization will be provided in the MARENA operational manual.	<b>EA Response</b>	<b>Requirement</b>
<b>Category : I</b> No impact.	-----	Review by Technical Environmental Unit
<b>Category: II</b> Subprojects that may create a few minor and easily recognizable environmental problems. Subprojects with minor environmental problems that require site visits to include construction modification to minimize or eliminate impact.	Environmental Review; Limited Environmental	Review by Technical Environmental Unit; MARENA.
<b>Category: III</b> Subprojects that may have irreversible impacts	Environmental Impact Assessment	Not financeable under the FONDEM or FAM

The CAM would make recommendations on subproject approval, rejection, or adjustments based on prescribed eligibility criteria, and consult with all the relevant parties, including regional MARENA delegates and appropriate technical units in MARENA. The Municipal Council and the official technical advisory board of the FAM thereafter would have final authority to approve the subprojects. The subprojects would have to be reflected both in the Municipal Development Plans and in the Municipal Investment Plans. See *Graphic 1 for proposed project cycle.*

The final approval for financing and disbursing would come from the Municipal Environmental Fund Accounts committee set up at the national level. (See Section 4.2 Project Management.)

**Project Implementation/Supervision:**

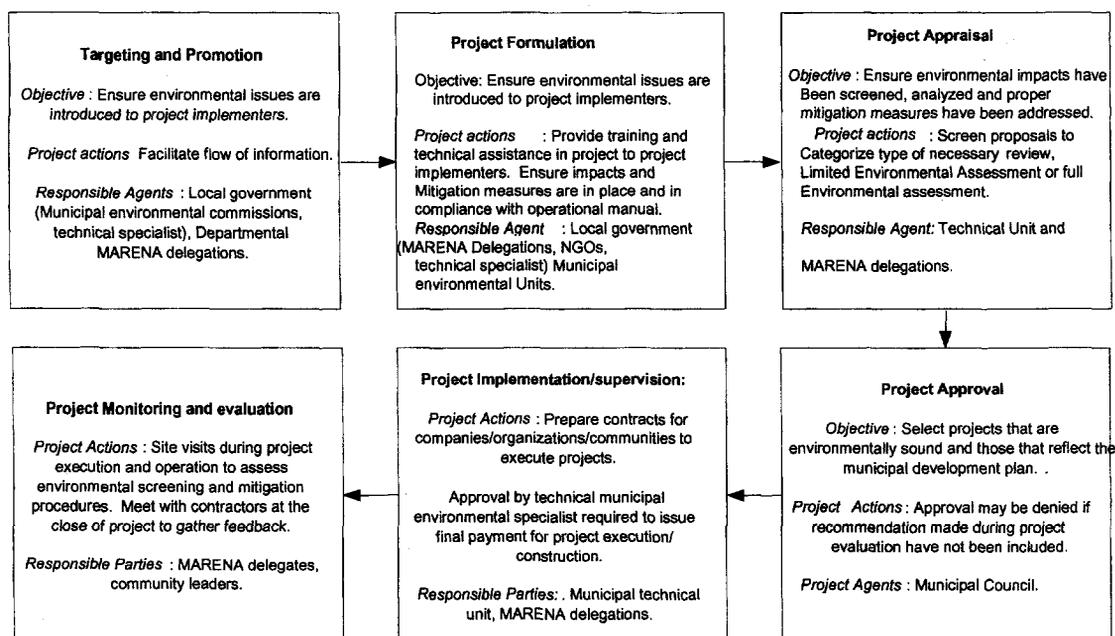
Administrative procedures are required for management review, procurement, disbursement, contracting and allocation of funds as per the legal contract signed between the municipal government and the implementing agency. Also included in the legal contract would be the results of the EA, covering mitigation measures, design specifications and supervision requirements.

**Final Steps: Evaluation and Exchange of Information with other Municipalities**

Project evaluation would assure that the implementing party met contractual obligations and that it carried out appropriate financial management. Evaluation would begin prior to project completion with a series of field visits to assess implementation progress. At the point of project completion, regional MARENA delegates would assist in the evaluation and on a random basis some impartial evaluations by outside consultants would be carried out. At this point, the knowledge base would remain at both the regional and municipal level. Success stories may be promoted regionally or nationally.

**Figure 1. Environmental Assessment Process of a municipal sub-project**

Adapted from "Environmental Guidelines for Social Funds," by Graham, et al., December 1998, The World Bank.



The MARENA Operational Manual, which would refer specifically to already established Nicaraguan environmental procedures, would include more detailed tables and examples of possible subprojects, their likely impacts, mitigation measures and proper environmental review response.

**Additional  
Annex 13**

**Evaluation and Policy Development**

Monitoring activities carried in several municipalities scattered in a large and difficult to access territory has been challenging in the ongoing project. In addition the types of municipal investments, or subprojects, span to all sectors (see annex 2 on FONDEM and FAM types of investments): from the more traditional social infrastructure, to transport infrastructure, water supply and sanitation, electrification, environmental management, and local economic development. However, the experience demonstrated that with the right incentives it is feasible to collect information on these kind of investments. INIFOM already has access to a substantial amount of data. However, the challenge is twofold: (i) develop the capacity to analyze available information, and generating technical evaluations of municipal performances; and (ii) translate these evaluations into policy development. Until recently, most evaluations of municipal efficiency were based on anecdotal evidences. Recently, the Evaluation of Effects and Potential Sustainability of the ongoing project (Latin America and Caribbean Region Sustainable Development Working Paper No. 11, December 2000) provided a significant analysis of evidence based on a statistically representative sample.

Because of the difficulty of the task to develop the data provided by the monitoring system into technical evaluations which could produce a policy discussion, it was decided to separate monitoring from evaluation, and assign the latter to a different institution. On the basis of this, the Sectoral Commission for Decentralization (*Comisión Sectorial para la Descentralización*, CSD) would be responsible to implement the sub-component 1(d): Evaluation and Policy Development. INIFOM, MARENA and the municipalities would remain responsible for monitoring, while the responsibility for evaluation and dissemination of evaluation results would be transferred to the CSD. In addition to reduce the burden of this additional task from INIFOM and MARENA, the independence of CSD would increase the credibility of the evaluations and therefore the possibility for constructive, policy development.

**Evaluation**

The mission of the CSD is to promote the establishment of the conditions and the normative-institutional context that make possible the development of the decentralization process in Nicaragua (Act No. 13; CDS, 9/10/98). The objective of CSD is to design, to propose and to promote plans and programs that guarantee a fiscal, administrative and organized functional process, in regards to the deconcentration and decentralization of activities and services towards the municipal governments (Decree 44-94). This Commission is presided over by the President of INIFOM and the Ministers of Education, Health, Transport and Infrastructure, Environment and Natural Resources, and the Executive Presidents of the FISE, the Rural Development Institute (IDR), and the Technical Secretary of the Presidency or its respective delegates (Decree no. 102-2000).

The CSD would carry out the baseline studies (described also in the Social Assessment), a mid-term, and project completion evaluation, dissemination of evaluation results, publishing evaluation studies and organizing high level workshop to discuss the results. The principal objectives of the evaluations would be to measure in a statistically relevant number of cases that municipal management causes *production* and *allocation efficiency* as presented by most literature on decentralization.

The basic indicators for project evaluation (and monitoring) are described in the Logical Framework (annex 1). CSD would evaluate municipal performances in relative terms, comparing performances of the same municipality in two different moments, and also comparing the average performances of a statistically relevant set of municipalities to the performances of the Central Government. For instance, in terms of unitary cost (production efficiency), CSD would compare the unitary costs of a statistically relevant sample of municipalities with a similarly statistically relevant sample of Central Government agencies. The evaluations would not be limited to the unitary cost of inputs, but would also consider the unitary cost in term of products (such as cost of the service provided).

Changes in efficiency would also be measured in terms of governance, even though its measurement is often limited to *perception* (such as the traditional *perception of transparency*). Perception may differ from reality but it is an important monitoring indicator nonetheless. After all, negative perception reflects a feeling of exclusion from public activities. Testing for governance would be across different groups: rural respondents would be separated from urban, representatives of the civil society would be separated from government officials and the private sectors, and so on.

The evaluations would also cover the institutional performances of INIFOM and MARENA. Some indicators would be quantitative (available budget, share of staff in regional offices) and others qualitative (perception of municipal staff, of INIFOM and MARENA staff, etc.)

**Evaluation Methodology.** The three evaluations (baseline, mid-term and final) would be separated in two parts (as described also in Annex 11 of the Social Assessment): a household survey and an institutional survey. The household survey would have a sample size of around 2000 households and would record basic data on access to services and governance perception. The institutional survey would be carried out in a statistically representative sample of the 40 municipalities. Secondary data from national sources would be used to complement information available at the local level.

Both surveys would also cover an area where the project has not intervened -- to act as a "control". This control would attempt to isolate the project effects from changes due to other causes. Although this isolation is not simple, this attempt would provide more elements for the evaluation, increasing in turn the legitimacy of the whole effort.

The evaluations would use the following data sources: CSD's surveys, the Municipal Monitoring System, INIFOM and MARENA Monitoring System, and other secondary information such as the 1999-2000 Nicaragua Environmental Plan, The National Institute of Statistics' Standard of Life Survey, The National Public Investment System, and FISE's Homes and Facilities Survey.

### **Dissemination**

The principal mechanisms for dissemination both monitoring and evaluation information would be: (i) a series of national workshops to present the advances of the decentralization experience; (ii) posting information on the web pages of INIFOM, MARENA, and CSD; (iii) publishing evaluation studies in the already existing CSD magazine; (iv) providing all monitoring and evaluation information in the Document Center for Decentralization; and (v) presentation of results in international workshops.

The national workshops would have the added value of providing an excellent locus to develop policy recommendations. Considering the recognized technical capacity of the CSD Technical Secretariat, these workshops should be able to attract the key policy makers of Nicaragua.

It is not expected, however, that CSD's main contribution would be the drafting of new decentralization laws. The dissemination campaign and its workshops would rather contribute to generate a technical discussion which would favor policy development.

### Work Plan

Plan of Action	Activity	Period	Cost (US\$)
Impact Evaluations	· Baseline	· January - March 2001	140,000
	· Intermediate evaluation	· June - August 2002	140,000
	· Final evaluation	· January - March 2004	140,000
Studies (Consultations)	· Unitary costs	· June - August 2001	40,000
	· Allocation and production efficiency	· March - June 2002	50,000
Publications	· Review, Bulletins	· Biannual for 3 years	42,000
	· Web	· Continuous	18,000
	· Studies' publication	· Bimonthly	18,000
Workshops	· National Forum on the decentralization experiences	· February 2001, 2002, 2003, 2004	20,000
International Technical Assistance	One institutional expert	Consulting fees for 3 years	300,000
Operating Costs Of the Technical Secretariat of CSD	Two Institutional Specialists	Salaries for 3 years	110,000
		Other expenses	72,000
Total			1,090,000

**Additional  
Annex 14**

**Summary of the Institutional Capacity Assessments**

The following annex summarizes reports prepared on the institutional assessments of the project's two implementing institutions, INIFOM and MARENA, and describes the complementarities between INIFOM and other institutions.

*The Nicaraguan Institute for Municipal Development (INIFOM)*

The following findings are based on an analysis of the institutional capacity of INIFOM prepared by Leonardo Romeo for the preparation of the Second Rural Municipal Development Project. The complete assessment can be found in the project files.

**Institutional Responsibilities.** Under the recently approved Organic Law, INIFOM is in charge of assisting local governments in municipal management. The list of responsibilities assigned to INIFOM can be summarized as follows:

- (i) promote an integrated decentralized financing system assisting municipalities in (a) local tax generation; (b) access to specific sources of financing - internal and external; (c) access to regular fiscal transfers;
- (ii) promote and regulate a municipal planning system, creating incentives and developing systems such that municipalities may adopt participatory procedures and technically valid planning, programming and budget preparation;
- (iii) design and manage a national municipal training system; and
- (iv) design and manage an integrated municipal information system aimed for statistical purposes and to support local decision making.

**Strengths.** As an institution, INIFOM has a solid background in knowledge management and data gathering of municipal management issues in Nicaragua. INIFOM still holds the support of the donor community which has financed several of the programs aimed to strengthen the supply of quality services to municipalities. In particular, INIFOM has been able to develop a municipal information system which tracks municipal cadastre, resources transferred and programmed locally, and the introduction of participatory municipal planning processes.

**Weaknesses.** Structural problems and limitations with INIFOM as an effective institution have been documented in numerous published reports. Weaknesses include among others (i) fragmentation and redundancy of different units; (ii) lack of planning, monitoring, and evaluation capacity; (iii) limited coordination among projects financed by several donors. Many of the project units are known by their funder's name rather than the institutional name; (iv) weak regional units; (v) limited understanding of its institutional role and responsibilities; and (vi) limited technical capacity and motivation of staff. With respect to personnel management, assessments have highlighted the following weaknesses: (i) weak human resources policies, including unclear recruiting methods, and the absence of a transparent evaluation system; (ii) low salaries and lack of financial incentives for qualified personnel; (iv) limited number of technical professionals in mid-level management; and (v) mismatch between specialized municipal assistance demand and services supply provided by INIFOM.

**Opportunities.** The recently approved Organic Law assigns INIFOM as the government's principal institutional agent for the support and supervision of municipalities. Likewise, the donor community has maintained "local development" as high in their list of priorities, which provides INIFOM with a strong potential for leveraging international donor resources.

**Threats.** INIFOM's fragile reputation puts the credibility of the institutional reform process at risk. The unclear institutional role risks overlapping with other institutions. An example is the case of the coordination with FISE, which required a long dialogue before clarifying the respective roles. Please see

Attachment 1 of this Annex for a definition of the roles of the two institutions, as specified in a recent inter-institutional agreement.

**Proposed Plan of Action.** In order to implement the "Municipal Development" component, INIFOM would need to undergo a major institutional change, involving both the re-focusing of its business and the re-engineering of its structure. The change process has already been initiated and the design of the proposed project has played a catalytic role. Indeed, project financing would be critical to facilitate the institutional change of INIFOM. However, completing the change process would take time, vision and a sustained effort by the senior management of the Institute.

To account for the lack of capacity in INIFOM, the consultant currently hired in the project implementation unit are being merged in the mainstream institution. The three main department of INIFOM – Operations, Monitoring, and Administration – would need substantial strengthening. Project resources would therefore be applied to: (i) train existing staff, (ii) provide adequate remuneration and financial incentives, and (iii) secure critical consulting and resident advisory services. Most importantly, the re-deployment of most current staff of the PROTIERRA unit would be essential to capitalize on already existing capacity, particularly at the departmental level. To increase salary remuneration, INIFOM would need to adopt a personnel management system specifying selection and remuneration criteria, and a transparent personnel evaluation system.

#### *The Ministry of Environment and Natural Resources (MARENA)*

The following findings are based on an analysis of the institutional capacity of MARENA prepared by Jose Parra Duhalde and Milton Fernandez for the preparation of the Second Rural Municipal Development Project. The complete assessments can be found in the project files.

**Strengths.** MARENA's dedicated staff have strong technical qualifications and offer an institutional memory on environmental protection and natural resources management. MARENA has a strong record of coordinating efforts with NGOs and is beginning to develop a relationship with municipalities through the municipal environmental commissions (CAMs).

**Weaknesses.** (i) weak field presence, particularly in rural areas, limits the institution's effectiveness and leverage as an key national player; (ii) as with INIFOM, MARENA also receives funding from multiple international donors, being home to several project units managing their own separate financial and human resources. Many of the project units are known by their project name rather than the institutional name; (iii) limited understanding of its new regulatory role, which does not anymore cover the difficult issue of forest management (passed to the Ministry of Agriculture and Forestry under the recently approved Law 290); (iv) weak coordination with other institutions; (v) low administrative and financial management capacity; (vi) weak communication between institutional levels, and local and municipal stakeholders which limit the possibility of addressing local demands on environmental protection; and (vii) absence of a proper personnel management system.

**Opportunities.** If well understood and properly implemented, the new institutional role of MARENA places it in an optimal position to foster an effective collaboration with other institutional actors, such as the civil society, local governments, and also the private sector. The potential benefits of these collaborations are significant and quite well understood at all institutional levels. MARENA's constructive participation in the Committee on Decentralization, and agreements on de-concentration and decentralization reached with INIFOM and AMUNIC sets the stage for the program's probability of success.

**Threats.** An increased budget gap between the national financed "recurrent costs" and externally funded "investment projects" may make MARENA more vulnerable and could result in further staff rotation and loss of expertise, and, in turn, decrease institutional sustainability. Also, staff resistance against decentralization of environmental management because of fear of job loss may jeopardize project success.

**Proposed Plan of Action.** The findings indicate that MARENA's permanent staff do not have sufficient capacity to implement the proposed project and that therefore substantial support would be financed by the credit. Several options were explored to assess the most suitable institutional arrangements for the project's execution. The analysis concluded that technical responsibility for project execution would be distributed within the regular structures of MARENA (both headquarters and regional delegations) which would in turn be strengthened by selected technical staff recruitment in a number of key line positions. However, the existing Project Coordinating Unit, which is currently responsible for the implementation of the Rural Municipalities Project and Atlantic Biological Corridor, would continue to be responsible for administrative aspects such as procurement and financial management. With project co-financing, MARENA would add permanent staff to the existing Project Coordinating Unit responsible for procurement and financial management, in so that a permanent capacity would be developed within regular MARENA staff.

**Attachment 1 of Annex 14**  
**Local institutional development: the complementary roles of INIFOM and FISE**

In recent years, many "Social Funds" in the region have been actively involved in the institutional development of local governments. Often operating in the frame of incipient and uncertain decentralization reforms and/or in the context of non-existent or weak institutions for State support and supervision to municipalities, Social Funds have become, sometimes by default, very important agents of municipal strengthening. The Nicaraguan FISE is a case in point.

Responsible for implementing a *central* government policy of poverty alleviation, FISE is increasingly devolving to municipalities the tasks of planning and implementing the projects it finances. It has also undertaken a parallel effort to extend to municipalities participatory planning procedures for broader municipal investment programs.

Given its major role in both decentralized financing of municipal investments and the build up of municipal planning capacity, legitimate questions may arise about division of labor, and risks of duplication or cross-purpose interventions, with INIFOM.

However, a closer look at the two organizations reveals more potential for synergy than conflict between their municipal strengthening programs. In fact, the two organizations are both *distinct* and *complementary* in terms of (i) their general mandate, (ii) their funding instruments and (iii) the scope of their effort, to promote local institutional development.

*First*, the two organizations have a different mandate, and degree of responsibility with respect to *local institutional development*. FISE may indeed contribute greatly to local institutional development, by realigning its operations with a decentralized environment and offering to municipal governments a greater role (and technical support) in planning, implementing, operating and maintaining basic social infrastructure.

Other central agencies and line ministries may also play a similar role as they restructure their operations to promote, or respond to, decentralization reforms. This multiple organizational effort is essential, because strengthening municipal institutions is a broad process that will require support from many different institutions of the national public administration.

Yet this effort also requires a focal point, a *dedicated organization* embodying the State's commitment to, and actual investment in, support and supervision to LGs. International experience suggests that the stalling or failure of many decentralization reforms can often be attributed to the lack of such commitment and investment.

In spite of its current weaknesses, INIFOM *is* such an organization in Nicaragua. The new Organic Law stresses INIFOM's identity as the *interface* between the State and municipalities and confirms it as the only unit in the Nicaraguan public administration that can claim strengthening municipal institutions as its primary mandate.

*Second*, in supporting institutions for municipal planning and financing of local development, the two organizations use different funding instruments, which are however *perfectly complementary* within a well developed framework of local public finances.

FISE, pursuing *central government's policy objective*, offers to municipalities a "principal-agent" relation in which the agents (the municipalities) assume responsibility for planning and monitoring the investments financed and, to a varying degree, managed by the principal (FISE) and in some cases by the municipalities themselves. The volume of resources transferred by FISE to municipalities is comparatively large and has been restricted, so far, to a "menu" of basic social infrastructure facilities.

On the other end, INIFOM, aiming to support *local choice and municipal policy-making* operates a

Municipal Development Fund (MDF). With support from the ongoing Rural Municipalities Development Project (PROTIERRA), during its first phase of implementation as a formula-based, matching but non-specific, fiscal transfer mechanism. The facility covers a broad range of spending purposes including social and economic infrastructure, environmental protection, and promotion of local economic development as well as local capacity building. The amount of resources transferred is intentionally modest, to be consistent with a sustainable system of regular fiscal transfers. It essentially provides a minimum of "free" programmable resources as incentive to the adoption of a statutory process of municipal planning, programming and budgeting, *independent* from national, sectoral or purpose-specific grants programs.

The set up of both (i) substantial, purpose-specific grants that signal national policy objectives (FISE-type) and (ii) more modest, but broadly unrestricted transfers that foster local choice (INIFOM-type), is a common feature of well developed systems of inter-governmental fiscal arrangements. Far from being contradictory or overlapping, the FISE and the INIFOM decentralized financing instruments are essentially complementary, including the possibility that INIFOM-MDF resources be applied, if necessary, by municipalities to co-finance FISE-supported projects.

*Third*, there is a difference in the scope of the two organisations' efforts to build local institutions. Given the difference of their mandate, such scope is obviously much broader for INIFOM than for FISE. Where an overlap of activity seems to exist is in the area of planning and management of municipal investment projects. This however should hardly be a motive for concern if looked at in an evolving, medium-term perspective.

FISE's main effort has been so far to extend to municipalities the "Participatory Micro-Planning" (MPP): a technique to prepare comprehensive Municipal Investment Plans. The technique, originally developed jointly with INIFOM, has also been, and could continue to be, extended jointly by FISE and INIFOM.

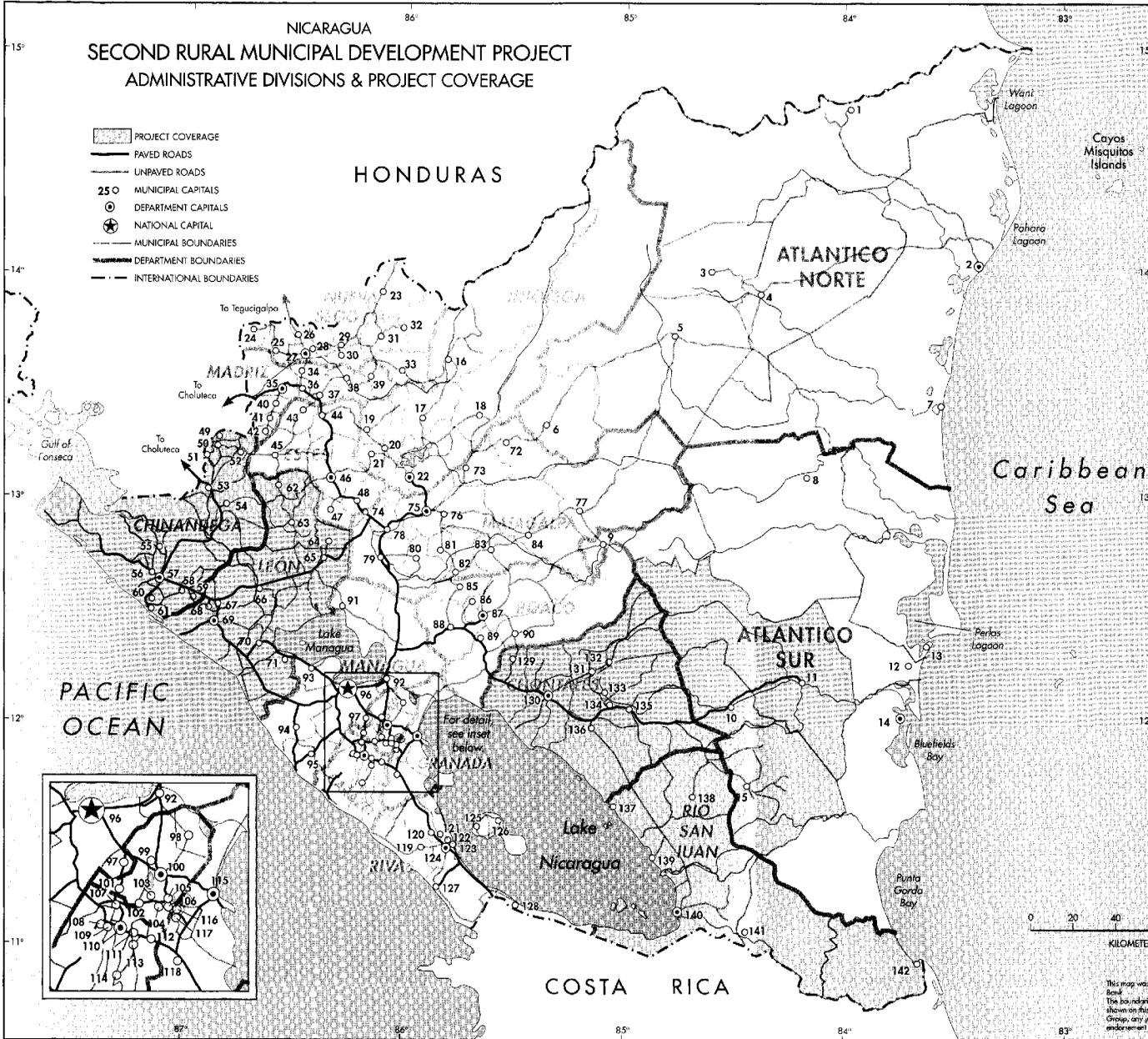
INIFOM's approach to the development of municipal planning institutions, must, by necessity, be a broader one. Through its Municipal Strengthening Program (MSP) and the assistance of this and other externally-funded projects DANIDA is currently supporting the review and design of municipal-level strategic planning practices., INIFOM aims at developing and gradually extending a comprehensive and statutory municipal planning process, including strategic planning, capital programming and improved budgeting techniques. While the MPP could be a key tool in such process, it would not, in and by itself, address the need for a both strategic and statutory municipal planning process.

Moreover, as INIFOM, as per its mandate, assists municipalities to adopt comprehensive municipal planning procedures, this would also serve the purpose of programming FISE-funded investments, making FISE-specific planning exercises, unnecessary. This will obviously be a gradual and extended process, requiring an agreed framework for action by the two organizations, but it is already a practical possibility in several municipalities assisted by INIFOM under the first phase of the Rural Municipalities Project (PROTIERRA).



# NICARAGUA SECOND RURAL MUNICIPAL DEVELOPMENT PROJECT ADMINISTRATIVE DIVISIONS & PROJECT COVERAGE

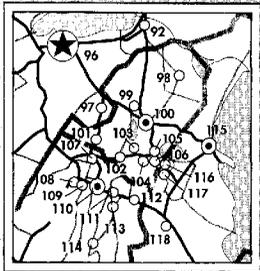
- PROJECT COVERAGE
- PAVED ROADS
- UNPAVED ROADS
- MUNICIPAL CAPITALS
- DEPARTMENT CAPITALS
- NATIONAL CAPITAL
- MUNICIPAL BOUNDARIES
- DEPARTMENT BOUNDARIES
- INTERNATIONAL BOUNDARIES



## MUNICIPAL CAPITALS

\*Department Capital    \*\*National Capital

<b>RAAN</b>	<b>CHINANDEGA</b>	<b>MASAYA</b>
1 Waspm	49 San Pedro del Norte	98 Tisma
*2 PUERTO CABEZAS	50 Cinco Pinos	99 Nindiri
3 Bonanza	51 Santa Tomás del Norte	*100 MASAYA
4 Rosita	52 San Francisco del Norte	101 La Concepción
5 Sina	53 Somotillo	102 Masatepe
6 Waslala	54 Villanueva	103 Nandayama
7 Prinzapolka	55 Taxala	104 Niquinoloma
	56 El Viejo	105 Cutatina
<b>RAAS</b>	*57 CHINANDEGA	106 San Juan de Oriente
8 La Cruz de Río Grande	58 Chichigalpa	
9 Bocaina de Paríwas	59 Pasolega	<b>CARAZO</b>
10 Muelle de los Bueyes	60 El Realejo	107 San Marcos
11 El Rama	61 Carrión	108 D'Hombia
12 Kukur Hill		109 Ocasere
13 Laguna de Perlas	<b>LEÓN</b>	*110 JINOTEPE
*14 BLUEFIELDS	62 Achuapa	111 El Rosario
15 Nueva Guinea	63 El Sauce	112 La Paz de Carazo
	64 Santa Rosa del Peñón	113 Santa Teresita
	65 El Jicaral	114 La Conquistita
<b>JINOTEGA</b>	66 Malpaisillo	
16 Wivili	67 Malco	<b>GRANADA</b>
17 Las Praderas	68 Guazaciguaque	*115 GRANADA
18 El Cuyo	69 LEÓN	116 Drius
19 San Sebastián de Yali	70 La Paz Centro	117 Driama
20 San Rafael del Norte	71 Nagareno	118 Nandaimé
21 La Concordia		
*22 JINOTEGA		
	<b>MATAGALPA</b>	<b>RIVAS</b>
<b>NUEVA SEGOVIA</b>	72 Rancho Grande	119 Tala
23 Jalapa	73 La Dalia	120 Balán
24 Santa María	74 San Isidro	121 Patasi
25 Macarizao	*75 MATAGALPA	122 Buenos Aires
26 Dipilo	76 San Ramón	123 San Jorge
*27 OCOTAL	77 Río Blanco	*124 RIVAS
28 Masorote	78 Sabarote	125 Mayagüita
29 San Fernando	79 Ciudad Dario	126 Altagracia
30 Ciudad Antigua	80 Terrabona	127 San Juan del Sur
31 Ciudad Sandino	81 San Dionisia	128 Cárdenas
32 Murra	82 Esquipulas	<b>CHONTALES</b>
33 Quilici	83 Muy Muy	129 Comalapa
	84 Matiguás	*130 JIJIGALPA
<b>MADRIZ</b>		131 La Libertad
34 Totogaitan	<b>BOACO</b>	132 Santo Domingo
*35 SOMOTO	85 San José de los Remates	133 San Pedro de Lavago
36 Yalögüita	86 Santa Lucía	134 Santa Tomás
37 Palocagüina	*87 BOACO	135 Villa Sandino
38 Telpaneca	88 Teustepe	136 Acayapa
39 San Juan del Río Coco	89 San Lorenzo	
40 San Lucas	90 Comapa	<b>RÍO SAN JUAN</b>
41 Los Sabalos		137 Maritza
42 San José de Cusmapa	<b>MANAGUA</b>	138 El Almendro
	91 San Francisco Libre	139 San Miguel
<b>ESTELI</b>	92 Tipitapa	*140 SAN CARLOS
43 Pueblo Nuevo	93 Mateare	141 Boca de Sabalos
44 Condega	94 Villa Carlos Fonseca A	142 San Juan del Norte
45 San Juan de Limay	*95 San Rafael del Sur	
*46 ESTELI	96 MANAGUA	
47 San Nicolas	*97 Tucantepe	
48 La Trinidad		



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