Annex: main arguments

1. Strengthening the mobilization of domestic resources and financing the city by the city

The mobilization of endogenous resources is 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]

The speakers will highlight that the mobilization of endogenous resources contributes to the improvement of the fiscal balance of local governments, and, at the same time, strengthens their borrowing capacity.

1.1 Reforming local taxation

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 yielding an average of 0.5% of GDP in developing countries, with revenue potential rarely achieved.[2] Property tax is 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.

However, some countries allow local authorities to benefit from part of national economic growth through the taxation of economic activities, income or local sales (VAT).[3]

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[1] See 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.

[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; tax on local sales is notably used in Canada and the United States. Morocco, has given 30% of VAT to local governments, but in the form of transfers.

In general, the sharing of national resources between subnational levels of government is done at the expense of the local level. Whether through tax-sharing or intergovernmental transfers, the resources allocated to sub-national governments do not match the competences that are devolved upon them, and equalization mechanisms, essential to ensure the sustainable delivery of basic services in the most disadvantaged areas and cities, lack efficiency.

The debates will focus on opportunities for reforming local taxation and transfers (fiscal decentralization), to foster the diversification and increase of local budgets and investments.

1.2 Unlocking land values to finance urban infrastructure

The capture of part of the land added value, generated by public investments is a very promising way to finance urban development, especially in countries undergoing rapid urban growth. By producing substantial immediate revenues that enable the reduction of credit dependency, this type of financing is well-suited to growing cities. It also helps to enhance the efficiency of urban land markets and to direct urban growth to areas most suitable to accommodate it.[4] Western cities largely financed their development in the 19th and 20th century with such resources and, more recently, some Latin American and Chinese countries have used 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".[5]

According to recent experiences, the **contribution could contribute between 10 and 50% of public investment**[6] in the context of development or urban restructuring projects.

The debates will explore the necessary conditions to better mobilize land-valuation in order to invest in urban development.

2. Strengthening long term financing

Whether through direct loans or private capital contributions, including in the form of PPP 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.

[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.

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

In terms of factors that limit subnational government access to loans and credit, national governments are keen to maintain macroeconomic equilibrium and restrict local governments' autonomy to access loans (often in an excessively constraining manner). Furthermore, private investors and banking institutions require sound financial management by local governments, long-term stability and ability to generate revenue in a sustainable way. Finally, private investors conduct due diligence processes to ensure performance and long-term profitability when investing in public services. Providing increased institutional capacity to local governments should be a priority in both the national and international agenda, but the legal, institutional and financial framework is critical as regards to the management efficiency they can reach.

In a context where risk and creditworthiness are important, the commitment of central governments to support local governments can facilitate the access of the latter to external resources (reforming, guarantees, prudential supervision …). On one hand, regional coordination among group of cities to jointly issue bonds may improve their credit ranking and access to financial markets. On the other hand, in many low and middle-income countries, municipal financial institutions (SFIs) have been created to provide local governments with access to investment capital. Despite their shortcomings, some important success stories[7] are worth considering as regards to SFIs' role in the credit enhancement of sub-national governments and utilities. Well-designed and with proper regulations, municipal corporations may enable local governments to borrow in local currency.

The debates will highlight the necessary conditions for fostering local governments' access to financing (loans, financial market, bonds, etc) in order to enable them to invest in sustainable urban development.

3. The role of development partners

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

Beyond their role in securing new resources, international institutions also have a critical role to play in supporting reforms, strengthening fiscal decentralization, creating legal frameworks for public-private partnerships, securing investors[8] and helping to

[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's 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.

develop sub-national markets. It is essential that development partners support local governments directly, promoting city-to-city cooperation, and developing financial instruments well-suited to meet their needs[9].

ODA will continue to play a significant role in financing basic infrastructure and social service investments, particularly in low-income countries. However, it must focus more effectively on those countries that are most vulnerable to social and environmental challenges. Climate-finance mechanisms should be made accessible to the local level for enabling local governments to invest in resilient infrastructures.

How can low-income countries be best supported during the transition from the current situation, characterized by low standards of living and insufficient long-term savings, towards local economic growth, substantial increase in standards of living and enabling environment for private investment? How can an enabling environment be fostered to enable the investment of the resources necessary to meet the demands of urbanization?

By way of sharing the experiences of cities and development partners, the debates will explore possible international recommendations.

[9] Example of « pool financing » for cities in Latin America, supported by the CAF, and for Johannesburg with the FMDV and AFD.