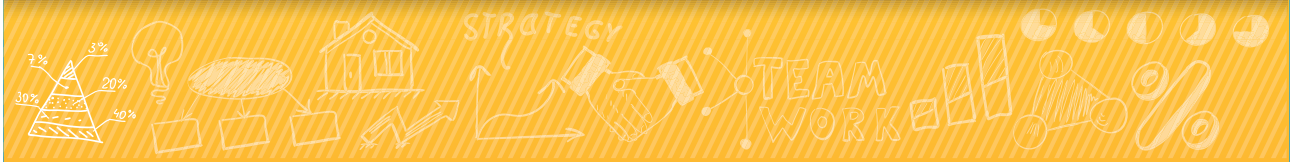


THE CHALLENGE OF LOCAL GOVERNMENT FINANCING IN DEVELOPING COUNTRIES

United Nations Human Settlements Programme (UN-Habitat),
the City of Barcelona and the Province of Barcelona



The Challenge of Local Government Financing in Developing Countries

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FOREWORD

Cities are assets, solutions and drivers of economic and social development. Cities possess huge untapped economic potential that can and should be leveraged to create wealth and economic opportunities for all. This requires good urban planning that supports urban compactness, integration, and connectivity. However, even the best urban plans risk ending up unused if they are not accompanied by financial and regulatory strategies for implementation. Strategic public investments must go hand in hand with strategic funding mechanisms and supporting governance systems.

Currently, many local governments in developing countries face the near-impossible task of funding the infrastructure and services required to meet the basic needs of growing urban populations, while forward-looking capital investments are not possible for financial reasons. Local financial management frequently suffers from lacking technological infrastructure and capacity, and opportunities for revenue generation are often restricted by inadequate regulatory frameworks or disadvantageous political structures. Lagging public-sector spending takes a toll on urban efficiency and local economic activity, creating a vicious cycle of budgetary shortfalls, choking urban conditions, and economic stagnation.

However, strategic governance and financing systems can provide hope for struggling local governments. There are opportunities for matching local needs with institutional frameworks and revenue-generation tools. Appropriate financial management can tap into strategies that improve efficiency of revenue collection, win public support, capitalize on urban and regional economies of scale, curb land speculation and sprawl, incentivize economic activity, and improve urban affordability for the poor. The resulting budgetary improvements can allow municipalities to make strategic investments in their cities, stimulating a virtuous cycle of growth, revenue generation, and prosperity.

This report – an outcome of an expert group meeting held on the challenge of local government financing in developing countries – documents both the challenges and solutions related to the ability of local governments to mobilize revenues from local resources. The report also identifies successful governance mechanisms for efficient and equitable provision of public services in metropolitan areas of developing countries, and shares experiences and methods to making public service provision more viable in peri-urban areas of large cities and in smaller urban centres of these countries.

Dr. Joan Clos
Executive Director of UN-Habitat

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INTRODUCTION

Local authorities in all parts of the world play an increasingly important role in the delivery of fundamental basic public services. But authorities also face great challenges. Most local authorities in developing countries are facing increasingly bigger challenges as a result of rapid and chaotic urbanization and due to the impacts of frequent natural disasters caused by climate change. The recent global financial and economic crisis has further aggravated these challenges.

The fundamental problem confronting most local authorities, especially those managing cities in developing countries, is the widening gap between the availability of financial resources and municipal spending needs. One of the main reasons for this increasing fiscal gap is the rapid growth of urban populations, which creates an ever-increasing demand for public services, new public infrastructure, and its maintenance.

Most cities in developing countries depend mostly on central government transfers, with lesser revenues derived from property taxation and service charges. The more lucrative sources of revenue potentially suitable for financing urban areas, such as income taxes, sales taxes, and business taxes, continue to be

In addition to addressing vertical fiscal imbalances, two other important factors could significantly contribute to a more efficient and equitable delivery of public services: (a) introducing more responsive and accountable governance practices and (b) ensuring that public service provision becomes more viable in peri-urban areas and smaller cities and towns.

*Cities are assets, solutions and drivers
of economic and social development.*

UN-Habitat, with the financial support of the Barcelona City Council, held an Expert Group Meeting (EGM) on 25 and 26 June 2014 in Barcelona to review the conventional wisdom and practices, and identify gaps, policy options, and capacity issues relevant to addressing the challenges mentioned above. The overall purpose of the EGM was to better understand the key elements and processes needed for local authorities to effectively use various financing mechanisms to implement city

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