Municipal finance:
Research summary

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Context

African cities require infrastructure and services to be liveable and sustainable spaces. These factors are also key to productivity, as public infrastructure is a crucial determinant of attracting investment to cities. Such investment provides employment opportunities, which is especially critical for the growing youth populations. It also underpins the structural transformation process that has, in other regions of the world, enabled cities to become engines for economic growth and development.

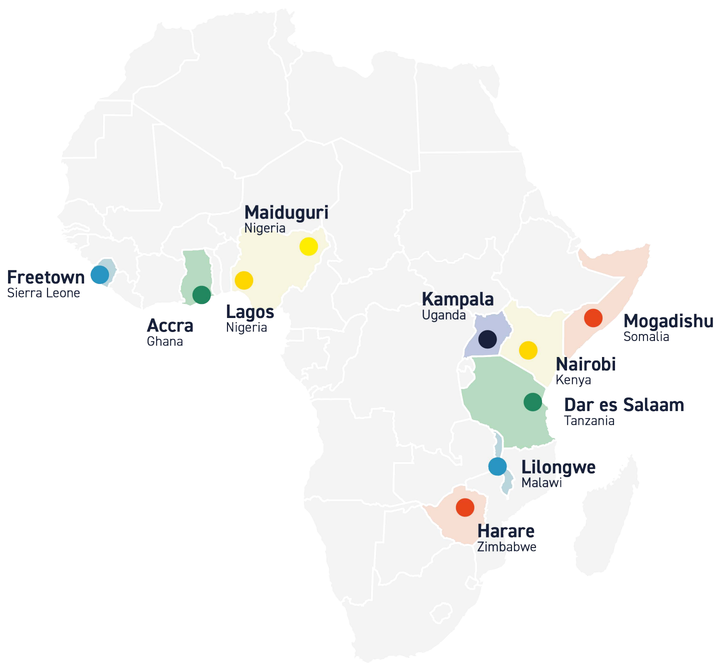
Both financing and funding are needed for cities to provide urban infrastructure and services. Financing, namely upfront capital investment, is required to build new and replace old infrastructure. Funding is used to pay for ongoing costs of operation and maintenance and to cover the repayment of finance if capital investments have been done through borrowing. How financing and funding happens will differ between cities and depends on the local legislative, institutional and economic environment, amongst other factors. Hence, every city will need to work out how it can allocate its financial resources most efficiently and equitably so as to achieve its respective policy goals and investment priorities.

Methods

This research draws out the findings on municipal financing across ten of the cities the African Cities Research Consortium (ACRC) has worked with, in an attempt to highlight general trends and lessons. Specifically, it draws on the ten "city of systems" reports prepared for these cities, as well as on seven cross-city domain reports: land and connectivity; informal settlements; youth and capability development; safety and security; housing; structural transformation; and health, wellbeing and nutrition.

Further research was conducted into the municipal finance systems of the five focus cities that were selected for the second stage of the ACRC project: Accra, Harare, Kampala, Lagos and Nairobi.

This analysis provides a brief overview of how functional responsibilities are assigned in cities and then reflects on the three key components of municipal finance, namely, expenditures, revenues and borrowing and how these manifest in the cities within ACRC's research remit.



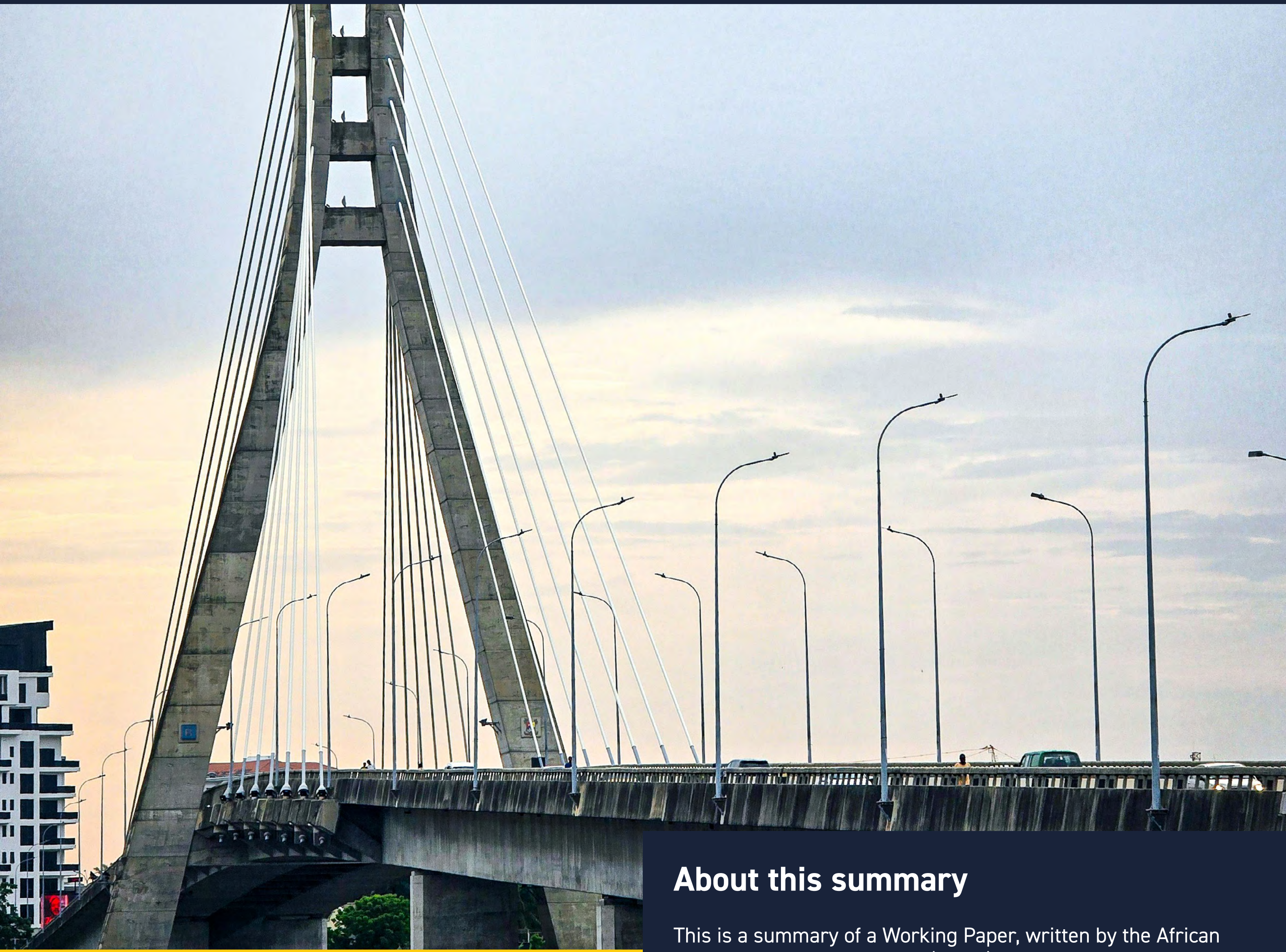
The assignment of functions to different levels of government is key in determining their respective expenditure responsibilities. The principle of subsidiarity states that public services should be delivered by the most localised level of government that can feasibly manage them. The functional responsibilities of a city government, or of the local government entity(ies) governing the city, are usually codified in the national legal framework of a country. In some countries they are enshrined in the constitution, while in others, they may be laid out in a local government act, or scattered across various pieces of sectoral legislation. What the assignment of expenditure responsibilities to each level of government looks like depends heavily on the degree and type of decentralisation within a country. Gaps or ambiguities can result in poor coordination or invite struggles over competencies.

Key findings

> **Expenditure assignments to city governments in ACRC cities tend to remain fairly limited, leaving an important role for central governments to play in urban service provision.** The review of the different expenditure assignments for urban service delivery shows that most city governments have exclusive responsibility for only a few services, including streetlighting or waste management. Exceptions here are cities like Nairobi that have a more extensive expenditure assignment. Many functions, such as health, education or water and sanitation tend to be shared functions between the central and city governments, where cities usually focus on implementation, often spending funds provided by central government for more or less specific purposes. Some expenditure responsibilities, such as for housing or transport, are found to be predominantly assumed by central government, even though their implementation happens at the city level, but without the involvement of the city government. Despite these general trends, variations between cities and countries can be quite considerable, as each context is uniquely defined by the nature, degree and maturity of decentralisation prevailing in the country.

> **Intergovernmental fiscal transfers tend to be the most important source of revenue for the majority of cities across Africa, including most ACRC cities, although some cities have been making progress with regards to local revenue mobilisation.** While intergovernmental fiscal transfers provide essential funding and financing to allow cities to meet at least some of their infrastructure and service delivery responsibilities, conditionalities restricting the use of these resources can limit the cities' ability to allocate them based on their priority needs. To reduce dependence on these transfers and to increase their revenues, many cities, including Freetown and Kampala, have been working on improving their own-source revenue mobilisation, particularly around property taxes. While some noticeable progress has been made here, in particular by leveraging digital reforms, important political and administrative challenges still need to be overcome.

> **Municipal borrowing is increasingly being explored as a way to finance urgently needed capital investments, but considerable hurdles remain.** To date, only very few African cities have overcome the legislative, political and capacity-related constraints that are preventing cities from accessing long-term debt financing from capital markets. These are some of the same constraints that are also impacting cities' ability to tap into climate finance, which is provided mostly in the form of loans. While most African cities still have a long way to go to become credible borrowers, central governments should support them on this journey by providing an enabling environment while safeguarding against the risks.



Implications for urban reform

A lot of city infrastructure and services are public goods that enhance urban liveability, boost the productivity of residents and firms and contribute to the overall sustainability and resilience of urban areas. Given these significant benefits and the rapid rates of urbanisation, African governments must not only substantially increase funding and financing for cities but also ensure that these resources effectively reach the local level, enabling cities to more efficiently fulfil their mandates.

The current shortcomings in the quantity, quality and distribution of urban services and infrastructure are also key factors in driving much of the discontent and distrust of government among city residents. Reforming the municipal finance system will enhance the provision of these essential services, strengthening the social contract with citizens. This, in turn, can create a positive cycle, encouraging better tax compliance, greater revenues and, if invested properly, can further expand and maintain infrastructure and services. leading to inclusive and sustainable urban growth and development.

About this summary

This is a summary of a Working Paper, written by the African Cities Research Consortium (ACRC) municipal finance crosscutting theme team: Astrid RN Haas and Gundula Löffler.

Read the full paper

Photo information (by order of appearance): 1. Women using a community water pump in Tafara informal settlement, Harare - Chris Jordan; 2. A construction site in Freetown - Random Institute / Unsplash; 3. The Lekki-Ikoyi Link Bridge in Lagos - Tunde Buremo / Unsplash.

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