Conclusion. Local Government Finance: The Challenges of the 21st Century

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Overview

Local governments around the world have become key public sector actors during the past two decades, and decentralization now ranks among the most common and consequential global reforms (See First GOLD Report on Decentralization and Local Democracy). This trend could ultimately be as influential as other major institutional transformations of the past century, such as decolonization in Africa and Asia or the transition from planned to market economies in the former Soviet Union, China, and elsewhere. Indeed, local governments have in many respects truly come of age. Their role is reinforced in global policy circles, including through major multilateral proclamations, such as the European Charter of Local Self-Government (1985) and the UN Habitat Guidelines on Decentralization and Reinforcement of Local Governments (2007).

In many regions of the world decentralization has enhanced the functions and autonomy of local entities. Local governments play increasingly more critical roles in delivering basic infrastructure services, such as roads, transportation and water, and social services, such as education and health. These developments have contributed in minor and major ways to the progressive deepening of local democracy, the alleviation of internal regional tensions in conflict prone areas, the promotion of broader and deeper citizen participation in public affairs, and the overall strengthening and efficiency of the public sector.

Decentralization has also generated a dramatic upsurge in expectations. Citizens look more to local governments for those public services that improve daily living conditions. Central governments depend on local governments to support priority development and poverty reduction goals. Private firms increasingly rely on local governments to deliver infrastructure and other services that support production and stimulate job creation.

One of the most critical factors underlying the ability of local governments to meet the growing expectations placed on them is the quality of the architecture and operation of the intergovernmental fiscal system. This Second GOLD Report focuses on local government finance worldwide. Local government finance is important not only because the role and impact of local governments have dramatically increased, but also because this progress has recently been confronted by daunting challenges.

The global economic and financial crisis that emerged in 2008 —the most significant crisis since the Great Depression— has imposed major financial constraints on local governments in many countries. Equally important, central authorities in some countries have responded to the crisis by taking recentralization measures to deal with their own fiscal problems and increasing control over local governments. It is too early to say whether these actions represent a durable change in the decentralization trend, but they clearly pose immediate challenges to the viability and effectiveness of local governments. Resource constraints during a period of greater responsibility and need pose obvious threats, but so does the damaging curtailment of local government autonomy, which is a necessary condition for the full realization of the promise of decentralization.

Beyond the impact of the global financial crisis, local governments are confronted with other significant structural challenges. As substantial urbanization continues unabated in some parts of the world, public service demands are growing faster than many local governments can keep up with. New needs are also arising as a result of an emerging understanding of the onerous implications of global environmental
challenges, as well as from major demographic changes, such as the increasing number of the elderly in some countries and the explosion of youth as a share of the population in others. These challenges, however, also present opportunities to strengthen and boldly reinvent the role of local governments. They are often in a unique position of strength to deal with pressing local problems, the solutions to which have important national consequences.

The preceding regional chapters document strengths and weaknesses of local government fiscal frameworks in different parts of the world and examine the capacity of local governments to mobilize resources and manage expenditures. The chapters also assess intergovernmental relations and developments in governance, such as broader and deeper citizen participation in local planning and budgeting. This chapter summarizes key challenges and issues discussed in the preceding regional chapters, and points to possible broad-based policy solutions that could both alleviate problems and weaknesses experienced to date and help to improve overall local government performance.

The next section outlines basic contextual factors that affect fiscal decentralization worldwide. This is followed by a summary of recent influential trends, experiences, and policy issues. Building on the review of fiscal decentralization parameters outlined in the introduction and discussed in the regional chapters, common and noteworthy local government finance issues and challenges are considered. Finally, the chapter closes with recommendations and concluding thoughts on the way forward in local finance reform and the next steps for UCLG.

The Context of Reform: Diversity, Politics and Change

The potential for local governments to serve as full partners in managing public functions and to contribute to local governance and improved service delivery remains a promising, but only partially fulfilled process in many countries. To some extent this should be expected, as decentralization occurs under different circumstances, is subject to powerful political forces, and requires some minimum capacity to be effective. Even in the most conducive environments, decentralization is a highly dynamic process that demands ongoing adaptation to evolving economic, social and political conditions.

Understanding Diversity

As highlighted in the introductory chapter, countries have been subject to different historical influences, so they are building from diverse institutional and governance traditions. This includes their experiences with and inclinations towards decentralization, as well as their ability to absorb decentralization reforms. The role of local governments in public finance varies considerably across regions (Figure 10.1 & Table 10.1), and there are also large differences within regions. An important implication of these various differences is that desired local finance reforms vary considerably across regions and countries. Clearly, the reforms needed to strengthen local finances differ between countries that have a long tradition with decentralization and those with a shorter history of relevant experience.

Local government finance is prospering in much of Europe, North America, and parts of East Asia and the Pacific (Korea, Japan, Australia, New Zealand). It remains at an early stage in some regions, such as the Middle East & Western Asia, where most local governments are deconcentrated units of the central government with limited autonomy. South Asia has a recent tradition of democracy, but local governments face controls by higher level governments. In Latin
Note: while local expenditures as a proportion of public expenditure may be relatively high in East Asia, Eurasia, and South Asia this does not necessarily mean that local governments have autonomous control over spending, which is an important aspect of decentralization (devolution).

The Comparative Fiscal Role of Local Government: Expenditure and Revenue as a Percentage of General Government Expenditure and Revenue

Source: Data from Table 10.1

The Comparative Role of Local Government

<table>
<thead>
<tr>
<th>Region</th>
<th>Local expenditures as percentage of total revenues</th>
<th>Local expenditure as percentage of total expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>3.2</td>
<td>7.9</td>
</tr>
<tr>
<td></td>
<td>(3.6)</td>
<td>(6.8)</td>
</tr>
<tr>
<td>Asia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Asia</td>
<td>1.5</td>
<td>16.0</td>
</tr>
<tr>
<td></td>
<td>(0.9)</td>
<td>(0.9)</td>
</tr>
<tr>
<td>East Asia</td>
<td>20.0</td>
<td>40.0</td>
</tr>
<tr>
<td></td>
<td>(0.3)</td>
<td>(0.3)</td>
</tr>
<tr>
<td>South-East Asia</td>
<td>5.3</td>
<td>15.5</td>
</tr>
<tr>
<td></td>
<td>(0.8)</td>
<td>(0.6)</td>
</tr>
<tr>
<td>Eurasia</td>
<td>N.A.</td>
<td>26.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(15.1)</td>
</tr>
<tr>
<td>Europe (2008)</td>
<td>13.0</td>
<td>23.9</td>
</tr>
<tr>
<td></td>
<td>(0.7)</td>
<td>(0.5)</td>
</tr>
<tr>
<td>Latin America</td>
<td>4.0</td>
<td>11.1</td>
</tr>
<tr>
<td></td>
<td>(4.5)</td>
<td>(?3)</td>
</tr>
<tr>
<td>Middle East &amp; Western Asia</td>
<td>N.A.</td>
<td>4.6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(1.7)</td>
</tr>
<tr>
<td>North America</td>
<td>12.8</td>
<td>26.8</td>
</tr>
<tr>
<td></td>
<td>(0.6)</td>
<td></td>
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Notes: Coefficient of variation in parentheses. The means include: Africa: Benin, Burkina Faso, Egypt, Ethiopia, Gabon, Ghana, Kenya, Malawi, Mali, Morocco, Mozambique, Niger, Nigeria, Senegal, South Africa, Tanzania, Togo, Tunisia, Uganda, Zambia, Zimbabwe. South Asia: Bangladesh, India, Pakistan; East Asia: China, Japan, Korea; South-East Asia: Indonesia, Philippines, Vietnam, Thailand. Eurasia: Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Ukraine. Europe: Austria, Belgium, Bulgaria, Cyprus, Czech Rep., Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovak Rep., Slovenia, Spain, Sweden, Switzerland, United Kingdom, Iceland, Norway, Switzerland; Latin America: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru. Middle East and Western Asia: Bahrain, Iran, Jordan, Lebanon, Palestine, Syrian Arab Republic, Turkey, United Arab Emirates, Palestine, Yemen. North America: Canada, U.S.A.
United Cities and Local Governments

In America and Eurasia, local finances are generally improving, but still face challenges associated with past centralized traditions. China and most of Southeast Asia have made progress, but intergovernmental fiscal relations are unevenly developed and still experience significant challenges. African local governments are rarely well empowered, but there are hopeful advances, especially in some Anglophone countries, such as South Africa or Tanzania.

One of the critical inferences emerging from the diversity of local government systems is that there is a need for diverse approaches to deal with fiscal challenges, even those that are relatively common. There is no magic formula to ensure that local government systems will function effectively. The road to success requires consistent and appropriately sequenced application of basic local public finance principles outlined in the introductory chapter. These are relatively few, and they leave adequate flexibility for each country to structure its intergovernmental finance system to fit its history and national goals.

Responding to Political Reality

Decentralization is an intensely political process since it involves the central government assigning powers and granting autonomy to local governments. While political forces can often open the door to decentralization, as discussed throughout this report, they can also pose challenges. These include reluctance of central politicians to devolve powers to local governments for fear of losing control, the opposition of central bureaucrats whose institutional and personal goals conflict with decentralization, or resistance to legally mandated decentralization reforms during implementation from elites and pre-existing deconcentrated agencies. At the local level, local politicians can undermine decentralization if they are not sufficiently accountable to their constituents. These political realities must be understood and responded to if decentralization is to be effective and prosper.

Developing Capacity

Effective local governments require administrative capacity. Local government capacity can be an important constraint, particularly in developing countries. At times, perhaps somewhat paradoxically, decentralization underperforms because of weak central institutions, either due to political instability or a lack of control of basic functions of government, such as unified tax administration or treasury and budget implementation controls. If decentralization is to meet its promise, capacity constraints and their consequences must be recognized and efforts to develop appropriate capacities need to be adopted.

Adapting to Change

Conditions and motivations for decentralization change, sometimes rapidly and dramatically. These changes can be relatively routine, such as the adoption of new legislation or the turnover of a government power after an election. They can also be momentous, such as a major political shift or a sudden economic and financial crisis. Local government policies and systems need to respond effectively to these changes, and adapt as necessary to shifting circumstances. At the same time, the 2008 global financial crisis showed that adapting to shifting circumstances can also damage local governments. Local governments and their advocates must be vigilant and be prepared to defend their legitimate interests when they come under threat.

Broad Policy Trends and Issues

Before reviewing major findings on local government finance, it is important to contextualize those findings by noting some broader trends and common decentralization
issues the report shows can affect local fiscal performance. Some of these are experienced globally, while others are particularly relevant in certain regions or some subset of countries across regions.

Global Crisis

The financial and economic crisis noted above is affecting local governments globally. Emerging countries of Asia and some in Latin America have been less impacted, but others have suffered drastic effects. In March 2010, for example, the Greek government reduced by decree the number of local governments from 1,034 to 355 in order to save an estimated 1.2 billion euros annually.

The pains of fiscal adjustment due to the crisis are being strongly felt by local governments in all the continents. In a number of countries in Africa, Eurasia, and Latin America, central governments have cut transfers or introduced recentralization measures. In some regions, the effects of the crisis simply compound the effects of existing challenges. In Africa, for example, trade liberalization and fiscal transition, and in less developed countries more generally, poverty and informality have long presented challenges for public finance in general and local governments in particular.

Even in the most advanced countries, stabilization policies to reduce public indebtedness, such as those being adopted in Europe and North America, are deeply impacting local finances. Local governments in many of those countries fear that a disproportionate share of the costs of further fiscal consolidation will fall on them in the form of cuts in intergovernmental transfers, restrictions on local credit, and other austerity measures.

The financial and economic crisis is not the only global crisis with relevance for local governments. Financing climate change mitigation policies and the investments required for the associated risk management would considerably increase the resource needs of local governments worldwide. The financial implications for local governments of the response to environmental challenges are only beginning to be understood.

Partial or Interrupted Decentralization Reform

The global crisis provides one example of how decentralization can be stalled or reversed, but this is a more general problem taking different forms as evidenced in the regional chapters. Fiscal decentralization frameworks involve complex systems with many interrelated components, and some are easier to implement or politically more feasible than others. Thus, some local finance systems are only partially designed (relative to best practice principles) and some are only partially implemented even if they are mandated in the legal framework design.

If only certain elements of the system are implemented or partially implemented, problems can arise because of the interdependencies involved. Deficiencies with one component often undermine the ability of the overall system to function effectively. For example, lack of clarity with functional assignment can lead to uncertainty regarding the financial needs of local governments. Similarly, problems with the design and implementation of intergovernmental transfer systems can compromise incentives and capacities for local service delivery, local revenue generation, and local borrowing.

Among the most pervasive and damaging instances of incomplete decentralization is the assignment of too few revenues to finance assigned functions. At a global scale, very few countries escape dealing with major gaps between local expenditure and local revenues. This can result from a flaw in system design, but revenue inadequacy tends to occur for
political or capacity reasons even in countries where constitutional or legal provisions prohibit unfunded local government mandates. The problem tends to be more significant in some regions. African countries, for example, generally have much less decentralization of revenues than of expenditures, leading to particularly severe revenue-expenditure gaps.

Demographic Shifts

Many European countries are confronted with the challenge of coping with the effects on public finances of a rapidly ageing population and the need to integrate immigrants into the labor market and society at large. The ageing population challenge is also relevant in several countries in Asia, such as China and Japan, and in Eurasia, such as Russia and Ukraine. In some developing countries, the growth of youth as a share of population poses different types of service challenges that also have serious financial implications.

Rapidly increasing urbanization, particularly in many of the developing countries of Africa, Asia, and Latin America, continues to create demand for public services and infrastructure that requires a huge volume of resources. The needs are even larger if investments for climate change adaptation are included. Given available information on maintenance and development costs of urban investments, it would seem reasonable to expect a need for about 200 billion USD per year over the next 25 years for the developing countries alone; this represents only one-third of the total spending need for total public infrastructure spending estimated by the World Bank.

Jurisdictional Fragmentation

Fragmentation is a major issue for many countries in most regions of the world. In many countries the appropriate structure and size of local governments is an ongoing debate. Small local governments cannot independently take advantage of economies of scale in the delivery of some services, resulting in higher costs. Smaller local governments, however, generally provide a stronger political connection to citizens and may be better able to respond to local demands. Getting the right balance, e.g. by maintaining smaller local governments but providing mechanisms for cooperative arrangements among them and links to higher levels for large scale services, is a critical challenge in many counties.

Thailand has more than 7,500 bottom tier local governments with an average population of less than 10,000, and there are concerns that these are too small for service delivery. In some cases, such as Uganda or Dominican Republic, new local governments are being constantly created, diluting the capacity of local governments that were only recently empowered. In a number of countries perverse incentives, such as offering equal lump sum transfers to all local governments regardless of size, create incentives for further jurisdictional fragmentation.

On the other hand, in countries such as France (with 36,600 local governments), citizens strongly identify with smaller local governments (communes). These are said to bring greater representation and accountability, thus potentially balancing the additional costs represented by the inability to realize economies of scale, particularly if the latter can be realized by creating cooperative arrangements among the smaller units. When local governments in South Africa were substantially consolidated in 2002, some analysts expressed concern that the new larger, more fiscally viable local governments had damaged political connectivity to citizens in some areas.

Deconcentration and Devolution

Devolution of spending and taxing powers to autonomous local governments is generally

1. UCLG. 2007. UCLG Policy Paper on Local Finance. UCLG.
2. World Bank (2005) estimated the investment needs in public infrastructure in developing countries, amounting to 600 billion USD per year over the next 25 years. However, these figures include all public infrastructures, whether national (energy, communications and information technology, transport, water and sanitation, etc.) or urban (local roads, local water supply, and sanitation, waste disposals, schools, street lighting...). (World Bank. 2005. Infrastructure and the World Bank: A progress report. The World Bank). The UCLG Committee on Local Finance estimated one third of this amount, i.e. 0.4 percent of World GDP, needs to be channeled to urban infrastructure (UCLG. 2007. UCLG Policy Paper on Local Finance. UCLG).
held up as the standard for decentralization, but even some countries with elected local councils maintain deconcentrated administration. In Kenya, for example, district administrations exist in the same territory as elected county councils. There is little clarity with respect to their distinct functions, sometimes resulting in service redundancy or gaps (although this situation should be corrected by forthcoming reforms based on the 2010 constitution).

In other cases, empowered local governments have not been created. In the MEWA region, for example, deconcentrated local administration prevails except in Turkey and Palestine. Similar situations can be found in countries in other regions, such as Egypt, Pakistan, Bangladesh, Thailand, and Kazakhstan. The use of local governments as deconcentrated units of the central administration leaves unexploited efficiency gains in the delivery of public services that are achievable with devolved systems by better matching the needs and preferences of local residents and making local officials more accountable to citizens.

Intermediate Governments in Federal and Hierarchical Systems

While a federal country is often associated with high fiscal decentralization, many federal constitutions do not recognize directly the right of local entities to self government. Instead, they empower states or other intermediate governments to establish fiscal relationships with local governments. This approach has led to considerable fiscal powers for local governments in Brazil, Canada, South Africa, and the United States.

In other cases, such as Argentina, Australia, India, Mexico, Nigeria, Pakistan, and Russia, local governments enjoy (often considerably) less fiscal autonomy even than those in some unitary countries with more centralized traditions. Depriving large populous countries like India or Pakistan (in the latter local authorities were suspended in 2009 by agreement between federal and provincial authorities) of accountable local governments diminishes their chances for attaining the potential benefits of decentralization. Limited authority for local governments is also present in unitary systems with strong hierarchical links between intermediate and local tiers of governments, such as China or Vietnam.

The Role of International Development Agencies

International development agencies often create challenges for the very developing countries in Africa, Asia, and Latin America that they are supposed to be assisting through support for decentralization and local government reforms. There are various issues in this regard, but two are particularly important. First, these agencies have often pushed particular types of reforms, sometimes based on particular objectives of the agencies or simply what has worked in other countries. As a result, in some cases, the reforms being promoted have been inappropriate for recipient countries or have proven unsustainable because there is no strong national ownership. Second, the donors have commonly created parallel mechanisms to implement programs that support the financing and delivery of local services because of concerns about low local administrative capacity, corruption, and other institutional weaknesses in the host country. These mechanisms can be based at higher levels or at local levels, but in either case they bypass the regular decision-making and resource management procedures of local governments. They can improve service delivery and may be appropriate in some form at early stages of decentralization when local governments are weak, but they ultimately undermine the legitimacy and effectiveness of local governments unless
the systems and procedures they use are adapted and institutionalized into regular government operations.

**Local Government Finance: Main Issues and Challenges**

As outlined in the introduction of the report, several key aspects of fiscal systems need to be in place and meet certain basic principles for local governments to perform effectively. These include expenditure assignments and management; local own source (autonomous) revenues; properly structured intergovernmental transfers; and, where appropriate, access to borrowing and other alternatives to mobilize resources for development expenditures. This section outlines key issues and challenges identified in the regional chapters with respect to each of these issues.

The emphasis in this section is on identifying problems and challenges that require attention, but it is important to acknowledge, as noted in the Introduction and some regional chapters, that there have been very significant improvements in local finance over the past decades in many developed and also developing countries. These improvements range from increased efficiency in public expenditures to greater revenue mobilization, and to innovations in public management, such as the more general adoption of the type of participatory budgeting that began in Latin America.

**Expenditure Assignment and Management**

A clear assignment of responsibilities and explicit methodologies to translate expenditure responsibilities into financial needs are fundamental for local finance. Deficiencies on this front weaken local governments and undermine the rest of the local fiscal framework. The challenges commonly fall under a number of categories outlined below.

*Clarity in expenditure assignment:* Insufficient clarity occurs in many regions, particularly in developing countries in Africa, Asia, Eurasia, and Latin America. This results from poorly drafted laws and conflicts between decentralization laws and sectoral laws regarding specific services. Sectoral responsibilities may continue to be implemented by line ministries without coordination or in competition with local governments, duplicating efforts by keeping deconcentrated offices and staff at pre-decentralization levels; this is a common occurrence, for example, in African and Latin American countries. The ambiguity of expenditure assignments can be more severe where there are more levels of government, as in China, and in federations where intermediate levels have significant but inadequately defined control over local governments under their jurisdiction, such as in the case of India. A related institutional issue in some countries, such as Australia and Argentina, is whether local governments should obtain separate legal status from their intermediate level governments, provinces, or states.

*Suitability of and compliance with expenditure assignment:* In some cases central authorities still play an unwarranted role in the delivery of basic local services, sometimes contrary to decentralization law. This can result in levels and types of services that differ from those desired by local people. In other cases, services with benefit spillovers (affecting people of jurisdictions beyond direct beneficiaries) or a heavy focus on redistribution lack coordination of tasks with higher levels of government; this can result in insufficient or uneven provision of services. This happens, for example, in China, which assigns responsibility for social security and public pensions to local governments.

*Funding expenditure mandates:* Lack of clarity in functional assignment creates room for cost shifting among levels of government, often
through unfunded local expenditure mandates that can be burdensome. These can involve requiring local governments to deliver specific services, use particular delivery approaches, or meet certain input or output standards in service delivery. This is a common occurrence among developing and developed countries. Sometimes such mandates may involve services that local governments are not required to provide under local government legislation.

**Budget approval and control by higher level authorities:** The central or regional authorities assist with and closely oversee—and ultimately may even approve—the budgets voted on by local elected councils in many countries, particularly in Africa, Asia, Eurasia, Latin America, and MEWA regions. This practice of ex-ante control weakens the budgetary autonomy of local authorities.

**Incentives for local expenditure efficiency:** Particularly in developing countries, local government spending quality is often low in terms of the outcomes produced relative to the costs incurred. This is partly attributable to resource constraints and the often-excessive administrative shares of the local government budget. But other factors noted above (lack of clarity in functional assignments, unfunded mandates, etc.) and below (conditional transfers and low revenue autonomy) also undermine local accountability and incentives to use resources efficiently.

**Local Revenue Generation/Autonomy**

Local revenue generation and autonomy are critical for local governments to be able to meet their expenditure responsibilities in an accountable and efficient way. Yet there are very few countries in the world that so far have provided local governments with the means and autonomy needed to raise adequate revenues. This problem is manifested in various ways related to the design and use of local revenue systems.

**Vertical fiscal imbalances:** The transfer of expenditure responsibilities to local governments has often not been accompanied by devolution of corresponding revenue sources (including intergovernmental transfers, which are discussed below). As noted above, local government revenues in many regions play a minor role in national public budgets. This has resulted in increasing financial pressures on the local government expenditure, and even where resources are more adequate, greater local government dependence on central transfers.

**Revenue autonomy:** Autonomy is highly constrained in most of Africa, Asia, and the Middle East and West Asia. The situation is better in Eurasia and Latin America, but not uniformly. Local governments have limited or no authority to introduce new taxes, and to decide on some or all tax rates, fees, and user charges. Even some decentralized countries, such as Australia, limit local revenue autonomy. A number of prominent attempts to enhance tax autonomy and reduce transfer dependence, such as recent “Trinity Reforms” in Japan, have only partially succeeded. Revenue autonomy is stronger, but not without challenges, in advanced economies of Western Europe and North America.

**Property taxation challenges:** The property tax is the most commonly recommended and globally used local government tax, but its significant revenue potential often remains unrealized. On average developing countries raise 0.5 percent of GDP from property tax compared to two percent in developed countries. This is partly because the tax is unpopular—even in some developed countries where it plays a significant role (U.S., Canada, U.K.), citizen opposition has been strong. In addition, it is difficult and expensive to
administer, all the more so in many developing countries without well defined property registers, with sizable informal areas, and with weaker local capacity for value assessments, enforcement, and collection.

Diversification of the local tax base: Local tax bases are often narrow, especially given the problems with heavy reliance on the property tax. A number of countries in Europe and North America use local personal income taxes. A local piggyback, flat-rate personal income tax is collected with the national income tax in Nordic countries and some transition economies of Central and Eastern Europe. In Latin America, several countries, such as Brazil, Chile, and Colombia use various types of local business taxation. Local sales taxes are used in a few countries, notably in Canada, with the presence of a national VAT, and in the United States, where there is no VAT. Poor diversification of the local tax base is often aggravated by the lack of flexibility to adapt to evolving circumstances (for example, growth in the service sector). Inelasticity (lack of revenue response to changes in the economic base) of many local taxes over time is problematic as progressively increasing demand for services and costs outstrip revenue growth. In a number of African countries (Tanzania, Uganda, and Zambia) some viable local taxes have been recently eliminated and partially replaced with transfers, and many countries, prominently Korea, suffer from a proliferation of “nuisance taxes” that yield low revenues relative to collection costs.

Fees and user charges: Local governments need to establish fees for services, ideally on a cost-recovery basis where this is feasible. In Canada and the U.S., local governments generate one-quarter of their own revenues with fees and charges, which is all the more significant given their broad high levels of local own tax revenue. The situation is very different in many developing countries. In some African countries, such as Algeria, Benin, Egypt and Tunisia, local governments have no authority to set local fees and charges.

Politics of local revenues: Political barriers to local revenue generation can be seen in both the reluctance of local government to raise taxes (for instance, in some EU countries) as well as in the limitations imposed on local revenue generation legislated by higher levels of government or citizen referendums (in many states in the U.S.). To some extent these phenomena result from poor taxpayer education and general expectations by citizens for more and better quality services with the same or lower taxes.

Local and central roles in revenue collection: International practice varies as countries seek to maximize revenues while minimizing administration and compliance costs (which favor a role for higher levels in administration and enforcement) and maximizing local accountability and local information advantages (which favor local governments’ direct involvement in administration and enforcement). Although centralized mechanisms are in principle desirable for certain taxes, central agencies do not in some regions, including MEWA and West Africa, transfer the resources they collect to local governments in a timely manner. The lack of incentives for central tax authorities to collect local revenues can also be a problem. The experience of a variety of countries (Costa Rica, Jordan, and some countries in Eurasia) shows significant increases in revenue collections when tax administration responsibilities are transferred from central to local authorities.

Intergovernmental Transfers

A properly structured system of intergovernmental transfers is a critical component of a local finance system. The use of transfers, however, faces a number of challenges that are
dealt with in different ways and to varying degrees across regions and countries.

**Appropriate and stable revenue sharing:** Most countries share some central taxes with local governments, an arrangement that is simple and has high revenue potential. This can be a partial solution to vertical imbalances, but shared revenues suffer from various constraints. Revenue sharing on a derivation basis can be seen as a stimulus for local economic activity, but it can also reinforce horizontal disparities and leads to higher volatility of local revenues. Particularly in developing countries, the amounts shared may be uncertain or lack transparency, making long term planning difficult for local governments. This is the case in a number of West African countries, where central governments withhold for their own purposes or delay resources to which local governments are entitled. Perhaps most importantly, substantial revenue sharing can create perverse incentives for local revenue generation, undermining both local autonomy and the accountability of local governments to their constituents.

**Horizontal fiscal imbalances:** Despite the often significant differences across local governments in expenditure needs and the ability to finance them, many countries lack effective equalization grants. In Africa, just a few countries (Morocco and South Africa) have introduced them, and in MEWA there are none. The situation is a little better in Latin America, where a few countries (e.g. Brazil and Chile) use explicit equalization schemes, although more countries in the region employ only limited redistribution elements in revenue sharing schemes. Some Asian countries use equalization transfers (e.g. Australia, Indonesia, Japan), while others virtually ignore fiscal disparities (e.g. China, India, Philippines, New Zealand). Equalization grants are common in Eurasia, Europe, and North America (except at the federal level in the United States), but with varying effectiveness. Some Eurasian countries have not used transparent methodologies for equalization transfers, although the situation is improving.

**Equalization transfer design:** Where equalization schemes exist, they often present problems; for example, (1) only differences in fiscal capacity or expenditure needs, instead of both, are considered; (2) actual revenues, instead of fiscal capacity, are measured, creating disincentives for local revenue mobilization; (3) the pool of funds are not stable or well defined, or (4) the use of funds is subject to rigid conditions that in effect make the equalization grants, which are normally general purpose grants without use restrictions, into conditional transfers. In federal countries, such as Australia, there are issues regarding how second tier governments (the states) interpret federal policies regarding equalization.

**Conditional transfer design:** Conditional grants from upper level governments are a key element of local fiscal frameworks. Such grants can (1) promote national standards and goals in the provision of important services that have been decentralized, for example, some aspects of education and health; (2) address inter-jurisdictional externalities with respect to, for example, environmental concerns; or (3) support local government infrastructure investments. Conditional or earmarked grants exist in many countries, especially for capital infrastructure purposes. However, in certain regions, such as Eurasia, conditional grants are not well developed. In other countries, such as Egypt, Nigeria, Tanzania, and Uganda, conditional transfers excessively dominate total transfers. Several problems are often associated with this type of grant, including their number and complexity, which impose high compliance costs on local governments; lack of transparency, stability or timeliness; and sometimes political manipulation. In addition, excessive reliance on conditional grants can overly constrain local government autonomy and move their focus from local to national priorities, potentially
reducing their own comparative advantage in focusing on local needs.

**Performance based grants.** A relatively recent innovation in the field of transfers has been the introduction of performance based transfers in some African and Asian countries with support from international organizations. Performance based grants condition the transfer of funds to meeting certain standards and objectives, generally leaving local governments to decide how best to use the funds. This type of transfer combines the flexibility of unconditional grants with an unconventional form of conditionality. On the downside, these transfers may privilege jurisdictions with greater administrative capacity, and they may suffer from the problems associated with voucher programs. Thus far they have been used more to promote compliance with financial and administrative management procedures than to improve service delivery outcomes. It is too early to definitively judge the effectiveness of performance based transfers but they are a promising mechanism and further trials are certainly desirable.

**Local Government Borrowing and Access to Financial Markets**

Perhaps the most neglected aspect of local government finance in many regions of the world is borrowing. In the context of the rapid urbanization discussed earlier, especially developing countries in Africa and Asia, the need for infrastructure investment is paramount. In this context, borrowing, with the intergenerational equity that it entails, is potentially an important means to finance longer term investments. At the same time, there are multiple factors that need to be considered.

**Local government borrowing and fiscal responsibility frameworks.** These frameworks are often weakly developed and poorly implemented. Some frameworks are highly restrictive, effectively precluding local government borrowing (e.g. Denmark, Chile, Kenya and Tunisia). Other frameworks are too lax, potentially allowing for the type of risky behavior that occurred in the 1990s in Brazil and Argentina. In a few case such as South Africa, robust frameworks that promote responsible borrowing have been developed.

**Access to credit.** In many cases, especially in poor developing countries, local governments often have poor and unreliable access to credit. Financial markets are not well developed, and many local governments do not have credit histories or do not meet technical standards required by lenders. The situation is brighter in the short and medium term in emerging economies where financial markets tend to be more developed with the introduction of systems for disclosure, credit ratings, pricing benchmarks, and so forth.

**Special institutions.** Special credit institutions that have been set up to lend to local governments (as is the case in more than 60 countries, often with support from international organizations in developing countries) have rarely performed well. Their often disappointing results have been associated with the politicization of lending decisions and problematic design issues. Many of the intermediary institutions are not sufficiently independent from the government, and they are not allowed or have not attempted to link with domestic credit markets. In this regard, local governments are not supported in learning how to become familiar with and develop capacity to comply with market expectations regarding financial capacities, disclosures, provisioning, and so on.

**Central government practices.** A number of central government practices, such as weak appraisal mechanisms for loans from government affiliated credit institutions, local government bailouts and automatic intercepts, have disrupted the normal development of local
credit markets. There has been a pervasive problem with approval by government associated lending mechanisms of inadequately vetted loans for non-viable projects. The practice of bailouts when local governments cannot or will not repay their loans undermines their fiscal discipline and distorts the credit market. Although reliance on automatic intercepts from transfers are generally associated with better repayment to special credit institutions and can help to develop access to credit, maintaining them for long periods without encouraging local government graduation to more market oriented sources can create poor incentives for local governments to properly consider and lenders to properly appraise local government projects.

Links to the broader intergovernmental fiscal system. Other aspects of local government finance covered above are sometimes not conducive to borrowing. Borrowing can be curtailed if local governments have insufficient access to discretionary sources of revenue to make loan payments or if intergovernmental transfers undermine incentives for even relatively wealthy local governments to borrow, for self-financing development projects. Lack of appropriate financial management practices also undermines the ability of local governments to properly prepare development projects, qualify for credit, and manage their debt portfolios.

Recommendations

The findings of GOLD II clearly indicate that local governments around the world—from the most industrialized to the least developed countries—suffer from problems and challenges in their local government finance systems, and in some respects the situation has stagnated or worsened in recent years. In Africa local governments represent well under 10 percent of public expenditures and less of public revenue. MEWA countries also have limited resources and even more limited autonomy. In many countries in Latin America, Asia, Eurasia, and even in Europe, local governments lack legitimacy because they cannot meet important responsibilities with available resources. Although some needed actions will be difficult to quickly implement, there is much that can be done.

Expenditure Assignment and Management

A clear assignment of expenditure responsibilities should be at the top of national reform agendas for local government finance. There are some important political economy issues noted throughout the report that often make this step difficult. Several basic measures need to be followed for this foundational reform that will in some cases require a revision of the legal framework and harmonization of decentralization and sector laws.

Identify the exclusive responsibilities of local governments is needed to increase the clarity required for accountability. In cases where there is legal clarity and the assignments have not been implemented, action is needed to enforce the provisions of the legal framework. In cases where it is deemed necessary to have concurrent responsibilities for particular services, it is important to identify which level has specific responsibilities for various aspects — i.e. regulation, financing, and implementation.

Limit higher controls on local expenditures. In the EU, for example, the Commission should not excessively control or interfere with local service delivery. In multi-tier systems the role played by intermediate tiers (states and provinces) in controlling local expenditures should be appropriate and restrained. There should be limited infringement on local autonomy, and with specifically local services, intermediate levels should not be interfering. In developing environments where there are significant differences in administrative
capacity across local governments, asymmetric assignment of responsibilities may be justified, at least temporarily. Over time local governments can graduate—with appropriate incentives and support—to more complete levels of responsibility as their capacity is developed.

**Determine financial requirements.** For a clear assignment of expenditure responsibilities to become useful for other aspects of the local fiscal framework, they must be translated into expenditure needs/financing requirements through application of an appropriate standardized methodology. A systematic evaluation of the cost of transferred responsibilities should precede the transfers of task and resources.

**Fund all mandates.** It is important to be explicit that the level of government with the power to regulate a function also has the obligation to pay for it. Increasing coordination and dialogue among levels of government regarding functional assignment is also needed, and there should be ex-ante review of all government legislation regarding local governments to detect any unfunded mandates.

**Ensure that human resources follow functions.** Funding/staffing of deconcentrated offices of line ministries should be downscaled or eliminated. This will reflect the functions transferred to local governments and ensure that they have the staff to execute them, while at the same time reducing the existence of staff at other levels who might interfere with local government functions.

**Reduce and progressively eliminate ex ante control of local government budgets.** In some developing environments this may not be possible to do quickly, but as the local finance system matures it is important to shift from an emphasis on ex ante control to an emphasis on ex post control, such as audits, and to a greater focus on developing accountability to the citizens.

**Implement expenditure decentralization strategically.** It may be appropriate to use the type of asymmetry noted above, and both performance incentives and capacity building may be needed. Capacity building and technical assistance should support local governments to establish a foundation in the first stages of decentralization and then help them adapt to performance incentives in later stages.

**Local Revenue Generation and Autonomy**

Autonomous local revenue generation is the most serious fiscal challenge faced in a majority of countries globally. Although the exact set of revenue reforms will vary across countries, this type of reform is to some extent needed in most countries.

**Increase reliance on own revenues with meaningful discretion.** This strengthens the link between benefits and costs of local services, making local officials more accountable to taxpayers and more fiscally responsible. This can be done through reforms to existing sources of revenue and/or the addition of new sources, and appropriate systems and capacity must be developed in conjunction with expanded revenue authority.

**Reform and modernize property tax administration.** Clearly the poor revenue performance of the property tax has a heavy administrative component. But there are political limits to using this source, so the nature and extent of reforms must be decided on a case-by-case basis.

**Diversify the local tax base.** This is needed in many countries but reforms should target viable and productive local revenues (i.e. not nuisance taxes) as well as ensure that local economic activity will not be impeded.

Only a limited number of local taxes meet these criteria, including vehicle taxes, business license taxes, piggyback income taxes and
betterment levies on real estate. Vehicle taxes can be based on registration, licensing, parking and similar bases. Business taxes can take different forms, but typically use sales turnover as a proxy for the tax base; care must be taken not to convert them into sales taxes that conflict with other consumption taxes, particularly national VAT. Going further in the direction of increasing local tax autonomy would be the introduction of a local piggy-back personal income tax with a flat rate collected at the same time as the national income tax is collected. Betterment levies are an important means for financing infrastructure investments in countries where they are used. All of these sources can be extremely productive, but they are most relevant for urban and intermediate-level (states, provinces) governments.

In addition to these more traditional resources, a potentially valuable but relatively unexploited source in most regions is environmental or “green” taxation related to waste management, water and air polluting activities, and the production of energy. Green taxes would provide a so-called “double dividend” since they promote both revenue generation and a cleaner environment. There are also opportunities to develop sources of revenue based on the increasingly important knowledge economy.

There is often an opportunity to adapt the fiscal system to include some taxation on activities from the informal sector, particularly in developing countries.

Increase freedom to raise fees and user charges. There are economic, technical, and political challenges and limitations associated with such revenues, but they could be more extensively used in most countries. Better and more explicit pricing for public services may help to improve efficiency if political obstacles to charges can be overcome. The principle of cost recovery on public services should be promoted where feasible, but in a way that does not undermine access to basic services by the poor.

Carefully organize local tax collection responsibilities. The challenges of getting the right arrangements between central and local governments, as noted above, are considerable. With local collection, robust systems and incentives are needed for the potential benefits to be realized. When centralized administration of local taxes is appropriate, it is important to establish the right incentives for central tax administrations. Extensive dialogue and cooperation between different levels of tax administration is always desirable and should be institutionalized. This includes information sharing on collections with local governments and allowing their participation in some aspects of management.

Engage local government officials more fully in mobilizing local resources, linking them to service delivery, and using them more transparently. Local officials must assume their responsibility to mobilize the local resources required to improve local service provision. The tax morale of local residents and their willingness to contribute to the local funds can be improved through campaigns of fiscal awareness that inform citizens about how resources are used and how decisions are made. Local officials should also ensure the transparent management of funds and encourage citizen participation in order to increase their confidence on the budget process.

Intergovernmental Transfers

Considerable challenges and weaknesses in intergovernmental transfer systems were outlined above. Multiple steps could commonly be taken to improve the structure and operation of intergovernmental transfer systems.

Assure predictable, regular, and transparent transfer mechanisms. A legal framework should establish a minimum level of public resources that the central government must transfer every
year to local authorities and offer sufficient assurance that they will be allocated in a clear and fair manner.

Secure an appropriate balance among the various types of transfers. There is no hard and fast rule about derivation based versus formula allocated tax sharing, although the former may worsen fiscal disparities, reinforcing the need for equalization (see below). Similarly, there is no normatively ideal balance between unconditional and conditional transfers. A significant share of unconditional funds however reinforces local government autonomy and accountability and it is the better option to support local autonomy and locally driven development when local governments have acquired minimum capacities.

Expand and improve the use of equalization transfers. Countries that do not use them should consider doing so to offset the differential abilities of local governments to meet basic service needs. Countries that do use them should take stock of their approach and move towards a system that uses an explicit and stable rule to determine the pool of funds; takes expenditure needs and revenue capacity (as opposed to actual expenditures or revenues) into account when allocating funds; and allows unconditional use of transferred funds. In countries where elements of equalization are imbedded in revenue sharing, as is common in Latin America, it would be desirable, following the rule of using a single instrument for each objective, to unbundle those schemes and separately introduce an explicit equalization transfer with the properties listed above.

Review and improve mechanisms used for allocating resources under conditional grants. Beyond the basic guidelines on equalization grants noted above, best practice for conditional grant systems calls for simplification, moving toward using fewer separate block grants with clear sectoral objectives and providing governments with sufficient flexibility for deciding on the best use of the funds while meeting the broader sectoral objectives defined by the upper level authorities.

Consolidating grants where large numbers of poorly coordinated programs exist. In some countries in Europe and Asia, for example, there are too many grants that are not clearly distinguished and the resources could be more productively used in a more consolidated system.

Local Government Borrowing and Investment Finance

In many countries, there are considerable opportunities for increasing the use of borrowing and other investment finance mechanisms as well as expanding and improving sources of funding for this purpose. A number of specific policies and reforms can often support this goal.

Promote local government borrowing. Borrowing is one of the necessary pillars of local finance. Responsible local borrowing, guided by prudent rules and regulations (a fiscal responsibility framework) should be allowed where feasible, in parallel to the strengthening of local capacities.

Develop and strengthen legal and regulatory frameworks for local government borrowing. Rules regarding debt level and debt service ratios need not be overly restrictive, but central authorities need to enforce hard budget constraints and avoid bailouts. Central monitoring of local borrowing is critical, especially where private market discipline is not operational. Such monitoring should cover not only regular debt but also “floating debt” or budgetary arrears with official institutions and private suppliers, and local government guarantees for municipal enterprises. Monitoring should be complemented with a credible system of penalties for lack of compliance.
Expand and improve options and support mechanisms for local government borrowing, including support where appropriate to intermediate financial institutions or municipal development funds. Beyond the regulation and monitoring, an even more important challenge for most developing countries is to facilitate a significant increase in credit availability to local governments for responsible borrowing, especially for smaller municipalities. The solution may be the creation of official financial intermediaries or municipal lending institutions, such as Municipal Development Banks or Funds. International experience, however, suggests that they must focus on lending operations rather than get involved in other matters (such as technical assistance to local governments), should be operated following strict banking criteria (including project appraisal), and should increase the share of private capital in their pool of resources over time. Policies to encourage the development of private markets for local credit are equally important. The exact mix of these activities will depend on the context of a particular country following the general rule to use the market to the extent feasible and to use public or mixed lending mechanisms in a way that prepares local governments for eventual commercial borrowing.

Reform other aspects of the local finance system as necessary to enhance the prospects for local government borrowing. Local governments must have access to and effectively use existing (and as needed additional) local taxes, user charges, and central government grants earmarked to local infrastructure. In addition, it is necessary to have good financial management practices in place.

Consider other investment financing mechanisms where feasible. Tax increment financing, betterment levies (valorization), and public-private partnerships can also provide necessary investment finance for local governments. These mechanisms, however, also require certain capacities and conditions and should not be seen as an easy alternative to borrowing.

Determine an appropriate role in infrastructure finance for International Financial Institutions and other development agencies. These institutions have long played an important role in developing and some transition countries, and in many cases they will continue to do so for the foreseeable future. Such resources have traditionally flowed to central governments with onlending to local governments. Such onlending should comply with the basic principles outlined above, and there should be an increasing role for direct sub-sovereign lending, especially to larger cities in countries where this is feasible.

Framing Institutional Reform

The finance system reforms outlined above will need to be reinforced by other measures of a more institutional nature, most of which were discussed earlier in this chapter to set the stage for the discussion of fiscal decentralization. A number of key institutional issues often impact local finances and merit consideration.

Assess and respond as necessary to local government jurisdictional fragmentation. Fragmentation is neither inherently desirable nor undesirable, but as discussed above it can create problems. There are two types of issues.

The first is ensuring that any creation of new jurisdictions is done according to clear criteria to prevent the proliferation of non-viable entities. In some cases there are perverse incentives (e.g. in the transfer system) to create new jurisdictions. These should be avoided.

The second is coping with existing fragmentation that is deemed to be problematic. Where politically feasible, consolidation of small, non-viable units may be considered, but this can undermine political connection and local accountability. An alternative policy is to
enable the creation of voluntary municipal partnerships to deliver public services requiring a minimum scale. Such associations and agreements can also help to address benefit spillovers across local government or the exporting of the costs of local services to neighboring jurisdictions by, for example, through agreements that provide for sharing service provision costs in accordance with benefits. Other solutions include voluntary jurisdictional consolidation, the creation of special districts to take advantage of economies of scale in selected services, or jointly contracting with private firms.

Identify the right roles for and interactions between deconcentrated and devolved government entities. In cases where both deconcentrated and devolved entities coexist side by side, it should be made clear what functions each is responsible for, and they should respectively be provided with appropriate staff, funding, and capacity to meet their obligations. In countries where there has been heavy reliance on deconcentration alone, consideration could be given to introducing democratically elected local governments with devolved autonomy to prioritize their budgets in accordance with the expressed needs of local residents. It is important to note that there can be room for both deconcentrated and devolved levels in some cases, but the system must be set up to tap the advantages of each and prevent one type—usually deconcentrated administration—from undermining the other.

Assess the appropriate role for and operations of external development assistance agencies and financial institutions in developing countries. As discussed earlier, there are two broad types of problems—the heavy handedness of external agents in promoting certain types of decentralization reforms, and their tendency to create parallel institutions and mechanisms for implementing their programs that at least partially bypass normal decision making and resource allocation procedures of local governments. The latter measure is generally intended to compensate for real and perceived problems, such as weak local government capacity, corruption, and ineffective and bureaucratic central government agencies. Parallel mechanisms can help to deliver services and may be appropriate in some form at early stages of decentralization when local governments are very weak, but ultimately they undermine the legitimacy and effectiveness of local governments. Neither of these donor approaches is consistent with current thinking on aid effectiveness, as reflected in the Paris Declaration on Aid Effectiveness (2005), Accra Agenda for Action (2008) and the upcoming Seoul High Level Forum on Aid Effectiveness (2011). The underlying philosophy highlights the harmonization of development assistance with national policy and stresses the importance of using national systems to deliver services, thereby reinforcing both national and subnational governments' capacity development and their accountability to citizens.

Ensuring that external development partners follow national policies is ideally the role of the national government. In countries with weak capacity and significant need for assistance, however, this may be difficult. Under such circumstances, the development partners themselves need to take steps to ensure that they align with national priorities.

Ideally parallel institutions should not be used. If it is necessary to use them for reasons noted above, they must be framed as temporary arrangements with a clear plan for phasing them out in favor of greater reliance on local mechanisms as they become institutionalized. When local mechanisms are sufficiently credible, external agencies should foresee budget support that empowers local decision making.

International agencies need to ensure that budget support programs contribute to the
strengthening of local governments and the development of their autonomy. Likewise, sector-wide approaches are often a centralizing force in practice, but they can be instrumental in strengthening and implementing the specific local powers and responsibilities as defined in the legal frameworks for decentralization.

**Create a regular and systematic dialogue between local governments and the central government on intergovernmental and local financial policy.** Although this has not been previously discussed in an extensive way, this report clearly leads to the conclusion that local governments in many countries are not sufficiently consulted on national policies of great consequence for them. Local governments could be consulted annually during the national budget process on all questions that directly or indirectly affect their financing. This would require a mechanism created to bring together the national actors (legislature and executive) and local governments. For such an approach to be effective, it would be important to ensure access to appropriate information on public finances, both in general and specifically regarding local government matters.

**The Way Forward**

Local governments have become more important and more autonomous in many countries around the world and higher expectations have been placed on them. Because this has happened in a challenging global environment of substantial urbanization, demographic shifts, climate change, and increasing risk, more attention needs to be given to developing the basic fiscal architecture that serves as a foundation for good local government performance. As highlighted throughout the report, there has been good progress on many fronts in many countries, but there are still major deficiencies and challenges in most cases, both in terms of the elements of the fiscal system that need to be in place and the capacity of local governments to function effectively. Unless these are confronted head on, there are great dangers of social and economic decline in the more advanced economies and a failure to meet key increasingly urgent needs in developing countries, including poverty reduction targets and the Millennium Development Goals.

Although diversity is great across countries, there are some shared challenges common to many places. Clarity of functional assignment in law and practice is a challenge in many developing countries, and unfunded mandates are a more general problem. In many countries there is a pressing need to reassess the structure of local taxes, and the degree of autonomy that local governments have in defining and using them. In many cases it will be desirable to move beyond traditional local revenue bases, and to search for a more appropriate distribution of transferred and own-source resources between national and local governments, as well as among subnational governments in the context of the emergence of new tiers and new units at particular levels. Growing investment requirements necessitate an expansion of local government access to capital, increasingly through market-oriented and non-traditional mechanisms. There is also a need for developing more innovative approaches to raising resources and delivering services, including through new and expanded forms of partnership with different actors (private sector and civil society).

As countries around the world strive to improve their local government systems, they will have to keep in mind some daunting short-term and longer term challenges. The most immediate challenge is the global financial and economic crisis that started near the end of 2008, which has resulted in revenue shortfalls for many local governments and even attempts to recentralize in some cases. Countries also face longer term challenges that cut across all levels of government, some of which can have
particularly important implications for local governments because of the increasing role this government level plays in the provision of social services, environmental control, and so on. Some of these challenges are common (global warming, energy crisis, etc.) but others differ by region of the world. Rapidly increasing urbanization, for example, particularly in many of the developing countries of Africa, Asia, and Latin America, is creating complex demands on public services and infrastructure, yet local governments in many countries in these regions do not have the necessary authority and autonomy to meet these demands. In addition they too frequently cannot even cover the operating costs of existing services much less the costs of the substantial additional investments needed.

Although many suggestions to improve local government finance systems have been made in the regional chapters and in this concluding chapter, in closing this volume it is important to reiterate again a few fundamental points regarding the approach to reform.

First, each country is unique and the basic principles for reform need to be tailored to the economic, political, fiscal, and social realities of individual countries. In Europe, for example, substantial capacity exists, but there is a need for system reforms and increased access to investment finance. At the other end of the spectrum, less developed countries in several regions need to build basic institutions gradually if reforms are to take root and be sustained, although more capacity may exist in larger cities for more immediate assumption of functions and resources.

Second, consultation and collaboration among levels of government and other actors will be critical as efforts to strengthen local finance systems advance —each actor has an important role, but no actor alone can do what needs to be done. In particular, central governments need to treat local governments as partners, with full consultation in all issues of shared responsibilities. Local governments also need to continue the efforts they are already pursuing in many countries to reach out to citizens, to develop partnerships with non-governmental organizations and private firms, and to seek innovative means to deal with the challenges they face.

Third, while political factors are critical and there is no point in pursuing reforms that are politically infeasible, it is also important to make decisions about reform based on good information and evidence, the lack of which created considerable challenges for the preparation of this report. Better information and analysis and broader and more transparent dissemination of such inputs can create and nurture a better environment for pursuing the right reforms over time. In addition, the success of initial modest reforms can create political momentum for the adoption of more advanced reforms with greater impact over time.

Finally, there is considerable value added from regional and global cooperation, sharing experiences, and learning by doing in pursuing local finance reform. The role of UCLG, its regional member organizations, and their individual country members, provides a strong foundation for collaborative learning at various levels, and these actors need to continue to strengthen those links going forward. Global and regional events, online access to information, country specific, regional and global networking activities, diagnostics to help countries and local governments to plan concrete productive action, and forums and mechanisms for sharing experiences and expertise would all be productive ways to support better local government finance. Some opportunities in these areas already exist, but much remains to be done to consolidate and improve knowledge about them, enhance access to them, and deepen an understanding among all stakeholders of how to effectively use them.