GLOBAL TASKFORCE
OF LOCAL AND REGIONAL GOVERNMENTS
FOR POST-2015 DEVELOPMENT AGENDA
TOWARDS HABITAT III

SDGs will not be achieved if financing does not reach local levels

A briefing on the position of the role of local and sub-national governments in the deliberations related to the Financing for Development Conference.

The Global Taskforce of Local and Regional Governments facilitated by UCLG gathers over 30 networks that are active internationally. Please visit www.GTF2016.org or write to globaltaskforce@uclg.org

The preparatory documents for the Conference on Financing for Development focus on international and national public and privates finances. Although "*many of the investments to achieve the SDGs will take place at the sub-national level and be led by local authorities*" (UN Secretary General Synthesis Report, p.94), the current debates do not raise the question of sub-national access to finances. Sub-national levels are a key dimension for sustainable financing that should be integrated into the debate for Addis Ababa.

Cities and territories are where women and men live, where poverty is tackled, where prosperity is generated, where health and education services are provided, and where ecosystems are protected on the ground. **Massive public and private investments** will be necessary to improve access to basic services in cities and territories to eradicate poverty, cope with the impact of climate change and to build the new cities that will host 2.5 billion new urban residents over the next three decades, mostly in developing countries.

The Conference on Financing for Development must lead to further reflection on the mechanisms that will allow for the **mobilization of funding necessary to promote sustainable local development, as well as for unlocking the economic potential of urban areas and territories**. How can local governments mobilize part of the wealth produced within their jurisdiction (domestic resources) to finance and support local development? What conditions are necessary to capture public and private resources at local, national and international levels, in order to meet the funding needs for infrastructure and the provision of basic services? How can we improve access to long-term investments for sub-national institutions and strengthen their capacities to deliver services, particularly in poor areas?

1. Strengthening the mobilization of domestic resources

The mobilization of endogenous resources seems to be crucial to the future of many countries undergoing rapid urbanization. Under certain conditions, the "city must be able to better finance the city", through optimal support for local financing with relation to land and property income as well as the productive urban economy. The history of urban development proves this.

However, the mechanisms enabling local public authorities to mobilize part of the wealth produced within their jurisdiction to be reinvested in local development in a transparent and efficient manner are not in place in many low and middle-income countries. Local taxation remains underdeveloped, and conditions to capture a portion of the capital gains in land value and the added value of economic activities are often not met.[1]

[1] See UCLG; Global Report on Decentralization and Local Democratie (GOLD II). In the late 2000s, local governments spent around USD 3000 – 4000 per person annually in the USA and in Europe, but just USD 36 in Africa. In Eurasia the average annual budget for local governments in terms of expenditure/person is around USD 232; in Latin America it is USD 133; in low- and middle-income countries in Asia it is USD 92.

Reforming local financing

Generally speaking, local governments lack the buoyant tax sources that would produce revenue growth in line with their increasing responsibilities. The vast majority of taxable goods and services are often concentrated at the national level, and systems of redistribution to local governments through transfers and grants do not guarantee equitable distribution. Furthermore, **local tax bases are very narrow and highly dependent on property taxes,** only yieldjng an average of 0.5% of GDP in developing countries, with revenue potential rarely achieved.[2] Property tax is indeed particularly difficult to manage in countries that do not have proper land registers, where informal construction is widespread, and where capacities are insufficient to assess property values. Hence the difficulties in ensuring the implementation of the tax and its collection.

Therefore, diversifying and expanding local tax bases seems necessary. Some countries allow local authorities to benefit from part of national economic growth **through the taxation of economic activities, people's income or local sales** (VAT).[3]

Unlocking land values to finance urban infrastructure

The capture of part of the land added-value, originated by the public authorities' investments (e.g. in roads or new equipment), is a very promising way to finance urban investments, especially in countries undergoing a rapid urban growth. By producing substantial immediate revenues that enables the reduction of dependency with regard to debt, this type of financing seems well suited to growing cities. It also helps to enhance the efficiency of urban land markets, and direct urban growth towards areas most suitable to accommodate it effectively.[4] Western cities largely financed their development in the 19th and 20th century with such resources, and more recently, some Latin American[5] and Chinese countries use these mechanisms to support urban development. However, in many developing countries, fiscal tools, both regulatory and institutional, are not in place to ensure that local governments can benefit from this fair "return on investment".

According to recent experiences, the land value-added **contribution could represent between 10 and 50% of public investment made**[6] in the context of development or urban restructuring projects. In general, the mobilization of local resources helps improve financial equilibrium within local governments, and at the same time strengthens their borrowing capacity.

2. Strengthening long term financing in infrastructures and basic services

Whether through direct loans or private capital contributions, including in the form of special purpose companies, PPPs or infrastructure facilities, local governments must have access to long-term financing to cover investment needs. Access to loans and financial markets has been the backbone of most infrastructure investments in Western cities over the past two centuries. Cities have led this process, supported by central governments.

Today, in emerging countries, an increasing number of cities are borrowing to expand service provision through loans and bonds. However, in many low- and middle-income countries, local government borrowing is legally constrained. Restrictive institutional frameworks, weak

[2] United Cities and Local Governments, *Local Government Finance, the Challenges of the 21st Century, Second Global Report on Decentralization and Local Democracy,* NY/London, Edward Elgar Publishing, p.322

[3] Brazil, Chile and Colombia, for example, have adopted various types of local taxes based on economic activities; several countries in Europe and North America resort to a local tax or surcharge on personal income; taxes on local sales are notably used in Canada and the United States. Morocco, has given 30% of VAT to local governments, but in the form of transfers.

[4] George E. Peterson: "Unlocking Land Values to Finance Urban Infrastructure", World Bank and PPIAF Trends and Policy Options collection, No.7.

[5] Several examples in Brazil and Colombia in particular. The experience of São Paulo could also illustrate this point well.

creditworthiness and local administrative constraints curb access to finance for local governments outside of metropolitan areas and large cities.

Regarding reimbursable resources, private investors and financial institutions require sound financial management of local governments, its long-term stability and ability to generate revenue in a sustainable way. In the same vein, in directly funding a public service, investors conduct due diligence processes to ensure performance and long-term profitability.

In this context, providing increased institutional capacity to local governments should be a priority in both the national and international agenda. The legal, institutional and financial decentralization framework is critical to create enabling environments for local authorities.

In a context where risk and creditworthiness take a prominent place, **the commitment of central governments to support local governments is indispensable and** can facilitate the access of the latter to adequate resources. In many low and middle-income countries, municipal financial institutions (MFDs or SFIs) have been created to provide local governments with access to investment capital. Although we need to recognize some of those experiences have had disappointing results, some important success stories[7] are worth considering. Despite their shortcomings, SFIs play an important role in the credit enhancement of sub-national governments and utilities.

International and regional development banks already play an important role in financing urban basic service infrastructure in different regions. However, these banks lend to national governments and the private sector, rarely granting credits directly to local governments. In order to overcome institutional barriers other options should be explored (e.g. innovative credit enhancement for sub-national loans to improve local governments' access to private finance and reduce foreign exchange risks).

Beyond their role in securing new resources, international finance institutions also have a critical role to play in supporting decentralization reforms (notably taxes reforms and predictable intragovermental fiscal transfers), creating legal and regulatory frameworks for public-private partnerships, providing grants and credit enhancements for the development of infrastructure projects, securing investors,[8] and helping to develop subnational debt markets. It is essential that development partners support local governments directly, promoting city-to-city cooperation and developing financial instruments adequate to meet their needs[9]. ODA will also continue to play a significant role in financing basic infrastructure and social service investments, particularly in low-income countries. Finally, access of local governments to global, regional, and national climate-change financing mechanisms (e.g., Green Climate Fund, GEF, etc) should be promoted in order to facilitate investments in adaptation infrastructure.

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The Third International Financing for Development Conference will not reach its objectives without devoting attention to local financing and containing recommendations related thereto. The *Global Task Force of Local and Regional Governments* is contributing to the success of Financing for Development and the formulation of an effective Outcome Document providing the inputs of local elected officials and practitioners.

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[7] The limited performances of SFIs are associated with problematic loan designs, market narrowness or professional weakness and politicization of lending decisions. With regard success stories, it is worth mentioning: Findeter in Colombia and FEC in Morocco; local development banks such as BNDES and CEF in Brazil.

[8] The case of the city of Dakar illustrates well the process of strengthening of capacities of the local government, supported in a dynamic manner by international donors. The city of Dakar should have access to financial markets for borrowing by February 2015, 50% of its debt being guaranteed by the US Treasury Department.

[9] Examples of pool financing mechanisms in India, Philippines, Kenya, and Colombia; and related study for local projects in Latin America supported by the CAF, and for Johannesburg with support from the FMDV and AFD.