



**TRAINING MANUAL**  
**ON**  
**URBAN LOCAL GOVERNMENT FINANCE**  
**FOR**  
**SOUTH ASIAN COUNTRIES**

**READINGS AND CASE STUDIES  
IN URBAN FINANCE**

**ECONOMIC DEVELOPMENT INSTITUTE  
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## FOREWORD

The United Nations Centre for Human Settlements (Habitat) and the Economic Development Institute of the World Bank place high priority on training as an element of human settlements strategies. As one of their activities in this area, they organize training courses and workshops, conducted in collaboration with local training institutions in developing countries and, often, sponsored jointly with other agencies, such as the United Nations Development Programme (UNDP), the United States Agency for International Development (USAID) and Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ). The principal objectives of these training programmes are to promote new approaches and techniques, to train trainers, and to develop and test training materials.

An important element of the Centre's training strategy is the strengthening of local-government financial-management capabilities. Municipal governments in many developing countries face immense challenges, having to cope with the physical and social costs of rapid urbanization from a low economic base. Efforts to improve living conditions in urban areas are frequently undermined by poor financial management, aggravating the problem of the scarcity of resources by misusing those that exist. Financial mismanagement is translated into inadequate services and a deteriorating environment - potholed roads, low water pressure, and drains choked with refuse, among other things.

Sound financial management is, therefore, an integral part of any human settlements development strategy. This manual describes the components of sound financial management - revenue generation, budget formulation and execution, financial information and control - and prescribes and illustrates a strategy for reform - a process by which central and local governments understand and commit themselves to a series of comprehensive measures to provide a sound financial base for municipal government over time by planned and feasible stages. An illustration is provided by a case study, which runs through the various stages of this Manual. Readers are asked to go through stages of analysis, calculation and choice aimed at putting an imaginary - but not too imaginary - city "back on its feet", not just in terms of finance but in terms of the services which money can buy.

Sound settlements management is seen as a key element in placing developing countries on a sustainable path to economic, social and physical improvement and in achieving the goals of the International Development Strategy for the Fourth United Nations Development Decade, 1991-2000. Expanding the human resources required for settlements management is a fundamental requirement, and this Manual is one of a series intended to assist training institutions in developing countries in the strengthening of their curricula in the human settlements sector.

This training manual, titled "Readings and Case Studies in Urban Finance" has been developed and tested in two courses in South Asia, jointly sponsored by the United Nations Centre for Human Settlements (Habitat), the Economic Development Institute of the World Bank and assisted by United Nations Development Programme. One of these courses also benefited from assistance of the Government of the Netherlands. A similar training manual has been produced and tested in three training programmes in Eastern and Southern Africa. The original training materials were produced by a team consisting of Professor Kenneth Davey, David Gossman and Philip Gidman, and they have been edited by Professor Davey in collaboration with the staff of the UNCHS (Habitat) Training Unit.

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## INTRODUCTORY TRAINER'S NOTES

This volume contains material for use in courses on urban financial management, particularly in relation to the rapidly growing cities and town in Africa. Such courses may be of different types and durations. On one hand they may be part of a larger curriculum for a post-graduate degree/diploma or a professional qualification. In such cases the course will be one of a number running concurrently, and the subject matter may occupy one or two sessions a week over one or two terms or semesters: candidates will be subject to some form of individual assessment. On the other hand, urban financial management may be the focus of a short seminar or course from central- or local-government officials, lasting perhaps from a week to a month, but not leading to any specific qualification: there will be no individual assessment and the emphasis will be on group discussion and problem-solving.

The material can be used in either context. By using the case exercises selectively, the subject matter could be compressed into a course of 10 days. Candidates preparing for a post-graduate or professional qualification, however, would be expected to read a wider literature, as this volume provides only a basis of lecture notes and illustrative exercises.

The volume has two components. The first is a set of readings on each of the main elements or topics of municipal financial management, including principles of revenue generation, individual types of municipal revenue, the various stages of the budgetary process, financial control and auditing. These readings are designed as a preface to seminar discussion. Ideally, participants would be asked to read the appropriate chapters the night before each day's discussions and to prepare contributions to the debate linked to their own experience.

The second component is made up of the case studies. These comprise an interlinked series of exercises covering the process of financial reform in an imaginary city (the city is not entirely imaginary; data from a number of real cities have been combined). The purposes of the case studies are:

- (a) To illustrate the processes described in the readings;
- (b) To give participants confidence in undertaking simple numerical analysis and to overcome any insecurity in considering the use of the processes of financial management;
- (c) To illustrate the concept of a strategic, medium-term approach to improving the financial performance of a municipal government;
- (d) To introduce variety into a curriculum.

The case studies are designed for small group work. However, they can be undertaken as individual written assignments and assessed for post-graduate or professional qualifications. Group work can be combined with individual assignments; for example, stage II (chapter X) involves a number of self-contained exercises which can be farmed out to individual members of a working group to undertake and report back.

The case studies do not have to be undertaken in their entirety. They can be used selectively according to the time available and the seniority and experience of the participants. For example, at stages II and III, only one of the service-costing exercises (education, refuse collection or roads and street lighting), might be undertaken to illustrate a zero-based, unit-costing approach. Tutors can simply feed in the results of the other exercises when needed in stage IV. Stage IV can be shortened by requiring participants to complete profiling in respect of one or two items only; the remainder can then be supplied for use in the budget-monitoring exercise.

It is difficult to predict accurately the amount of time required for the group work. Experience suggests that it is better to timetable group exercises in the afternoon with report-back, plenary sessions at the beginning of the following morning. This gives groups the opportunity to extend work into the evening if necessary; this type of activity also tends to command more attention after lunch than does general discussion.

The case studies are, of necessity, oversimplified to fit into the constraints of a curriculum. Undertaking these processes in real life would involve far more detailed information and far more time. This should be mentioned to participants at the outset, though it is readily understood by them.

# PART ONE: INTRODUCTION

## I. REFORMING MUNICIPAL FINANCE

### ***Trainers' notes***

This chapter sets urban financial management in its context and outlines the agenda of issues to be examined in the course. It should be used as preparation for a discussion in which participants analyse and compare:

- (a) The general problems of urbanization
- (b) The system of urban government
- (c) The specifically financial problems of their own countries and cities.

Oral presentation may be invited in respect of each city or country represented, using the chapter as a framework.

If the course is international, it is particularly important that institutional differences in the various systems of urban government are identified in this initial discussion. Later discussion of individual issues can be very confused if participants do not realise that systems are not uniform: e.g., that water supply is a municipal responsibility in country A but that of a State-level enterprise in B.

Finally, this chapter aims to make participants conscious, from the outset, of the multi-faceted nature of urban finance and the usual need for reform on a broad front. It introduces the idea of strategic management; i.e., of a comprehensive multi-year approach to strengthening financial management. Changes which might encounter resistance may be acceptable when planned to take place in progressive stages over a number of years.

### **A. *The urban context***

1. During the last quarter of the twentieth century, the population of urban areas in developing countries is likely to grow by 1 billion. Some individual cities are growing by 250,000 to 500,000 people annually. Whether this is good or bad is academic; measures to stem population growth or rural-urban migration might or might not reduce the rate of urbanization, but its scale over the next two decades will still be massive and unprecedented.
2. Urbanization involves costs to the public sector, which amount to large shares of total public spending. Dense human settlements require levels of servicing - for health reasons, if no other - which are not essential elsewhere. Rising incomes increase demands for water, electricity, road space, telephones and similar public services. Expectations for urban amenities and appearances are high, and the costs of providing them are also high. The growth of large cities often involves diseconomies of scale in some types of infrastructure - long pumping distances for water and travelling distances for commuters, for example. In some of the largest metropolitan areas, geographical shape and terrain accentuate the costs of growth: Bangkok, Lagos and Rio de Janeiro are cases that come to mind.
3. As a result, urban areas in developing countries are demanding rates of investment that are far higher than those achieved (or needed) by the cities of Europe and North America during their periods of rapid growth. Heavy investments give rise to high levels of current expenditure, and these combined demands pose considerable problems for national and local governments. They place heavy strains upon absolute levels of public resources: they add to political conflicts over the allocation of resources between regions or between town and country: they may endanger national investment priorities, particularly efforts to contend with the conditions of rural poverty which produce much pressure upon urban areas.



4. The financial consequences of urbanization and the dangers of over investing national resources in urban services have two implications, which will provide themes for this Manual. The first is the need for cities, as a whole, and urban government agencies, in particular, to generate as much as possible of the resources they need for investment and current spending. The second is the need for public agencies to make the most effective use of resources - to seek low-cost solutions to problems wherever possible, to diffuse the benefits of investment as widely as possible, and to avoid waste and leakage.
5. There is a further dimension to these two points. Most large cities have big concentrations of poverty. Wide disparities in standards of living are not unique to cities, but they are highly visible and have often been accentuated by past practices in public-sector policy and the provision of services. It is a matter of great and growing concern that attempts to generate public revenue in cities should not add, at least disproportionately, to the burdens of the poor and that priority in public expenditure should be given, wherever feasible, to those types and methods of service provision which will benefit the poor.
6. It is likely that this context and these objectives of urban financial policy will be widely understood and accepted by readers. It will not be necessary, therefore, to devote further time to discussing or defining them in general. They will, however, underlie the content and the discussion of individual financial issues and practices.

## **B. The role of municipal government**

7. Despite tremendous variations in its character, municipal government is a worldwide institution. Almost all towns and cities have a representative or quasi-representative system of local government. There are many differences, however, in characteristics. Important variations are as follows:
  - (a) *The relationship of municipal boundaries to urban settlements.* In cities such as Bombay, Lusaka and Nairobi, a single local authority has been responsible for the core city and virtually all suburban development. Cairo, Calcutta and Manila, by contrast, represent cities fragmented between a number of municipal jurisdictions.
  - (b) *The extent of municipal functions.* Refuse collection, market administration, local road maintenance, cleansing, drainage, lighting, parks and recreation are virtually always municipal responsibilities. What varies widely is municipal involvement in:
    - (i) Public utilities, chiefly water and sewerage (provided, sometimes, by a national corporation, or typically by a metropolitan corporation or, a municipally controlled enterprise) and electricity (usually a national utility responsibility, but, sometimes, a function of local government);
    - (ii) Social services (municipalities often provide primary schools and clinics, but less frequently secondary schools and hospitals);

- (iii) Public protection (fire services are frequently municipal, but police forces infrequently so outside Europe and North America);
  - (iv) Trunk roads, which can be a national, provincial or local responsibility;
  - (v) Provision of rental or purchase housing or serviced sites (sometimes a municipal activity, sometimes that of a special purpose authority);
  - (vi) Regulation of land use and development (usually, a municipal but, on occasion, provincial or metropolitan authority function).
- (c) *The degree of integration in a vertical chain of administration.* American, British and (to some extent) Spanish traditions treat municipalities as separate political, legal and administrative entities, albeit subject to varying degrees of external supervision. French and Ottoman traditions place local government within a vertical hierarchy of governmental institutions; locally elected assemblies have legislative powers, but executive responsibility is often exercised by administrators (governors, prefects, etc.) with a dual responsibility to central and local government. (This pattern is changing within France itself but is still prevalent in French-speaking African countries).
- (d) *The location of executive as opposed to legislative responsibility.* This may be vested in an elected leader, governor or mayor, an administrator appointed by central or local government, or the elected representatives who, as a body, directly supervise their professional staff.
- (e) *The extent of external supervision.* This applies particularly to the requirement for central- or provincial-government approval of budgets, revenue tariffs, staff appointments, contracts and development plans.
- (f) *The nature and buoyancy of revenue sources.* These will be discussed in Part Two.

### ***Non-municipal authorities and enterprises***

8. A further variable is the existence of parastatal authorities or enterprises at city (as opposed to national) level. These may have three types of function:
- (a) The provision of specific urban services, such as water supply, sewerage or public transport;
  - (b) Comprehensive development of new areas for residential, commercial or industrial occupation;
  - (c) Metropolitan planning and development control.

Occasionally, a single authority performs two or all of these functions. The Karachi Development Authority, for example, is responsible for master planning and new area development (and, until recently, for bulk water supply).

### ***Private-sector involvement***

9. A final variation is the role of the private and voluntary sectors in the provision of urban services. Private enterprise, in many cities, provides, totally or partly, services which, in other cities, are run by the public sector. Examples are public transport, medical services, nursery education and commercial refuse collection. Furthermore, public-sector responsibilities may be contracted out to private-enterprise or voluntary bodies. Examples are refuse collection, road maintenance or the operation of sporting and other recreational amenities. Inputs to services may also be contracted out in this way, such as architectural design or office cleaning. Although private-sector involvement in urban services has a long history, preceding, in many cases, the growth of municipal government and public enterprise, there is much current interest in its expansion. Privatization is seen as a device for eliminating a whole area of public expenditure; alternatively, contracting out is intended to reduce costs, through competition or use of voluntary effort, while maintaining overall public responsibility.

### Box 1

Faced with continuing urbanization and severe economic constraints, several governments are increasing the role of municipal government in urban management. Objectives include improvements in investment decisions; execution of projects through the involvement of local knowledge, preference and accountability; mobilising extra resources from local revenues and communal participation.

Mexico, for example, amended its Constitution in 1983 to give municipal administrations prime responsibility for land-use planning and development control, water supply and sanitation, cleaning, roads, parks, markets and street lighting. Property tax revenues were vested in municipalities by the same amendment and they had already been given statutory shares in federal revenues. The 1988 Constitution in Brazil considerably increased both municipalities' shares of federal and state taxes and their own taxing powers; a number of additional responsibilities are being transferred to them particularly in the field of public health. In Turkey, a series of legal amendments between 1983 and 1988 increased municipal taxing powers and shares of national revenues, and established powerful, elected metropolitan authorities in the larger cities. In India, constitutional amendments to protect the existence and powers of municipal bodies were introduced in Parliament in 1989.

### Conclusion

10. Two features of this brief analysis have financial implications, *viz.*,
  - (a) Very wide variations between countries (and even, within countries) in the structure of urban government and the allocation of responsibility for individual urban functions;
  - (b) Considerable fragmentation of responsibility between levels of government between general and special purpose authorities, between territorial jurisdictions and between public and private sectors.

Numerous attempts have been made to rationalize the institutional framework, to extend municipal boundaries, to amalgamate municipalities, and to superimpose metropolitan-wide co-ordinating or planning authorities, among others. All such attempts meet institutional resistance; all reorganisations are very costly, and few have yielded more than partial success. The system of urban finance has to live within the specificities of governmental structure.

### C. *Municipal financial management*

11. The main purposes of financial management in municipal government are:
  - (a) To keep the municipality solvent;
  - (b) To ensure it enough revenue to carry out its main responsibilities to the community;
  - (c) To see that the burden of financing the municipality, through taxes, charges etc., is fairly apportioned;
  - (d) To ensure that the municipality's resources are used in accordance with its priorities;
  - (e) To see that resources are used legally and honestly;
  - (f) To provide those who run the municipality with adequate information for discharging their

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