Management of Municipal Finance for Environmental Infrastructure in the New Independent States

Terms of Reference

Prepared by the EAP TF Secretariat
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Acronyms used

EAP TF = Task Force for the implementation of Environmental Action Program for Central and Eastern Europe
CEE = Central and Eastern European countries (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, other Balkan countries)
NIS = New Independent States (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan, and Ukraine).
IFI = International Financial Institutions (World Bank, European Bank for Reconstruction and Development, ...)
PM= Project Manager
PPC= Project Preparation Committee
USAID = United States Agency for International Development
1. Background and Rationale of the project

1.1. Municipal finance in the NIS

Although many NIS countries have prepared national/regional environmental action plans and some of them even financing strategies, the link between these plans and municipal budget planning, especially with regard to investments, remains weak. Good financial management is key in any municipal investment in the NIS countries, where financial resources in municipal budgets are very limited, and very small expenditures are allocated to investments. Reforming financial management in the NIS municipalities need to involve a whole bundle of regulatory, institutional and mental changes on both the revenue and the expenditure management side of the municipal finance.

On the revenue side, municipalities in the region lack sources of revenues and access to capital to be able to support urban infrastructure projects. Notwithstanding some reforms in selected countries of former Soviet Union, in most NIS tax systems remain highly centralized. Most tax revenues are collected by the central government, and then partially transferred down to the regional authorities and municipalities. These transfers are usually done in an arbitrary and non-transparent way (in most cases, depending on the particular local government’s political loyalty to the regional authorities and/or central government). This makes it difficult for municipalities to implement long-term financial planning, as they cannot predict the amount of funds that will be provided to them by the central government.

On the expenditure management side, municipalities often have little (if any) experience in long-term strategic/investment planning, neither do they have the proper skills and techniques to conduct this planning. Also traditional procedures of preparation and implementation of local budgets are not conducive to the sustainable management of environmental (and indeed other) infrastructure. There have been few attempts to involve the public in the budgeting/financial planning process.

The scope of this project includes assistance to the cities in the NIS in reforming their expenditure management practices and tools. The focus is on improving the management of whatever budgetary resources for investments are controlled by municipalities. Issues of increasing the sources of a municipal revenue and of fiscal relations between different government levels are complementary to the core of this project and will be addressed through synergies with other donor activities.

The rationale for the project can be summarised as follows:

- the financial management in NIS municipalities is distorted because of the single year horizon in investment planning and the budgeting process that is not related to achieving clear outcomes in terms of level and quality of services to citizens
- this is a fundamental obstacle to developing projects financed domestically and externally and leads to inefficient use of scarce resources
- as a result infrastructure continues to deteriorate badly with potentially massive environmental, health and welfare consequences
- there is relevant practical experience in CEECs which demonstrates that progress is possible and which can be adapted to the NIS (See Annex II)
- if long-term, sustainable progress is to be achieved, it is essential that the municipal finance systems be reformed along the lines proposed in this project (see Annex I)
- this process will take a long time, but through well developed demonstration implementation in selected cities a start can be made
multiplication affect and sustainability will require development of a critical mass of local skills and expertise
this activity will also help to provide a more solid basis for the project identification and preparation work of IFIs/PPC

Further details on the current situation in municipal investment planning and budgeting in the NIS as well as on the principles of good municipal finance management can be found in Annex I.

2. Objectives and focus of the project

2.1. Overall goal
The ultimate goal of the activity is to assist NIS municipalities in making better use of their existing budgets and in mobilising additional finance for municipal environmental infrastructure through improved programming and budgeting.

2.2. Specific Objectives
Specific objectives listed below are to be achieved by the time of the Kyiv conference in selected, pilot municipalities in the NIS.

• Introduce long term financial/investment planning as the basis for annual municipal budget preparation;
• Focus scarce municipal resources on critical infrastructure needs;
• Improve municipal long-term investment capacity;
• Enhance financial viability and creditworthiness of cities;
• Facilitate access to external sources of finance;
• Support reform of subsidies to local utilities;
• Improve efficiency and transparency of resource allocation decisions in local budgets;
• Decrease the distortionary influence of frequent changes in day-to-day politics on the investment process in municipalities, in particular on the project selection.

The lessons learned from these pilot demonstration projects will be disseminated widely throughout the NIS.

2.3. Sectoral focus and beneficiaries

Long-term investment plans for municipal environmental infrastructure will be applicable for overall capital needs of municipal services. Particular attention will be paid to water, sanitation, district heating, solid waste and public transportation infrastructure.

The project will benefit all twelve NIS countries. However, pilot implementation of demonstration projects will only occur in selected countries and cities. Transparent process within the framework of the EAP Task Force, involving NIS and donor countries and IFIs will be initiated to select cities for the pilot, demonstration projects. Within the scope of this project pilot implementation will be supported in minimum four cities in different NIS countries, but efforts will be taken to mobilise donor support for more pilot activities. The selection of the pilot cities would be based on the following criteria:

• Effective demand expressed by the City authorities and supported by the central government
• Demonstrated commitment by the City to lead the participatory process involving citizen’s groups and other relevant stakeholders. Commitment to allocate adequate time and priority to these activities and to follow the general approach and philosophy expressed in this note

• Large scale of environmental infrastructure investment needs and potential for, or success in, attracting external finance, in particular IFI loans.

• Potential for replication

• Basic legal framework in place, which would ensure essential enabling conditions for the implementation of the project

• Sustainable fiscal position of the city (solid base for stable local revenue)

• Previous/current participation in donor-funded technical assistance projects in municipal development

• Availability of donor funding.

The Cities willing to participate in the pilot projects would send a written request to the EAP TF Secretariat signed jointly by the City Mayor, Head of the City Council and the representative of the government agency, which acts as an EAP Task Force liaison (typically Ministry or Committee of Environment).

Indirect, ultimate beneficiaries are all NIS cities. They will be reached through dissemination activities (workshops, study-tours, municipality twinning, tool-kit, publications, etc.) and through increased availability of trained local experts. The training courses and certified exams for local experts will be open to participants from all the NIS.

If demanded, project manager will provide effective support for the implementation of ongoing bilateral donor-funded technical assistance activities, if they are consistent with the objectives of this project. For such purposes the tools and the expertise accumulated within this project will be freely available to the NIS municipalities and donor agencies as a "public domain". The project manger will also seek other synergies with ongoing donor-funded projects to draw and disseminate lessons learned from the widest possible pool of experience.

This activity would also benefit NIS indirectly through synergy with the work of the PPC. In particular it should lead to an increased ability of the NIS municipalities to absorb long-term IFI loans. In addition, this activity would also lead to a more country-driven project identification process within or outside of the PPC framework. The important factor of success would be to draw upon the relevant experience and activities of the PPC.

3. Implementation arrangements and roles of different actors

The implementation of the activity will be co-ordinated by a Project Manager - senior, long-term expert in municipal finance and infrastructure hired by the EAP TF Secretariat. Project manager is based in the EAP TF Secretariat in Paris (OECD), but will extensively travel throughout the NIS. He will provide substantive leadership and manage the development and implementation of the project. In particular, the work will entail:

• Working with donors to develop and implement technical assistance demonstration projects to introduce multi-year environmental infrastructure investment plans and elements of task-based budgets in selected municipalities in the NIS; this would include identifying pilot municipalities, assuring local ownership, managing, supervising, and assuring quality of work of international consultants that would assume direct responsibility for implementation of the demonstration projects
• Developing a handbook and computer-based toolkit for multi-year infrastructure investment planning by building upon and adjusting the tools developed already in the NIS and Central and Eastern Europe to fit specific institutional, regulatory and cultural framework of the NIS cities; this activity would be implemented with the assistance of software programmers;

• Organising a policy-level workshops on municipal budgeting and multi-year investment planning in the NIS

• Initiating and working with donors to organise training sessions for NIS experts

• Working with the NIS to manage local and CEE consultants to build local capacity and sustainability through NIS-CEE/NIS-NIS study tours, municipality twinning and CEE-NIS/NIS-NIS learning by doing;

• Disseminating results and promoting their adoption by preparing case studies, good practices, inputs to the EAP TF web page, brochures on innovative practice, articles for the local press and participating in seminars

• Coordinating and co-operating with ongoing international donor projects in the municipal finance area to enhance the impact of the training and technical assistance provided by the international community.

• Co-operating with the NIS, donors, international organisations and International Financing Institutions to design effective assistance programmes to promote good practices in financial management of urban environmental infrastructure in the NIS;

Project Manager will be supported by the Environmental Finance Team at the EAP TF Secretariat. Project Manager will also manage the NIS and CEE short-term consultants hired directly by the EAP TF Secretariat on an as needed basis to implement specific tasks related to capacity building, know-how transfer and dissemination.

Pilot demonstration projects in the selected NIS cities would be implemented by the international consultants ("the Consultants") through technical assistance projects financed through bilateral grants offered by the donor countries (contracting parties) to specific NIS. These donor countries still need to be identified. The preference will be to approach those donors who have already financed similar TA projects in the NIS or CEE countries. The consultants would be responsible for providing methodological support and technical assistance to the selected cities and to the Project Manager. The support would include all actions necessary to develop realistic multi-year investment plans for municipal environmental infrastructure in these cities and to link these plans to the municipal budgets. The consultant would provide a diverse team of experts in each country to work with the beneficiary municipality and the Project Manager. The support would include all actions necessary to develop realistic multi-year investment plans for municipal environmental infrastructure in these cities and to link these plans to the municipal budgets. The consultant would provide a diverse team of experts in each country to work with the beneficiary municipality and the Project Manager. Participation of CEE experts with hands-on experience in introducing multi-year investment plans and reforming municipal budgets in the teams put up by international consultants will be strongly encouraged for the first two pilot demonstration projects. Participation of NIS experts in the consultants’ team will be strongly encouraged for the other two demonstration projects. The Consultants will report to the hiring agency and to the EAP TF Secretariat (represented by the Project Manager).

Beneficiaries in the NIS are expected to take an active part in the implementation of the pilot projects and in the development of a handbook. Central governments will be expected to provide an enabling framework for implementation of the activities planned within the scope of this project and express the willingness to engage in a policy dialogue with the project staff and the EAP Task Force. This dialogue would lead to identification of next steps in reform of the regulatory and institutional framework for municipal finance in the NIS. Outputs of the dialogue would feed to the Kyiv Ministerial Conference in 2003. Municipal authorities will be expected to provide effective local support needed for a successful implementation of pilot projects. This support would include designated persons from financial, investment and environmental departments of the municipal governments to work with the consultants on collecting data, accessing and analysing documents, developing forecasts and interacting with all relevant stakeholders. City authorities and designated experts will also be essential to provide guidance to PM and the consultants in adjusting the toolkit to the specific NIS institutional and regulatory framework.
4. Scope and timing of activities

4.1. Milestones

1. **Inception and two pilot demonstration projects.** International consultants (including CEE practitioners), supported by local experts will carry out pilot development of multi-year investment plans for municipal environmental infrastructure in 2 cities in the NIS.

2. **Development of a toolkit.** The lessons learned from the demonstration projects will be used to develop a toolkit consisting of handbooks (guidelines), software, templates of documents etc. The toolkit will not be developed out of scratch. Instead, Project Manager will identify best available tools (e.g. those used in municipal finance reform in CEE countries) and adjust them to fit NIS needs, regulatory and institutional framework.

3. **Regional workshop.** The toolkit will be tested and widely distributed among NIS municipalities, *inter alia* through a workshop on municipal budgeting and multi-year investment planning.

4. **Training.** Two formal training sessions concluded with exams and diplomas will be organised in co-operation with IFIs and donors. The objective of will be to create a “critical mass” of local expertise in municipal financial management. It would enhance sustainability of the activity, since local consultants will be more accessible and more affordable to the NIS municipalities. In addition course materials will be developed with an indigenous training company and delivered as a for-fee course by local trainers.

5. **Two additional pilot demonstration projects.** Implementation of multi-year investment plans and task budgeting for additional 2 municipalities in NIS will be developed by certified local experts, supported by international consultants, using the toolkit developed in phase 2.

6. **Replication and dissemination of know-how.** Local experts will be used to build regional capacity through NIS-NIS study tours, municipality twinning and learning by doing.

4.2. Specific tasks

4.2.1. Inception and pilot demonstration projects

*Inception - building alliances*

**Purpose:** To identify existing tools and best practices; to identify at least two NIS municipalities for pilot implementation; to familiarise local NIS partners in the project substance and implementation approach; to build alliances with IFI and donors.

**Time period:** April 2001 - July 2001

**Scope of work:** Project Manager (PM) will collect and review existing methodologies and toolkits in other countries, in particular CEE, including lesson learned reports, manuals and software. PM will identify local NIS institutions (consulting firms, institutes, municipal associations, municipal staff) that can be involved in pilot demonstration projects, preparation of a toolkit, workshops and training. PM will also identify and co-ordinate with international institutions and donors involved in activity (World Bank, EBRD, PPC, US, EU). CEE and NIS consultants (individuals, firms) that can contribute to methodology the project will be identified. PM will write scope of work for their assignments. PM will use EAP TF framework to select two municipalities for pilot demonstration projects.
Pilot demonstration project in 2 cities and NIS-CEE study tours

Purpose: Pilot implementations will assist in preparation of a toolkit; study tour will help local experts better to understand methodology and to see how similar activities have been implemented;

Time period: June 2001 - December 2001

Scope of work: Project Manager, jointly with donor country representative (contracting party) will prepare scopes of work for international consultants and local experts to provide technical assistance in two NIS municipalities. PM will introduce consultants to selected city authorities and help them to oversight consultants' work. All reports and other deliverables will be evaluated jointly by the city authorities and PM before they are submitted for approval to the contracting authority. As a support for demonstration projects Project manager will prepare and co-ordinate study tours for local experts and key staff from selected municipalities to the CEE municipalities that have already implemented long term infrastructure investment plans and task-based budgets. CEE and local experts will provide technical assistance to two pilot municipalities prepare reports and case studies as part of their work.

4.2.2. Development of a toolkit (handbook and software for task based budgeting and multi-year investment planning for municipal environmental infrastructure in NIS)

Purpose: To develop a "toolkit" (handbook and software) ready for dissemination, to be used for training of local experts and for future implementation. "Toolkit " will be compatible with IFI's standards, to help municipalities in future access to financial sources of local and international financial institutions.

Time period: August 2001 - February 2002

Scope: Project Manager will use the lessons learned from the two pilot demonstration projects to write two handbooks, one on multiyear investment planning and another on task budgeting for environmental infrastructure. The best available CEE tools will be used as a framework but the content will be carefully adjusted to the particular needs, regulatory and institutional framework of the NIS countries. The handbooks will be available in English and Russian and in a national language of the relevant country as appropriate. PM will also prepare two sets of standard presentations, ready for dissemination of the results of the demonstration projects. S(he) will also prepare detailed SOW for a computer specialists to develop software tools and will provide oversight and guidance in the development of these tools. Handbooks, presentations and software will be reviewed by external experts and practitioners identified by beneficiary municipalities, IFIs, contracting party and the EAP TF.

4.2.3. Regional workshop on municipal budgeting and multi-year investment planning

Purpose: Three-day long workshop will be organised in the NIS in order to present lessons learned and the tool-kit to the wide representation of the NIS municipalities and to test the quality and the practical relevance of the toolkit.

Time period: March-April 2002

Scope: The first part (0,5 days) will consist of a set of lectures, provided by the Project Manager and invited experts. NIS expert(s) will make a presentation on the local legal frameworks. The second part (1,5 days) will consist of practical workshops conducted in small groups. Each group will be led by a CEE or a NIS expert. The final part (0,5 days) will be focused on a discussion about proposed approaches and a toolkit. Project Manager will prepare the agenda of the workshop. EAP TF Secretariat will be responsible for workshop facilities (conference room(s), participant and trainer accommodation, lunches and refreshments, translators), scopes of work and contracting of NIS and CEE trainers. PM will be responsible for facilitating core training about developed methodology. Following the workshop, Project Manager will use the recommendations of participants to revise and improve the toolkit.
4.2.4. Training the NIS experts

**Purpose:** Formal training of local NIS experts will be organised in order to ensure the sustainability of the results of the project. The aim is to develop a "critical mass" of local know how in each NIS country. The target group consists of local experts who will be available in future to the NIS municipalities either as stand alone consultants or as competent local partners of international consulting firms working in the municipalities on multi-year investment planning and task-based budgeting. Training will be focused on practical skills and exercises, however, with due consideration given to local legal and institutional framework. Following these training sessions, a set of course materials will be developed with an indigenous training company or institution. Using these materials, additional training courses will be delivered to the municipal officials by local trainers for a fee with initial donor support. Eventually, donor subsidies will be phased-out in order to create a sustainable training capacity.

**Time period:** Two weeks in March - April 2002.

**Scope:** Training will be organised in co-operation with or hosted by a local training institution, such as municipality association(s), public administration school, etc. Two training sessions are envisaged. One for Western NIS and Caucasus, and the other one for Central Asia. Each training session will last 1 week and will accommodate about 30-35 participants each, at least 2 from each NIS country. Eligible trainees will take final exam conducted jointly by local experts representing municipalities, IFIs experts, experts recommended by the contracting party and the Project Manager (representing EAP TF). Curriculum of the training, trainers, questions and certification criteria will be developed in consultation with all these institutions. The scope of the exam will draw from the best examples of such exams organised in the CEE countries and will probably include the test module (about 50 questions testing general knowledge), and practical exercises demonstrating the ability of the trainee to solve practical problems. Successful trainees will be awarded a certificate co-signed by the representatives of all involved institutions.

4.2.5. Additional demonstration projects

**Purpose:** At least two additional demonstration projects will be implemented with an assistance of the certified local consultants in order to finally test the toolkit under the field conditions

**Time period:** June 2002 – January 2003

**Scope:** Two additional municipalities will be selected for implementation. Technical assistance will be provided by the teams put up by international consulting firm, but led by the experts who have achieved the highest scores in the exams organised in the previous phase. The process will be supervised by the Project Manager in a manner similar to the first two pilot demonstration projects.

4.2.6. Replication and dissemination of know-how

**Purpose:** After two years of activity dissemination task will be facilitated.

**Time period:** October 2002 - May 2003

**Scope:** Project Manager will:
- prepare database of local experts,
- prepare final publication of a toolkit and of case studies and ensure their wide dissemination,
- prepare policy report to be submitted to the Kyiv conference,
- prepare web page in English & Russian about activity, including lessons learned,
- prepare dissemination brochures on innovative practices,
- prepare articles to the local press,
- disseminate lessons learned through contribution to relevant seminars in the NIS countries (made by PM or designated local experts),
- organise study tours and other forms of know-how transfer between the NIS countries and from CEE to the NIS

The Project Manager will also be also responsible for networking with the NIS and CEE authorities and experts, monitoring and internal reporting as well as co-operating with international organisations and financing institutions, such as PPC, World Bank, EBRD, USAID and other donors.

5. Outputs and outcomes

The following outputs are expected:

- Multi-year investment plans and elements of task-based budgeting implemented in selected NIS cities,
- Practical, computer-aided toolkit, fully applicable in the NIS regulatory and institutional conditions, made available to a wide range of NIS municipalities,
- About 50 local experts trained in methodology and certified to implement multi-year investment plans and to manage a reform towards task based budgets in the NIS municipalities

6. Indicators of success

- Toolkit transferred to the municipalities covered by the pilot projects, is used and regularly maintained by the municipalities themselves.
- Multi Year Investment Plans and basics of "task-based budgeting" implemented in at least 4 cities and adopted as local laws
- Multi Year Investment Plans used by these municipalities after TA is over, regularly updated and linked to annual budgets
- Financially feasible infrastructure investment projects prepared in two NIS municipalities
- Toolkit is requested by at least 40 other municipalities. At least 10 of them prove willingness and readiness to implement multi-year investment plans.
- 60-70 local NIS experts (minimum 2 from each country) formally trained to prepare multi-year investment plans and elements of task-based budgets in the NIS municipalities. At least 50 of them passed the exam and received qualifying diplomas.
7. Budget

7.1. EAP Task Force Secretariat Budget (1 EURO = 6,5 FRF)

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<td></td>
<td>Editing (Russian) per page</td>
<td>200</td>
<td>12</td>
<td>2,308</td>
</tr>
<tr>
<td></td>
<td>Editing (English) per page</td>
<td>50</td>
<td>18</td>
<td>923</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-total</strong></td>
<td></td>
<td></td>
<td><strong>89,354</strong></td>
</tr>
<tr>
<td>Training of NIS experts</td>
<td>Project Manager/Senior Expert in Municipal Finance (EAP TF) months</td>
<td>4</td>
<td>7,631</td>
<td>30,523</td>
</tr>
<tr>
<td></td>
<td>Full-time Consultant/environmental finance expert months</td>
<td>2</td>
<td>5,631</td>
<td>11,262</td>
</tr>
<tr>
<td></td>
<td>Support staff (Grant funded) months</td>
<td>3</td>
<td>3,323</td>
<td>9,969</td>
</tr>
<tr>
<td></td>
<td>Consultant (CEECs) days</td>
<td>40</td>
<td>231</td>
<td>9,231</td>
</tr>
<tr>
<td></td>
<td>Consultant (NIS) days</td>
<td>40</td>
<td>113</td>
<td>4,523</td>
</tr>
<tr>
<td></td>
<td>Mission (NIS)</td>
<td>6</td>
<td>3,077</td>
<td>18,462</td>
</tr>
<tr>
<td></td>
<td>Translation per page</td>
<td>200</td>
<td>12</td>
<td>2,308</td>
</tr>
<tr>
<td></td>
<td>Publication (other)</td>
<td>1</td>
<td>1,538</td>
<td>1,538</td>
</tr>
<tr>
<td></td>
<td>Communication</td>
<td>0</td>
<td>154</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Editing (Russian) per page</td>
<td>200</td>
<td>12</td>
<td>2,308</td>
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<tr>
<td></td>
<td>Editing (English) per page</td>
<td>60</td>
<td>18</td>
<td>1,108</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-total</strong></td>
<td></td>
<td></td>
<td>91,385</td>
</tr>
</tbody>
</table>

| Two additional pilot demonstration projects      | Project Manager/Senior Expert in Municipal Finance (EAP TF) months | 6 | 7,631 | 45,785 |
|                                                 | Support staff (Grant funded) months                              | 1 | 2,985 | 1,492  |
|                                                 | Consultant (OECD) days                                          | 2 | 462   | 923    |
|                                                 | Consultant (CEECs) days                                         | 20| 231   | 4,615  |
|                                                 | Consultant (NIS) days                                           | 120| 113   | 13,569 |
|                                                 | Mission (NIS)                                                   | 8 | 3,077 | 24,615 |
|                                                 | Missions (Europe)                                               | 2 | 1,538 | 3,077  |
|                                                 | NIS-NIS study tours                                             | 0 | 0     | 15,385 |
|                                                 | Translation per page                                             | 60 | 12   | 732    |
|                                                 | Publication (other)                                              | 2 | 1,538 | 3,077  |
|                                                 | Communication                                                    | 0 | 154   |        |
|                                                 | Editing (Russian) per page                                       | 180| 12   | 2,077  |
|                                                 | Editing (English) per page                                       | 180| 18   | 3,323  |
|                                                 | **Sub-total**                                                    |   |        | 118,785|

All tasks to be performed by the EAP TF Secretariat | 522,077

### 7.2. Budget of individual demonstration projects

**Option A:** Estimated budget of pilot demonstration projects to be financed directly by donors (to be multiplied by 4 pilot projects)

<table>
<thead>
<tr>
<th>Category</th>
<th>Quantity</th>
<th>Price (EURO) per Unit/Deliverable</th>
<th>Total Cost (EURO)</th>
</tr>
</thead>
<tbody>
<tr>
<td>International finance experts (OECD)</td>
<td>3 person months</td>
<td>15,000 inclusive</td>
<td>45,000</td>
</tr>
<tr>
<td>Fee for a consulting company providing computerised model</td>
<td>A deliverable</td>
<td>120,000</td>
<td>120,000</td>
</tr>
<tr>
<td>Local municipal finance experts (NIS)</td>
<td>4 person months</td>
<td>2,376 inclusive</td>
<td>9,504</td>
</tr>
<tr>
<td>Computer consultants (NIS)</td>
<td>4 person months</td>
<td>2,376 inclusive</td>
<td>9,504</td>
</tr>
<tr>
<td>Translation (Russian) of manual and investment program files</td>
<td>350 pages</td>
<td>12</td>
<td>4,200</td>
</tr>
<tr>
<td>Project Manager/Senior Expert in Municipal Finance (EAP TF)</td>
<td>5 missions</td>
<td>3,077</td>
<td>15,385</td>
</tr>
<tr>
<td>Local lawyers (NIS)</td>
<td>1 person month</td>
<td>4,400</td>
<td>4,400</td>
</tr>
<tr>
<td>Trainers for local authorities (NIS)</td>
<td>2 person months</td>
<td>2,376 inclusive</td>
<td>4,752</td>
</tr>
<tr>
<td><strong>TOTAL COST</strong></td>
<td></td>
<td></td>
<td>212,745</td>
</tr>
</tbody>
</table>
Option B: Estimated budget of pilot demonstration projects to be managed by EAP TF and financed by donors indirectly through EAP TF Secretariat at OECD (to be multiplied by 4 pilot projects)

<table>
<thead>
<tr>
<th>Category</th>
<th>Quantity</th>
<th>Price (EURO) per Unit/Deliverable</th>
<th>Total Cost (EURO)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Manager/Senior Expert in Municipal Finance (EAP TF)</td>
<td>3 person months</td>
<td>7,631</td>
<td>22,893</td>
</tr>
<tr>
<td>Municipal Finance Consultants (CEE)</td>
<td>6 person months</td>
<td>5,082</td>
<td>30,492</td>
</tr>
<tr>
<td>Local municipal finance experts (NIS)</td>
<td>6 person months</td>
<td>2,376/inclusive</td>
<td>14,256</td>
</tr>
<tr>
<td>Software programmers (CEE)</td>
<td>2 person months</td>
<td>5,082</td>
<td>10,164</td>
</tr>
<tr>
<td>Computer specialists (NIS)</td>
<td>2 person months</td>
<td>2,376/inclusive</td>
<td>4,752</td>
</tr>
<tr>
<td>Translation (Russian) of an existing CEE manuals</td>
<td>200 pages</td>
<td>12</td>
<td>2,400</td>
</tr>
<tr>
<td>Missions Europe-NIS (EAP TF Project Manager and CEE consultants)</td>
<td>10 missions</td>
<td>3,077</td>
<td>30,770</td>
</tr>
<tr>
<td>Local lawyers (NIS)</td>
<td>1 person month</td>
<td>4,400 inclusive</td>
<td>4,400</td>
</tr>
<tr>
<td>Production and publication of a multi-year investment plan</td>
<td>250 pages</td>
<td>12</td>
<td>3,000</td>
</tr>
<tr>
<td>Communications</td>
<td></td>
<td></td>
<td>3,000</td>
</tr>
<tr>
<td>TOTAL COST</td>
<td></td>
<td></td>
<td>126,127</td>
</tr>
</tbody>
</table>

7.3. Budget of the training session (other than the costs to be borne by the EAP TF)

<table>
<thead>
<tr>
<th>Category</th>
<th>Units</th>
<th>Total Cost (EURO)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conference facilities</td>
<td></td>
<td>To be determined</td>
</tr>
<tr>
<td>Travel and accommodation for trainees</td>
<td></td>
<td>To be determined</td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td>To be determined</td>
</tr>
<tr>
<td>TOTAL COST</td>
<td></td>
<td>To be determined</td>
</tr>
</tbody>
</table>
Annex I  Methodological approach

Current situation in municipal investment planning and budgeting in the NIS

The development of municipal infrastructure is of crucial importance for the future economic and social development of communities. A great part of municipal infrastructure has immediate impact on local environment and thus on the quality of life of citizens. This includes heating, water supply and sanitation, solid waste management and public transport infrastructure. Local budgets in NIS municipalities are very small compared to the tasks of maintaining and developing infrastructure services. Responsibility for many municipal infrastructure services was transferred to municipalities or Oblasts and delivered through local enterprises (for example Vodocanals). Due to the financial weakness of municipal enterprises, investments, if any, are usually made directly from municipal budgets. Most municipalities still cover at least a portion of operational expenditures of municipal enterprises.

NIS countries have traditional budgets and budgeting processes. Budgets are managed at the national and municipal levels. In large countries, such as the Russian Federation, Ukraine or Kazakhstan, administrative bodies at the third, intermediary level of administration (called Oblasts or Akims) also prepare and implement their own budgets. All revenues and expenditures are allocated annually through year-long financial plans. Neither a long-term vision of investment needs nor a forecast of the municipality’s future financial situation exists. On a national level a notable exception is the Public Investment Program in Kazakhstan.

The budgets delineate revenues and expenditures in accordance with a prescribed classification system defined by national legislation, along with a standardised chart of accounts. The abstruse classification system is a carryover from the Soviet administrative structure and was not designed with the particular needs of local government in mind. The budget preparation and monitoring system is focused on spending money in accordance with specified budget lines and does not correspond to the results or tasks to be achieved by municipalities. Expenditure classification system for current expenditures also is not relevant to the task performed by the administration, such as delivery of municipal infrastructure services. City authorities have little information on how much money is used by various utilities or how much money is needed to implement various tasks over the years. Although most municipal tasks are underpaid, it may well happen that some receive too much budgetary funding than needed. This may be particularly the case with inefficient subsidies to municipal utilities. With current budget structure, however it is difficult to track the effects of reforming municipal subsidies. Through a reform of financial management systems, municipalities could provide better and more extensive services to their citizens with the same amount of money in the budget.

Investment planning in NIS municipalities is focused not only on short-term outputs, but also on priorities, that are often too numerous and too volatile. There are no clear and transparent criteria for appraising and prioritising investment projects that will be financed from municipal budgets. Money is typically allocated ad hoc to projects “where the situation is the worst,” although a definition of what is “the worst situation” is ambiguous and discretionary. If anything, only public procurement rules are applied in investment process in the countries that have appropriate legislation. Consequently, a small fragment of project cycle management is used. Improving budget preparation and monitoring processes may result in significant savings through subsidy reform and better prioritisation.

Better investment planning and budget management could enhance creditworthiness of the municipalities. It helps control municipal debt and makes it easier for municipalities to raise external finance from domestic and foreign financing sources, where they have rights to do so.
There are well-managed municipalities in NIS countries, especially in some of the larger cities. These municipalities begun to accumulate experience in investment planning with a longer time horizon. A market for consultants to assist municipalities in better financial management, in raising external debt and in providing independent municipal credit ratings is slowly emerging. However, the know-how in multi-year investment planning and task-based budgeting is still extremely scarce among NIS experts. Bringing Western consultants on a "project-by-project" basis solves part of the problem only. It does not necessarily lead to the sustainability of the consulting services, and above all it contributes very little to the transfer of knowledge of how to make a successful transition from the current budgeting and investment planning practices to the multi-year investment plans and task based budgets.

### Better financial management

Financial management is the planning, budgeting, utilisation, recording, monitoring, and reporting of financial resources in a manner that minimises costs, maximises outputs and provides for efficient resource allocation and use through effective decision making. A sound financial management system facilitates the communication of financial information to interested parties, enhancing access to credit and other outside resources through its demonstrated conformity with the principles of accountability and transparency.

A comprehensive financial management framework for local governments should consist of the following elements:

- A vision or set of long-term objectives for the municipality that is achievable and measurable
- An system for valuation and recording of fixed assets and assessing their condition
- A long-term investment plan that addresses foreseeable requirements for infrastructure development and municipal service delivery, including the provision of adequate maintenance to insure efficient asset utilisation
- An accounting system that ensures accurate recording of all financial transactions
- An information and reporting system that enhances effective decision making
- Indicators of financial performance that permit trend analysis and intergovernmental comparison
- A budgeting process that addresses municipal vision and investment demands while ensuring transparency
- Linkages between the municipal budget and expected outcomes that facilitate the measurement, verification and costing of key services

In the present framework all expenditures are allocated by a single year financial plan called a budget. The annual nature of budgets prevents local governments from making multi-year appropriations. The fact that all revenues must be spent by the end of the financial year makes it difficult to set aside funds for future debt retirement, as there is no permissible accounting mechanism for the establishment of significant reserves or designation of funds for such purposes.

The major constraints of the local budget include the following:

- single year horizon,
- all values in budget are classified according to budgetary classification, which is unclear and non-transparent.

These attributes make the budget document difficult to analyse and render it a poor management tool. An improved and task-oriented budget preparation process is also important because it rationalises operating expenditures and subsidies to municipal entities.
Several modern financial tools that assist local government in better management of their finances were developed and implemented in CEE countries (most of them in Czech Republic, Poland, Romania and Hungary). From an environmental infrastructure point of view, the most important tool used to avoid constraints of the local budget procedures is a "multi-year investment plan.

**Multi-year Investment Planning**

The project preparation stage itself takes longer than one year for most infrastructure projects and when the implementation period is also considered, the only conclusion is that infrastructure investment planning must be long-term. The tool that helps municipalities to develop a long-term financial vision is the Multi-year Investment Plan.

Multi-year investment planning is a process of selecting strategic investment projects in a long-term perspective that achieve the largest possible benefits (financial, social, ecological and other) as a result of their implementation.

Multi-year investment planning includes the following elements:

- multi-year financial plan:
  - revenue forecast
  - forecast of operating and maintenance expenditure
  - service and repayment of liabilities incurred
  - amount of debt to be incurred
- total funds intended for investments projects
- clear selection criteria and investment project priorities
- list of investment projects to be implemented along with the material scope and sources of financing year by year.

There are several objectives of multi-year horizon in investment planning:

- it introduces a multi-year perspective in addition to one-year planning,
- it ensures that investment project selection is objective,
- it establishes transparent selection criteria for investment projects,
- it serves as a tool for developing implementation strategy.

There are several advantages of implementing a multi-year investment plan

- realistic overview of all needed funds and all expected revenue,
- decreased influence of current politics on the investment process in municipalities, in particular on the project selection process,
- more realistic priorities and improved resource allocation,
- concentration of resources and faster implementation of investment projects,
- reduced practice of overstating needs,
- improved transparency for the local community,
- facilitated access to external sources of finance through improved debt and risk management.

A financial forecast of the local budget, including revenues and expenditures, debt to be incurred and debt service forecast as well as a list of investments with identification of sources of financing creates a long-term perspective of local finances.

Since both the local government and the financial institution can assess the ability of municipality to repay debt, this tool is designed to convince local bodies and financial institutions to employ debt financing of investment projects.
A multi-year investment plan, by organising and rationalising the municipal investment process, often decreases losses during the planning and implementation period. By concentrating on only the few investment projects, most desired by local community, the municipal government may build more cheaply and quickly. External financing, like loans, also speeds the whole process by securing financial sources.

Municipalities can use the multi-year investment plan as an additional document for a loan application. A very similar methodology is used to prepare municipal bonds, but in this case a special memorandum is required.

**Task Based Budgeting**

As mentioned above, local budgets are prepared according to budgetary classification, which is not relevant to the task performed by the administration. The budget preparation and monitoring system is focused on spending money in accordance to specified budget lines. This system is not transparent and includes only expenditures in terms of money, with no connection to the results to be achieved due to the operation or investment.

The task based budgeting is a procedure in which the administration staff develops detailed plans to be accomplished. The basic structure of this plan consists of programs and tasks. Each task is defined by:

- a clearly specified objective,
- a schedule of all activities and expenses,
- a quantitative result to be achieved,
- a calculation of expenditure needed (sometimes including own resources),
- the person(s) responsible for implementation.

When the budget preparation procedure is completed, it is converted into the traditional budgetary classification, but with analysis and full knowledge of detailed plans and results to be achieved over several years. Then the administration can introduce performance monitoring of planned activities. Such monitoring is impossible when the traditional budget preparation process is used, because only expenditures are known, without any connection to the results to be achieved. The task-based budgeting improves planning quality and efficiency.
Annex II  Related programmes and donor activities in CEE and the NIS

EAP Task Force
The EAP Task Force provides needed support to NIS to improve environmental policies and conditions. Specifically, the Task Force:

- Promotes analysis and exchange of experience among NIS on key environmental policy and institutional reforms;
- Develops guidelines and best practices for environmental policy and institutional reforms based on experience in the NIS, CEECs and OECD countries;
- Identifies ways in which environmental policy reform can be integrated into the broader process of economic and political reform;
- Works with donors, including the Project Preparation Committee (PPC), to strengthen support for capacity building to implement demonstration projects which can serve as models for environmental reform and to remove obstacles to investments in the environmental sector;
- Co-operates with the governmental and non-governmental sectors to build public and political support for environmental protection.

In the years 1999-2000 the EAP Task Force has facilitated the development of national and regional environmental finance strategies in several NIS countries. The financing strategies introduced more realism and longer-term perspective into the programs of maintenance and development of environmental infrastructure at the country and the "Oblast" level. This top-down financial planning process needs to be matched with equally realistic and long-term project pipelines developed from the bottom-up, at the municipal level.

USAID
The most important USAID program in the area of municipal finance in the CEE and the NIS was the pilot local government partnership program (pilot LGPP). It covered single activities in a number of municipalities in the CEE and NIS countries. During the Pilot LGPP, several municipal financial models were created and tested, such as a creditworthiness model for local governments in the Czech Republic and GFAM (Gmina Financial Analysis Model) in Poland. Unfortunately the Pilot LGPP, working with a small number of municipalities and with isolated tools, did not have the opportunity to disseminate widely its methodology. LGPP focused on technical assistance to improve standards of municipal financial management not only when seeking credit, although analytical tools were based on creditworthiness analyses prepared in previous USAID activities. Financial management activities were focused on credit rating enhancement and reporting, as well as laying the groundwork for strategic, long-term approaches to municipal budgeting. Technical assistance was provided to several dozen municipalities in CEE countries, but financial management was included in only a few of the TA packages. Other assistance for CEE cities, that included elements of financial management, were Local Government and Housing Privatization (LGHP) and East European Regional Housing Sector Assistance Projects in the Czech Republic and Romania. These projects covered elements of municipal accounting, reporting and auditing (including financial reporting, municipal financial statements and credit rating). Following the pilot phase LGPP was successfully developed in Poland, where it covered 340 municipalities and facilitated technical assistance in financial management in over 150 communities. In the NIS USAID cooperates with selected cities in enhancing their creditworthiness. USAID, in conjunction with the Urban Institute, established the Institute for Urban Economics in Moscow and associated with them EA-Ratings affiliated with Standard & Poor’s. In Ukraine, USAID began its activities in municipal finance in 1993 through its Municipal Finance and Management project, where USAID supported efforts in three pilot cities to increase the effectiveness, accountability and openness of local government, and to boost citizen involvement. Improvement of
administrative procedures and budget management by local governments was the goal of the USAID-funded Effective Local Government Project (1997-1998) where six Ukrainian cities were assisted in the improvement of budget and financial management through the use of financial analysis models. Another USAID activity aimed at local government managerial capacity building and citizens’ involvement in decision-making was the Community Partnerships Program for Training and Education (CPP) that paired 18 competitively selected cities in Ukraine and the U.S. The CPP provided training to Ukrainian government officials in U.S. and Polish local government practices through internships to the U.S. and in-country training in the cities and at four Regional Training Centers (RTCs). An important part of this activity was to provide training of municipal officials from the partner and non-partner cities in strategic planning and the use of financial analysis models. Issues of local government’s access to capital were addressed through two separate activities. First, the USAID Municipal Development Loan Fund project helped two municipalities, with the assistance of citizens’ task forces, develop business plans for infrastructure projects which could be funded by World Bank loans in the future. Both communities chose water and heating improvement projects. Secondly, the Budget Reform Activity worked with the GOU and the Parliament in order to support the implementation of the formula-based intergovernmental budget funds transfers. Currently, USAID Municipal Water Roll-out and Tariff Reform and Communal Services Enterprise Restructuring activities work with Ukrainian cities to enhance their access to capital for urban infrastructure improvements through improved financial planning and budgeting, and by assisting them to become eligible for the IFI’s loans. In particular, USAID provided assistance to the Lviv Vodokanal in its preparation for the pending World Bank loan for water and wastewater infrastructure improvement, and completed pre-feasibility studies in eight Ukrainian cities for EBRD Ukraine Municipal Utility Development Programme that is to provide loans for a number of cities to improve their water/wastewater infrastructure, per request from EBRD.”

World Bank
The World Bank provides large-scale loans for municipalities in the CEE and NIS countries. The Bank also provides loans for governments, which then are delivered to municipalities as grants for investments in selected sectors. World Bank loans for municipalities always require sovereign guarantee issued by the central state government. Loans are also contingent upon a detailed preparation stage, including an analysis of creditworthiness and a presentation of a long-term vision for local finances. Some loans are supported by technical assistance for recipients. (for example, the Polish Rural Development Programme supports all municipalities that are to receive grants).

EBRD
Under the operational approach in municipal and environmental infrastructure sector the EBRD envisages expanding its presence in the NIS and creating a sustainable project pipeline. In its project preparation and financing activities EBRD would concentrate on financially sustainable municipalities and Regions with proactive reform-minded governments who recognise the importance of municipal services sector restructuring and are active in this direction. In principle, EBRD can lend directly to municipalities, without sovereign guarantees, but in the NIS the municipal credit risk is perceived as still to high. Many municipal and environmental infrastructure loans of EBRD involve technical assistance packages provided by donors aimed at enhancing creditworthiness of municipalities. Several technical assistance projects are in the pipeline. Municipal and regional creditworthiness enhancement programmes are designed to strengthen local and regional budgetary process and create project implementation and monitoring capacity at the municipal and regional levels.

European Union
The European Union is collaborating with NIS countries and Mongolia through the TACIS programme. About 15 per cent of the total TACIS budget is allocated to “public administration reform, social services and education.” These programs are, however, only marginally address local financial management problems.