



Financing cities

In order to finance the needs of their cities, local authorities must demonstrate unprecedented capacities for managing and diversifying their sources of funding. The daily living conditions of city dwellers are dependent on the way in which this highly technical issue is managed.

Today cities have substantial financial requirements that are supported by their growth. Access to basic services, housing, transport, waste collection and disposal, environmental protection and providing the urban population with decent living conditions all demand considerable investment and sizeable operating funds. In the wastewater treatment sector alone, an estimated 14 billion euros of investment will be needed every year until 2025.

Traditionally, cities' needs have been financed by States and local taxes. Today, State transfers have not entirely disappeared, but they are now part of a move towards decentralization, which tends to increase local responsibilities without always transferring the corresponding means of action. Furthermore, local taxation is often too low to provide the missing resources needed.

This situation is observed in all cities and opens up three broad possibilities for funding city proj-

ects: developing local taxation; resorting to borrowing; and implementing public-private partnerships. None of these options rules out the others; on the contrary, good local management implies combining all three and offering them in as many different forms as possible.

Developing own resources

Cities are in a paradoxical economic situation. Today, everywhere in the world, they are the engines of economic development, hosting the majority of industrial and commercial activities. Their contribution to national wealth fluctuates from country to country, standing

A change of approach

Any talk of "financing local authorities" implies moving away from selective initiatives linked to the decision to finance a specific project and towards financing mechanisms that meet medium- and long-term financial requirements, in line with the model of action carried out within specialized financial institutions in North Africa (CPSCL, FEC) and South Africa (DBSA, INCA). Risk assessment is different and stresses borrower risk, without underestimating project risk.



Achieving autonomy

The Senegal Municipal development agency (MDA) was created in 1997 to provide all municipalities in Senegal with financial services: automatic financing is established on the basis of simple criteria (population size and creditworthiness). A subsidy covers 70% of the amount, supplemented by a loan for 20% and the remaining 10% are self-financed. Investment is put into operation by a delegated project manager, in close cooperation with the MDA. Finally, this financing is set down in a city contract with the State to which is added a financing agreement between the municipality and the MDA and especially a capacity building program. The main objective is to improve the municipality's creditworthiness in order to allow it to gradually borrow more and to become less dependent on State subsidies.

Access to basic services, housing, transport, waste collection and disposal, environmental protection: providing the urban population with decent living conditions demands considerable investment.

at between 50% and 80% of GNP. The major cities of South Africa – Johannesburg, Durban and Cape Town – produce 50% of the country's GNP. But this important role does not provide them with their own resources. In most cases, the State collects revenue from economic activities without any redistribution.

Furthermore, local taxation is not always equal to needs. In African economies, taxation does not exceed 1% of local GDP, when it should be closer to 5%; the informal sector and households do not pay taxes deemed illegitimate. Increasing tax coverage first implies defining an urban policy project capable of mobilizing local resources.

Another stumbling block is the definition of land ownership, the basis of the main local taxes. Setting up an urban register – identifying parcels and their owners – makes it possible to expand the tax base. In Benin, the creation of an addressing system has resulted in tax resources being

Local wealth

The importance of cities as economic actors is growing, as measured by the economic product of cities.

The cities that produce the most wealth in the world are in the US, Europe and some in Asia. Most of the cities with the lowest product are found in Africa and Asia.

Source: *Global Urban Observatory, 1998.*

City	Country	Product/cap.
Hartford	USA	\$ 44 392.00
Basel	Switzerland	\$ 42 300.00
Salt Lake	USA	\$ 37 116.00
Stockholm	Sweden	\$ 36 240.00
Providence	USA	\$ 30 155.00
Birmingham - USA	USA	\$ 28 750.00
Edinburgh	United Kingdom	\$ 26 333.00
London	United Kingdom	\$ 24 989.00
Umea	Sweden	\$ 23 100.00
Singapore	Singapore	\$ 22 955.00
Belfast	United Kingdom	\$ 21 672.00
Madrid	Spain	\$ 18 717.00
Ljubljana	Slovenia	\$ 17 865.00
Birmingham	United Kingdom	\$ 17 776.00
Cardiff	United Kingdom	\$ 17 759.00
Amal	Sweden	\$ 17 360.00
Manchester	United Kingdom	\$ 16 218.00
Des Moines	USA	\$ 15 342.00
Pamplona	Spain	\$ 14 840.00
Phnom Penh	Cambodia	\$ 699.00
Semarang	Indonesia	\$ 614.00
Parakou	Benin	\$ 571.00
Bangalore	India	\$ 564.00
Chennai	India	\$ 547.00
Kigali	Rwanda	\$ 538.00
Tokyo	Japan	\$ 537.00
Brazzaville	Congo	\$ 518.00
Ulan-Bator	Mongolia	\$ 505.00
Dhaka	Bangladesh	\$ 500.00
Bulawayo	Zimbabwe	\$ 402.00
Entebbe	Uganda	\$ 400.00
Vientiane	Laos	\$ 340.00
Port-Gentil	Gabon	\$ 186.00
Libreville	Gabon	\$ 180.00
Sokode	Togo	\$ 156.00
Thiès	Senegal	\$ 119.20
Colombo	Sri Lanka	\$ 43.30
Erevan	Armenia	\$ 12.59

quadrupled in a relatively short space of time without increasing tax pressure. Likewise, in Central European countries, local authorities have associated private land ownership and taxes.

Finally, the decentralization process often transfers responsibilities relating to education and health rather than the management of water and electricity services, which represent a more solid basis for securing loans or public-private partnerships.

The challenge of borrowing

Faced with requirements that often exceed their own resources, local authorities are forced to find additional funding. Resorting to borrowing is a new, but significant, trend for local finances. Since the 1980s, municipal loans amount to around 12 billion euros per year. The biggest borrowers, outside the G7, are South Africa, Bulgaria, Poland, Hungary, Estonia, Brazil, Columbia, China, Slovakia and Ukraine.

Technically, two paths allow cities to access market financing.

In most cases, cities have no access – because of status or technical reasons – to financial markets, or



even to international backers' programs. Local authorities then need an intermediary whose statutes allow to guarantee their loan and lend them money. This is the principle of the specialized financial institutions (SFIs) set up in many countries to lend to authorities and collect repayments.

A second path is for local authorities to gain direct access to financial markets by issuing municipal bonds. These bonds may have a general scope, but are more often linked to an equipment project or issued by an SFI in order to guarantee external funding. A series of conditions must be met if these bonds are to be operational:

- Transparency of local finances. Municipal results must be available and exempt from misappropriation or bankruptcy. The stability of own resources and the effectiveness of the service pricing system are other indicators of a good financial management.
- A minimal, transparent and effective regulatory framework. The existence of rules makes it possible to define the responsibilities of different stakeholders and provides recourse for backers.
- A favorable economic context. Local authorities can set up tax incentives to encourage the bond issuance system, such as bond interest tax exemption. Other guarantees and incentives may be provided externally: a pool of banks can create a guarantee fund for municipal bond issuance; financial transfers from the State to the issuing company may be sizable, as in the Philippines; some financial backers offer guarantee

The economic product per capita of the city of Hartford in the United States is 3 256 times higher than that of Erevan in Armenia.

Unequal budgets

Cities' resources are difficult to compare. Those with the highest budget per capita are found in Europe or the US. The cities of Africa, Asia and Latin America have the lowest budgets; results that leave them unable to fund potential investment.

Source : *Global Urban Observatory, 1998.*

City	Country	Budget/Cap.
Stockholm	Sweden	\$ 5 450.00
Umea	Sweden	\$ 4 942.00
Amal	Sweden	\$ 4 835.00
Singapore	Singapore	\$ 4 637.00
New York	USA	\$ 3 962.00
Wiesbaden	Germany	\$ 3 609.00
Cologne	Germany	\$ 3 531.00
Duisburg	Germany	\$ 3 273.00
Leipzig	Germany	\$ 3 273.00
Freiburg	Germany	\$ 2 803.00
Boston	USA	\$ 2 668.00
Erfurt	Germany	\$ 2 552.00
Hartford	USA	\$ 2 442.00
Washington	USA	\$ 2 379.00
San Jose	USA	\$ 2 232.00
Seattle	USA	\$ 2 232.00
Minneapolis-St. Paul	USA	\$ 2 066.00
Atlanta	USA	\$ 1 902.00
Des Moines	USA	\$ 1 854.00
Bujumbura	Burundi	\$ 7.50
Mysore	India	\$ 7.30
Nairobi	Kenya	\$ 7.00
Yamoussoukro	Côte d'Ivoire	\$ 6.92
Jinja	Uganda	\$ 5.59
Colon	Panama	\$ 5.48
Muscat	Oman	\$ 5.41
Phnom Penh	Cambodia	\$ 5.20
Huanuco	Peru	\$ 4.92
Ulan-Bator	Mongolia	\$ 4.36
Cebu	Philippines	\$ 4.14
Porto-Novo	Benin	\$ 4.10
Tacna	Peru	\$ 2.61
Lagos	Nigeria	\$ 2.29
Bulawayo	Zimbabwe	\$ 2.23
Colombo	Sri Lanka	\$ 2.19
Brazzaville	Congo	\$ 0.94
Sokode	Togo	\$ 0.91
Kinshasa	Dem. Rep. of Congo	\$ 0.09



The city of Stockholm in Sweden has a budget of 5450 US\$ per inhabitant, compared to only 0.09 US\$ in Kinshasa, in the Democratic Republic of Congo.

mechanisms, generally directed at the private sector. For example, the Development Credit Authority of the US development agency USAID guarantees 50% of municipal bond issues and provides technical assistance.

These mechanisms do not rule out the possibility of simultaneously developing public-private partnership systems for local public services, which falls outside the scope of municipal credit in the strict sense.

Becoming partners

Another source of funding for services is the formation of public-private partnerships.

Suitable financial support

Recognition of the new requirements of cities is leading certain financial backers, including the French Development Agency (AFD), to adapt their financial tools. In addition to financing provided to States ("sovereign"), they offer financing to authorities ("sub-sovereign") either directly or through specialized institutions. Another option is to make it easier for them to gain access to the financial market. These new tools are in the development process and require new and specific techniques. The Municipal Finance Task Force centralizes many of these experiments and thereby offers a forum for reflection on current practices.

www.afd.fr — www.mftf.org

Rating the Indian way

In India, the Credit Rating Information Service of India Ltd., the leading national rating agency, launched a credit rating service in 1997 for authorities based on six factors: (1) the legal and regulatory framework, (2) the region's economic base, (3) the current financial situation, (4) the municipality's existing operations, (5) the municipality's managerial capacities, and (6) the project in question. Special importance is given to the availability of a stable and assessable resource for repayment of the debt service.

The idea is to link the pursuit of a common interest – generally the development of basic services – with a private means of management reputed to be more efficient. Private co-financing for services eases municipal budget constraints. In Buenos Aires, only 6 million of the total 11 million inhabitants are connected to the water mains. Meeting these requirements means extending the existing mains and building wastewater treatment plants; huge costs that the municipal authorities are unable to bear alone. However, since these services represent important futures markets, it is possible to associate private operators with their running.

Two kinds of partnership exist: full privatization or the conditional delegation of the management of infrastructure of common interest, such as a water supply network or a transport network.

Service privatization has been implemented in certain Anglo-Saxon countries, especially the United Kingdom where it is systematic. While it limits the work of local authorities, it means large amounts of own funds must be immobilized on a long-term basis in private infrastructure.

Public service delegation differs from public contracts by stipulating a fixed term for contracts (15 to 50 years) and basing the payment of contracting parties on operational results. Delegation can take different shapes, but always involves a contract between a public authority and an operator (private, semi-public or public) for a fixed term.

Two broad traditions can be seen at the heart of this model. The Anglo-Saxon approach to project financing – Build Operate Transfer (BOT) – tasks the concessionaire with the construction and operation of the service. It only becomes the effective owner at the end of the contract. The interest lies in financing the initial investment through users rather than through taxpayers.

In the French experience of *delegated management*, public authorities retain responsibility for works and ownership of infrastructure. The concession is made with specifications highlighting the general interest duties that the private manager must respect.

These partnerships are aimed at making service management more efficient – personnel management, the devolution of contracts and invoice recovery. Thus, the first initiatives implemented

by the SODECI in Côte d'Ivoire or *Aguas Argentinas* involved rationalizing marketing management for the service and the internal management of the company. It is also hoped that greater attention will be paid to service quality and customer management.

In the late 1990s, these partnerships received considerable interest with the signing of high-profile contracts between different cities of the world and international groups, such as Suez in Buenos Aires. However, given the start-up investment needed, the profitability of these contracts requires high stability. Exchange rate fluctuations and economic crises have shown that delegated management does not always provide sufficient guarantees for major operators. Turning to public or private operators at the national level, whose requirements are more modest, may in many cases prove more functional. This option is supported by the French Development Agency (AFD) in sub-Saharan Africa and in all over the world.

Whatever the technical methods chosen, the guarantees needed to secure external funding remain inaccessible to many cities of the world and the field for cooperation in this domain remains extensive. ■

When the Bank becomes municipal

Obligated by its statutes to restrict access to its credit lines for States, the World Bank created the Municipal Fund in 2003 with the International Financial Corporation. This institution offers sub-sovereign credits across a broad range of sectors (drinking water, sanitation, transport, electricity, solid waste, district heating, education and health, and other basic public services), which can benefit a broad range of bodies from the municipal or regional public sector (local or provincial government, public service companies, semi-public companies, public-private partnerships and financial intermediaries).

Webography

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