1. INTRODUCTION

In a context of rapid urbanization and dwindling revenues, in which local governments have increasing responsibilities relating to meeting the basic needs of citizens, local economic development, and environmental protection; the funds available for the promotion of local development are far inferior to the resources required to take on these challenges.

Based on the studies conducted by OECD\textsuperscript{1}, IEA\textsuperscript{2} and GWI\textsuperscript{3}, McKinsey estimated that required investments in infrastructure by the year 2030 will be U.S. $ 57,000 billion. In sub-Saharan Africa, about 15% of the regional GDP will be needed throughout this period, whereas just over half has been effectively mobilized as of today. In East and South Asia, the total required investments would be between 6.5 and 7 % of GDP.

A substantial part of these investments fall under the local budgets. However, despite the recommendations of the international community, fiscal decentralization has not been implemented in many countries: the revenues devolved upon local governments are still, in general, inadequate and inappropriate for the fulfillment of the responsibilities entrusted to them under the law.

When decentralization is effective, it constitutes a form of government capable allowing the needs of the people to be met more efficiently owing to, most notably: the closeness of local governments to citizens and their increased participation in public decision-making and hereby the better allocation of resources. However the materialization of this potential is lagging behind due to the lack of funds and often slow or incomplete implementation.

The member countries of UN Habitat had already focused on these risks during the Habitat II Conference, and the recommendations adopted put great emphasis on the need to strengthen the institutional and financial capacities of local governments in view of the status of the countries surveyed. They also highlighted the need to, "\textit{ensure that the principle of subsidiarity serves as guidelines for the distribution of responsibilities and resources to the different levels of government.}" These recommendations were reiterated during the adoption in 2007 of the \textit{International Guidelines on Decentralization and Strengthening of Local Authorities} and again in 2009, with the \textit{International Guidelines on Access to Basic Services for All}.

However, studies conducted within the framework of the Millennium Development Goals showed that the low level of attainment of MDGs is strongly linked to the lack of funds granted to local governments, the inability of the latter to raise external funds - national or international -, whereas the powers relating to the delivery of basic services are mainly devolved upon them.

Access to basic services is therefore based on the financial capacity building of local governments, and this issue is especially crucial as a lack of basic investments entail a very high cost in terms of local, social and economic development, climate change and resilience. The deficit in basic urban infrastructures hinders the economic growth of countries, limits the

\textsuperscript{1} Organization for Economic Cooperation and Development
\textsuperscript{2} International Energy Agency
\textsuperscript{3} Global Water Intelligence
attractiveness of regions and business productivity. In Africa, for instance, the value of the investments needed to connect people to the water and sanitation networks is estimated at 1% of GDP, while some studies estimate that the economic loss due to the lack of access to these services would account for 6.5% of GDP\(^4\). Other studies\(^5\) estimate that the low-income countries in Africa could gain 2.2 points of growth per year if their infrastructures were at the level of those in India or Pakistan, and that middle-income countries in Latin America could gain 2% of growth if their facilities were at the level of countries such as Turkey.

2. CURRENT SITUATION

The evolution of fiscal decentralization over the last two decades varies between countries and is difficult to measure in a completely satisfactory manner due to the lack of comprehensive or quality data, and the difficulty in comparing different accounting systems. However, studies have succeeded in highlighting the major trends that show for instance very favorable developments in Latin America and Europe. Other positive elements were noted in countries that succeeded in developing investment strategies that meet, at least partially, the challenges of financing urbanization (e.g. China).

All in all, the allocation of resources process suffers from a clear mismatch when compared to the devolution of powers process.

2.1. The structural revenues of local governments are made up essentially of local taxation, central government transfers, and fees for the services delivered to the citizens. These are intended to finance the current expenditures of the services delivered by the local governments, and they depend totally on the level of national revenue distribution between the central and local governments. However, in a majority of developing countries, this distribution is conducted unfairly and in mismatch with the powers devolved upon the local governments.

The ratio “local government revenues / national government revenues”\(^6\) accounts for, on average, 20% in East Asia, 17.8% in North America and 13% in Europe, falls to 5.3% in South-East Asia, 4% in Latin America, 3.2% in Africa, and 1.5% in South Asia.

In general, local taxation is sluggish and the growth of local revenues rarely matches the growing burden of the responsibilities fulfilled by the local governments. This gap between the upward trend of spending and the stagnant revenues stems, to a great extent, from the inability of local governments to act on their resources. However margins exist, especially in countries where the economic growth is dynamic, resulting in a situation that the national and local governments can harness to find local solutions to the investment deficiencies.

As for the transfers, they play an important role in the coordination of national priority and equalization policies between territories. Large cities whose tax bases are broader and whose revenue mobilization capacities are higher, have relatively more resources to fund services and infrastructures. However it is in the intermediate cities that the investment needs are felt more pressing given that urban growth will be concentrated in these areas over the coming decades. However, many countries lack equalization mechanisms which are essential to ensure access to public services in the regions or cities undergoing difficulties. Intermunicipality which also plays a local solidarity role between the territories, is generally undeveloped.

The fees i.e. the payments by users for the services delivered, contribute on the one hand to the financial sustainability of services and, on the other, encourages an efficient and responsible use of these services. In France for example, the tariff revenues received from the

---

\(^4\) GOLD III: “Access to basic services and the world urbanization” - UCLG 2013 p.116
\(^5\) McKinsey Global Institute “Infrastructure productivity: how to save $1 trillion a year” 2013 p.18
payments made by the users, account for 90% of the total revenues of the water sector, but they represent only 40% in South Korea and 10% in Egypt. As a result important growth margins do exist, however in the countries where the users have a limited capacity to pay, these revenues still have to be completed by the public authorities, most especially as the investment needs are huge.

2.2. The external revenues of local governments, made up of essentially borrowings and private sector funding - therefore reimbursable -, are intended to prefinance investments, thereby exerting a leverage effect on the invested amounts. These mechanisms help to spread over time the financing of infrastructures and equipments, which, in a context of rapid population growth, will benefit a growing number of inhabitants. Funding investment through prior savings is actually equivalent to making the current population pay for an investment that will benefit a larger future population, in cities whose capacities will be increased through the broadening of the tax base.

However, in many developing countries, local governments face difficulties to gain access to credit, either because they are not legally allowed, or because the financial markets are too poor. As for the banking sector, it is usually reluctant to open up to the local governments, the latter are not considered very attractive due mainly to their poor repayment capacities. The role of central governments and international aid donors is therefore crucial in order to secure or fulfill a coaching role in the market. As for the Public-Private Partnerships which are on the decline with the crisis, they are concentrated in the emerging countries and in some of the most profitable sectors. According to PPIAF, in the low-income countries, the contribution of private operators is limited to improving the operational efficiency of services, but its weight in terms of investment funding is very limited.

Tapping this funding potential implies that national reforms must be undertaken in order to encourage, secure, and adapt the funds to the needs and capacities of local governments.

2.3. The revenues drawn from the urban land value for local governments come from the wealth creation induced by the demographic and economic attractiveness of their territory. Today, 80% of world GDP is produced in the urban areas, and this movement of concentration of economic activities in the cities is more rapid in the least urbanized countries undergoing an adjustment process. The population growth in the cities also exerts a strong pressure on land whose value increases, especially in the areas where equipments are provided.

Local governments harnessing a portion of these resources, particularly through taxation and development operations, is all the more legitimate as it is to a great extent the result of the public investments made by the local governments. Western cities financed their development in the 19th and 20th centuries thanks to these endogenous resources, and more recently, Latin America and China also succeeded in using this potential for the benefit of urban development. However, in many developing countries, the legal context does not yet allow the local governments to benefit from this fair return on investment that helps to "fund city by city."

Local tax systems, mostly based on land value, only pay a scanty attention to taxes from the economic activities, and the low tax autonomy of local governments does not allow them to mobilize these funds. Furthermore, the prerequisites that enable them to harness a portion of the appreciation of land do not always exist in the developing countries, e.g. unsuitable land law, inadequate controls, or lack of urban management tools and competent operators.

Consequently funding opportunities do exist, but it is only the proactive reforms that will contribute to harnessing them fully. The legal and institutional context of decentralization is indeed one of the factors determining the financing of local governments: clear definition of
the roles and powers of local governments in the constitution, laws and the regulations that
contribute to their implementation.

Similarly, the qualitative aspects relating to financial management such as the skills of local
government staff, the degree of transparency and accountability of local administration, or
the efficiency, productivity and performance of local public action, have a direct impact on
the capacities of local government funding.

3. ELEMENTS FOR CONSIDERATION IN THE PREPARATION OF HABITAT III

Funding services and urban infrastructures is a central reflection and recommendation theme
that will be supported by UCLG at the Habitat III Conference. Without appropriate and
adequate funds, a sustainable urbanization cannot be envisaged in terms of inclusiveness,
economic development, environmental protection or cultural heritage.

However, the plight of local finance in a majority of developing countries does not contribute
to attaining the goal of sustainable development of territories. Many components of local
finance mechanisms do not exist, are incomplete or are implemented without taking into
account the institutional context.

"Some central governments seem not to have understood that they need to create an
enabling environment for the action of local governments. The trend which is to the contrary
toward recentralization in some countries seems to have been exacerbated by the impact of
the global economic and financial crisis".

3.1. What are the impediments to fiscal decentralization? Why the recommendations of the
international community are not enforced at the national level?

3.2. What are the real needs and which types of investments to prioritize? How to improve
the quality and productivity of investment?

3.3. Based on the different contexts, which financial mechanisms to promote, which resources
to mobilize in order to fill the gap between the funding needs and the effectively mobilized
amounts?

- Which tax reforms to undertake to mobilize local and national wealth? How to ensure
  a better distribution of resources between the levels of government, and guarantee for
  the local governments a level and a sufficient dynamism to meet the growing needs of
  the people? How best to adjust the level of local government ownership over revenues to
  ensure the application of the principle of subsidiarity, while guaranteeing at the same
time a solidarity between the territories and a consistency in the implementation of
priority national policies?

- Which mechanisms to promote in order to facilitate the access to borrowing and Public-
  Private Partnership? How to support the structuring of markets, secure them, and adapt
  the products to the needs and capacities of local governments? How to support the low-
  income countries in the transition from the current situation (where the standard of living
  is low and the long-term savings is insufficient) to a situation in which the economic
growth of cities and territories contributes to a substantial rise in the standard of living
and the setting up of an enabling environment for private investment? What role may the
international community play to mobilize long-term financing during this transition?
Specific mechanisms need to be considered for the secondary cities whose financial
capacity is still very low, whereas their needs are exploding?

- How to develop investment funding mechanisms through land development? Which
  reforms to embark on to create conditions conducive to the mobilization of this
potential? Why many countries fail to set up the appropriate legislative, regulatory and

institutional framework that can help them to use this leverage to fund "city by city"? What are the obstacles and risks associated with the implementation of these funding mechanisms? To what extent are some land rights reconcilable with the use of such financial tools?

- Are the international "green" funds expected to evolve and provide a greater support to the local governments? What about their attractiveness? Do they succeed in completing usefully the funding plans of projects? Which innovative mechanisms?

8 Thierry PAULAIS : "Financing Africa's cities" 2012 The World Bank - AFD