CONDITIONS FOR MOBILIZING LOCAL FINANCE RESOURCES FOR A SUSTAINABLE URBANIZATION

Note : Record of the conclusions of the 1st phase of the study and launch of the second phase

Table of content:

I. Background of the study

Urbanization has the potential to play a large role in sustainable development. It has however been undermined by past and present shortcomings in investment: various studies have shown that current expenditures would have to be expanded at least two-fold in the next two decades.

A way to fill this gap between actual needs and available means is to strengthen local finance. In this regard, general international agreement has been reached around a number of recommendations in favor of decentralization, particularly finance-wise. Around the world, a widespread decentralization trend is indeed pushing local governments to undertake major responsibilities in every environmental, economic, social and cultural aspects of urban development.

However, there is a mismatch between the competences vested in those local governments and the financial resources at their disposition: studies conducted in the context of the Millennium Development Goals show a strong correlation between the limited results of the MDG and the fragility of local taxation, the lack of funding of local governments by the central ones, and the inability of the local scale to raise external funds, on both domestic and international markets.

Habitat III conference (Quito, October 2016) offers the opportunity to frame and apply a new roadmap in favor of a coherent and lasting urban finance answering to sustainable social and economic goals while addressing climate-change-related challenges.

What are the dynamics operating here ? What burdens hamper financial decentralization? What are the financial mechanisms that shall be strengthened in order to exert a leverage effect on investment? To which context are they adapted – or not – and what are the legal, economic and cultural prerequisites? How to improve performance and coherence of local governments financing systems?

In this context, UCLG – notably through its Committee on Local Finance for Development – has engaged in the capitalization of technical knowledge and local practices to support the plea of local governments on the international stage. These studies specifically aim at analyzing what drives urbanization funding public policies to success, following a territorial approach centered on local governments' *main sources of funding*.

- Taxation and recurring local resources (local governments' structural resources, enabling the operation of public services);
- Mobilization of real estate and land value gains (endogenous resource enabling the "city to finance itself");
- External long term resources (refundable resources enabling to exert a leverage effect on the funds dedicated to investment, mainly loans and public-private partnerships)

Those three components of the study were completed in two distinct phases.

<u>A deductive analysis of the literature</u> shows, on the basis of documented examples, the necessary conditions to an effective use of the various financial instruments. This phase is

in its final stage. The arguments-fueling examples are organized in a database that will soon be available on UCLG Committee on Local Finance for Development's website1 .

A further approach to the targeted issues based on case-study analyses (a dozen cities) will enable the inductive formulation of international recommendations to UCLG members. The unfolding of this phase will be spread among the experts of the three components. It will be based on the involvement of selected cities' chief financial officers, in order to develop the analysis jointly with local actors. College students interested by the study could be brought in to help. Thus appropriated, the analyses aim at identifying the actions to take to implement one or several financing projects[2].

The study is coordinated by UCLG Committee on Local Finance for Development, under the supervision of a steering committee consisted of the experts, financiers and its partners.

II. General remarks on the 1st phase of the study

2.1. A heterogenous field

At the international level, there are several decentralized entities[3] of multiple kinds. They belong to much contrasted regional and national development contexts, and refer to various interpretations and applications of the subsidiarity principle. They finally display a great diversity of dynamics, institutional capacities, and multi-body governance qualities. Furthermore, within the same country, there are several non-financial variables (economical, geographical, regulatory, political, etc.) at play in the political and financial management of local governments.

Administrative systems and local governments prerogatives are the result of a country's trajectory, of its governance mechanisms, and of its political and economic past and present contexts. To pursue proactive reforms, it is therefore necessary to account for the nature and persistency of those mechanisms and to understand how they influence the long term viability of local public finance's evolution.

This composite environment translates into a great variety of local finance instruments that combine with and adapt to national and local contexts. They so adapt that every single resource mobilizing mechanism is specific. It is thus very difficult to put on an exhaustive list of local governments' financing tools that would fit the actual conditions of resource mobilization; and it is equally difficult to come up with an standardized toolkit that would allow for an innovative potential equivalent to that generated by subsidiarity when it comes to engineering local finance.

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[1]www.uclg-localfinance.org

[2]This study could lead to a third operational phase capitalizing on “pilot projects”

[3]*“99,9% of the world's governments are local governments”* (cf Joseph Roig's intervention).

However, a number of key-factors were highlighted in each of the three components' reports. They will help setting up a structured framework of analysis. This will enhance the creativity of local governments, as they define their financing needs and means.

During the second phase of the study, this frame will enable us to identify the contexts in which selected cities did or could act and what levers they did or could use, in oder to improve their capacity to mobilize local resources.

2.2. A literature essentially revolving around emerging cities

Methodically, the first phase of the study is based on existing literature and the experts' skills. Thus, this approach focused essentially on the cases best documented, either for their success or their innovative character. Literature tends to multiply the sometimes redundant examples of "exemplary" metropolises located in high or medium income countries[4]. In the present synthesis, we tried to correct that bias. We reintroduced African analyses developed by UCLG-Africa and, for the same purpose, we will pay particular attention to cities of low revenue countries during the case study selection for the second phase of the study.

In this regard, the contribution of African situations is important. The continent is host to all steps of national and local fiscal deployment, from inertia to innovation. Furthermore, it displays some national examples of evolving economic models of infrastructure funding progressively involving forms local resources mobilization. A screenshot of those African examples will allow us to describe the state and nature of local budgets resources, and to understand the dynamics of both the systemic variables and processes (not only financial ones) that could explain how collectivities could reinforce their capacity to mobilize resources extracted from their territory. In this perspective, African transition could be revealing, when it comes to local resources.

Through its field work, the second phase of the study will go beyond expertise. It will turn to local representatives to understand the deciding factors and the trajectories of their financial practices. If the first phase of the study - partially – answered the question of "which instruments in which contexts?", the second phase will address the question of "which contextual evolutions will allow for the use of which new financing tools?" The final goal will be to understand the determining factors in the reciprocal relation between tools and contexts and to make a dynamic analysis of it.

[4]Literature review for the 1st phase of the study has focused on case studies of which 50% were located in developed countries, 45% in countries with intermediary revenue, and 5% in the less developed countries.

III. From the assessment of needs to the mobilization of resources.

3.1. The financing needs and their evolution

The assessment of financing needs is a delicate exercise the the present study does not mean to fully tackle. Beyond the fact that the very notion of need is subject to various interpretations, studies take into account very different parameters from one another. They do not always distinguish urban investments from major national structuring bodies, and even less those that depend from local or national funding.

Let us focus on an order of magnitude: according to the international experts committee on development finance[5], $5 000 to $7 000 billion a year will be necessary to cope with investment needs in the next two decades. McKinsey institute6, studied different sectors and estimates there will be a need for a 60% increase in the budgets allocated to investments in the next 18 years compared with what has been done in the past 18 years – and that it will take 3,5% of forecasted global GDP. The share of those investments that would be undertaken by local governments is estimated to be 30%7.

In its second phase, the study will thus focus on an easier notion to grasp: demand. It will be assessed for each local government on the basis of its territorial project and according to the priorities set by political leaders. Those amounts will be referred to available means, considering the resources that can be mobilized, as for investments than for the recurring operational costs induced.

Indeed, the contribution of decentralized collectivities to local economic development mostly consists of delivering services and utilities adapted to local contexts and citizen preferences. Induced operational costs should be covered by recurring resources[8]. It is usually not the case: the observations made by the authors of the Gold II[9] report are still pertinent. Local budgetary imbalance is pretty much endemic in most developing countries.

3.2. The funding demand elaboration process

The perception of needs by deciders is, first of all, tied to actual needs: demand for infrastructure, basic urban services, catch-up, economic or demographic growth, etc. It is equally tied to the anticipated impact10 of answering those needs. Let us take for example

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[5] http://www.un.org/esa/ffd/wp-content/uploads/2015/03/SummaryICESDF_Fr.pdf (2014)

[6]McKinsey Global Institute (2013) : "Infrastructure productivity : how to save $1 trillion a year".

[7]Sources : World Bank and UCLG

[8]Taxes, user fees, transfers.

[9]GOLD II (2010) – Global report on decentralization and local democracy: «Local Government Finance : The Challenges of the 21st Century ». CGLU - Ed Bruyant.

[10]Some needs can more or less be "accounted for" by local leaders as serving their own interest (that can overlap with general interest as they perceive it but is face from equating to it), which directly impacts their rank. Roads and water supply are very noticeable by the population. Supply and valuation

the social stability created by access to public service, high employment rates on the territory, or the satisfaction of influent economic groups. The processing of a need in equipment into an actual financing request is the result of a slow process made of confrontations, negotiation among actors, conflicts and arbitrations. It implies political, institutional, economic, social and cultural aspects. Decrease in more traditional funding11 and lack thereof, as well as the relative cost (financial, economic, political or social) of alternative options12 complete the driving forces. Those may go through a both iterative and progressive process of arbitration, negotiation, conflicts and opposition. For the financing to be implemented, its potential benefits (that also depends on legal capacities and operational tools) have to exceed its financial and political costs. It has to enable the mobilization of enough extra resources for the consequences of its use to be deemed worthy by those controlling it and those with the power to block it.

Those decisional processes underlying the advent of a funding request will be thoroughly analyzed during the second phase of the study.

3.3. The choice of resource mobilizing tools

Chosen tools theoretically depend on the nature of the spending to cover and the local government's mandate. According to the principles of decentralization, actions decided by local governments would have to be funded by their own resources. It is the one necessary corollary to decentralization. Some public utilities should be financed – at least in part – by user's fees. Finally, spending transferred to the local governments by central ones supposedly in charge of it should be covered for by transferred tax money or financial resources coming from the latter.

of new land is a vital need to the real estate sector. Transportation and access are major issues in economic development. Sanitation, costly and less obvious, has long been an often-forgotten aspect of structural urban investment.

[11]Reversal of primary annuities export prices, impossibility to contract more debt on national or international markets, excessive local or national debt, inadequate endowments, negative tax yield, unreachable subsidies,...

[12]among which non-funding or absence of any action

Local budgets funding principles

Decentralized Budget	
Spending	Revenue
<u>**Tasks and responsibilities repartition**</u>	<u>**Resources repartition**</u>
[1] Local public goods (LPGs) of their own right *(Choice)* = devolved responsibilities	**[A] Own-source taxes** - shared tax(es) - specific tax(es) - choice between taxes and user fees
[2] Specific tasks (devolved or delegated)	**[B] User fees**
[3] Delegated tasks *(Agency)* - general - incentives	**[C] Endowments and subsidies** - unassigned endowments or shares / taxes - specific incentive subsidies

Source: Dafflon & Gilbert

When it comes to financing tools, those principles range in two distinct categories: <u>endogenous instruments</u>, answering to a public finances logic (mostly recurrent taxation and land value gains), and <u>exogenous ones</u>, following a market logic (loans, PPPs, PSDs) to which we can add grants and external subventions. We will come back to those later to define them and contextualize their implementation. The tricky articulation – and even sometimes opposition – between decentralization and deconcentration adds to this combination of missions. Federal and unitary states also have to be distinguished.

3.4. Pools of available resources

Through taxation or recurring resources, land value gains or external funding, potential pools of resources do exist. At various degrees, cities around the world are powerful machines when it comes to generate indiscriminately either added production value or land and real estate value gains. Based on those endogenous resources, cities should be able to access to external funding, by the means of loans and PPPs. The sum of global savings could actually cover for sustainable development funding needs[13],. Endogenous resources pools are yet modestly mobilized. The "actual local taxation / GDP" ratio is on average quite low, especially in developing countries. The economic model for long-term funding of cities in those most of the time suffers from structural imbalance. As a matter fact, for over two decades, decentralization and shrinking States have caused the infrastructure prerogatives of cities of "the South" to broadly widen. In the meantime, their

[13]The intergovernmental exerts committee on development finance report (2014) estimates the world's savings (public and private) around US$22 000 billions a year

capacity to generate added value through production or rent[14] has increased (to various extents). Still, legitimate taxation[15] of part of this resource has not systematically been implemented in proportion to what was at stake. Some dynamic local governments have taken efficient measures when some have been crippled by degraded infrastructures, proving urbanization economic model to be hard to balance.

Financial importance of local governments in public finances, by geographic region[16] :

Region	Local Revenue in % of Total Public Revenue	Local Expenditure in % of Total Public Expenditure	Share of Local Expenditure/Share of Local Revenue
Africa	3.2 (3.6)	7.9 (6.8)	2.47
North America	17.8 (0.6)	26.6	1.49
Latin America	4 (4.5)	11.1 (7.3)	2.78
South Asia	1.5 (0.9)	16 (0.9)	10.67
South-East Asia	5.3 (0.8)	15.5 (0.6)	2.92
East Asia	20 (0.3)	40 (0.3)	2.00
Eurasia	N/A	26.5 (15.1)	N/A
Europe (2008)	13 (0.7)	23.9 (0.5)	1.84
Middle East and Western Asia	N/A	4.6 (1.7)	N/A

Note: Coefficient of variation in parentheses.

To promote a balanced and sustainable urbanization, synergy between State and local governments in matters local public infrastructure funding is an absolute necessity. Top-down financial transfers must of course be maintained. However, the end of the welfare state paradigm in which public economies are financed by debt and inflation, combined with a decrease in mainstream revenues17 are forcing national approaches to local finance to evolve. In this situation it is in the interest of States to accompany and reinforce local governments in their capacity to mobilize local resources pools that are still widely underexploited by public authorities in the development context.

[14]Real estate or land rent

[15]As they are mainly generated by public equipment

[16]Source : GOLD II (2010) page 315, data collected between 2007 and 2009.

[17]National public resources depending on international trade indirect taxation will, for example, shrink with the expansion of free-trade zones.

Territorial community infrastructures under municipal management use economic models most of the time imbalanced in the long term. Local equipment needs are by nature growing, when actual resources are permanently insufficient and even depleting when they come from the State. However, leveling would not be appropriate. Municipal situations are indeed much contrasted between regions of least advanced countries and those is emerged economies.

Furthermore, will and capacity to respond vary from a territory to another. Some local governments innovate and implement efficient solutions. Some progressively reform their financial systems. Some cannot even start a response process to the infrastructure funding challenge. But in no way can this gap between local funding needs and mobilized means be explained by the lack or depletion of local resources pools[18], nor by the absence or mismatch of financial instruments.

It is clear that the reasons for this recurring and growing mismatch are to be found in the context of mobilization of local resources. The capacity of States to fund infrastructure fails to expand while potential input from local governments is not solicited enough. In an important number of developing countries, it is way below its potential and territories' needs.

IV. Main drives to the mobilization of local resources

At this stage in the analysis, the variety of local governments' contexts and dynamics, added to the diversity of instruments and the wide range of available resources lead us to attempt an approach based on the studies reports.

This approach should allow us to go past the mainstream perception that, first of all, reasons in "averages" in a heterogeneous constellation of very diverse localities and financial engineering practices and, on the other hand, solely describes the use of financial tools without explaining how time and needs shaped them so they could be put to use today.

We are no more concerned by how local governments manage to fund all or part of their infrastructure. We are now trying to understand why some are able to do it and acquired adapted tools, why some are barely engaging in this process, and why some seem helpless (or seem not to be attempting anything) to develop their financial engineering means.

To address this systemic perspective, we need to start from the many empirical examples provided by the sectorial studies conducted during the first phase of the study. Those have observed both contexts and mechanisms of financial engineering, and revealed discriminating factors in local resources mobilization trajectories.

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[18]Even though potentialities depend on material and immaterial resources and on territorial growth and density

4.1. Development levels and dynamics

The three components' reports bring us to consider that development levels and contexts are connected with, first, the occurrence of local finance instruments and their combinations and, second, the acuteness of certain difficulties and processes met by local financial engineering.

The connection between development modalities, taxation and local resources mobilization is well identified: let us remind that local governments in developed countries members to the OECD receive 30% of national resources to perform 70% of civil investments. Developing countries data is lacking and satisfying comparisons cannot me made[19]. However, when it comes to local taxation, financial transfers, land value gains or access to external resources (loan, PPP, climate finance), examples drawn from literature clearly show the shortcomings in the implementation of those tools in developing countries, especially in the least developed ones (LDC).

Thanks to the situations described by multiple experts' approaches, the mobilization process however appears to be gradual and progressive: modalities (intensity, complexity) of local resources mobilization happen according to a continuum correlated with national development level.

Related factors will participate to facilitate, strengthen, amplify or, on the contrary, impediment this mobilization. Modalities according to which subsidiarity is implemented and the way governance is exercised between layers of government and towards economic actors or populations are key variables in the mobilization of local resources. In any case, the implementation of tools, their choice and their adaptation to local context are explained by series of local contextual factors that constrain us to distinguish between general tendencies obtained on averages and the progressive trajectories of cities or countries that witness the positive evolution of their local financial engineering.

Using the land value gains example again, it is "stronger in demographically and economically attractive cities"[20], the dynamism of which creating land pressure and demand. The use of those tools could be considered in a great number of LDC cities going through important demographic and economic growth.

The challenge of the study lies here: working on incremental situation, emerging signals showing that local funding conditions are not always steady and that variably perceptible singular tendencies can appear in certain circumstances. The idea is precisely to spot them and understand the directions and conditions of a spread, in an increasingly changing, mobile and unstable residential and economic context.

[19] It is actually the focus of the project for an observatory of local finance led by UCLG / Committee on Local Finance for Development, in partnership with OECD and AFD.

[20] Suzuki et al, 2015, ACC

In this regard, the IMF[21] underlines that "*while some* [countries] *show little movement in tax ratios*[22] *over extended periods, others have made impressive progress. Peru, for instance, increased its tax ratio from 6 to 13 percent over the 1990s and to around 17 percent now. Some have achieved sustained* [tax] *revenue increases of 4-5 percent of GDP over just a few years. Appendix VI details three cases of substantial progress: El Salvador, Tanzania, and Vietnam*".

4.2. Institutional context

Local governments' financing is the result of a set of complex systems, composed of numerous interdependent components. Some are politically easier to implement than others. Thus, the architecture of those local financing systems can be incomplete and their implementation partial, even regarding the current legal frame. The partial or incomplete realization of those devices often undermines the capacity of the whole system. A frequent and harmful practice in incompletely decentralized contexts is the inadequacy of funds credited to local governments in comparison with the responsibilities assigned to them.

4.2.1. Accountability and citizen participation, at the core of the decentralization process.

Decentralization in a greatly political process as it consists, for the State, in a delegation of its powers and the granting of autonomy to local governments. If political forces often pave the way to decentralization, they can be as much of an obstacle to its efficient implementation[23]. At the local level, political leader can hamper decentralization by not associating voters and citizen to the local project.

The groundwork for participation follows a democratic electoral agenda, even if countries have different ways of calling for free local elections. They are a method for participation only; other informative, consultative and deliberative mechanisms are at play in the consolidation and maturity of local consultation. Should not plain decentralization combine "representative" and "participative" democracy?

In this regard, participatory and consultative mechanisms are at the core of local, tax (mostly tax compliance) and land resources mobilization. As for land value gains capture mechanisms, they are the product of subtle contextual blends of consensus and discretionary action, of negotiations between the various concerned public authorities, land owners, users, developers and planners. Such synergies imply relative agreements

[21]Ibid. FMI 2011. p.21.

[22]Fiscal resources / GDP

[23]E.g. The reluctance of national political leaders to transfer responsibilities to local government by fear of losing control over them, opposition by central government bureaucrat whom institutional and personal objectives go against decentralization, resistance of elites and deconcentrated State services to reforms, etc.

about land prices[24] and value gains repartition. On this matter, numerous authors[25] insist on the importance of implementing tools within the frame of transparent and stable rules, as to maintain trust between actors and minimize hints of corruption that come with matters of public land use.

Transparency of operation enables not only an optimal repartition of resources but also a stronger citizen consent. This transparency concerns both the capture of the resource (who is taxed? methods of repartition, competition, bids, etc.) and its use (compensations, visibility of financed actions).

4.2.2. Lack of clarity in the actual attribution of local responsibilities hampers their expression in financial needs.

In several regions, mostly in developing countries, this lack weakens local governments and undermines their financial systems. Laws and decrees are incomplete; there are inconsistencies between decentralization laws and sectorial rules commanding to specific public services. Furthermore, the State or regional administrations assist, control – and even sometimes authorize – budgets voted by elected local authorities. This supervising power exercised *ex ante*[26] goes against the budgetary autonomy of local public authorities.

Preliminary to the question of local resources mobilization, an approximate repartition of responsibilities between local governments and the State will blur the actual local fiscal needs. Those funding needs will be biased by the following recurring problems:

- The first and probably most fundamental one results from the fact that the repartition of responsibilities between central or federal States and local governments is blurry or unstable. It is very often the case in African of Latin American countries. Texts are often badly written, imprecise or inapplicable. The resulting "spending need" cannot be precisely evaluated;

- The second problem results from the fact that responsibilities assigned to local governments are either partially carried out (or not carried out at all) or carried out by deconcentrated State bodies, sometimes in contradiction with decentralization laws. In fact, there is a generalized confusion between devolution and decentralization. The poor coordination between actions carried out by local authorities and those undertaken by the State leads to inefficiency and waste of resources. Services performed by deconcentrated State bodies can be at odds with local governments' contexts and preferences. Worse, sustainability of local equipment policies is often problematic when the State finances equipment that the collectivity is not able to use by lack of human, material and financial

[24] Measuring land value (Who estimates past and present prices? By what means? With which method?) is a recurring impediment to the implementation of numerous land value gains capture instruments.

[25] Smolka 2013, Peterson 2009 and 2013.

[26] Appropriateness of spending

means. Local equipment programs funded by international organizations are subject to this matter as well.

Consequently, imperfectly identified "financial needs" of local governments will be inadequately funded. Local governments are not entirely responsible for this, since numerous States transfer responsibilities to the local level without ensuring sustainable funding by appropriate financial transfers (cost shifting, unfunded mandates). Central states often set service requirements and supply standards, limiting the decision power of local governments in their own jurisdictions.

Yet, is it undoubtedly another crucial issue in a decentralization context. With no knowledge of costs, a well advised arbitration between policy choices is impossible, so is an efficient service delivery and, ultimately, tax compliance. Furthermore, with no knowledge of costs, a correct evaluation of local "financial needs" becomes equally impossible, impairing the efficiency of efficient intergovernmental financial transfers, may they be compensatory or redistributive.

4.3. The territorial strategy

4.3.1. Administrative division of national territory seldom fits the map of residential and economic local development.

The question of organizing responsibilities also has important consequences in terms of territorial coherence, especially when it comes to govern large metropolises where they are shared by several local governments. For example, networked services generating important outcome benefit citizens of several communities. Still, their operation and their funding are too often inequitably shared. This limited coherence also exerts a strong influence on land value gains capture tools. They could be optimized when peripheral municipalities absorbing urban sprawl and central ones bearing investments costs share stronger common interests.

In this regard, any urban planning project involving land value appreciation necessitates a clear repartition of responsibilities between the various stakeholders and the nomination of a steering authority legitimate enough to lead the process in an integrated fashion. The legal – but most importantly actual – repartition of responsibilities among government layer is essential to identify the actors that will be in charge of implementing funding mechanisms.

Financial imbalance of local budgets is partly imputable to the common offset between "recurrent local spending" and "recurrent local resources". Intersect and multiple "spillover effects" occur between local jurisdictions. Some collectivities behave as stowaway as they benefit from equipment and services financed by others. On the other hand, lack of equalization often leads to uneven capture of local revenues: collectivities on which the wealthiest taxpayers (firms and natural resources) are located benefit from revenues far superior to others that can become "supporting territories" (as it is the case for “dormitory towns”) by having to cover for costs induced by an active population without perceiving the amounting resources. This distortion is frequent in developed countries, and particularly in France (in the Paris region). It is specifically the case in countries where the territorial grid is dense and/or where there are a great number of governmental layers. This point is all the more important when economic and residential development is focused on a few territories (coastal areas in Asia or Africa, for example).

Resulting political difficulties are equally obvious. The principle of decentralization itself is to match the map of users/beneficiaries of collective local services with that of contributors and paying users. Assumed proximity between use and requested contribution strengthen political pressure of local deciders. It is illustrated by the increase in tax protests and reluctance towards tax increases, in European and North American countries specifically.

4.3.2. Coherent urban planning is essential to efficiently mobilize the different sets of financial tools.

Coherent urban planning is a key element to the mobilization of local resources. It can serve as an elaboration platform for urban equipment scheduling and for the fiscal strategy that will contribute to its funding by mobilizing its land valorization potential. It also is an essential element to access external long-term resources, may they be loans of PPPs. Strategic urban planning is at last an essential aspect in the quality of urban governance.

For public actors, a major issue is to anticipate urban sprawl and the spatial evolution of urbanization. In this regard, urban planning is an important aspect of any public land valorization operation. On the contrary, spontaneous and unplanned urban production forces deciders to implement design catch-up policies. Despite being considered more costly and less efficient[27], they are still common practice.

Ideally, urban planning is based on long-term thinking; it enables actors to think forward to design and implement projects; it goes on with a flexible conception of urban regulations as to enable an adaptation to market conditions when the time comes to implement design projects. It is necessary for a local government to be skilled in urban planning and land administration.

4.3.3. A basic and adequate legal framework is a prerequisite [28] to the implementation of all financial tools, without exception.

Local public resources management systems and procedures and the definition of interaction frames with other government layers, economic actors and non-governmental

[27]Anticipation can lead to a waste of public funds through sterile investments (ex : new towns, underexploited or non-exploited industrial areas)

[28]Necessary insufficient condition

entities are essential for local authorities to carry out with the responsibilities they were assigned.

In a lot of countries, especially developing ones, various aspects of those mechanisms are missing, incomplete, or operate with no regard with institutional context. If collectivities' legal and constitutional frames[29] may exist, they are sometimes barely drafted:

Local governments have little room for maneuver regarding their tax rates, tax bases and tax collection. They are seldom authorized to create new taxes or royalties;

The situation is even less advantageous concerning loans, to which local governments are legally forbidden to access in a lot of countries. In this regard, we must mention that a corpus of adequate prudential rules can set the base for a relationship based on mutual trust between local public sector and private sector. Those prudential measures work as an incentive to good management for the collectivities and as a form of warranty for eventual private investors;

As for the land value gains capture instruments, they require an adequate legal framework. It can be property law, right of use, or any set of rules associated with urban planning law.

4.5. Financial decentralization

A frequent and harmful practice in incompletely decentralized contexts is the inadequacy of funds credited to local governments in comparison with the responsibilities assigned to them. In very few countries do city have enough local autonomous resources to cover for their spending needs. The most common case is one of an offset between local autonomous resources and recurring spending. <u>Transfer of responsibilities from central governments to local ones has seldom been provided with matching resources</u>. Most constitutions yet guarantee a balanced resource transfer *ex ante*, not *ex post*. The transfer itself usually takes the form of a budgetary allocation that varies a lot depending on the State's annual budget. It does not enable collectivities with a strong decisional power. Even when it legally does, that power only regards a small part of the local government's resources.

4.5.1. Development of funding capacities at the local scale is a major challenge

There are only few countries where collectivities have the legal power to set their own tax base. At best, they might supplement the State's action by actualizing land registers or recording new plots and tax payers.

This is easily explained: the set of a tax base and tax collection are administrative tasks with strong scale performance. But they are so only if deconcentrated tax authorities are trustworthy enough and collected tax revenue well redistributed (time and worth-wise) back to the collectivities (subject to tax sharing or equalizing mechanisms). Several field

[29] Legal status, political mechanisms, responsibilities, administrative and employee structures, etc.

studies in Africa, Asia and Latin America testify that these two requirements are not always met. On the other hand, several cases of increasing local taxation yield rates have been witnessed in countries where local governments were entrusted with more responsibilities.

In developing countries however, management of local government's prerogatives is often inefficient. This is a major constraint and even sometimes a real barrier to local public action, especially in terms of financial management. To aim for proactive decentralization and local sustainable development, those constraints must be identified and efforts must be made to overcome them.

The use of land value gains capture instruments also requires local authorities to have expertise in land and real estate markets, as well as in operational planning[30]. Those skill requirements are subject to the tools at their disposition and are all the more important in the collectivity is involved in entrepreneurship. Most of the time, local authorities' capacity to capture land value gains is closely associated with their capacity to measure the benefits, costs and risks inherent to those operations. It concerns for example land sales, property value based land taxes, public-private development operations and commercial rental stock. The multiple sets of skills mobilized in this case could form a privileged field of action for institutional capacity strengthening programs, especially when in supplement of land and real estate value gains capture projects.

Finally, low operational capacity is underlined in explaining the difficulties collectivities might encounter to submit adequately formulated funding requests to private backers. This is especially the case in Africa (Cape Verde, Tunisia, and Morocco).

4.5.2. Taxation autonomy is central to the funding of decentralization

The soundness of a certain degree of autonomy in local spending management is broadly accepted – including by central governments. It is not the case when it comes to revenue. Autonomy in local resources management is very limited in most African, Asian and Middle Eastern / Western Asian countries. Yet, margin of maneuver in revenue management is essential to the reinforcement of local responsibilities. Cities where management skills were improved testify for this.

Furthermore, the extent of decentralization and financial autonomy appears to be a key factor in local governments' access to long-term external resources. Taking initiatives with their own resources can indeed enable them to face exogenous shocks. Thus, investors concerned with the long-term reimbursement of loaned funds perceive some degree of financial autonomy in partnering collectivities as a positive factor.

Diversification of local tax base is essential to increase the taxation potential of local governments. Local tax bases are often narrow and land tax potential often underexploited. On average, land tax accounts for 0,5% of GDP in developing countries and

[30]Suzuki et. al., 2015, Walters 2011.

2% in developed ones. It is unpopular even in countries where it plays an important role (United States, Canada or United Kingdom). Besides this tax is expensive and difficult to collect, particularly in developing countries that do not keep land registers and where informal housing is common practice. In those countries, sums allocated to both property valuation and tax implementation and collection are low.

In addition to its definition, actualization of the local tax bases is an equally recurrent issue. In the case of land and real estate taxes, the evolution of those bases requires expansive information devices to scope for market prices or cadastral values. It is similarly the case with royalties, user fees and local taxes on individual economic activity.

Finally, the role of local governments in the collection of local resources is insufficiently developed. All countries try to maximize their revenues while minimizing management and control fees and reinforcing the authority of upper government layers. Centralized management can be more adequate for certain taxes. But, in a number of regions, central agencies do not transfer in time the resources they collected in the name of local governments. When inadequately stimulated to collect local revenue, State's taxation agencies can be an obstacle to local taxation dynamism. In various countries (Costa Rica, Jordan, numerous Eurasian countries), experience shows that a significant revenue increase occurs when taxation responsibilities are transferred to local governments.

Royalties and user fees theoretically are the second pillar of local government funding. Yet, an efficient use of them supposes that users of collective services may be identified. It is not always the case. Supply costs and amounts of delivered service should also be measurable. Finally, legal and statutory frameworks should enable collectivities to fix new prices. All those reasons explain why the share of user fees does not usually exceed 10 % of local resources, at the notable exception of Canada and the United-States.

4.5.3. Uneven resource repartition among layers of government.

Shared sums are significantly inadequate in regard to entrusted responsibilities, particularly in developing countries. Lack of measuring methods to assess the cost of transferred responsibilities is an obstacle to the development of a balanced funding system. Lack of transparency and assurance in transfers undermines local governments' long-term planning. It is the case of some western African States that hold local resources back for their own use or delay their transfer.

Uneven of inefficient sharing of revenue can have a perverse impact on the production of local resources. It can hamper local autonomy and collectivities' accountability to voters and weaken local capacities to deliver services, collect revenue or borrow money. The systematic disregard for local public equipment recurring fees has dramatic consequences on decentralization dynamics and territorial economic development. Unmaintained or misused equipment and inefficient services put local governments in a permanently delicate situation. How can local taxes be collected if voters get nothing back : roads are not maintained, garbage is not collected and disposed of, lighting is faulty, marketplaces and parking lots disorganized ?

In most countries, part of national taxes is automatically transferred to local governments. This simple mechanism has strong revenue potential. It can be a partial solution to vertical misfits but is subject to constraints. Sharing revenue according to where resources were collected can be seen as a push for local economic activity, or reinforce horizontal inequalities and participate in a higher volatility of local budgets :

a. A well-structured system of equalizing transfers is a key factor of local finance. It enables to fight horizontal budget deficits. The implementation of those mechanisms is necessary to cope with, among other factors, poverty or demographic growth is some municipalities. But despite growing revenue inequalities among collectivities across the world, few countries use efficient equalizing subsidies to enable a more equal access to resources;

b. Assigned transfers (conditional ones) allocated by the State or intermediary administrations are also part of local budgets. They participate in the promotion of national objectives and norms of decentralized service delivery, in health or education for example. This type of subsidy is often met with difficulties caused by their numbers of their complexity, since they usually imply high implementation costs for the collectivities. They can also lack transparency or stability (sometimes on the long term) and can be subject to political manipulation. Furthermore, excessive dependence on assigned subsidies can harm the autonomy of local governments and push them to prioritize national matters over local ones, destroying what empowered them;

c. Subsidies based on performance and innovation are newcomers on the financial transfers field. They were brought to African and Asian countries by international organizations. Local governments are usually free to decide what to do with those funds. These transfers combine the flexibility of unconditional subsidies to an unusual form of conditionality.

It is thus important not to restrict local governments' resources to their sole owns. Financial transfers from upper administrative layers can be legitimate as long as their objectives are, but all transfers are not equally efficient, depending on what they aim for. There is no such thing as a “good” type of transfer, but there are certainly good and bad combinations of type of transfers and set up goals.

One could argue that transfers leaving local governments with the widest margin of maneuver (in terms of funds and planning choices) are best suited to enable them to carry out with decentralized prerogatives. It is the case for global, fixed, unlimited transfers. Even then, other necessary conditions to the exercise of assigned responsibilities would have to be met.

4.6. Multi-layer governance

Coherence between the various layers of government, economic actors and civil society appears as a key factor in mobilizing local resources, regardless of the financial tools at use.

4.6.1. Necessary synergy between national and local governments

To finance public local infrastructure, State and local governments have to overcome a mutual distrust. They have to work towards a synergy that is often undermined by political disagreements and related power issues. Despite the apparent weariness of such a claim, it is absolutely necessary to achieve a sustainable and balanced urbanization.

Financial transfers for States to local governments must carry on. The end of welfare State and the drought in both traditional revenue and debt or inflation-funded local resources[31] prompt national territorial funding strategies to evolve. The relative share of local resources in urban infrastructure funding (and, incidentally, the share of municipal participation in national public spending) will have to increase.

In this context, it is of the States' interest to support and strengthen local governments' capacity to mobilize chunks of local resources still vastly unexploited by public powers to enable development.

A number of arguments pleading in favor of a State-Collectivities dialogue have been mentioned in the previous chapters through various notions like fair sharing of national resources, taxation, transfers, territorial division or decentralization's statutory and legal frameworks. This dialogue is equally necessary when it comes to accessing exogenous long-term resources like loans, PPPs, climate finance or land value gains:

Safety and pooling devices set in place by central governments to enable local governments to borrow money are essential to spur the interest of banks in these potential clients. The creation of national Bond banks[32], or dedicated funds (SPV), enables a very rewarding leverage effect on local investments (Communal Equipment Fund on Morocco, INCA in RSA, LGUGC in the Philippines) through the pooling of credit risk and the expertise they can bring;

As for PPPs, let us take into account that beyond the supply on an adequate prudential frame, elaborating national strategic plans to reassure financial and industrial investors, while easing the access of collectivities to that type of tools, greatly enhances the attractiveness of local governments;

Despite undertaking a great share of climate-adaptation investments, local governments do not have much access to climate-finance. In this regard, national gateways[33] to the green fund are not particularly focused on local action as could be ministries of internal affairs or decentralization;

In the end, the use of any existing land value increasing tools implies synergy or at least interest convergence between not only government layers but also economic actors and

[31]National public resources depending on international trade indirect taxation will, for example, shrink with the expansion of free-trade zones.

[32]Financial intermediaries borrowing on financial markets to lend money to local governments based on this resource.

[33]Mainly Ministries of environment or spatial planning.

civil society.

4.6.2. In favor of financial collaborative synergies anchored in territories.

Importance of citizen participation mechanisms has been underlined as a on of the bases of decentralization processes. Civic dialogue is also a key factor of tax compliance. Yet, it is concerning the capture of land value gains that it plays the most important rôle.

Land value gains capture mechanisms are complex and contextual arrangements between actors. Tools requiring a broad consent[34] take time to be put to use. However, enabling local financial engineering to be jointly built in the necessary amount of time will ensure results both potentially fairer (for land owners, users, investors and public authorities) and long-lasting.

5. Framework suggestions for the 2nd phase of the study

5.1. Issues to examine

Literature reviews completed about the 3 components of the study have brought up bases on which optimally developing financial engineering to cope with development needs. Most of which are "exogenous" factors depending on economic and social contexts as well as legal and statutory national frameworks.

Looking at specific situations in a dozen cities, the second phase of the study will focus on how cities actually embed those contextual elements, use them as a base to develop their financial strategies, and what they end up implementing to mobilize local resources. It will mostly concentrate on factors endogenous to the collectivity. For each studied city, the central question will be : **what are to local decisions that, within this exogenous frame, enable the internal production of additional long-lasting resources for local development?**

In every city of the sample, the study will question the **circumstances in which a locally based virtuous financing mechanism was enabled to emerge**, duplicate, and grow in the long-term. Why isn't this progressive mechanism systematic in all collectivities? What are the impediments to this dynamic? In a given national context, how was a local government able (or not) to mobilize financing tools? What were the determining, spurring or undermining factors? What shifting mechanisms did it rely on to fund its territory's development?

The study will highlight **actual field interactions between the various financing sources**. In this regard, taxation and recurring resources are central to funding systems. Land value gains capturing tools are "often restrained and, most importantly, non-recurring", as are long-term exogenous resources. Used as preliminary funds, the latter must be refundable by the city's global budget.

[34] With specific dominant actors, depending on the context and other actors more or less radically excluded.

In addition to providing a snapshot of each city's financing engineering situation, the study will make an attempt at identifying a **dynamic approach** by focusing in the meantime on how resources evolved and on the resource potential mobilizing levers.

Finally, if the cities themselves partake in those analyses, levers on which to press to enable the implementation of funding projects could be identified. They would make for a precious toolkit for local politicians.

5.2. Method

The second phase of the study will mostly rely on **involving selected cities' financial executive**. The Committee on Local Finance for Development expands a local finance on-the-field experts network constituted of cities' financial executives very much eager to share practices among peers to develop their skills. This second phase is the opportunity to create a platform to share practices, organize seminaries and collaborate to create ready-to-use tools for financial executives (toolkits, decision-making support, baselines, typologies, etc.). In the meantime, their knowledge of the field will be a very valuable source of information for the case studies.

The involvement of this network will play a central part in data collection. One of the experts will analyze the data in the first place, before is it cross-checked by experts from the other components. Then, it will be the focus of collective thinking during the seminar organized with the financial executives.

Financial executives will have the opportunity to be assisted for a month by a local of foreign student (in exchange of a 500€ compensation) that will help collecting data through a form. This form will be divided in three parts, to be completed a month apart from each other.

The scope of the study will be the local government, hence, the field of action of its chief financial executive – even though other territorial actors can be interrogated. The studied field will include:

- A contextual analysis (institutions, economy…)
- A structural analysis of revenues and spending,
- The analysis of 2 to 3 implemented flagship projects, and of 2 to 3 projects encountering funding difficulties.

The 11 pre-identified cities for the case studies were chosen among metropolises and intermediary cities on every continent. Following the partners' appeal to some countries, extraordinary highlights could be made to put in evidence – within similar national contexts - "endogenous" success factors specific to the collectivity itself. At this point, Moroccan or Tunisian cities could be added to the following sample:

Goteborg - Sweden	Addis Ababa – Ethiopia
La Paz - Bolivia	Dakar – Senegal
Cusco - Peru	Douala – Cameroun
Ho Chi Minh - Vietnam	Sousse – Tunisia
Ulaan Bataar - Mongolia	Marrakech - Morocco
Muntinlupa - Philippines	

Individual analyses of the cities will be distributed among the studies' 3 experts. Each city will thus have a privileged relationship with one of them, who will be their « lead » expert. Still, the monographs to be produced will be subject to exchanges among experts, in order to get deeper perspectives on specific matters.

5.3. Projected timetable

- Late October / mid-November, 2015: Contacting chief financial executives of pre-selected cities to request their participation to the program, mailing of 1st batch of documentation about the study and of the 1st part of the question form;

- Mid-November, 2015: Monitoring the case studies through an online platform[35], uploading online of all reports concerning the 1st phase of the study in English and French, as well as all 3 parts of the question form;

- November 30th, 2015: return of the 1st part of the question form (documents available in the municipality) and the Mayor and collectivity's agreement. 1st discussions between the financial executives and their lead expert;

- December 30th, 2015: return of the 2nd part of the question form concerning the municipality's past and present financial history, discussions with the lead experts;

- January 30th, 2016: return of the 3rd part of the question form concerning flagship projects already implemented or currently being developed (possible support from students will come for this part). Discussions with lead experts;

- April 6th-8th, 2016 - Paris: discussion seminar with financial executives, experts and partners;

- May 30th, 2016: completion of the study;

- June 30th, 2016: translation and publication of the study.

[35]on a specific page on UCLG Committee on Local Finance for Development's website (www.uclg-localfinance.org) dedicated to financial executives involved in the study, partners and experts.