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# **Analysis of the State of Local Finance in Intermediary Cities**

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## **Executive Summary**

Intermediary cities face many diverse challenges in their quest to become financially sustainable and strengthen their ability to plan and implement measures to foster growth, and development. This rapid analysis of the state of intermediary city finances seeks to identify these challenges and assess the ability of intermediary cities across the globe to respond to them and create the framework conditions for a vibrant urban economic, social and cultural life outside the big metropolitan centers.

In most developed countries with a long history of decentralized governance, the legal and institutional frameworks determining the functional responsibilities and fiscal powers of intermediary cities are well established. This is not necessarily the case in the developing world, where intermediary cities often lack the institutional incentive and support to efficiently exploit their fiscal potential and manage their financial resources. However, the financial situation of intermediary cities also depends to a large extent on their economic structure and growth. Here, the divisions do not run as clearly between the developed and the developing world, but rather between regions with greater and lesser national and international connectivity. Intermediary cities that see their economies expand, tend to benefit from greater access to financial resources and increased latitude in resource allocation. The majority of intermediary cities however have not been able to attract much outside investment and their economies tend to be localized, stagnating and largely informal, which results in only humble revenue yields and limited access to external financial resources. Consequently, many of these intermediary cities struggle to meet their responsibilities with regards to infrastructure provision. These pressures are most strongly felt by rapidly expanding intermediary cities.

Not surprisingly, there are large disparities in the amount of financial resources that intermediary cities across the world have at their disposal. Cities in OECD countries take in by far the most revenue per capita, while cities in Africa and Asia take in the least. Intermediary cities in Latin America fall in between these two categories. There are also large variations as to where intermediary cities draw their revenue from. While a considerable number of intermediary cities obtain most of their revenue from local revenue sources, many of them are heavily reliant on intergovernmental transfers to meet both recurrent and capital expenditure costs. Intergovernmental transfers tend to have a less important role in more developed cities, as they are usually in a better position to meet their expenditure needs through other revenue sources.

With regards to the composition of local own revenue, local taxes play the largest role in the majority intermediary cities. One common source of revenue is taxes on business activity. While, they are fairly widespread in developing countries, due to their ease of collection, their importance tends to be limited in OECD countries. Taxes on land and immobile property are also widely devolved to local governments in both developed and developing countries, although there are large discrepancies regarding the effectiveness of their exploitation. In most developed countries, property taxes are administered equally effectively in all types of urban settlements, while in developing countries effective property and property transfer tax

collection is often limited to metropolitan areas. Many intermediary cities in Africa, Asia and Latin America, despite substantive revenue potential, often fail to systematically collect these taxes due to their fairly complex administration, but also due to political economy issues.

Land development payments that serve to capture value increases from public infrastructure development are another relevant land related revenue source. They make most sense in fast growing urban settings and are commonly used to finance public infrastructure projects. In developing countries however, the use of such mechanisms is often limited to metropolitan areas, mainly due to the fact that an effective application of most of these instruments requires fairly high institutional capacity. Here, intermediary cities need to catch up. Local revenue can also be generated from renting, leasing or selling public assets. In most large and intermediary cities in Europe and North America, local governments make these assets work for them effectively. In developing countries, the record of intermediary cities regarding the use of their public assets is somewhat mixed, mainly due to poor management including the recording, valuation and depreciation of public assets.

While Public-Private-Partnerships (PPPs) are widely promoted as a means to improve efficiency in service provision and to overcome capital constraints, many intermediary cities, mainly but not only in developing countries, still lack the capacity to properly structure and manage and evaluate such arrangements. They also frequently lack the bargaining power to effectively negotiate with the private sector, while struggling to make offers attractive enough for private companies to get involved. Here partnerships with citizen groups controlling large amounts of remittance monies, which have become increasingly important in some developing countries, offer a viable alternative for some intermediary cities.

Another way for local governments to access additional capital is through borrowing. In most developed countries, both large and intermediary cities routinely borrow financial resources. Here, strong regulatory frameworks that determine and monitor the rules and procedures for local government lending, typically help intermediary cities access credit, manage their debt and reduce their risk for insolvency. In contrast to this, municipal borrowing in the developing world is often limited to metropolitan areas. Intermediary cities frequently suffer from poor creditworthiness aggravated by administrative and regulatory restrictions, and the immaturity of national financial markets.

An innovative but rarely explored way for intermediary cities to access external funding is through climate financing. It is however not very well understood by many intermediary city governments as its implementation requires a certain level of technical and institutional capacity. Finally, Official Development Assistance (ODA) in the form of grants and soft loans continues to play an important role in the financing of infrastructure in the developing world. However, Intermediary cities primarily benefit from ODA through local government support programs or different sector support programs, where conditions are negotiated at the national level and intermediary cities have relatively little influence on them.

## **Introduction**

Urban areas outside of metropolitan agglomerations, so called intermediary cities, face many diverse challenges in their quest to become financially sustainable and strengthen their ability to plan and implement measures to foster their growth, and development and the wellbeing of their population. This rapid analysis of the state of intermediary city finances seeks to identify these challenges and assess the ability of intermediary cities across the globe to respond to them and create the framework conditions for a vibrant urban economic, social and cultural life outside the big metropolitan centers. It does so by discussing the institutional and economic framework conditions that intermediary cities find themselves exposed to as well as their particular expenditure patterns and needs. It then assesses the financial situation and revenue structure of intermediary cities, illustrated by revenue data of selected intermediary cities from different countries and regions of the world. Then it examines the revenue sources most relevant to intermediary city finance exploring the effectiveness of their exploitation. The last sections of the analysis address other mechanisms for infrastructure financing and the extent to which intermediary cities have been able to employ them successfully.

### ***1. Legal and institutional framework for intermediary cities: Fiscal decentralization and local financing responsibilities***

The powers and responsibilities of intermediary cities are determined by the national legal frameworks of their respective countries. In some countries these powers and responsibilities have evolved historically over long periods of time, while in others they have been assigned rather recently and intermediary cities still have to learn how best to fulfill them. As an overall trend, powers and responsibilities for intermediary cities have been increasing over the last 30 years due to a growing number of countries adopting decentralization policies.

As part of their decentralization reform, a large number of countries – rich and poor economies, unitary and federal states, competitive and single party systems – have instituted constitutional provisions for the transfer of powers, functions and resources to lower level governments. Subsequent laws and regulations are required to further elaborate on the detailed institutional structures and procedures (Smoke, 2013). While normative principles of decentralization provide clear rationale and recommendations for its design and implementation, including the appropriate assignment of functions and finances to local governments, it is important to realize that the outcome is always a reflection of the political negotiation process between various local and national stakeholders (Eaton & Smoke, 2011).

In most developed countries with a long history of decentralized governance, the legal and institutional frameworks determining the functional responsibilities and fiscal powers of local governments are well established and elaborated in detail. Here, intermediary cities have not only been assigned clear mandatory and elective expenditure responsibilities and fiscal powers in terms of revenues, transfers and borrowing authority, they are also further enabled by a comprehensive set of effective rules and regulations that nudges local governments to operate

in an efficient, transparent and accountable manner. These rules and regulations help incentivize local governments to become effective tax collectors, to curb corruption, to develop and maintain creditworthiness and to become attractive partners for the private sector.

In many developing countries these advantageous legal and institutional framework conditions for good local government fiscal performance are not in place. Subsequent legislation further detailing the assignment of fiscal powers and responsibilities often remains ambiguous, fragmentary and incomplete. The same is true for subsidiary rules and regulations. As a result, local governments including intermediary cities lack the institutional incentive and support to efficiently exploit their fiscal potential and manage their financial resources. Some developing countries such as the Philippines, South Africa or Colombia have made some progress in this regard improving the institutional enabling environment for local governments. Still, they have quite a long way to go.

Many national decentralization frameworks, in particular in the developed world, make different provisions for urban and rural local governments. Urban local governments are typically assigned more functions, more, revenue sources and are granted greater autonomy in terms of expenditure decisions. In developing countries, property taxes for example are often formally or practically restricted to urban areas. There are however (at least to the knowledge of the author) no provisions specifically targeted to intermediary cities. South Africa differentiates between municipal categories A, B and C, where the category A municipalities are 8 metropolitan areas that meet certain criteria related to size, location and function. These municipalities are stand-alone and hold exclusive authority over local public services and finance, while category B municipalities are clustered within category C municipalities and the two levels co-share this authority. Currently there is a debate about expanding this differentiation of municipalities to other types of settlements to be better able to address their distinct conditions, but so far no decision has been taken (SACN, 2014).

## ***2. The economic structure and framework conditions of intermediary cities***

Besides the assignment of fiscal powers, the financial situation of intermediary cities depends to a large extent on their economic structure and growth. Here the divisions do not run as clearly between the developed and the developing world, but rather between regions with greater and lesser national and international connectivity (Robert, 2014). A smaller share of intermediary cities, such as Kumasi in Ghana, Denpasar in Indonesia, Mannheim in Germany, Toulouse in France or Cuzco in Peru, has been successful at attracting private business and investment and is connected to the global market place, either due to natural or cultural resource endowment or the exploration of other competitive advantages (Roberts, 2014). These intermediary cities see their economies expanding. They tend to benefit from greater amounts of own source revenue as well as opportunities for private sector engagement increasing their access to financial resources as well as their latitude in terms of resource allocation.

At the same time, these booming intermediary cities, despite their favorable prospects, tend to be faced with various challenges. Economic expansion often comes with rapid urban growth which puts them under considerable financial strain due to extensive infrastructure requirements. Here the strategic use of value capturing finance instruments can help these cities shoulder their increasing expenditure needs. Furthermore, the economic growth in many of these intermediary cities relies heavily on only one or very few sectors or industries. This makes intermediary cities much more vulnerable to economic fluctuations or other external factors than larger, more diversified metropolitan areas. The city of Matlosana for example developed mostly around gold mining activities which started expanding after the 2<sup>nd</sup> World War. When in the 1990s the gold price started to fall drastically and the gold reserves in the area were coming to an end, mining activities downscaled substantively stalling the local economy and putting the city in tremendous financial difficulties (SACN, 2013). A similar effect can be observed since last summer in the city of Aberdeen, UK, where about one third of all jobs depend on the oil and gas sector. The big slump in oil prices has had a substantive effect on the city's economy and, if this trend continues, will also stunt its own revenues (The Economist, 2015).

The larger share of intermediary cities has not been able to attract much outside investment and their economies tend to be localized and stagnating (Roberts, 2014). In the developing world, where still most of these cities can be found, their economies are small and largely informal. This pertains to businesses, employment as well as settlements, which hinders not only investment and growth but also effective taxation. Nevertheless, many of these intermediary cities continue to grow substantively due to rural-urban migration of poor, un-skilled people moving into already crowded areas. From a fiscal perspective this constitutes a double whammy as it means both small revenue potential and large expenditure needs. These intermediary cities are typically more dependent on intergovernmental transfers, without being able to alleviate the pressures on their infrastructure.

In OECD countries, economically dwindling cities such as St. Etienne in France, Detroit in the USA, or Schwerin in Germany, by far do not have to deal with informality to the same extent. They typically struggle with job loss and population decline, which depreciates property values, diminishes tax revenues, and subjects the cities' infrastructure to underutilization and slow decay. These cities face the necessity to find a way to break out of the downward spiral of declining attractiveness to get back on their feet.

### ***3. Expenditure needs and patterns of intermediary cities: Bottleneck infrastructure***

Intermediary cities are typically responsible for the provision of a wide range of infrastructure from roads, public transportation, water and sanitation systems, and energy provision, to schools, hospitals and other public amenities. A large share of intermediary cities in the developing world, however, struggles to meet these responsibilities and the level and quality of the infrastructure provided tends to be much lower compared to metropolitan areas (Roberts,

2014). This poor provision of infrastructure stems to a large extent from a limited access to financial resources. As a result, many intermediary cities under-prioritize allocating their scarce finances to the maintenance and repair of its existing infrastructure, resulting in much faster degradation, frequent service interruptions and poor service quality. A study of six intermediary cities in South Africa for example found that the intermediary cities spent on average only 3.1 % of their budgets on maintenance and repairs of their infrastructure, compared to an average of 5.2 % spent by the country's metropolitan areas (SACN, 2014). Consequently, some of these cities have serious infrastructure problems: The city of Emfuleni for example loses up to 39 % of its drinking water due to pipe leakage (SACN, 2014).

In many cases, the under-spending on maintenance and repairs relates to the fact that many poor intermediary cities heavily depend on intergovernmental transfers, which tend to disregard local government expenditure needs in this area, instead concentrating their allocations in new investments. In these situations, many poor intermediary cities, instead of using their scarce own source revenue to keep up their infrastructure, allow it to degenerate to a point beyond repair waiting for an opportunity to secure funding for replacement.

The pressure to build new infrastructure is most strongly felt by rapidly expanding intermediary cities. Booming cities with dynamic economies are often in a good position to attract private investors for Public-Private Partnerships or employ value capture mechanisms for this purpose. Moreover, economically strong cities usually take in greater amounts of own source revenue and tend to possess better planning and financial management capacities, which put them into a more favorable position with regards to accessing loans for capital investments. This is increasingly the case for intermediary cities in the developing world as well, as their legal and institutional frameworks improve and booming cities are incentivized to strengthen their urban management practices.

The intermediary cities in the most difficult situation with regards to infrastructure provision are those with a depressed economy that are still experiencing large population growth due to in-migration of the rural poor. These cities face great needs for infrastructure expansion without having the means to finance them. This quickly results in the massive congestion of the existing infrastructure such as roads, or public transit, or illegal tapping of water or electricity networks, which decreases overall service quality and reliability even further.

#### ***4. The fiscal situation of intermediary cities***

Not surprisingly, there are large disparities in the amount of financial resources that intermediary cities across the world have at their disposal. Table 1 presents revenue data for a number of selected intermediary cities from different countries and regions in the world. As the table shows, the total revenue per capita of the intermediary cities presented here ranges from USD 5,612 in Aberdeen, UK to USD 0.31 in Kenema, Sierra Leone. The table also clearly shows a clustering by region: The intermediary cities in OECD countries take in by far the most revenue per capita, while cities in Africa and Asia take in the least – on average almost 30 times

less than their counterparts in the developed world. Intermediary cities in Latin America fall in between these two categories with total revenue per capita of selected cities ranging from USD 399 in Feira de Santana, Brazil to USD 644 in Monteria, Colombia. These differences in revenue are substantive and give an indication of the resources these intermediary cities can spend on services and infrastructure for their citizens.

*Table 1: Intermediary city revenue, total and per capita for selected intermediary cities*

Intermediary City	Country	Population	Total revenue (in USD)	Total revenue per capita (in USD)
Saskatoon <sup>a</sup>	Canada	248,700	276,933,309	1,114
Peterborough <sup>b</sup>	Canada	78,700	211,044,965	2,682
Freiburg <sup>c</sup>	Germany	230,542	838,805,311	3,638
Leipzig <sup>d</sup>	Germany	526,909	1,388,328,786	2,635
Bristol <sup>e</sup>	UK	442,500	2,171,129,880	4,907
Aberdeen <sup>f</sup>	UK	196,670	1,103,790,822	5,612
Polokwane <sup>g</sup>	South Africa	642,183	141,731,803	221
Matlosana <sup>h</sup>	South Africa	433,973	121,637,691	280
Bo <sup>i</sup>	Sierra Leone	149,957	53,542	0.36
Kenema <sup>i</sup>	Sierra Leone	128,402	40,370	0.31
Iwo <sup>j</sup>	Nigeria	224,550	3,237,533	14
Pekalongan <sup>k</sup>	Indonesia	275,241	27,667,913	101
Langsa <sup>k</sup>	Indonesia	140,267	23,715,334	169
General Santos City <sup>l</sup>	Philippines	538,086	31,174,093	58
Lucena City <sup>m</sup>	Philippines	246,392	13,326,453	54
Cucuta <sup>n</sup>	Colombia	566,244	242,481,541	428
Monteria <sup>o</sup>	Colombia	288,192	185,703,370	644
Feira de Santana <sup>p</sup>	Brazil	556,642	221,875,911	399
Guarapuava <sup>p</sup>	Brazil	167,328	88,482,758	529

### *5. Sources of intermediary city revenue*

There are large variations as to where intermediary cities draw their revenue from. While a large number of intermediary cities obtain most of their revenue from local revenue sources, many of them are heavily reliant on intergovernmental transfers. In principle, these differences depend on the design of the intergovernmental fiscal framework, i.e. the extent to which productive revenue sources have been devolved to local governments and the extent to which these revenue sources can cover the cost for the functions assigned to them. In practice, uneven revenue potentialities and poorly developed capacities for local revenue collection tend to shift the balance towards a greater reliance on intergovernmental transfers. Hence, it is not surprising that many intermediary cities in developing countries depend heavily on grants and subsidies from central government to meet both recurrent and capital expenditure costs (Roberts, 2014).



Table 2 provides a good illustration of this by presenting local own revenue and intergovernmental transfers as shares of total revenue for selected intermediary cities. The table shows clearly that most intermediary cities in developing countries obtain the majority of their revenues through intergovernmental transfers. Feira de Santana and Guarapuava in Brazil for example receive 72.2 % and 73.2 % of their revenue from intergovernmental transfers respectively, while Langsa and Pekalongan in Indonesia and Iwo in Nigeria have transfer shares as high as 93.1 %, 94.1 %, and 97.8 % respectively. However, there are also exceptions to this trend as demonstrated by the two sample cities from South Africa, Matlosana and Polokwane, where only 28.6 % and 32.3 % of their revenues come from transfers respectively.

*Table 2: Shares of own revenue and intergovernmental transfers for selected intermediary cities*

Intermediary City	Country	Total revenue (in USD)	Own revenue (in USD)	Own revenue as share of total revenue	Intergov. Transfers (in USD)	Inter- gov. Transfers as share of total revenue
Saskatoon <sup>a</sup>	Canada	276,933,309	232,022,453	83.8%	44,910,855	16.2%
Peterborough <sup>b</sup>	Canada	211,044,965	151,377,519	71.7%	59,667,447	28.3%
Freiburg <sup>c</sup>	Germany	838,805,311	577,518,508	68.9%	261,397,776	31.2%
Leipzig <sup>d</sup>	Germany	1,388,328,786	856,358,845	61.7%	531,969,941	38.3%
Bristol <sup>e</sup>	UK	2,171,129,880	1,025,332,711	47.2%	1,145,797,168	52.8%
Aberdeen <sup>f</sup>	UK	1,103,790,822	502,835,018	45.6%	600,955,804	54.4%
Polokwane <sup>g</sup>	South Africa	141,731,803	95,945,832	67.7%	45,785,971	32.3%
Matlosana <sup>h</sup>	South Africa	121,637,691	86,873,134	71.4%	34,764,558	28.6%
Bo <sup>i</sup>	Sierra Leone	53,542	20,514	38.3%	33,028	61.7%
Kenema <sup>i</sup>	Sierra Leone	40,370	15,408	38.2%	24,961	61.8%
Iwo <sup>j</sup>	Nigeria	3,237,533	71,703	2.2%	3,165,830	97.8%
Pekalongan <sup>k</sup>	Indonesia	27,667,913	1,634,133	5.9%	26,033,780	94.1%
Langsa <sup>k</sup>	Indonesia	23,715,334	1,630,770	6.9%	22,084,564	93.1%
General Santos City <sup>l</sup>	Philippines	31,174,093	12,529,209	40.2%	18,644,884	59.8%
Lucena City <sup>m</sup>	Philippines	13,326,453	5,299,701	39.8%	8,026,752	60.2%
Cucuta <sup>n</sup>	Colombia	242,481,541	57,970,204	23.9%	184,511,337	76.1%
Monteria <sup>o</sup>	Colombia	185,703,370	53,450,200	28.8%	132,253,170	71.2%
Feira de Santana <sup>p</sup>	Brazil	221,875,911	61,715,088	27.8%	160,160,823	72.2%
Guarapuava <sup>p</sup>	Brazil	88,482,758	23,700,989	26.8%	64,781,769	73.2%

As the sample intermediary cities from the OECD countries show, intergovernmental transfers tend to have a less important role in more developed cities, as they are usually in a better position to meet their expenditure needs through other revenue sources. Here however there are also considerable variations, as can be seen from table 2: While the share of intergovernmental transfers in Saskatoon, Canada is as low as 16.2 % of the city's total revenue, this share rises to 54.4 % in Aberdeen, UK. The high overall volume of the Aberdeen's revenue suggests however, that the intergovernmental transfers pay to a large extent for delegated functions mandated by the central government.

Intergovernmental transfers can take a variety of forms and serve a number of different purposes. The overall pool of resources to be transferred can be open, determined ad hoc such as in Egypt, South Africa or Uganda, or defined as a fixed share of overall revenue like in Cambodia, Ghana, Indonesia, Mexico or the Philippines. Sometimes transfers also consist of sharing the proceeds of a specific tax such as in Brazil or Indonesia (Smoke, 2013). The assignment to local governments can be based on a formula incorporating allocation criteria, such as area, population, poverty level or fiscal gap, on periodic intergovernmental negotiations, or on derivation. Generally, specific amounts or formula based allocations are more predictable than ad hoc allocations. Intergovernmental transfers that seek to close the fiscal gap or increase horizontal equity between different local entities often come as unconditional transfers, which allow for considerable local discretion in terms of resource allocation such as in the case of Indonesia, South Africa or the Philippines (Smoke, 2013). When transfers are intended to ensure local expenditures in certain sectors or when they are made to compensate the local governments for carrying out specific mandates, their use is typically much more restricted. These conditional or earmarked transfers tend to leave considerably less autonomy over resource allocation to local governments such as in Ghana, Rwanda or Uganda, but also increasingly in Brazil (Smoke, 2013). Compared to metropolitan areas, intermediary cities tend to be more dependent on intergovernmental transfers due to their lower capacity for own revenue generation and their limited access to credit. This dependency can create problems for the cities' budget planning and execution, if transfer amounts are difficult to predict or disbursement is unreliable. In cases where intergovernmental transfers come with a lot of conditionalities attached, this also means that intermediary cities have less discretion on how to spend their revenues.

#### ***6. Own source revenue mobilization in intermediary cities***

Local own source revenue of intermediary cities usually consists of local taxes, fees, fines and user charges as well as income from rent, lease or sale of local government property. In some cases, intermediary cities can also obtain revenue from investment activities. The composition of local own revenue varies substantially between intermediary cities. Table 3 provides some insight into this variation by presenting the share of taxes and the share of fees and user charges in the local own revenue for selected intermediary cities. The table shows that while local taxes play the largest role in local own revenue in the majority of the cases, for example constituting 60.3 % of local own revenue in Saskatoon, Canada, or 77.9 % in Cucuta, Colombia, their relative importance can be fairly small: In Polokwane and Matlosana, South Africa for example, local taxes make up only 18.8 % and 17.2 % of total own revenue respectively.

Table 3: Shares of local own revenue that comes from local taxes and user fees and charges for selected intermediary cities

Intermediary City	Country	Own revenue (in USD)	Own revenue from taxes (in USD)	Own revenue from taxes per capita (in USD)	Tax revenue as share of total own revenue	Own revenue from user fees and charges (in USD)	Own revenue from user fees and charges per capita (in USD)	Revenue from fees and user charges as share of total own revenue
Saskatoon <sup>a</sup>	Canada	232,022,453	139,800,090	562	60.3%	26,649,916	107	11.5%
Peterborough <sup>b</sup>	Canada	151,377,519	77,504,188	985	51.2%	47,382,581	602	31.3%
Freiburg <sup>c</sup>	Germany	577,518,508	271,450,811	1,177	47.0%	21,091,509	91	3.7%
Leipzig <sup>d</sup>	Germany	856,358,845	486,299,921	923	56.8%	37,322,355	71	4.4%
Bristol <sup>e</sup>	UK	1,025,332,711	280,991,004	635	27.4%			
Aberdeen <sup>f</sup>	UK	502,835,018	157,052,257	799	31.2%			
Polokwane <sup>g</sup>	South Africa	95,945,832	18,079,909	28	18.8%	61,569,630	96	64.2%
Matlosana <sup>h</sup>	South Africa	86,873,134	14,950,050	34	17.2%	59,533,677	137	68.5%
General Santos City <sup>l</sup>	Philippines	12,529,209	7,832,169	15	62.5%	1,413,833	3	11.3%
Lucena City <sup>m</sup>	Philippines	5,299,701	4,034,509	16	76.1%	257,805	1	4.9%
Cucuta <sup>n</sup>	Colombia	57,970,204	45,156,432	80	77.9%	110,892	0.20	0.2%
Monteria <sup>o</sup>	Colombia	53,450,200	24,468,840	85	45.8%			
Feira de Santana <sup>p</sup>	Brazil	61,715,088	44,656,084	80	72.4%			
Guarapuava <sup>p</sup>	Brazil	23,700,989	14,616,820	87	61.7%			

Table 3 also shows the local tax revenue per capita for the selected intermediary cities, which can be used as a proxy for the local tax burden. This shows a large spread between the intermediary cities ranging from USD 1,177 per capita in Freiburg, Germany to only USD 15 per capita in General Santos City in the Philippines. However after taking the large income disparities between the countries into consideration, the differences become somewhat proportionate. The following sections will discuss the most important sources of local own revenue for intermediary cities in more detail.

### 7. *Local taxation on economic activity*

One common source of revenue for many urban governments is taxes on formal and to some extent informal business activity (Joshi, Prichard & Heady, 2014). This type of taxation comes in many different forms, such as business licensing taxes, market fees, trading taxes, turnover or other sales taxes and VAT. Taxes on local businesses are fairly widespread in developing countries, e.g. in China, Kenya, Rwanda, Ivory Coast, Brazil, Venezuela, Philippines and others due to their ease of collection. They can also be found in OECD countries, e.g. France, Belgium, the UK and Switzerland, although their importance tends to be limited, except for in Germany, where municipalities levy the so called *Gewerbesteuer*, a local business tax, and in some states in the U.S.A., where local governments can impose local sales taxes and/or business privilege taxes (Devas & Kelly, 2001). Local business taxes are often considered a mixed blessing: In economically vibrant settings they can be highly productive and usually find decent political acceptance. However, local business taxes also often lead to economic distortions, such as in the case of the now abolished Regional Services Council Levy in South Africa, and can further damage already struggling local economies.

Table 4 presents information on levels and shares of taxes on economic activities for selected intermediary cities. It clearly shows the varying importance of this type of taxes. In Freiburg and Leipzig, the *Gewerbesteuer* yields 24.0 % and 29.5 % of the cities' total own revenue respectively – almost threefold the amount of the property tax. In Kenema, Sierra Leone market dues constitute as much as 68.0 % of the total own revenue. However, some intermediary cities also put less emphasis on collecting taxes from economic activities such as Monteria in Colombia, where this type of taxes makes up only 9.8 % the total own revenue.

In intermediary cities, where most economic activity revolves around one or few industry sectors or enterprises, the heavy reliance on business taxation leaves city revenues vulnerable to the economic health of the sector or company. In September 2015, the city of Zwickau, Germany, for example, was forced to impose a temporary budget freeze as its major tax payer, the Volkswagen Company, responsible for 64 % of the city's trade tax receipts, saw its stock-market value collapse over its emission scandal. The revised budget predicted a 33 % decrease in tax revenues coming from Volkswagen. A similar crisis 10 years earlier had resulted in substantive cutbacks in expenditure – e.g. two of the three public pools of the city had to close down (Gesellmann, 2015).

*Table 4: Shares of own local revenue that comes from property taxes and taxes/fees on economic activities for selected intermediary cities*

Intermediary City	Country	Own revenue (in USD)	Property taxes (in USD)	Property tax as share of total own revenue	Taxes/fees from economic activity (in USD)	Taxes econ as share of total own revenue
Saskatoon <sup>a</sup>	Canada	232,022,453	139,534,655	60.1%		
Peterborough <sup>b</sup>	Canada	151,377,519	77,504,188	51.2%		
Freiburg <sup>c</sup>	Germany	577,518,508	50,803,394	8.8%	138,882,584	24.0%
Leipzig <sup>d</sup>	Germany	856,358,845	97,894,695	11.4%	252,794,218	29.5%
Bristol <sup>e</sup>	UK	1,025,332,711	280,991,004	27.4%		
Aberdeen <sup>f</sup>	UK	502,835,018	157,052,257	31.2%		
Polokwane <sup>g</sup>	South Africa	95,945,832	18,079,909	18.8%		
Matlosana <sup>h</sup>	South Africa	86,873,134	14,950,050	17.2%		
Bo <sup>i</sup>	Sierra Leone	20,514	2,462	12.0%	12,719	62.0%
Kenema <sup>i</sup>	Sierra Leone	15,408	1,387	9.0%	10,478	68.0%
General Santos City <sup>l</sup>	Philippines	12,529,209	2,823,318	22.5%		
Lucena City <sup>m</sup>	Philippines	5,299,701	756,942	14.3%		
Cucuta <sup>n</sup>	Colombia	57,970,204	17,057,842	29.4%	11,881,063	20.5%
Monteria <sup>o</sup>	Colombia	53,450,200	6,852,400	12.8%	5,223,660	9.8%
Feira de Santana <sup>p</sup>	Brazil	61,715,088	10,847,275	17.6%	26,128,537	42.3%
Guarapuava <sup>p</sup>	Brazil	23,700,989	4,391,602	18.5%	6,200,142	26.2%

### **8. Local taxation on land and property**

From an economic perspective, taxes on land and immobile property are an ideal source of local revenue, and in an increasing number of countries, they are assigned to urban governments through fiscal decentralization arrangements. In countries like Australia, Canada, the United Kingdom, Colombia, Mexico, Argentina, Chile, Guinea, Tunisia and some states in India, property tax yields constitute over 30 % of local revenues (Kitchen, 2013). The productivity of property taxes however can vary considerably due to great variations in the value of the tax base, resulting in substantive inter-jurisdictional inequalities (Oates, 1999). In the United States, this as lead to important discussions regarding the horizontal fairness of the tax in light of its role as the main funding mechanism of local school districts (Nechyba, 1996). In intermediary cities with strong, dynamic housing markets such as Cambridge, Surrey or George where real estate prices are high and growing quickly, property taxes can be a productive source of own revenue, provided value increases are appropriately reflected in the assessed tax base. In intermediary cities where the economy is slow and housing markets are depressed, local revenues from property taxes might be inadequate.

Table 4 provides an overview of property tax revenue in dollars and as share of total own revenue for selected intermediary cities. The table illustrates the varying importance of property

taxes for the total own revenue of different intermediary cities. In Saskatoon and Peterborough in Canada, property taxes constitute 60.1 % and 51.2 % of total local revenue making them the single most important revenue source for these cities. In contrast to this, property taxes contribute only 8.8 % of total own revenue in Freiburg, Germany, and only 9.0 % in Kenema, Sierra Leone. It should be noted however, that in these two latter cases the underlying reasons for these small shares are very different. In the case of Freiburg, the small share originates from the size of the tax rate and base that are relatively small compared to the other sources, while in Kenema, the small share mostly stems from poor tax collection practices. Considerable efforts in improving property tax administration subsequently lead to large increases in the city's property tax revenue (Jibao & Prichard, 2013).

While in most developed countries, property taxes are administered equally effectively in all types of urban settlements; developing countries still experience large variations in this regard. Here, effective property and property transfer tax collection is often limited to large, capital cities and metropolitan areas. Intermediary cities, despite substantive potential, often fail to systematically collect taxes on land and land related investments. This is mainly due to the fairly complex administration of the property tax, but also to political economy issues.

Many intermediary cities in Africa, the Middle East and some parts of Asia and Latin America exhibit poor public land management practices. The ownership information in urban land cadastres is often non-existent, outdated or incomplete, such as in many cities in Africa, which renders the identification of tax payers somewhat difficult. This is often due to incomplete land titling or poor record keeping but also to informal land sales in order to evade administrative transfer costs. In Dakar, Senegal for example, the vast majority of informal settlement dwellers are still without a land title despite a national tenure regularization program that was launched in 1987. Similar delays in the titling process have been observed in Accra, Ghana, Tanzania and Indonesia (Payne, Durand-Lasserve, Rakodi, 2009). Without title, land owners cannot be made liable for paying taxes on their property. Sometimes the ownership records are not digitalized or held by higher level governments, so that city revenue departments have difficulties accessing up-dated information. In Rwanda for example, land registration data is managed by the national Rwanda Natural Resource Authority, which local governments do not have direct access to. As a result, urban governments struggle to obtain current lists of property lease and ownership, while the government of the capital city Kigali takes advantage of its political connectedness to gain privileged access to this information.

Another hurdle to effective property tax administration is inadequate valuations, in particular gross under-valuations of urban property. Depending on the tax base, the taxable property to be valued is either land, improvements on the land such as buildings, or both. Due to the difficulty of observing the true market value of property, urban governments have used a number of proxy methods, such as unit value determined by size, rental value, self-assessed or comparable market value, to estimate the alleged market value of the property. Many of these methods, especially when relying on outdated or owner-provided information, are prone to severe under-valuation. In Ethiopia for example, Addis Ababa and a few other larger cities determine urban land leases by auctions. In the other cities, however, leases are set based on

notional land prices determined by the government, which are between 20 and 60 times lower than market values observed in the vibrant secondary market, incurring tremendous revenue shortfalls for those municipalities (Paulais, 2012).

Over the last 20 years, many large cities in developing countries have made efforts to increase the frequency and accuracy of their property valuations, which, together with other improvements, have resulted in large revenue increases. India provides a good example for this, where Ahmadabad Municipal Corporation has been widely recognized for its innovative property tax reforms, in particular for establishing an effective market-based valuation system. Many other metropolitan areas such as Mumbai and Delhi have followed suit (Karnik, Rath & Sharma, 2004). Intermediary cities however have not yet followed this trend to the same extent. This is mainly due to the substantive up-front cost for such reform: In particular, more accurate value-based appraisal methods require large investments in technical capacity and information acquisition, which many intermediary cities cannot afford without external assistance. Furthermore, the paucity of professional valuers and the predominance of informal, intransparent property markets in intermediary cities, especially in Asia and Africa, also contribute to the inadequacy of the valuation systems. Here property markets oftentimes are largely dominated by wealthy families, cartels and other opaque structures, which deliberately try to keep their transactions “off the books”. A common practice here for example is the preparation of multiple contracts with different sale prices, to underreport the cost of the property transfer. This practice also incurs huge losses in property transfer taxes.

The administration and enforcement of property taxes in intermediary cities of the developing world often suffers from lack of manpower and streamlined processes supported by adequate IT software to improve the efficiency, transparency and taxpayer convenience of local taxation. Again, reforming this aspect of local property taxation implies considerable up-front costs which many intermediary cities alone are not willing or able to shoulder. A comparative study (Jibao & Prichard, 2013) of property tax reform in the capital (Freetown) and three intermediary cities (Bo, Makeni, and Kenema) in Sierra Leone showed that external support in form of technical and financial development partner assistance was crucial in developing the reform strategy and securing the necessary funding. The reform resulted in substantive revenue increases, albeit from very low levels and to varying degrees. Not surprisingly, the city with the most systematic and robust reform implementation, Bo, registered the highest revenue gains (Jibao & Prichard, 2013).

The comparative study of Sierra Leone, also demonstrates that besides technical and financial shortcomings related to tax administration, other issues such as corruption and extensive tax evasion on the part of the tax payers are an important contributor to the poor performance of property taxation in many intermediary cities. Effective property taxation often faces tremendous resistance from large property owners with close ties to local decision makers (Jibao & Prichard, 2013). The resulting reform inertia can sometimes only be broken up by progressive higher-level leadership that can override entrenched local interests to impose the reform agenda. Intermediary cities tend to attract less attention and hence support from national

governments which might explain why their local elites frequently continue to be able to block local tax reform against the efforts of reform-minded majors.

In summary, many intermediary cities, in developing countries, have tremendous untapped financial resources that they could capitalize on by improving practices related to property tax and property transfer tax administration and collection. Here, it must be acknowledged that the main obstacles to implementing such improvements are not only technical but also political, as oftentimes, large land owners with intimate relations to local officials stall such reforms for personal gains.

### ***9. Capturing value from urban land development***

Another land related revenue source for urban governments is land development payments such as betterment levies, developer contributions, infrastructure head works and development charges, or air space rights. They serve to capture value increases from public infrastructure development, thus re-mutualizing some of the private benefit of the positive externality of public investment. They make most sense in fast growing environments and are commonly used to finance public infrastructure projects. Different forms of value capture are applied across Europe (Paulais, 2012) and the United States. In the UK for example, local governments can levy a so called *community infrastructure levy* on all new building projects to be paid by the developer, which is charged in quickly expanding, both large and intermediary cities alike (Walters, 2012). In Poland, local authorities are allowed to impose so called *adjacency levies* on landowners, taxing the increase of property values due to infrastructure improvements such as roads, water supply, electricity, telecommunications, etc. (Peterson, 2009)

In developing countries, the use of such mechanisms is not very well established. This is mainly due to the fact that an effective application of most of these instruments requires fairly high institutional capacity to determine value increments. Still, examples can be found in Brazil, Colombia, Peru, Argentina and India (Walters, 2012). Here, the application of value capturing mechanisms is mostly limited to metropolitan areas however. Sao Paulo, Brazil for example, uses the sale of development rights to finance infrastructure investments. Developers are charged a fee for additional floor space that raises the density beyond the maximum threshold (Peterson, 2009). One of the best documented examples of betterment levies is the case of Bogota, Colombia, which levies a *contribución de valorización*, raising substantive amounts of revenue for the city's infrastructure development (24 % of total income of Bogota in 1993) (Borrero, 2011; World Bank, 2013). Here, charging a city wide fee instead of estimating a levy specific to each parcel constituted a helpful administrative simplification. However, other administrative challenges have led Medellin, Colombia, and Lima, Peru, to discontinue the use of betterment levies (World Bank, 2013). In light of this, it is not surprising that betterment levies and other value capturing mechanisms still find limited use in most developing country intermediary cities.



## ***10. Local public assets***

Local public assets such as land, infrastructure, buildings, publicly owned enterprises etc., are a crucial source of urban finance. Local governments generate revenue through renting, leasing or selling their assets, or they can use them as collateral to access credit. In most large and intermediary cities in Europe and North America, local governments make these assets work for them effectively. This however does not preclude cases of mismanagement or short-sighted decisions to avert financial squeeze. The city of Gera in Germany for example sold part of its municipal electricity company to a French energy corporation. Based on the contractual agreement, profits were to be shared while losses were to be absorbed by the city alone. This compounded into an unsustainable situation for Gera: In 2014 the city became subject to budgetary supervision, and the municipal utility company went bankrupt (Kogel, 2014).

In developing countries, the record of intermediary cities regarding the use of their public assets is somewhat mixed. While some have found effective ways of realizing the value of their assets, others manifest substantive shortfalls in this area. This is not as much due to a lack of assets but rather to their poor management. Hence, many intermediary cities in the developing world are "asset rich but cash poor" (Roberts, 2014). The reason for this lies in their lack of capacity to conduct proper asset management, including the recording, valuation and depreciation of public assets. Developing this capacity however is essential in view of the fact that their physical assets are often the only way for these intermediary cities to raise sufficient capital outlays for large scale infrastructure investments.

In the majority of intermediary city cases, rents and leases constitute only a fairly small share of city revenues. In Gothenburg, Sweden they only represented 3 % of all city receipts in 2014, while in Peterborough, Canada or Matlosana, South Africa this share was as low as 0.5 % (in 2010 and 2012/13 respectively). However, in some cases, they can take a much more substantive role, such as in Ethiopia or China, where, due to the all land being under public ownership, land leasing is an important source of municipal revenue (Peterson, 2006; World Bank, 2013). The cities of Adigrat, Mekele, Gondar and Bahir Dar in Ethiopia for example generate 21.5 %, 24.2 %, 42.3 % and 45.3 % of their total revenue respectively from land leases (Peterson, 2006).

The sale of local public assets, such as land, infrastructure or public enterprises seems like a fairly simple way to gain financial resources. However, to make the transactions viable for both seller and buyer, certain institutional mechanisms need to be in place that protect property ownership, determine value and sale prices of public assets and handle potential disputes (World Bank, 2013), as well as prevent excessive land speculation or land grabbing (Paulais, 2012). In countries where the legal and institutional framework conditions are not present, metropolitan areas as well as intermediary cities find it difficult to effectively manage the privatization of their assets. Furthermore, in the absence of functioning formal land markets and robust local public asset and financial management systems, such as is the case in many intermediary cities in the developing world, there is a substantive risk of municipalities selling their assets far below market prices. Selling public assets via auction can circumvent this issue,

provided that it attracts a sufficient number of potential buyers with equal access to the auction (Peterson, 2007 & 2009). Especially in fast growing, economically dynamic intermediary cities, this can yield large amounts of revenues. In some intermediary cities in Nigeria or India for example, land values are comparable to land values in metropolitan cities like London or New York (Roberts & Hohmann, 2014).

### ***11. Fees and user charges***

Local fees and user charges are a widespread source of local revenue, common in both developed and developing countries. Fees and user charges show a clear tax-benefit-link and, tend to be fairly simple to collect, at least when non-payers can be excluded from using the service that they are supposed to be charged for. The extent to which fees and user charges contribute a substantive share of revenue however varies considerably across intermediary cities. As table 3 shows, cities like Freiburg, Leipzig, Lucena City or Cucuta collect only small shares of their own revenue, between 0.2 % and 4.9%, from fees and user charges. For other cities like Peterborough, Canada, user charges constitute around one third of their own revenues, and for the South African cities Matlosana and Polokwane, this share is as high as 68.5% and 64.2% respectively. These large differences in the shares of fees and user charges between different intermediary cities can at least partly be explained by the range of services the cities directly charge for. While in countries like Germany or Sweden, many ‘free’ local services are financed by local taxes, Anglo-Saxon countries such as the UK or Canada tend to rely more heavily on the user-pays principle. Furthermore, many intermediary cities have outsourced certain services, such as water, electricity or public transportation to external service providers, who then become the beneficiaries of the fees and user charges paid by the consumers of the services.

This great variation in the importance of fees and user charges for the local government budgets also obscures a more problematic issue with levying these revenue sources that many intermediary cities in the developing world are struggling with. Due to their generally poor financial and asset management capacities, these intermediary cities often lack the ability to properly manage the services they provide. This includes costing the services, assessing and billing for their usage and collecting the respective fees or charges. Instead, fees and user charges are often set too low using inadequate approximations and are collected arbitrarily. On the side of the service users, poor payment morale, often aggravated by inadequate service standards, tends to lower receipts even further. As a result these cities have great difficulty retrieving at least some of the real cost for public service provision through the fees or user charges they impose. In many cases, this leads to a situation, where public utilities make tremendous losses and require an unsustainable amount of subsidization to be kept going. This has been the case for example in Emalaheni, South Africa, where the city has been unable to ensure adequate provision of drinking water. As a result, the local mining company has set up a water purification plant selling clean water to the city as well as to individual users (SACN, 2014).

Unsustainable public service provision is particularly salient in those intermediary cities with large shares of poor people who are unable to shoulder steep increases in user charges for necessary services, or access public services such as water or electricity through illegal connections thus evading payment all together. While privatization has been widely advocated as an effective remedy to such scenarios, the generally weak regulatory and supervisory capacities of intermediary city governments have resulted in the failure of many privatization arrangements.

## ***12. Public-Private-Partnerships***

Public-Private-Partnerships (PPPs) have been promoted as way for local governments to improve efficiency in service provision and to overcome capital constraints (CDIA, 2010; World Bank, 2013; World Bank Institute & PPIAF, 2012). This might sound particularly attractive for intermediary cities as many of them suffer from severe infrastructure pressures while lacking access to the necessary funding. Indeed, an increasing number of intermediary cities in OECD countries like Manchester, UK or Wiesbaden, Germany opt for PPP models to finance municipal investment projects. Nevertheless, many intermediary cities, mainly but not only in developing countries still lack the capacity to properly structure and manage and evaluate such partnerships. In particular risk assessments and cost estimations can pose a serious challenge to inexperienced city managers and often result in over-commitment on their part (World Bank, 2013). Such problems are of course not exclusive to intermediary cities. Early adopters of PPP models such as Seoul or Buenos Aires had to sustain substantive losses due to poorly managed PPPs (World Bank Institute & PPIAF, 2012). The weaker position of intermediary city governments compared to metropolitan city governments or central governments however can explain why not many successful PPPs with intermediary cities can be found.

Intermediary cities often not only lack the technical and managerial ability but also the bargaining power to negotiate a partnership with the private sector that keeps everyone's interests in view. Their bargaining power is often diminished due to their lack of feasible alternatives. Even a well managed procurement procedure will not help if there are not enough bidders to create real competition. By playing the take-it-or-leave-it card, especially larger companies can exploit this situation and shift the risk bearing to the city. Even when a reasonable deal has been struck, intermediary cities are often not able to hold their private partners accountable for meeting their obligations. The city of Cochabamba, Bolivia privatized its water supply system awarding a concession over 40 years to a private consortium. Once the consortium held the concession, it raised the rates beyond what local households could afford resulting in massive protests against the private provider, who ended up withdrawing from the contract (World Bank, 2013).

Another obstacle for intermediary cities to successfully engage in PPPs is that infrastructure projects in partnership with intermediary cities, in particular the less dynamic ones with lower

economic and urban growth projections, are often not attractive enough for private companies to get involved. PPPs should entail a reasonable expectation for yielding a profit. If this is not the case, private partners will shy away from such investments. For this reason, many intermediary cities in developing countries struggle to get the private sector interested in such partnership arrangements.

One somewhat different type of PPP, namely partnership arrangements with citizen groups controlling large amounts of remittance monies through migrant hometown associations (HTAs), has started to play a non-trivial role in some countries in Asia and Latin America, and in particular in intermediary cities (Orozco, 2008; Orozco & Rouse, 2013; Roberts, 2014; Roberts & Hohmann, 2014). Remittances not only constitute a large source of capital formation for private investment, they are also increasingly used to co-finance public investments in infrastructure and services (Iskander, 2010; Orozco & Rouse, 2013). Of all Philippino remitters working in Hong Kong, 63 % contribute to HTAs, as do 88 % of all Indonesian remitters working in Malaysia (Orozco & Rouse, 2013). Considering that in such partnerships the focus of interest lies in the welfare of the community by improving the provision of public goods and services such as clinics, classrooms or parks (Orozco & Rouse, 2013) rather than in making a profit, it should be easier for intermediary cities and their partners to identify suitable projects. In Mexico for example, 80 % of HTA's coordinate their activities with municipal leaders (Orozco & Rouse, 2013).

### ***13. Borrowing***

In developed countries both large and intermediary cities routinely borrow financial resources mostly to finance capital investments but to a lesser extent also to smoothen their cash flow, or ensure a balanced budget. They do so by taking loans from financial intermediaries such as commercial banks or specialized financial institutions, or by issuing bonds directly on the capital market. In most European countries, local governments can access credit through specialized municipal finance institutions, which, backed by subsidies and central government guarantees, can offer favorable lending terms to their local government customers (Paulais, 2012). Furthermore, countries like the USA, Canada, Belgium, Finland, Sweden, France and Spain have established bond banks that facilitate local government access to bond markets (Kaganova, 2011; World Bank, 2013). Such institutions, together with strong regulatory frameworks that determine and monitor the rules and procedures for local government lending, including debt ceilings and utilization, typically help local governments manage their debt and reduce their risk for insolvency (World Bank, 2013).

In contrast, the record of intermediary city borrowing in the developing world is moderate at best. In many developing countries, with the exception of some of the least developed in Africa and Asia, local government borrowing is permitted in principle (Smoke, 2013). In practice however, this possibility has been largely underexploited, mainly due to severe administrative obstacles, or poorly developed financial markets. In some countries, like Egypt, Ghana or Uganda for example, local governments are rarely found to take on debt. In other countries, such as Indonesia, Mexico, Colombia, South Africa or the Philippines, local government

borrowing is more common (Smoke, 2013). In many cases however, borrowing is much more prevalent among urban governments with a clear bias towards large agglomerations. In Brazil for example, the three metropolitan cities Sao Paulo, Rio de Janeiro and Salvador account for about 75 % of total local borrowing (de Mello, 2007). In South Africa, only 26 of the 283 municipalities took out loans in 2008, among which were all large cities and metropolitan areas (Smoke, 2013). Hence, intermediary cities in these countries are still lagging behind when it comes to borrowing capital for infrastructure investments, mainly due to their lack of creditworthiness.

Besides administrative and regulatory restrictions and the immaturity of national financial markets, poor creditworthiness of local governments often constitutes the major obstacle to intermediary city borrowing. Poor creditworthiness often has multiple sources including weak financial management practices, lack of transparency regarding the fiscal situation, lack of collateral due to inadequate asset management, insufficient revenue yields from taxes or user charges, and limited reserves. One way to bypass poor creditworthiness of local governments is to provide lenders with guarantees, e.g. from central government in case of local government default. However, if these guarantees are given without appropriate regulation or incentivization enticing local governments to honor their obligations, this might lead to severe problems including widespread local government insolvency and even macroeconomic instability, as it was widely observed in Latin America of the 1990s (World Bank, 2013). Such scenarios can be avoided when intermediary city creditworthiness is improved through robust frameworks for propagating fiscal discipline, efficiency and transparency. In Colombia for example, a simple traffic-light rating indicates local government borrowing capacity measured by a combination of liquidity and solvency indicators (World Bank, 2013). This is not only a transparent way of signaling creditworthiness to potential creditors but also constitutes an incentive for local governments to improve their fiscal discipline.

In cases where financial markets are not well developed, or local governments are not in the position to access them, central governments have devised various governmental or quasi-governmental mechanisms, such as specialized financial intermediaries that help smaller and intermediary cities gain access to credit, such as municipal development funds, bond banks or resource pools. In Colombia, for example, *Financiera de Desarrollo Territorial* (FINDETER) was established as a quasi-public financial institution that functions as a second-tier lender to commercial banks increasing their willingness to lend to local governments (World Bank, 2013). In India, the federal government created the *Pooled Finance Development Fund* to help smaller local governments such as intermediary cities pool their resources in order to jointly access credit. The guidelines of the fund also provide clear fiscal and financial standards that local governments must meet in order to gain access to credit markets (World Bank 2011 & 2013).

#### ***14. Climate financing***

One innovative way for intermediary cities to access external funding, is through climate financing. Here, based on the Kyoto Protocol, local governments can gain revenue from the sale of reductions in green house gas emissions, so called ‘carbon credits’, on the national or international carbon markets. Carbon credits can be earned from the implementation of local government projects that reduce the emission of greenhouse gases. The city of Salta in Argentina, for example sells carbon credits that it earns from reducing greenhouse gas emissions by capturing and burning methane gas from its landfill. In Moldova, 13 municipal governments earn revenue from selling carbon credits for insulating and improving the heating system of public buildings. This also increases the energy efficiency of these buildings and lowers the cost for heat production (World Bank, 2009). Such emission reducing projects can not only serve as revenue generation mechanism, they can also be used to leverage finance for upfront investment from creditors or investors. The problem with this financing mechanism is that it is not very well understood by many intermediary city governments and requires a certain level of technical and institutional capacity. It does however constitute a viable financing option for many intermediary cities to complement other revenue sources while reducing their carbon footprint.

#### ***15. The role of ODA***

Financial support from Official Development Aid (ODA) obviously plays a role only in developing countries. Cases of intermediary cities in these countries gaining direct access to ODA appear rather uncommon. Most aid funding comes from bi- or multi-lateral donors that routinely conclude cooperation agreements with national governments rather than city governments. In the cases where funds have been granted directly to city governments, recipient cities were mostly capital cities or metropolitan areas such as Cairo or Jakarta. Intermediary cities primarily benefit from ODA through local government support programs or different sector support programs, where conditions are negotiated at the national level and intermediary cities have relatively little influence on them (Smoke, 2013). This also means that intermediary cities have only limited knowledge and experience of working directly with development partner agencies (Roberts, 2014), although the latter continue to play an important role in the financing of infrastructure and other capital investments in the developing world, in particular in Africa (Paulais, 2012).

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<sup>a</sup> 2012 financial data taken from *City of Saskatoon 2013 Annual Report*

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<sup>b</sup> 2011 financial data taken from *2011 Financial Report Corporation of the City of Peterborough*

<http://www.peterborough.ca/Assets/City+Assets/Finance/Documents/Financial+Reports/2011+Consolidated+Financial+Report.pdf>

<sup>c</sup> 2012 financial data taken from *Haushaltsplan 2013/2014 der Stadt Freiburg*

[https://www.freiburg.de/pb/site/Freiburg/get/761131/Doppelhaushalt%202013\\_2014.pdf](https://www.freiburg.de/pb/site/Freiburg/get/761131/Doppelhaushalt%202013_2014.pdf)

<sup>d</sup> 2012 financial data taken from *Haushaltsplan 2014 der Stadt Leipzig – Band 2*

<http://www.leipzig.de/buergerservice-und-verwaltung/stadtverwaltung/haushalt-und-finanzen/>

<sup>e</sup> 2012/13 financial data taken from *Statement of Accounts Bristol City Council for the Year Ended March 31 2013*

<https://www.bristol.gov.uk/documents/20182/33624/BCC%20Statement%20of%20Accounts%20Master%2030%20September%202013.pdf/c574f888-81bd-4d5b-80b5-8849d47e9e49>

<sup>f</sup> 2012/13 financial data taken from *Aberdeen City Council Statement of Accounts for the Period 1 April 2013 to 31 March 2014*

<http://www.aberdeencity.gov.uk/nmsruntime/saveasdialog.asp?IID=60394&sID=936>

<sup>g</sup> 2012/13 financial data taken from *City of Polokwane 2012/13 Draft Annual Report*

[http://www.polokwane.gov.za/userfiles/1/2012\\_2013\\_annual\\_report.pdf](http://www.polokwane.gov.za/userfiles/1/2012_2013_annual_report.pdf)

<sup>h</sup> 2012/13 financial data taken from *City of Matlosana Annual Report 2013/14*

<http://mfma.treasury.gov.za/Documents/06.%20Annual%20Reports/2013-14/02.%20Local%20municipalities/NW403%20City%20Of%20Matlosana/NW403%20Matlosana%20Annual%20Report%202013-14.pdf>

<sup>i</sup> 2007 financial data extrapolated from information provided in Jibao, S., Prichard, W. (2013): *Rebuilding Local Government Finance After Conflict: The Political Economy of Property Tax Reform in Post-Conflict Sierra Leone. ICTD Working Paper 12*, International Centre for Tax and Development, Institute of Development Studies, University of Sussex.

<sup>j</sup> 2011 financial data taken from Murana A.O. (2015): *Local Government Finance in Nigeria: A Case Study of Iwo Local Government Area of Osun State. International Journal of Politics and Good Governance*, 6(1).

<sup>k</sup> 2008 financial data obtained from the Ministry of Finance of the Republic of Indonesia.

<sup>l</sup> 2013 financial data taken from General Santos City *Statement of Receipts and Expenditures 4<sup>th</sup> Quarter 2013*

<http://www.gensantos.gov.ph/>

<sup>m</sup> 2013 financial data taken from *Statement of Receipts and Expenditures Fiscal Year 2014 Lucena City*

<http://www.lucenacity.gov.ph/reports2014.php>

<sup>n</sup> 2013 financial data taken from *Informe de Gestión Vigencia 2014 Contraloría Municipal de Cúcuta*

<http://contraloria-cucuta-nortedesantander.gov.co/apc-aa-files/34373731333163633834613734343730/informe-gestin-2014.pdf>

<sup>o</sup> 2012 financial data taken from *Municipio de Montería Cierre 2012 - Informe sobre Viabilidad Fiscal de las Capitales*

<http://www.minhacienda.gov.co/portal/page/portal/HomeMinhacienda/asistenciaentidadesterritoriales/Cordoba/ViabilidadFiscal/MUNICIPIO%20DE%20MONTER%CDA.pdf>

<sup>p</sup> 2013 financial data taken from *Meu Município*

<http://www.meumunicipio.org.br/meumunicipio/municipio/355030?from=home>