GTF2016
GLOBAL TASKFORCE
POST-2015
DEVELOPMENT
AGENDA
TOWARDS
HABITAT III

FINANCING LOCAL AND REGIONAL GOVERNMENTS

The missing link in sustainable development finance

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Recommendations of Local and Regional Governments for the **Financing for Development Conference**.

This set of recommendations has been drawn up in collaboration with Paul Smoke, Professor of Public Finance and Planning and Director of International Programs at New York University.

The **Global Taskforce of Local and Regional Governments** facilitated by UCLG gathers over 30 networks that are active internationally.

Note: This document has been produced with the financial assistance of the European Union. Its contents are the sole responsibility of UCLG and the Global Taskforce and can under no circumstances be regarded as reflecting the position of the European Union.

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TABLE OF CONTENTS

SUSTAINABLE DEVELOPMENT GOALS WILL BE IMPLEMENTED AT THE LOCAL AND REGIONAL LEVEL

FINANCING MUST REACH LOCAL LEVELS TO UNLOCK THE ECONOMIC POTENTIAL OF URBAN AREAS AND TERRITORIES

KEY RECOMMENDATIONS

01

Provide suitable regulatory and legal environments at the national level to ensure that local and regional governments have appropriate powers and capacities to manage local/urban development.

02

Ensure appropriate fiscal decentralization and sharing of national resources. Provide a set of productive sources of revenue (local taxes, including land value capture, some types of business taxation, etc) and regular and predictable transfers to support the execution of LRGs responsabilities.

03

Increase technical assistance and capacity building for subnational governments to develop their capacities to raise local taxes and improve budget management, enhance creditworthiness, design bankable projects and implement infrastructure for the provision of basic services that respond to the community's local needs.

04

Strengthen local governments' access to the instruments enabling them to raise long-term financing (banking system, financial markets, international grants and loans), through the creation of:

- Well-structured and well-justified guarantee mechanisms to secure investment
- Infrastructure Project Preparation Facilities and Urban Development Funds.

05

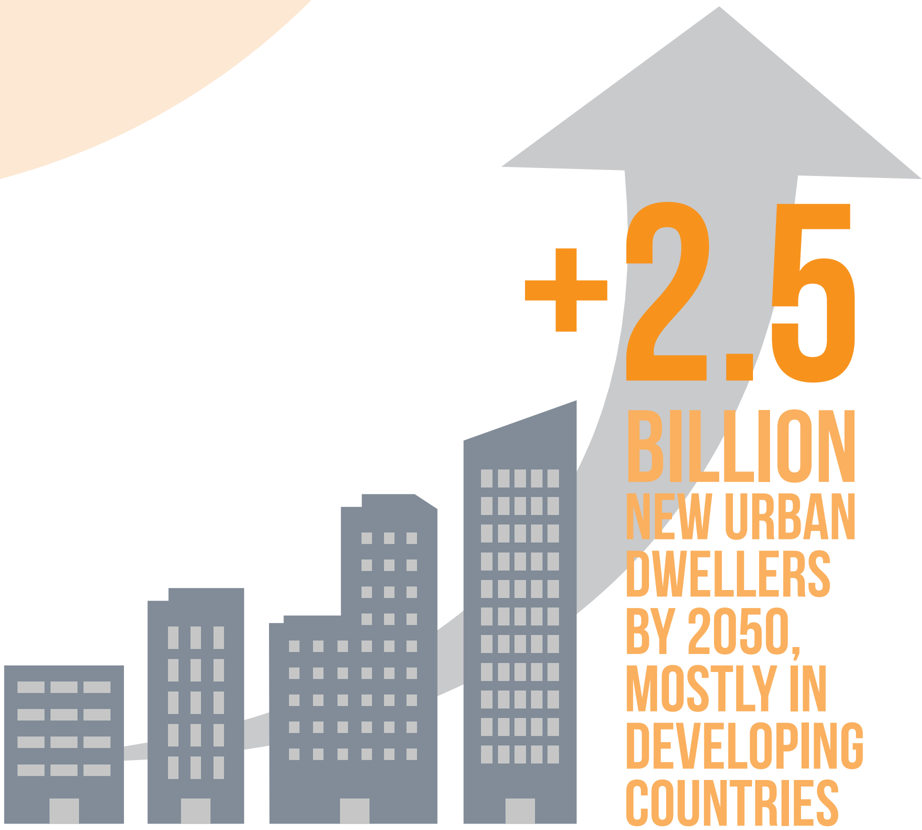
Develop innovative and responsible ways for MDBs to lend to local and regional governments (sub-sovereign loans), and ensure LRGs **access to global, regional, and national climate-change financing mechanisms** (e.g., Green Climate Fund, GEF) in order to facilitate investments in adaptation infrastructure.

06

Improve monitoring of official flows (IFIs, ODA and emerging actors) **invested in local infrastructures and services** and in the development of local and regional governments capacities.

INTRODUCTION

There is a general acknowledgment of the huge volume of public and private investments needed to eradicate poverty, cope with the impact of climate change and promote prosperity. Many countries face a **considerable backlog of infrastructure demands and anticipate new demands due to population growth and continued urbanization.** Expectations of total need vary widely, with some estimates as high as $90 trillion. These vast needs for investment in productive infrastructure coincide with unprecedented amounts of global liquidity in search of investment opportunities.



“THE BATTLE FOR SUSTAINABLE DEVELOPMENT WILL BE LOST OR WON IN CITIES“

High level Panel on the Post-2015 Agenda

The **Zero Draft of the Addis Ababa Accord** recognizes that **“in more and more countries, responsibilities for revenues, expenditures and investments in sustainable development are being devolved to the sub-national level and municipalities, which often lack adequate technical capacity, financing and support.”**

To support local authorities, it commits **“to develop mechanisms to assist them, including to strengthen capacity, particularly in areas of infrastructure project development, local taxation, sectorial finance and debt issuance and management, including access to domestic bond markets (...)”**

It also proposes **“(...) implementing resilient infrastructure and climate-friendly policies and investments.”**

“MANY OF THE INVESTMENTS TO ACHIEVE SUSTAINABLE DEVELOPMENT GOALS WILL TAKE PLACE AT THE SUBNATIONAL LEVEL AND BE LED BY LOCAL AUTHORITIES”

UN SG Synthesis Report

While the zero draft represents a step forward in the recognition of sub-national governments, it does not go far enough. Sub-national reforms will be necessary, as well as flexible policy responses that can respond to the diverse needs of different types of local and regional governments.

The upcoming FfD3 Conference provides a unique opportunity, not only to advance our thinking on how to facilitate the mobilization of funding to promote sustainable local development, but also to deepen the global understanding of how to unlock the developmental potential of local and regional areas and the bodies that govern them.

How can LRGs mobilize part of the wealth produced within their jurisdiction (domestic resources) to finance and support development?

?

What steps are necessary to enable LRGs to play these roles?

How can national and global actors improve LRG creditworthiness an access to long-term finance and strengthen their capacities to deliver sustainable services, particularly in poor areas?

FULL POLICY PROPOSALS AND RECOMMENDATIONS

IF LOCAL AND REGIONAL GOVERNMENTS ARE TO FULLY PLAY THEIR ROLE IN MEETING THE SDGS, A SUITABLE BLEND OF APPROPRIATE FISCAL REFORMS AND FINANCIAL INSTRUMENTS MUST BE ADOPTED.

When they are empowered, well-structured and supported, LRGs can contribute substantially to development outcomes, meeting not only local needs but also supporting national objectives. It will also be essential to set up review and monitoring mechanisms within the FfD process to ensure that the inclusion and performance of LRGs is being adequately incorporated and assessed.

- Build effective global and national partnerships
- Mobilize domestic resources at both local and national levels
- Strengthen long-term financing through domestic and international private sources
- Localize official development aid

BUILD EFFECTIVE GLOBAL AND NATIONAL PARTNERSHIPS

The role of LRGs in planning and financing the SDGs should be more prominently acknowledged.

Measures should be undertaken to lay a stronger foundation to facilitate their ability to contribute to the financing of development.

- Highlight the role of LRGs in the SDGs and FfD **more prominently in policy statements** and involve LRGs **more deeply in building the Global Partnership for Sustainable Development** so that they can contribute to, and help to ensure the consistency of public policies at sub-national, national and international levels.
- **Strengthen LRGs capacities to lead the sustainable developmental process,** to create and implement strategic plans and to ensure the long-term delivery of SDGs at local levels, ensuring the identification of bankable infrastructure and social service projects that respond to prioritized communities demands.
- **Increase domestic resource mobilization and give a more prominent role to LRGs** through policy reforms, and innovations in the way finances are channeled to them, to improve infrastructures and social services.
- Support the development of **broader intergovernmental frameworks to narrow vertical fiscal imbalances**, building capacity and incentives for LRGs **to meet the fundamental requirements for effective sustainable development policies**, and enabling essential aspects of accountability and transparency.
- Develop an **enabling environment to encourage the private sector to invest in local infrastructure and work in partnership with LRGs** in the SDG and FfD arena, including adequate PPP frameworks and local public procurement systems that prioritize local economic development and job creation.
- **Provide financial advisory support and strengthen the capacity of LRGs** to promote, manage and monitor PPPs and to develop viable planning mechanisms to help ensure universal access to public services and to protect the commons.

MOBILIZE DOMESTIC RESOURCES AT BOTH LOCAL AND NATIONAL LEVELS

LOCAL TAXATION

There is considerable scope to increase domestic revenue generation by LRGs through appropriate fiscal reforms and fiscal decentralization.

- Provide LRGs with **adequate powers and capacities to raise revenues** (tax, non-tax, user charges) and to discharge their obligations and pursue broader activities to meet the goals outlined above.

- Focus on allowing and/or improving the use of **a set of productive sources of revenue: land value capture** merits particular attention, especially in growing urban areas; other sources, including motor vehicle revenues, user charges and some types of **business taxation**, hold great potential.

- Allow LRGs to **piggyback** on selected national or regional revenues that are productive but best administered at a higher level, e.g. income-related taxes and VAT.

- **Develop better information** on tax bases and taxpayers, **simplify** tax structure and administration, and adopt policies to **improve administration/collection so as to reduce tax avoidance and tax evasion at local levels.**

- **Promote participatory mechanisms to increase citizen engagement, integrate the informal economy, strengthen local accountability and tackle corruption** (e.g. local participatory budgets).

SHARING OF NATIONAL RESOURCES

National governments can improve domestic tax and non-tax revenue mobilization, and devote an appropriate share to better structured intergovernmental transfers that increase LRGs' access to resources and encourage them to raise their own revenues, to deliver basic services and play a stronger role in development.

- **Regularize the intergovernmental transfer system** to ensure that an adequate share of national resources is provided to create incentives to achieve the SDGs and support LGRs in carrying out their responsibilities. This should be done using rule-based mechanisms and predictable resource flows, adapted to local institutional and regulatory contexts (derivation-based or formula-allocated tax sharing; conditional or unconditional transfers).

- **Use intergovernmental transfers to support LRG reform objectives and to meet broader policy objectives, particularly the SDGs.** Some countries have started to use transfers to reward LRGs for compliance with fiscal and managerial regulations and for their performance in delivering national priority services.

- **Increase transparency and improve data collection at local level to support the design of the transfer allocation process.** This will help to improve effectiveness and to reassure LRGs and the public that resources are being allocated in a transparent and fair way.

- **Improve linkages between transfers and other elements of the intergovernmental fiscal system.** In particular, it is essential to ensure that transfers do not undermine the incentives of LRGs to raise revenues from own sources or discourage creditworthy LRGs from borrowing for infrastructure investments.

STRENGTHEN LONG-TERM FINANCING THROUGH DOMESTIC AND INTERNATIONAL PRIVATE SOURCES

Many LRGs, especially in urban areas, could increase borrowing to finance investments that support the SDGs.

Since countries and LRGs vary widely, a range of measures and mechanisms would be required and must be appropriately applied in specific situations.

- **Promote and facilitate access to credit markets where LRGs are in a position to borrow**, mainly large urban areas in low and middle-income countries.

- **Develop effective financing alternatives for LRGs that are not in a position to go to the market**; these include special credit institutions like municipal development banks and risk mitigation strategies (such as full or partial credit guarantees from the central government or development partners, co-financing initiatives, secondary market support, and the use of bond banks and credit pooling).

- **Ensure the provision of an appropriate range of LRG investment finance options**, ranging from grants and subsidies (according to clear criteria and conditions) loans for poorer LRGs and non-self-financing projects, to various types of loans on market terms for the more fiscally sound LRGs and self-financing projects.

- **Build creditworthiness over time by developing an asymmetric and integrated financing system that creates robust incentives for stronger LRGs to borrow and for weaker LRGs to improve their capacities and begin to borrow**, initially through special credit mechanisms and later on more market-based terms.

- Support the **establishment of new mechanisms for financing cities in developing countries**, e.g. an Urban Development Fund, an enhancement of the urban agency concept into a financing vehicle that can bring institutional investors, development finance and the public sector in cities together.

- **Encourage regulators and rating agencies to incorporate the positive impact of sustainability and resilience into evaluation of investments in urban areas.** This approach could be allied to existing work being undertaken in relation to risk assessment and use of risk instruments offered by the insurance industry.

LOCALIZE OFFICIAL DEVELOPMENT AID

Official Development Aid (ODA) can be better targeted and used to increase the resources available to LRGs in developing countries to support them to implement the SDGs. Development partners need to be more aware of the roles of LRGs in achieving the SDGs, and act accordingly.

- Design more appropriate mechanisms to **engage LRGs in order to understand more fully the considerable opportunities they present and the prominent challenges they face**; such mechanisms must recognize the diversity of LRGs within each country, which may necessitate asymmetric approaches.

- Develop innovative ways for international and regional development banks to **lend more widely to LRGs** (e.g. innovative credit enhancement for sub-national loans and reduction of foreign exchange risks).

- Devise creative ways for development partners to **channel resources to LRGs** in ways that both support them as empowered, autonomous entities with a **general developmental mandate for their territories** and provide them with **dedicated funding for capacity-building and financial advisory services, so they can begin to develop solutions that are customized to their needs and leverage distinctive resources.**

- Ensure LRGs **access to global, regional, and national climate-change financing mechanisms** (Green Climate Fund, GEF, etc) in order to facilitate investments in adaptation infrastructure.

A GLOBAL OBSERVATORY ON LOCAL FINANCE – AN ESSENTIAL TOOL FOR THE FOLLOW-UP OF DECENTRALIZATION PROGRESS AND THE ACHIEVEMENT OF THE SDGS

The creation of an observatory on local finance at the global level will enable local and regional authorities to improve their creditworthiness by promoting governance and fiscal management transparency, and allow international development partners to follow the progress of reform commitments.

- Support the **development and maturation of the broader intergovernmental fiscal system in which LRGs must operate**: local own source revenues, intergovernmental transfers and credit mechanisms/innovations (including development of subnational debt markets); many partners already work on these areas, but too often in fragmented ways that can undermine national policy and system coherence as well as weaken prospects for LRG engagement with domestic and international providers of finance.

- **Help provide a foundation for the collection and use of better information**, including the gathering of local data and the creation of national systems that integrate disaggregated data at subnational levels.

- Support **city-to-city cooperation** as a way to strengthen local capacities and facilitate exchanges of knowledge and good practice on city management, risk prevention, and innovative and clean technologies, among other areas, to implement the post-2015 development agenda.

HOW TO INCLUDE LRGs MORE PROMINENTLY IN THE FFD PROCESS

In addition to the recommendations made above to support the role of LRGs in achieving the SDGs, specific efforts should be made to include LRGs more prominently in the FfD process.

This is needed, not only for consultation purposes and the development of particular targets, but also to facilitate better understanding of the evolving role of LRGs.

01

Establish an FfD mechanism to monitor trends in LRG resource mobilization and expenditure, particularly with respect to the SDGs and for larger urban areas. On the revenue side, this would include LRG revenue generation, intergovernmental transfers (conditional/unconditional) and borrowing (by type of mechanism--public, private, mixed). On the expenditure side, this should focus on basic services and goals related to the SDGs. Documentation of spending pattern trends from dedicated sources of finance (conditional transfers and loans) should be provided.

02

Pay particular attention to monitoring the role that international financial institutions, traditional ODA providers and emerging development assistance actors (multi-actor sectoral mechanisms and South-South cooperation) play in directly supporting the development of more fiscally capable LRGs.

03

Create a mechanism to monitor and facilitate sub-sovereign creditworthiness and debt. Although many LRGs in developing countries need support for borrowing and capacity development, many countries have at least some LRGs that can already, within the boundaries imposed by fiscal responsibility frameworks, effectively tap financial markets to provide infrastructure.

04

Consider setting up a process to track the progress of the ability of LRGs in particular countries to borrow for SDG development expenditures over a specific period of time. In each country this could include a mix of LRGs, from fiscally stronger cities that agree to work on needed reforms, obtain a credit rating and obtain a market loan, to less creditworthy local governments that agree to work on reforms that allow them to begin on a path to creditworthiness by initially taking subsidized loans from dedicated finance mechanisms. Tracking the progress of LRGs in this area would provide valuable inputs and lessons on how to build more fiscally capable LRGs.

GLOBAL TASKFORCE

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TOWARDS HABITAT III

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Contribution of UCLG and its Committee on Local Finance for Development

UCLG Committee on Local Finance and Development