LOCAL FINANCING AS A CONDITION FOR INCLUSIVE AND SUSTAINABLE TERRITORIAL DEVELOPMENT


La Paz, Bolivia © Lou Payrat

Increasing urbanisation further concentrates the concentration of management function, whether of population, services or infrastructure equipment. Countries in the global South therefore need to face up to the challenges linked to this urban change, whilst steering a sustainable course in the terms of development. The greater part of the investments that will be required to meet the Millennium Development Goals will therefore need to be made at the local level, under the control of local territorial, urban and rural authorities. However, in the majority of developing countries, the means at the disposal of local authorities do not match up to the challenges faced. The shortfall in funding for investments in the infrastructure sector is estimated to be US$1 trillion per year between now and 2020. (*World Bank, Financing for Development Post-2015*, October 2013, p.4).
Thus, the issue of local financing is the critical challenge to the success of the post-2015 agenda, in terms of development as well as climate. The issue presents itself in terms of territorial scale, powers and remit, but also in terms of financial tools.

LOCAL AUTHORITIES AND THE CHALLENGE OF FINANCIAL AND BUDGETARY AUTONOMY

Respect for **local autonomy** must be the guiding principle for any public policy implemented on the territorial scale. As they are closest to the inhabitants, local authorities are best placed to respond their needs and implement an integrated approach to territorial development, whilst ensuring the linkage between citizens and the various institutions. Transparency and accountability must be the guiding principles of this approach, as they are necessary to ensure citizens' support for local policies. Participatory budgets, for example, help strengthen this support through a better dialogue between civil society and local authorities.

In order to effectively lead public policy and be genuine drivers of sustainable urban development, local authorities must take a global approach to local financing and find the right balance between the different possible sources of funding. These can be endogenous: transfers from the state (allocations), which are often limited, and local taxation, which are often poorly managed; or external, repayable resources, mainly borrowings.

These different levers at the disposal of local authorities are highly dependent on the specificities of each national context (regulatory, economic, financial). The implementation of **financial and fiscal decentralisation** determines the level of autonomy of territorial authorities, their capacity to develop their own fiscal policy and to access banking and financial markets.

Given the significant investments required for spatial planning actions, the financial solidity of local authorities is an important factor for the successful implementation of ambitious projects on their territory.

FRENCH ORIENTATIONS FOR THE FINANCING OF LOCAL AUTHORITIES

In order to meet the challenges of the Urban Agenda, local authorities must need to have a genuine ability to mobilise financial resources. The gap between the needs and the funding is such that the approach required should be centred on optimising the resources that have significant leveraging effects, particularly for spending on investments.

Orientation 1:

Ensuring transparent and effective management

Local authorities must ensure that the management of public finances is based on the principles of budgetary discipline, strategic allocation of resources and efficient delivery of public services. This sound management is a condition for their credibility and, hence, their solvency.

Investment programmes must be conceived within a realistic and multi-annual framework that can rest on a process of participatory development. The quality of the budgetary and accounting framework is of prime importance in ensuring transparency, effectiveness and the correct allocation of resources.

The partners in cities must use this framework for their funding in order to ensure that spending is effective and actions are coordinated. The overall control of local authorities as main contractors must be respected.

Therefore, capacity-building initiatives in financial engineering for the local authority should be put in place, either nationally, by the government, or internationally, through international partners. Support for local actors can take several forms: studies, technical assistance, training in project management, exchanges of expertise. Such initiatives must enable the local authority to build their capacity to define goals, monitor project implementation, set up appropriate financing.

Orientation 2:

Strengthening budgetary autonomy and ensuring national resources are shared equitably

The decentralisation processes, and associated transfer of powers, are aimed at ensuring an efficient and balanced allocation of resources, as close as possible to the populations concerned. Countries must therefore embark on institutional reforms that enable the transfer of powers to be accompanied by financial decentralisation in order to ensure that the means to exercise those powers are allocated. Therefore, a regulatory framework needs to be developed (at the national, regional and local levels) that is favourable to the mobilisation of own funds, notably through higher local taxation income.

Local authorities need to have stable and predictable resources (transfers or subsidies) as part of a transparent State allocation system. **Regularity and predictability** are preconditions for local authority budgetary autonomy. Similarly, guaranteeing the free allocation of transfers helps reinforce this autonomy.

Finally, financial transfers from the State must contribute to reducing inequality between territories through equalisation mechanisms, even if State allocations often represent a rather but a small part of those cities' resources.

Orientation 3:

Mobilising a greater amount of own resources at the territorial level

A significant part of cities' own resources come from their fiscal and non-fiscal revenues (taxes, duties, contributions, levies). The authority's decision-making capacity in terms of revenue-raising - defining the tax base and rates - as well as the regulatory framework condition its financial autonomy. Several factors contribute to making the collection of local taxes a complex matter: income levels of the local population, identifying taxpayers, the yield on certain taxes, capacity within the local administration, corruption or similar practices.

Local authorities must therefore be able to build and diversify their tax bases, notably through:

- appropriate charges for basic urban services: this enables recovery of the costs inherent to the delivery of those services, whilst ensuring access for all;
- optimising property taxes by modernising and optimising the information and recovery systems for local taxes;
- increases in land value resulting from infrastructure funded by the local authority could be used to finance further investments. Beyond generating immediate income, this mechanism also strengthens the efficiency of urban property markets and contributes to directing urban growth towards the areas best placed to host the development. Nonetheless, this complex mechanism, used notably in transport projects (transit oriented development), requires reforms in the area of land laws and the creation of specialised instruments and operators in order to ensure effective management and prevent the income from being captured by private agents

Orientation 4:

Diversifying the external resources and increasing local authorities' access to long-term financing

In many developing countries, local authorities wishing to diversify their sources of funding find it hard to access borrowing, for several reasons. It may be the case that they are not legally permitted to resort to borrowing from financial markets, the markets themselves may be too weak or poorly adapted, or the local authorities' solvency prevents them from borrowing. The banking sector has little incentive to lend to local authorities, particularly because of the fact that they have a low capacity for repayment.

There are several ways in which technical partners can provide support to help local authorities broaden their external funding.

Support should also be provided to structuring the financial market at the national level and adapting the products to the capacities of the local authorities. Guarantee schemes can be developed to support local authority access to financial markets, such as sub-sovereign loans requiring a guarantee from the state. Some development banks can also provide such a guarantee.

Mutualising needs and using an intermediary (municipal equipment funds, municipal development agencies, local authority loans funds, etc.) can also be a means for local authorities to access financial markets and insure them against the risk of borrowings. The intermediary would raise funds on the markets and offer loans to the local authorities.

The Agence France Locale (AFL, Local France Agency), which was created on 22 October 2013, is tasked with funding French local authority investments, particularly at a time when access to bank credit facilities is difficult. In order to do this, the AFL raises funds on the borrowing markets and, in return, offers short, medium or long-term loans at fixed or simple variable rates. Local authorities can thus finance themselves by mutualising their needs, diversifying their sources and having access to more advantageous, therefore reducing the cost of their debt. The AFL aims to cover 25% of the funding needs of French local authorities.

At the international level, local authorities can borrow by issuing debt securities on the bond market. This direct form of funding involves committing large sums and is therefore more suited for local authorities that have a solid fiscal base and for funding large-scale projects.

Besides the financial markets, local authorities can also enter into public-private partnerships to fund their investments. With the condition that it is well supervised and negotiated equitably, this tool enables local authorities to join up with the private sector and benefit from its capital base.

Finally, some donors have the ability to raise significant sums on the international financial markets: they must be able to make local authorities benefit from this - either bilaterally or through intermediaries - by providing them with loans under adapted conditions, until such a time that regional or national markets are sufficiently mature. Access to loans from development banks is therefore of major importance for the development of cities. While loans should be encouraged, cases of vulnerability should be taken specific account of. The most vulnerable local authorities should be able to receive public aid in grants, in whole or in part.

Orientation 5:

Building the capacities of local authorities

In order to diversify their financial resources, local authorities must, as described above, be solvent, increase their financial autonomy, and develop new partnerships, in particular with the private sector.

Building the capacities of local actors (elected representatives, managers, financial directors) is not optional. Their capacity to utilise and broaden the range of financial instruments is of capital importance.

The partners of local authorities can also support them by developing innovative tools, combining the functions of supportive banking intermediary and expertise. This enables the local authorities to have improved access to the financial market (local, bonds, long-term loans, public-private partnerships), and to diversify their sources of funding.

There are examples of innovative mechanisms for mixed funding to support local authorities in becoming autonomous in terms of their budgets: it is a question of combining subsidies, which are necessary for developing their services and their solidity, with loans that will serve to reduce their dependency on those subsidies. This progressive approach makes it easier to assess and build local management. This condition is a prerequisite to consolidating the credibility of a local authority in the eyes of private investors, financial institutions or development aid agencies, and thus facilitating its access to the financial market.

This note was prepared in collaboration with the French Partnership for Cities and Territories (PFVT), the platform for exchange and promotion of French expertise in urban development at the international level.
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