UCLG inputs to Habitat III
on the discussion on local finance
by the Committee on Local Finance for Development

The Habitat III Summit of the United Nations will take place in Quito in October 2016, as the result of a long series of international negotiations during which UCLG was highly involved over the years 2014-2015: Financing for Development, the Sustainable Development Goals, the Climate negotiations, etc.

The negotiations have reached a global consensus on the **objectives** to be met (in particular through SDG 11), and on the **growing economic, social and environmental challenges** of financing urban development worldwide, and in particular in developing countries.

However, the issue that is still pending relates to the **effective implementation** of the public policies and infrastructures necessary to reach these objectives, and meet these challenges. Finance, together with planning and governance frameworks are the three main elements required for harmonious urban development for all. While urban planning requires rules, multi-level concertation and regulations for urban expansion and finance to pay for city extensions, municipal finance requires planning and good city layout, as well as a policy and multi-stakeholders framework that supports land-value sharing and private investment in public projects.

As regards **local finance**, the imbalance between the responsibilities devolved upon local authorities and their resources have severe consequences on the well-being of inhabitants of urban areas. The urgency to meet the needs, and the costs of inaction, are a call for a quick joint-mobilization of all stakeholders. **The issues revolving around the means of implementation, and sustainable financing of urbanization, will be at the core of the Summit in Quito.** How can cities access the financing and secure the political will needed to achieve these ambitious goals?

As a result the UCLG Committee on Local Finance for Development, through its various activities, is trying to bring out key **fundamental principles** on local finance, in order to draw **concrete and universal recommendations** for Habitat III, to be adjusted and prioritized according to local, national and regional frameworks.

1. Develop national roadmaps in order to reach 20% of national resources to be dedicated to local governments over 5-10 years

1.1 With the global phenomenon of urbanization, local governments throughout the world contribute at an increasing rate to economic development and growth at the national levels. However in most cases**, local governments do not receive in return an equitable share of the wealth that is generated at the subnational level, leading to incomplete decentralization processes.** On average, the share of national resources devolved upon local governments hardly reach 8% to 12% in developing countries, and up to more than 25% in developed countries, where local governments are responsible for more than 60% of public investments. Depending on local economic and development contexts, a fair balance need to be found between directly granting local autonomy through local taxes, and relying on solidarity mechanisms through transfers to subnational levels.

1.2 Such efforts rely on the **synergies** and dialogue between the Central and Subnational governments. In this sense, the existence of **multi-level governance framework**, through the role of institutions such as National Committees on local finance, are key to facilitate dialogue. When based on transparency and accountability between levels of government, such framework facilitates an equitable allocation of financial resources. Moreover, this dialogue should ensure consistency between territorial needs and national priorities, with the participation of citizens and local stakeholders.

1.3 Ones of the main challenges in the identification of those territorial needs are the **lack of clarity and stability in local governments' allocation of responsibilities** on one hand**,** and spillovers induced by the mismatch between the perimeter of **local governments' jurisdictions and the economic development and residential maps** on the other hand. Yet, without precise knowledge of the costs, it is difficult to take well-informed decisions, and to finance properly the needs (unfunded mandates). Thereby incentives should be put in place, through fiscal measures or legal frameworks, to define more coherent territories, especially regarding metropolitan areas. The latter should also benefit from the creation of municipal development funds with multiple funding sources that restore territorial fairness.

2. Rethinking local financing systems in order to make them sustainable

2.1 Fiscal transfers from national governments are, with local taxes, the key mechanism for funding devolved responsibilities. They are also at the core of national cohesion through compensating for gaps in local development and supporting the poorest territories through **appropriate equalization systems**, and incentives for local governments to reach national priorities of development. To some extent, predictable, stable and unconditional transfers are essential to enable local authorities to implement long-term public policies. However, regarding budgetary constraints in most countries, it would be unrealistic to say that transfers would be sufficient on their own to fill the financial gap, in a context of growing needs.

2.2 As a result, it is necessary to **enhance the mobilization of endogenous wealth,** giving local governments enough autonomy and fiscal tools that allow them to capture a part of the added-value (economic, land, property, etc) produced within their territory. Indeed, cities concentrates most of the economic growth, gathering production factors within employment and commercial areas which, combined with network of public amenities made of infrastructures and superstructures, enable for **agglomeration economies** attractive to inhabitants and companies. To benefit from this dynamism, legal frameworks should ensure a sufficient return on investment for a durable financing of urbanization and the "financing of the city by the city", through three main instruments: local taxation, land value capture and sustainable financing of basic public services.

2.3 Enhanced **local taxation power and fiscal autonomy** may ensure more flexibility on structural resources for local governments, when the financial management process is transparent to ensure tax consent from local citizens. Whereas the property tax is the most widespread fiscal tool, it has a low performance, in particular in less developed countries where local authorities lack the tools to implement and collect this tax effectively (land register, GIS…). It is then necessary to help them to implement an efficient collect of taxes, and to diversify local fiscal policy (to be adjusted depending on local economic and residential specificities).

2.4 **Land and property-based valuation** is another type of mechanism for cities to get back part of the wealth generated by public investments, relying on **public land management, well-adjusted instruments and regulations**. However, land-based mechanisms must come together with legal regulations to ensure it will not go against social and environmental objectives, and will not deepen spatial and social segregation between and within cities. In particular, participatory and compensations mechanisms are crucial to avoid in particular the capture of rent by local elites, and to resist to the financialization of the urban economy.

2.5 The provision and **financing of basic local services** has a vital role to play in ensuring sustainable urban development and local financing systems. In each country, a multilevel dialogue between national and local governments, service providers and users, should be structured, in order to find the adjusted balance of funding. A mix of tariffs, national grants, local resources, private investments, and loans should aim to cover operating costs and, contribute to investment and service expansion. Concurrently, mechanisms such as social tariffs, cross-subsidies and safety nets should ensure a more equitable financing system.

3. Access to long term external resources is necessary to leverage additional funding for investments

3.1 The urgency and the magnitude of the needs to be satisfied imply the necessity to **work on multiplier effects to prefund investments**. These multiplier effects are closely related to local governments' structural resource, and accordingly their reimbursement capacity. Investment funds transferred from the State also play an important role to complete, boost and secure the amounts of financing. Besides local efforts to improve financial management, the legal and fiscal decentralization framework, the predictability of local finance, local fiscal autonomy, and the prudential framework are all in favor of enhancing the relation of trust between investors and the demand in long-term resources.

3.2 Knowing that financial conditions at the global level, characterized by low interest rates and abundant global saving, are in favor of long-term investment, we should reinforce the levers from which these financings can be channeled to the local. **Financial intermediation institutions** such as special finance institutions (SFIs), national municipal corporations or bond banks, can enhance access of local governments of all size to external financing, in particular through pooling of resources, and to help overcome the mismatch between the duration wanted by investors and the depreciation of urban investments.

3.3 Reinforcing local capacities and creating such institutions are key pillars to allow local governments access to borrowing long-term resources, but their implementation takes time. However, cities are facing urgency, and inaction has growing consequences. Besides working on those two pillars, there is a need to develop, in parallel, **appropriate guarantee mechanisms** to secure investors and channel global savings, public and private, towards the local level. Certainly, these mechanisms have a cost, but can represent a strategic way for ODA and climate finance to exerce a multiplier effect on the amounts raised.

3.4 **Official Development Aid (ODA),** through North-South or South-South cooperation is an application of principles of international solidarity. In this sense, it should play a key leverage role for local and regional governments, particularly in middle and low-income countries. Through a wide range of financial instruments, international donors should better adjust and target the implementation of the SDGs and resilience by local authorities. It can also promote blended financing to provide incentives to private investors and thereby have a leading role on the financial market.

3.5 **Climate finance** can represent a great opportunity to strengthen investment in adaptation and mitigation at the local level, provided that local governments have access to those funds. It is a necessity for national governments to involve local authorities in the design of the financial mechanisms and their management, as well as supporting them to generate climate friendly projects.

4. Promote an enabling environment and legal framework towards more fiscally capable local governments

4.1 Support the development and **maturation of broad intergovernmental fiscal system** along with national legal frameworks, through necessary reforms, to reach effective fiscal decentralization and coherent local financing systems. These reforms must focus on transparency in monitoring and evaluation, and the fight against corruption, that are the main challenges for building more fiscally capable local governments.

4.2 Very often in developing countries, it is necessary to **establish specialized operators** to accompany urban development operations and the delivery of basic urban services, which may take the form of public or semi-public companies. It is also important for local authorities to reform land rights and to have **integrated planning strategies** as well as the necessary **instruments,** such as updated land registries, accounting systems, and electronic network.

4.3 In a global and local environment more and more complex, characterized by multi-stakeholders involvement, comprehensive approaches, extensive requirements and regulations, there is a crucial need for the cities Chiefs Financial Officers and their team to increase their expertise. Moreover, a cross-sector management should be implemented to ensure the coherence of local policies. In this sense, **capacity building in financial management** and promoting innovation through **learning from experience and peer-to-peer exchanges** are assets highly needed to support the empowerment of local authorities.

5. The creation of a global observatory on local finance

5.1 At the national level, an extensive database on local finance is a much-needed tool to **boost dialogues between national and local levels** on the sharing of national resources, their allocation, and on the necessary reforms to be undertaken. To go further in understanding the strengths and weaknesses of a system of fiscal decentralization, the global observatory on local finance will provide accurate comparative data and analysis to help UCLG's members to **enhance their advocacy.**

5.2 At the international level, this project is also important to **raise awareness** of central states and international partners **on the investment capacity of local governments**. Through the collection and analysis of local financial information, that is often missing or disaggregated, the transparency which governs such an approach is likely to facilitate local governments' access to borrowing and more broadly external resources.

5.3 Beyond the utility of a global database to monitor concrete progresses of decentralization, the observatory on local finance aims to **organize a global reflection on local finance**: Policy recommendations and financing solutions need to be understood and applied taking into account a range of different realities, cultures and contexts. There can be no one-size-fits-all approach. Yet, the range of instruments available for the international community to get a better knowledge of the financial health of local governments is very limited. **This multi-stakeholders platform could lead to a Community of Practice on local finance**, including on-the-ground experts such as cities CFOs, and conducted by UCLG. Such a platform will enhance exchanges and debates towards the evolution and amelioration of different financing systems.