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Municipal finance: Crosscutting report

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Abstract

Financial resources are key to providing urban services and infrastructure and fostering inclusive and sustainable urban growth and development. This paper synthesises the insights and learnings on municipal finance from ACRC research across ten cities and seven urban development domains. The focus cities are Accra, Dar es Salaam, Freetown, Harare, Kampala, Lagos, Lilongwe, Maiduguri, Mogadishu and Nairobi. The domains are land and connectivity; informal settlements; youth and capability development; safety and security; housing; structural transformation; and health, wellbeing and nutrition. In particular, the paper examines the functional assignment of different sector responsibilities, and the expenditures related to them. It also explores the sources of funding and financing necessary to realise the expenditures under a city's remit, namely the different types of revenues, including intergovernmental fiscal transfers, own-source revenues and development finance, as well as borrowing. The research shows that in the majority of ACRC cities, most functional responsibilities for urban services and infrastructure are either the responsibility of the central government or they constitute shared functions, where city governments tend to focus on implementation, with financing provided by the centre. In terms of revenue, most city governments depend on grants from central government, although there have been recent attempts at strengthening own-source revenue mobilisation. Municipal borrowing is still more the exception than the norm, despite increasing pressures for infrastructure investments.

Keywords: Municipal finance, African cities, functional responsibilities, expenditures, revenues, borrowing

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1. Introduction

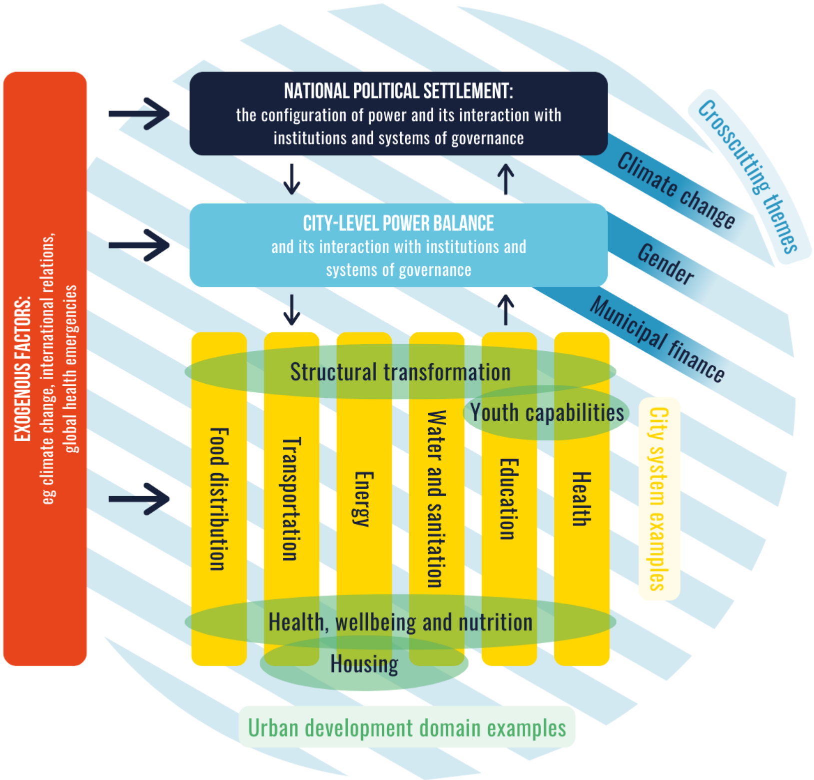
Cities require infrastructure and services to be liveable and sustainable spaces. These factors are also key to productivity, as public infrastructure is a crucial determinant of attracting investment to cities. Such investment provides employment opportunities, which is especially critical for the growing 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.

This paper draws out the findings on municipal financing from ten of the cities[1] the African Cities Research Consortium (ACRC) has worked with, in an attempt to highlight general trends and lessons. It draws on the ten "city of systems" reports prepared for these cities, as well as on seven[2] cross-city domain reports and further research that was conducted into the financial systems of the five[3] focus cities that were selected for the second stage of the ACRC project.

1 The ten city systems reports included are: Accra, Dar es Salaam, Freetown, Harare, Kampala, Lagos, Lilongwe, Maiduguri, Mogadishu and Nairobi.
2 The seven cross-city domain reports included are: land and connectivity; informal settlements; youth and capability development; safety and security; housing; structural transformation; and health, wellbeing and nutrition.
3 The five focus cities are: Accra, Harare, Kampala, Lagos and Nairobi.

Figure 1: ACRC's conceptual framework



This analysis starts with a brief overview of how functional responsibilities are assigned in cities. The following three sections reflect the most important components of municipal finance, namely expenditures, revenues, and borrowing with the following summarised findings:

- **Expenditure:** Which level of government is responsible for different sector expenditures will, in general, depend on the extent and type of decentralisation within a country. While city governments, based on the principle of subsidiarity, should be responsible for spending on those infrastructure and services that have a local remit and impact, such as streetlighting, waste collection or local roads, this is not always the case.
- **Revenues:** For most cities across Africa, including the majority of ACRC cities, intergovernmental fiscal transfers are the most important source of revenue. To reduce the dependence on these transfers and to increase revenue collection, many cities, including Freetown and Kampala, have been focusing on improving own-source revenue collection, particularly around property taxes.
- **Borrowing:** Legislative, creditworthiness and political constraints are the major reasons that African cities, with the exception of South Africa, have not yet managed to substantially undertake long-term borrowing from capital markets. It is also one reason impacting their ability to tap into climate finance, which is provided mostly in the form of loans.

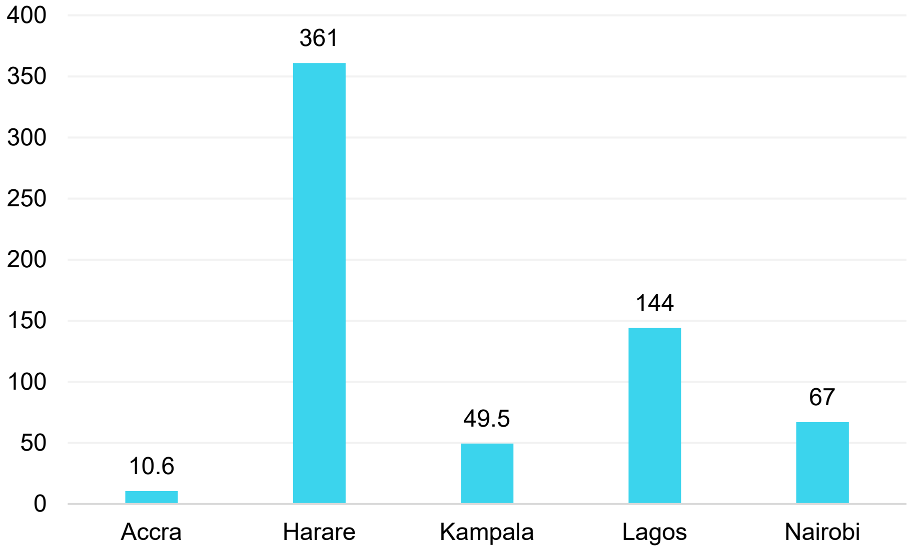
2. Functional responsibilities

The primary functions of public finance are commonly recognised as stabilising the economy, achieving a desired income distribution, and efficiently allocating resources. Efficient resource allocation involves assigning expenditure or service delivery responsibilities – sometimes referred to as functional assignment – to the level of government best suited to handle them. This is supported by the principle of subsidiarity, which states that public services should be delivered by the most localised level of government that can feasibly manage them. The expenditure 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, such as Kenya, 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.

While some expenditure functions are managed only by one level of government (for example, defence is typically an exclusively national government function, while streetlighting is commonly the sole responsibility of local governments), many are in fact shared functions between the local and the central governments, meaning that both levels of government are responsible for providing different parts of the function. In health service delivery, for example, local governments might be responsible for operating local health centres, including hiring and managing staff, while the central government might be responsible for procuring and distributing medicines for those health centres. While, in principle, the sharing of functions between levels of government can make a lot of sense in certain cases, as a way to maximise efficiency in service delivery by reaping economies of scale or mitigating externalities, it can be quite challenging in practice. One challenge can result from an unclear or ambiguous assignment of responsibilities between different levels of government. This is observed fairly frequently, often resulting from underlying political economy issues, such as struggles over competences. But even in cases where respective responsibilities are clearly defined, weak coordination between levels of government sometimes results in poor service delivery outcomes. Another important issue to keep in mind is that in some cases, central or local governments might deliberately deny the provision of public services to informal areas within a city, due to concerns that doing so might be considered a de facto acceptance of those settlements giving their residents a legal basis for claiming their right to remain.

The assignment of expenditure responsibilities to different levels of government depends on the degree and type of decentralisation within a country. In some countries such as Kenya or Nigeria, subnational governments, including Nairobi and Lagos, have extensive political, administrative and fiscal autonomy and self-governing powers. In others, such as Ghana, Tanzania or Uganda, the powers of cities like Accra, Dar es Salaam or Kampala are more restricted, each of them in their own way. Ghana, for example, has only limited political autonomy, with its local governments being led by mayors appointed by the president. In Uganda, local government fiscal autonomy is curtailed by grant conditionalities and the capital city Kampala is not even its own local government but is managed by the Kampala Capital City Authority (KCCA) under the Ministry of Kampala and Metropolitan Affairs. These varying degrees of decentralisation also determine the functions that cities are responsible for. However, it is important to note that the level of decentralisation defined by law often differs from actual practice. This may be due to capacity limitations or political factors.

Figure 2: Municipal budget per capita FY 2023/24 in USD (ACRC cities)[4]



The following sections will highlight key sectors within ACRC research and provide an overview of which government level is responsible for service provision and how these services are financed in the selected cities. These differences in functional responsibilities contribute to the significantly varied per capita spending figures in cities, as shown in Figure 2.

3. Expenditures: What is money spent on in African cities and by whom?

In general, national governments tend to retain those functional areas of spending that involve redistribution across jurisdictions, considerable externalities and spillover effects, and where the government aims to achieve national policy objectives. This can include some or all aspects of housing, education or health. In other contexts, these functions can be partially or fully devolved to local governments, including cities. In most cases, city governments will be responsible for functions with a distinct local impact, including waste collection, streetlighting or the management of local markets. The exact distribution of functions, and therefore required expenditure by cities, will

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4 It should be noted that it is difficult to get detailed, accurate and publicly accessible up-to-date budget data for the city. This is frequently highlighted by the auditor general, which in its 2020 report noted that even the mandated national audit could not be carried out in the city, as the financial accounts were not available. Furthermore, some of the bank accounts the city uses are not recorded in the overall Ministry of Finance systems. In response to the audit report, the city council noted that it was in the process of developing standard operating procedures for public financial management.

differ across countries and sometimes even across different types of local government, with cities holding relatively more responsibilities compared to rural localities. However, as noted, the assignments stipulated in law are frequently not followed in practice because, ultimately, expenditure assignments tend to be political. For example, in Ghana, according to the 1993 Local Government Act, 86 functions, in sectors including health, education, water, sanitation, drainage and electricity, should be carried out by metropolitan, municipal and district assemblies (MMDAs) (OECD/UCLG, 2022). However, many of these functions are yet to be devolved.

3.1. Education, health and food

National government spending tends to include social services, which are important drivers of how youth and other, particularly marginalised, groups within cities experience citizenship. This spending includes education, where an important policy shift across Africa has been towards universal primary education achieved through the general removal of fees. This is the prevailing policy in Sierra Leone, for example, and therefore also impacts schools in Freetown. Providing universal access while, at the same time, ensuring certain standards of educational attainment, requires significant financing and funding. Therefore, this is usually managed by national government budgets together with development finance from donors, as in the case of Sierra Leone and Uganda.

Uganda adopted universal primary education in 1997, and the central government provides conditional transfers to local governments, including Kampala, primarily to cover teachers' salaries, with a small portion allocated to enhancing school infrastructure. Cities are responsible for managing the provision. However, given the rapid rise in population through urbanisation, without commensurate increases in tax intake, financing such universal policies is becoming difficult for many city governments. Education systems are becoming strained, which is reflected in falling educational outcomes measured across various dimensions. Furthermore, in the case of both Freetown and Kampala, although there is universal primary education, and thus fees have officially been eliminated, there are still several hidden costs. These informal requirements for student contributions are essentially making up for a shortfall in the education budget. The costs may also result in the exclusion of the most marginalised populations from the education system.

Like education, health is another sector where functions tend to be shared between central and local governments, including cities, although the lion's share of the financing and funding often comes from the national government, including through intergovernmental transfers. In the case of Nairobi, however, health services are funded by several sources of revenue at both the county and the national level. These are supplemented by other funding, including from development partners, as well as the National Health Insurance Fund. While these various funding sources ensure greater reliability of funding flows overall, total funding for the sector is still not sufficient, and it is therefore estimated that households contribute more than half of the total expenditure on health in Nairobi (Nairobi City County Taskforce, 2023).

Sectors that entail redistribution also tend to be directly financed by national government. This includes, for example, food subsidies, which can play a particularly important role for people living in urban areas, who are more likely to be dependent on food imports and therefore vulnerable to international price hikes, as experienced especially by residents of informal urban areas in DRC, Sierra Leone and Uganda. However, some local governments are now developing more targeted, local food subsidies aimed at specific vulnerable groups to improve health outcomes. A prominent example is the governor of Nairobi's school feeding programme across public schools in Nairobi County (Nairobi City County, 2023b). As a result of this programme, eligible students receive one school meal per day, for which their parents contribute a nominal amount, and the remaining costs are subsidised by the county government, together with international donor organisations.

3.2. Transport

Large transport infrastructure is another sector where expenditure tends to be managed at a national level. This is due to the overall positive spillover effects from having a large transport network that connect many parts of a country. Furthermore, for transport networks to be effective in enhancing connectivity between where people live and where they work, in most cities there will be a need to cross multiple administrative jurisdictions. Exceptions may include urban roads and in some cases the city may be responsible for financing its own public transport systems.

In the African cities considered in this analysis, however, some of the largest transport investments are being financed by external partners, including bilateral donors and financiers, as well as multilateral development finance institutions. In Kampala, for example, all the major road networks in recent years have been financed through loans from the World Bank (World Bank, 2022) and the African Development Bank (AfDB, 2019), administered via the Ministry of Finance.

Similarly, in Nairobi, the more traditional development partners, including the African Development Bank (AfDB), Japan International Corporation Agency (JICA) and the World Bank, provided significant infrastructure financing for roads and the transport sector, including for the forthcoming bus rapid transit system (Klopp, 2012). However, in Nairobi, there is now also significant involvement of emerging bilateral development partners, particularly China. In fact, the Kenyan transport ministry is one of the main recipients of Chinese infrastructure finance in Africa (Owino, 2022). This has included loans for investments such as the USD 162 million Nairobi Western Bypass Road (KENHA, 2021). Much of this finance is provided in the form of loans to the national government, which is also the responsible implementing entity for these projects. There has also been the establishment of various public–private partnerships (PPPs) – for example, the Nairobi Expressway, which is the most expensive road ever built in Kenya (Aloo, 2022). Another emerging bilateral partner in the transport sector for many African cities is Turkey, which, for example, is responsible for financing and managing much of the airport and port infrastructure in Mogadishu (Barigaba, 2024).

3.3. Security and waste collection

As noted, the level of government responsible for expenditures should be determined by what can most effectively and efficiently be carried out at that level. For cities, this tends to include the provision of local public goods, such as streetlighting and waste management. Streetlighting constitutes critical urban infrastructure for improving safety and security in cities by providing better visibility at night and reducing the opportunity for crime. It is a service that is often particularly valued by women, as it allows them to extend their hours of activity outside their homes into the late evenings, such as visiting communal water points or toilets, or attending to their market stalls. Despite these important benefits, many low-income and informal areas within African cities remain dark at night.

Waste management is another important service usually under the remit of city governments. However, here it has been difficult to establish sustainable financing models and so the sector generally remains critically underfinanced. In addition, this sector is not always prioritised within a city's budget. In Kampala, for example, in 2016, the city spent USD 1.53 million per month to remove only 30% of the total waste generated (Agiresaasi, 2016). It further spent approximately USD 2.6 million annually in unblocking drainage channels from plastic waste and other debris (Agiresaasi, 2016). However, this is far from the allocations needed to be able to carry out waste management effectively, which according to the World Bank could comprise anywhere from 20% to 50% of a city's budget (World Bank, 2019). Due to this shortfall in funding, many neighbourhoods in African cities are not serviced by city waste collectors, resulting in residents organising their own waste management or hiring private collection services. In Freetown, the mayor has turned to external partners, namely the Global Cities Fund for Inclusive Pandemic Response, to access funding for waste collection services in informal settlements (Freetown City Council, 2021).

3.4. Water and sanitation

Water and sanitation are sectors that may be assigned to either the national level or the city level or, in some cases, it may be a shared responsibility between different levels of government. In all cases, it is a sector that is increasingly difficult to finance and therefore is often reliant on external sources of funding. Even with this additional funding, public provision is usually unable to reach all urban residents, many of which remain underserved. For example, in Freetown, sanitation is financed directly by the central government, but funding remains limited, and it has been identified by the government as one of their most challenging areas to raise finance for (Sanitation and Water for All, 2019). In Kampala, the city also lacks sufficient funding to allocate to water, sanitation and hygiene programmes and is therefore reliant on donors and multilateral development banks in this sector (WASH Agenda for Change, 2020). At the same time, many residents of low-income or informal areas are unable afford even a basic supply of water, which is often provided by private vendors, who are filling the gaps in public water provision (Beard and Mitlin, 2021). In Mogadishu, the construction and expansion of water networks tend to be self-financed through diaspora investments coupled with limited development aid (Muchunu et al., 2023).

To provide an alternative avenue for financing city utilities and services, Nairobi County manages a variety of municipal corporations. One of these is the Nairobi County Water and Sanitation Corporation (NCWSC), which is tasked with revenue generation from its operations and issues charges based on a regulated tariff (NWSC, 2019). Asset management of the infrastructure used by the NSWSC, however, is still done by the national agency. This complex ownership and management structure has had implications for both service delivery and accountability to residents, as it is sometimes unclear who is responsible for which part of the system and therefore where to direct concerns to.

3.5. Housing and informal settlements

Housing is a function that is usually under the responsibility of the central government. City governments tend to be mostly responsible for levying and collecting local taxes related to property and land and ensuring that zoning and building regulations are enforced, rather than being directly involved in the financing or provision of an adequate affordable housing stock. This responsibility falls to other entities, primarily individuals providing their own housing and, increasingly, the private sector. Nowadays, national public housing programmes in Africa, in particular successful ones, are few and far between, but continue to exist in numerous countries, including Nigeria, Ghana, Ethiopia and Kenya. However, many of them have failed to learn from mistakes of earlier programmes and continue to be riddled with problems while not really being affordable for those most in need of housing support (UCLG, 2020). Furthermore, the policy shift towards relying more on “market-based solutions” has had the impact of further decreasing the stock of affordable housing across all cities: in many African countries, only the upper 5-10% of income groups can afford housing from the available formal stock (World Bank, 2015). The overall withdrawal of government from the housing sector has also shifted the discourse towards more market- and asset-based approaches, rather than a rights- and justice-based orientation (Rolnik, 2019).

For informal settlement upgrading, cities may be responsible for improvements in infrastructure and service provision, in particular water and electricity in specific areas. In these cases, the value of land and property within the settlements will increase. Without sufficient land value capture instruments in place, as noted, these increases in value are likely to be captured by local elites who own the land the settlements are on (Collier and Venables, 2018). Another concern is that increased land values resulting from improvements in infrastructure and service provision will result in higher housing prices, for renters. Therefore, it is important that in the context of expenditure on upgrading, there are countervailing measures put in place that ensure that the upgrading does not exacerbate poverty and inequality.

Overall, this review of the different functions for urban service delivery shows that there are very few services that are exclusively within the remit of city governments, such as streetlighting or waste management. Instead, most functions are either the responsibility of the central government, such as housing or transport, or they constitute shared functions, such as health, education or water and sanitation, where cities tend to focus on implementation. Of course, there are exceptions among the cities that were examined, such as Nairobi, which, due to Kenya’s devolution policy, has quite extensive functional responsibilities. However, even in cases where Africa cities have a fairly broad service delivery mandate, they are still quite heavily dependent on funding and financing from central government and development partners. This often comes with conditionalities attached, limiting the cities’ ability to spend the resources as they see fit.

4. Revenues

Cities generally have access to three main sources of revenues: intergovernmental fiscal transfers, own-source revenues and funds from external development partners (Farvacque-Vitkovic and Kopanyi, 2014). This section will outline each one of these in turn.

4.1. Intergovernmental fiscal transfers

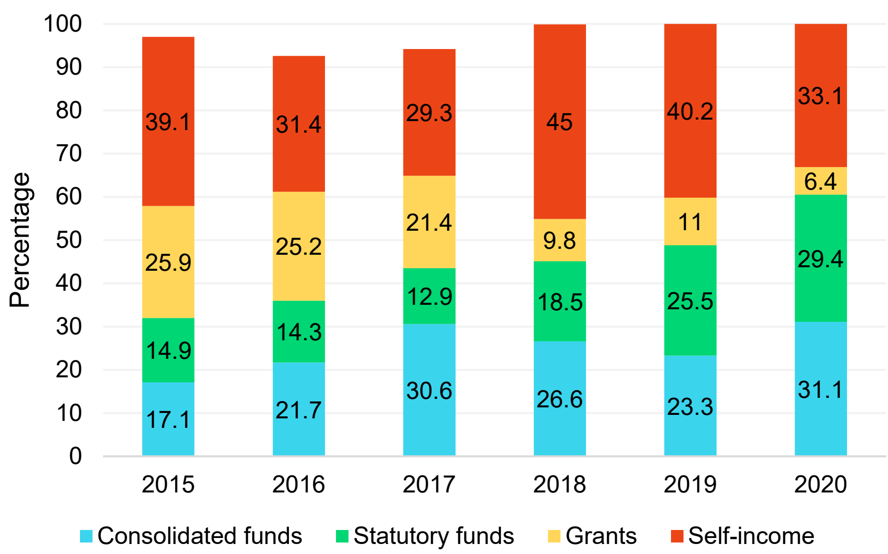
Intergovernmental fiscal transfers are grants from a higher-level government – that is, national, regional or state – that are intended for spending at the city level (Smoke, 2023). Virtually all local governments require such transfers in one form or another, in order to meet their expenditure needs, as higher-level governments, in particular central government, have the inherent advantage of collecting revenue in an efficient and effective manner (Oates, 1972; Brennan and Buchanan, 1980). These intergovernmental fiscal transfers can be structured in different ways: where they are unconditional, they can be spent on priorities determined by the cities themselves. However, in many cases, the higher-level government imposes conditions on how the funds are spent, or conditions the level of funding received based on pre-specified performance targets to be met by the city. For most cities across Africa, intergovernmental fiscal transfers are the most important source of revenue (OECD/UCLG, 2022). For example, although Kampala has the strongest own-source revenue collection compared to other cities and local governments across Uganda, it is still heavily reliant on central government transfers. They currently make up about 40% of KCCA’s total budget (Government of Uganda, 2023). In Nairobi, intergovernmental fiscal transfers made up about 66% of the city’s total budget in FY 2022/23 (Nairobi City County, 2023a). While many cities are making efforts to increase their own-source revenue, and some few are working on expanding their borrowing capacity, intergovernmental fiscal transfer will continue to play a substantial role in the financing of African cities in the foreseeable future (Boex, 2024). The key will be to design these grants in a way that allows them to meet their expenditure needs efficiently and effectively.

The distribution of transfers among cities and local governments is usually governed by law. This can either be overall guidance on how this should be done, or more specific criteria, including in some instances involving the apportionment using a formula. In Malawi, for example, central government transfers are managed by the National Local Government Finance Committee and calculated using a formula that is meant to ensure horizontal equity across the different district councils, including Lilongwe (NLGFC, 2022). The committee also earmarks a predetermined portion of the transfers for health and education.

In Uganda, general guidance on the allocations from the national government budget to districts, including Kampala, is found in principles enshrined in the Constitution (Parliament of Uganda, 1995). However, given the relatively tight national budget, coupled with the proliferation of districts in Uganda, the transfers from national government are getting smaller. In the most recent budget for FY 2023/24, for example, the Kampala Capital City Authority (KCCA) was only allocated about USD 68 million from the national government budget, less than 0.5% of the total national government budget, which came to USD 14.3 billion that same year (Government of Uganda, 2023). This is despite the fact that Kampala generates an estimated 40-60% of the country's GDP and the majority of the national revenue (World Bank, 2017a). This allocation is also significantly below what the city requires to implement its ten-year master plan, which is estimated to be up to USD 216 million annually (Parliament of Uganda, 2023).

Transfers that are based on formulas can consider the varying needs of different local governments. They can also be designed to ensure that the transfer system becomes redistributive. For example, in Ghana, the intergovernmental transfer system has been designed to provide for horizontal equity in terms of service delivery across local governments (Fuemy, 2018). Metropolitan, Municipal and District Assemblies (MMDAs) in Ghana receive transfers from the consolidated fund as well as various statutory funds (Figure 3). The main payments made from transfers out of the consolidated fund are for salaries of employees, while those from the statutory funds pay for infrastructure and services (Auditor General of Ghana, 2022).

Figure 3: Composition of Accra's revenue FY 2015-2020



Although ensuring horizontal equity through fiscal transfer design can be important to support the poorest regions in a country, it may also negatively impact cities. For example, in Kenya, one of the main aims of devolution, and of the transfer formula, was to make spending more redistributive across the country (Wamalwa et al., 2022). As a result, Nairobi, being the richest county in Kenya, receives one of the lowest per capita allocations. At the same time, its investment needs are growing exponentially.

As mentioned above, many intergovernmental grants come with some sort of conditionality attached. These do not need to be sector specific, they can also pertain to the type of spending that cities are allowed to make, either with those grants specifically, or, for highly grant-dependent cities, with their entire revenue. Many cities, for example, are required to use a certain minimum percentage of their revenue for capital investment, or a certain maximum percentage for salaries. For example, in Harare this should be a ratio of 70:30 for capital expenditure and operational expenditure. However, in 2018, 56.8% of the USD 145 million collected in revenues was directed to salaries (Auditor General of Zimbabwe, 2021). This relative overspending on operational expenses, particularly salaries, as opposed to investment expenditure, is a challenge across many African cities, which contributes to the underinvestment in infrastructure at a local level. In Kenya, counties are held to the same ratios. However, for cities like Nairobi, it is nearly impossible to adhere to this ratio, since one of its largest service functions is health and education provision, both which are mainly comprised of operational spending (Nairobi City County, 2023a).

In some countries, the intergovernmental transfer system is not yet fully developed or is still contested. This is the case, for example, in Somalia, where disputes over designing the overall structure of the intergovernmental fiscal system mean that there is currently no robust transfer mechanism in place from the federal government to the regions (Isak and Sheikh Ali, 2019). Furthermore, the regions collect their own customs revenues, which may often be higher than overall national tax revenue (Ministry of Finance Somalia, 2022). Mogadishu is, however, a special case in this context, as it is the only region where the federal government collects its own revenue (Isak and Sheikh Ali, 2019). To compensate the city for this, it allocates Mogadishu 15% of the revenue generated from customs duties. Furthermore, it also transfers some of the budget support received from the European Union, the World Bank and others.

4.2. Own-source revenues

Revenues that are within the city's direct remit to collect and to spend are comprised of both tax sources, such as property taxes, and non-tax sources, such as user fees, charges and fines. Of the cities under examination, Accra managed to collect 35% of its total revenue from own sources (in 2021), Kampala 24% (in 2018/19), Nairobi 34% (in 2022/23) and Lagos intended to collect 80% (in 2023/24).[5] Although own-source revenues usually make up a relatively smaller percentage of budgets for African cities,

5 Lagos constitutes an outlier here, as it is technically a state government that has access to personal income tax as one of its main own revenue sources.

strengthening their collection has been a focus of several recent reform programmes. This is not only to increase overall revenues for cities but, importantly, to lessen their dependence on intergovernmental fiscal transfers that may be highly earmarked or unpredictable over time.

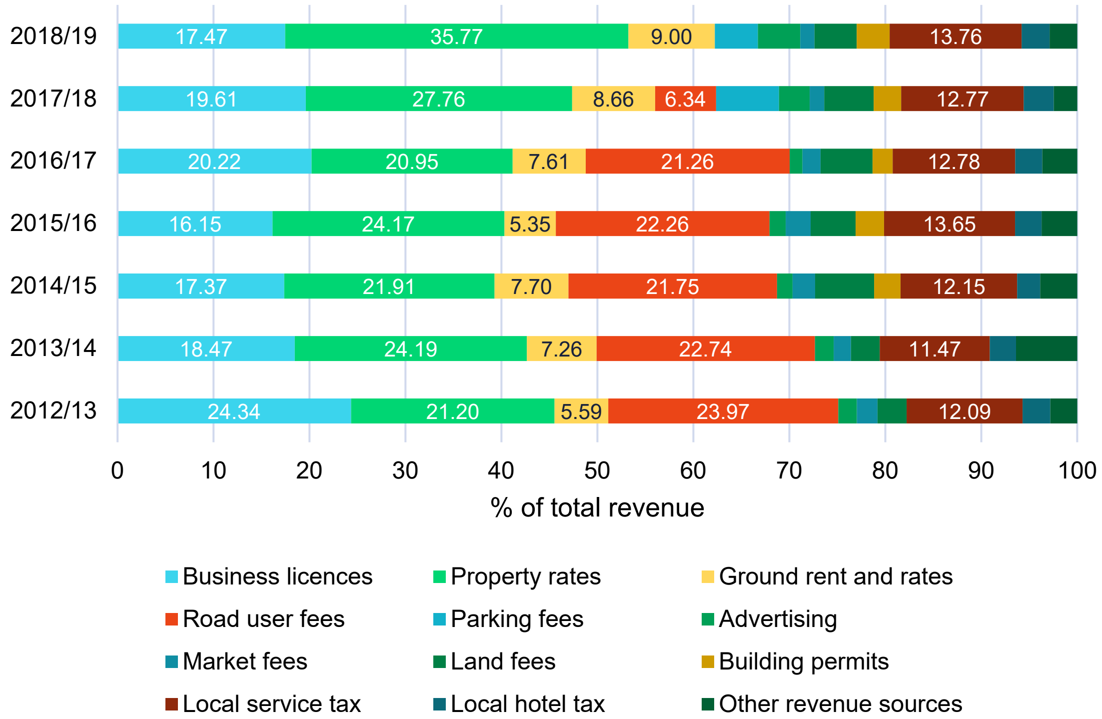
Kampala has 24 sources of revenue that it can collect and, as shown in Table 1 and Figure 4, the composition of own-source revenue between the different taxes and fees has shifted over time (KCCA, 2019). Perhaps most notably, there have been substantial increases in property taxes, which has driven the overall total increase in own-source revenue. Road user fees that were an important source of revenue for the KCCA were suspended by the president in 2017 but reinstated in 2021 (The Independent, 2021). Other sources of own-source revenue have remained relatively stable.

Table 1: Kampala own-source revenue FY 2012/13-2018/19

Millions of UGX	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Business licences	13,558	12,931	13,994	13,540	19,008	16,735	15,815
Property rates	11,810	16,931	17,647	20,265	19,696	23,682	32,393
Ground rent and rates	3,113	5,084	6,205	4,483	7,152	7,386	8,152
Road user fees	13,352	15,920	17,516	18,660	19,984	5,409	
Parking fees						5,590	4,054
Advertising	1,080	1,373	1,298	1,408	1,248	2,737	3,993
Market fees	1,192	1,260	1,888	2,187	1,763	1,293	1,351
Land fees	1,691	2,095	4,952	3,927	5,093	4,389	3,985
Building permits			2,227	2,483	1,973	2,455	3,108
Local service tax	6,732	8,027	9,783	11,442	12,011	10,894	12,456
Local hotel tax	1,610	1,915	1,931	2,330	2,646	2,666	2,642
Other revenue sources*	1,563	4,462	3,109	3,103	3,421	2,085	2,598
Total	**55,701**	**69,998**	**80,550**	**83,828**	**93,995**	**85,321**	**90,547**

*Other revenue sources include migration permits, yellow fever vaccination fees, public convenience, agency/tender fees, penalties, fines, community-based organisation registration fees, public health examination fees and other miscellaneous income.

Figure 4: Evolution of KCCA own-source revenue (FY 2012/13–2018/19)



In Harare, the city's main revenue streams include property tax and sewer, water and refuse charges (Parliament of Zimbabwe, 2019). In Mogadishu, the municipality only collects the relatively smaller revenues, such as permits, licences and market levies, given, as previously noted, the federal government is responsible for collecting other sources of revenue (Mohammed, 2017). In contrast, in Lilongwe, own-source revenues include fees and service charges (including for building permits), business licences and property rates (Delbridge et al., 2021a). Given the paucity of transfers in Malawi, these sources can make up 50-60% of the budget for urban councils, including Lilongwe.

Local tax revenues

Most cities can charge some form of local taxes. In federal countries like Nigeria, the federal entities tend to have more substantial taxation powers. Lagos State, for example, can levy 12 taxes, including personal income tax and capital gains tax. One of the main challenges that cities face in terms of taxation is mobilising revenue collection without stifling economic activity in the city. In Lagos, for example, the state government, under then Governor Tinubu (1999-2007), unsuccessfully lobbied the federal government to increase its share of transfers. In the absence of additional federal revenue, the state government embarked on an aggressive local revenue collection drive. Whilst it showed success in terms of increasing revenue through reforming its land-use charge and a consolidation of its various property-related taxes, its increased focus on taxing formal businesses initially negatively impacted economic activity in the state (de Gramont, 2015).

Across most African cities, however, a significant portion of the economic activity is happening outside the formal tax net as the informal sector accounts for up to 80% of job provision in some cities (Guven and Karlen, 2020). This is directly linked to the fact that Africa's urbanisation is not happening concurrently with industrialisation and this lack of structural transformation means that there are many small, informal sector firms that are not generating much profit, and therefore revenue for the state (Gollin et al., 2016). Cities still tax informal sector economic activity quite heavily, for example, through some sort of market fees, or day trading licences charged to market vendors. These levies are usually collected daily and on the spot from marketplaces provided and/or operated by the city. In addition to these official city taxes, informal sector businesses often also pay multiple fees to non-state entities, which collect informal taxes. Sometimes, this is even done by the same revenue collectors, who use the fact that they are perceived as holding government authority to pressure people into paying unsanctioned levies. In Harare, these so-called "invisible unofficial tax collectors" use extortion measures to collect transport rank and market stall charges (McGregor, 2013). In Mogadishu, where there are still contested systems of governance, tax collection also happens from various entities beyond formal state taxation (Abshir et al., 2020; Harper, 2020). These include traditional and religious authorities, as well as non-state actors. These overlapping forms of tax collection can lead to significant burdens for the local populations and businesses, which can be exacerbated by revenue mobilisation policies by the state, such as the national tax on mobile money transaction, which has created severe challenges for small traders (Omoegun and Gelb, 2023).

In Lagos and in other cities, those entities who manage to avoid official taxes tend to be the more powerful individuals and the larger firms that are more likely to have closer political connections to the elite (de Gramont, 2015). This not only reduces potential revenue for the city from those entities that would be more able to afford their tax liability, it also further increases the tax burden on smaller firms and poorer individuals. One sector that has been continuously impacted by this, across African cities, is market food vendors (Resnick, 2018). Although they play a critical role in terms of ensuring food security for cities, they face an insecure operating environment characterised by changing regulations and imposition of multiple market taxes and fees by city governments. These nuisance taxes have knock-on effects: if the burden of the tax is passed onto the consumer, it will raise prices for consumers. This will directly impact which market produce they can afford and may make healthier options, like fruit and vegetables, unaffordable, thus negatively influencing the uptake of healthy diets.

The actual process of collecting tax revenue also remains a significant challenge for many African city governments. This is both due to their lack of administrative capacity to collect revenues, as well as challenges that are more of a political nature – for example, from unofficial land sales leading to the loss of revenue from land transfer fees, as well as the subsequent utility connection and refuse collection fees. In Harare, there have been major revenue losses due to non-collection; in 2018, the tax collection efficiency of the city was estimated to be only 67%, with only about 73% of those revenues that were said to be collected being reflected in the government budget (We Pay You Deliver Consortium, 2018).

Revenues can also be impacted by external events beyond a city's control. The most significant such event recently was the Covid-19 pandemic. In Kampala, for example, the lockdowns associated with the pandemic significantly hampered the city's revenue performance, resulting in an over 80% loss of revenue collection (The Independent, 2020). However, collection increased again post-pandemic, and in the first quarter of the fiscal year 2022/2023 revenue performance had reached pre-Covid levels (KCCA, 2022).

In an effort to raise their own-source revenues, many cities are undertaking administrative reforms that are often connected to the introduction of digitisation and technology (Knebelmann, 2022). The reduction of reliance on manual systems is meant to improve revenue performance by both improving efficiency of collection as well as reducing opportunities for collusion and corruption. Kampala, for example, has adopted a so-called integrated revenue administration system (Andema and Haas, 2018). However, technology will only be as good as the underlying system it supports. In the case of Kampala, it still faces significant challenges characterised by frequent system breakdowns and therefore is not functioning as optimally as intended.

Land-based financing

In principle, a major source of revenue for African cities should come from land, as this tends to be a city's most important asset (Farvacque-Vitkovic and Kopanyi, 2014). This potential for revenue is premised on the fact that infrastructure investments made in land, improving its connectivity and utility, directly impact land value. Given that the government is usually the entity responsible for making these investments, it is deemed appropriate and fair that the incremental increase in land value on private land should be captured and reinvested further into public infrastructure and services (Germán and Bernstein, 2020). The instruments to capture these increases in value include land sales, leasing, betterment levies and others.

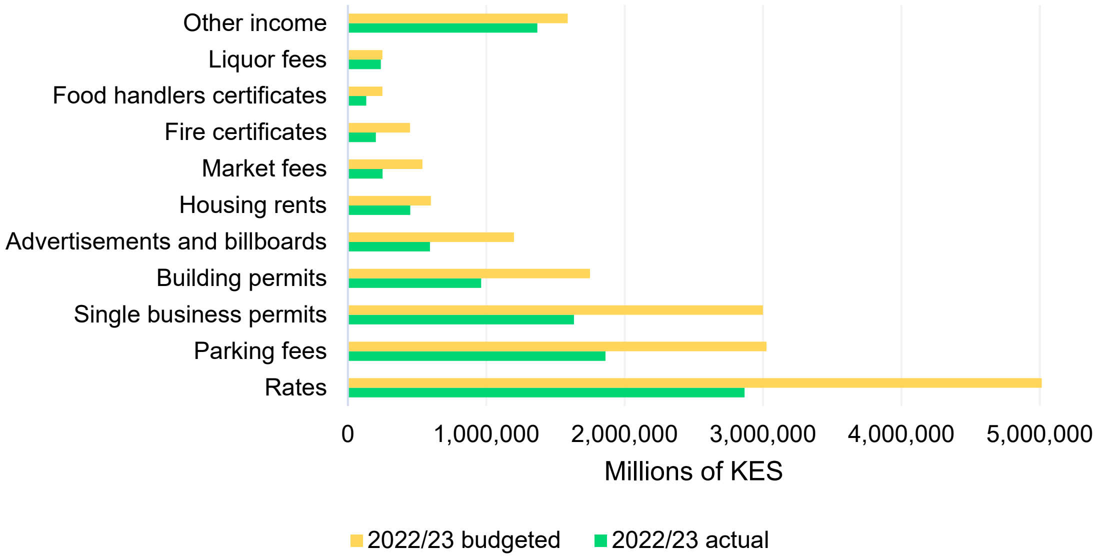
In practice, however, most African cities have not yet been able to unlock the potential of land-based financing (OECD/Lincoln Institute of Land Policy, 2022). In part, this is due to the complex dynamics of land tenure in African cities, related to customary ownership structures, coupled with weak formal land administration systems (Collord et al., 2021). In addition, the allocation and use of urban land is inherently political and deeply rooted in vested interests, leading to strong resistance to revenue generation from private landowners, particularly from the elite. As such, the often significant increases in land value that are seen in African cities are not being captured by the government. Instead, these windfall gains accrue to a relatively small group of non-state actors, such as brokers, making them very wealthy (Lawanson and Agunbiade, 2018; Steel et al., 2019; Goodfellow, 2022; Gillespie, 2020). These own-source revenue losses to the city are exacerbated by corruption as well as asymmetric information on land sales due to inadequate data that can be exploited by brokers, which across all the city studies is particularly rampant in the transfer of land.

One key form of land-based financing, the property tax, is gaining more prominence in many African cities (Franzsen and McCluskey, 2017). There are various methods of levying property tax that are employed across African cities. For example, in Accra, the tax is levied solely on the value of buildings. In contrast, in Maiduguri, the property tax is solely levied on the value of land, ignoring any improvements made. In Freetown, which has recently undergone one of the most comprehensive property tax reforms globally, the property tax is calculated through a points-based system that attempts to mimic the market value of property, albeit in a simplified way (Grieco et al., 2019; Prichard et al., 2020). This is to ensure a fairer system as well as one that remains transparent and thus comprehensible to taxpayers.

Kampala has a more complex system that is experimenting with computer-aided mass valuation to reflect market value more accurately (Manwaring and Regan, 2020). This came as a result of multiple concurrent reforms, starting in 2016, with funding from the World Bank. These reforms included implementing a street addressing system, which involved providing street names and property numbers to all the properties in Kampala and capturing their GIS coordinates in a digital database. This ensured that all properties could be easily identified, and new properties added to the register accordingly. In addition, they launched a computer aided mass valuation system (CAMV), which can estimate the value of a property through predictive models. The benefit of such a system is that it requires much less data collection, as the computer model is based on those data points most likely to predict the value of the property. Although there are still some challenges with implementing it, this form of valuation has made property tax revenue the third most important source of local revenue for the KCCA (see Table 1 and Figure 4). Furthermore, KCCA Revenue Directorate predicts that in the fiscal year 2023/24 at least 50% of their own-source revenue is now going to be generated by property tax.

In general, however, property tax is still significantly underperforming, as is the case in Nairobi (Figure 5). This is due to several factors, including that in many cities, most properties are not reflected in the tax roll. For example, in Lilongwe, a valuation is meant to take place every five years to update both the number of properties on the roll, as well as their value (Delbridge et al., 2021a). However, a full revaluation has not happened for several years, in part due to the cost of undertaking a comprehensive valuation exercise, which, as per the stipulations in law, has to be conducted by registered surveyors. With a shortage of registered surveyors in the country, undertaking valuation roll updates becomes unfeasible. In addition, there may also be political challenges with increasing rates, and this can lead to significant resistance by the city’s elites to updating the roll (Delbridge et al., 2021a).

Figure 5: Nairobi City budgeted vs actual own-source revenue FY 2022/23



Even where the properties may be reflected in the tax roll, the property tax may still underperform in terms of revenue generation, due to poor collection and political resistance (Fjeldstad et al., 2017). In Nairobi, in FY 2022/2023 only about 56% of the target property tax was collected (Nairobi City County, 2023a). Furthermore, in Harare, for example, between 2013 and 2017, 85,000 properties, representing over a third of all properties on the valuation roll, did not pay their taxes (World Bank, 2017b). This equates to approximately a USD 600 million loss in revenue for the city. In some cases, there may be a direct policy choice not to collect taxes from poorer properties on the roll. For example, in Kampala's case, the city government specifically targets its collection efforts to higher-value properties (Andema and Haas, 2018; Manwaring and Regan, 2020). This is both an economic decision to allocate the limited resources to where they may be able to collect the most revenue, but also a political one not to burden potential voters. In Freetown's recent property tax reform, the city's low-income residents were included in the valuation roll, even though many of them are not required to pay the tax (Grieco et al., 2019; Prichard, et al., 2020). However, some still opted to do so, as it provides a traceable administrative document that supports their claim to their property. In general, however, for the property tax to achieve its potential in these rapidly urbanising environments, further reforms need to be undertaken, particularly with respect to valuation and collection (Ali et al., 2017).

Non-tax revenues

User fees, tariffs, fines and other charges are non-tax own-source revenues that are usually within a city's remit to manage directly (Farvacque-Vitkovic and Kopanyi, 2014). User fees tend to be applied to infrastructure and services where it is possible to measure the extent of use as well as to exclude populations for non-payment. Across the cities in this analysis, local fees are applied to services such as waste collection or utility provision, particularly in water and sanitation.

As a principle, when it comes to setting the level of fees, it is important to maintain a balance between the need to generate sufficient revenues for operations and maintenance, and, at the same time, ensure affordability of services (Haas, 2020). In practice, however, this is difficult to achieve. In Lilongwe, for example, to improve access to quality water in some informal settlements, water kiosks were established (Dagdeviren and Simon, 2009). However, the prices that were set for the water were not affordable for most of the targeted population, who purchased a lower volume of the higher quality water than was anticipated by the initial tariff calculations. This had a knock-on effect, as it did not generate sufficient revenue to continue to operate and maintain the kiosks, which ultimately fell into disuse. The many analogous situations in other African cities are a key reason why large, networked utilities tend not to be extended to informal settlements, as the resident populations are not likely to be able to afford fees that would cover the costs of maintaining them (Ashraf et al., 2021; Mitlin and Walnycki, 2019).

4.3. Development finance

Development finance can come in various forms, from grants, which do not need to be repaid, to soft loans, which are a form of borrowing and will require repayment, albeit at concessional rates and conditions (Jackson, 2022). Although some of it may come directly to the city, where it does go through the municipal budget, both grants and loans will mostly be channelled via the national government and then transferred to the city through the intergovernmental transfer system. This is because development finance is usually provided on a national-government-to-national-government basis. In the case of loans, although they may be benefiting investments in the city, the responsibility for repayment usually sits with national government. For example, in Kampala, nearly 50% of the city’s budget in 2023/24 was funded by development partners, most notably the World Bank (Government of Uganda, 2023). Most of this money went into capital expenditures (road infrastructure). As such, 93% of the city’s capital budget in that fiscal year was externally financed.

In some cases, whilst development finance may be critical for service provision, it may completely bypass a government’s budget. This is where project spending is executed by development partners directly, but still reflects areas that are the city’s priorities. This is the case, for example in Freetown, where many projects under the current mayor’s flagship Transform Freetown agenda are financed and carried out directly by development partners, including foundations and international non-governmental organisations, rather than being funnelled through the city government’s budget (Freetown City Council, 2022).

5. Borrowing

In addition to revenue, some African cities may have, or work on gaining access to, borrowing as a source of financing, particularly for long-term infrastructure. This type of finance can be raised from a variety of different lenders. The principal and interest of what was borrowed will need to be repaid from revenue – either the city's general revenue or a specific revenue stream generated by the investment itself. Therefore, whatever is borrowed is not classified as revenue but rather as a liability on the city's balance sheet.

Where cities are allowed to borrow, which is not the case in all African countries, it is usually only to cover long-term capital expenditure, although there are exceptions, such as the Kenyan counties, including Nairobi, that are also allowed obtain short-term loans to smooth their cash flow (National Treasury of Kenya, 2012). In Nigeria, Lagos State has a long history of raising debt from domestic markets for infrastructure projects for the city (Haas et al., 2023). A few cities, like Harare, have been borrowing to finance both infrastructure but also recurrent expenditure. Although there are no specific figures for Harare, local government debt has been growing since 2013 and is becoming increasingly unstainable (OECD/UCLG, 2022).

For most African cities, however, direct long-term borrowing is not yet an option, for a number of reasons. One is legislative constraints – just because municipal borrowing is permitted in principle, does not mean that all related regulations and approval processes, or even basic local fiscal autonomy, are sufficiently well developed to make it practically feasible for cities to take on debt (Haas et al., 2023; Smoke, 2019; Gorelick, 2018). For example, although Ghana's Public Financial Management Act provides for local government domestic borrowing, no local government, including Accra, has undertaken any longer-term borrowing (OECD/UCLG 2022).

Another reason lies in the cities' lack of creditworthiness. Subpar PFM procedures, lack of transparency, and inadequate financial performance and other challenges result in them not being considered credible borrowers by potential investors and credit-rating agencies alike. However, even if a city performs well financially, its credit rating, and therefore its ability to borrow, will be impacted by the macroeconomic environment of the country, which is largely outside of the city's control (Haas et al., 2023; Löffler and Haas, 2023).

Furthermore, unlike national governments, cities do not have the instruments to hedge against exchange rate fluctuations. Hence, it is preferable for cities to borrow in local currency, given this is what most of their revenue will be generated in, as otherwise, a rapid depreciation of local currency, as in the case of Harare for example, might inhibit cities to repay their international debt, further constraining the provision of infrastructure and services. Yet the shallowness of local currency financial markets across many countries may mean that domestic finance for cities is not sufficiently available.

Although Dakar is not a city that ACRC is focusing on, it provides an important example of some of the political challenges associated with city borrowing. In 2015, Dakar was poised to be among the first African cities outside of South Africa to issue a municipal bond to attract long-term financing of a market, having completed all necessary preparations (Delbridge et al., 2021b). The bond intended to fund market infrastructure, was set to be launched. However, the night before the scheduled issuance, the national government intervened, asserting that the city had not secured all the required approvals, despite confirming it had done so previously. Although the intervention was on a legal basis, some viewed this intervention as a purely political manoeuvre, given the prospect of an opposition-led capital city achieving such financial autonomy (Delbridge et al., 2021b). This setback not only hindered Dakar's ability to issue a bond but also increased investor concerns about the political risks of directly engaging with cities across the continent.

Even where the city is borrowing locally, whilst the ability to raise debt is a clear advantage for the state, particularly in terms of financing its capital budget, one of the major challenges is the cost of servicing debt. In particular, the volatile macroeconomic conditions in Nigeria often lead to high inflation and stark currency depreciation of the Naira, which makes the debt more difficult to service, particularly if they are borrowing in local currency but expenditures are in foreign currency (Haas et al., 2023). In July 2023, Lagos' credit rating was downgraded to a "B-", reflecting the very high risk that the state may struggle to meet its debt obligations between 2023 and 2027.

In some cases, governments have put in place institutional structures to enhance the potential finance for cities. Such financial intermediaries can provide concessional loans (or a combination of loans and grants) to local governments who are unable to go to the financial markets to borrow (Smoke, 2022). One example is the Development Fund for Local Authorities (DFLA) in Malawi, which is a revolving fund from which local governments, including Lilongwe, can borrow to finance their projects (Löffler and Haas, 2023). However, due to the extremely low initial capitalisation, coupled with poor repayment rates, the DFLA has only awarded one or two loans annually since 2017, for an average value of USD 170,000, which is much too small to bridge the significant financing needs of growing cities like Lilongwe.

The constraints on city borrowing are also one of the major reasons that African cities have not yet managed to substantially tap into climate financing, as most of the climate financing is issued in the form of loans for mitigation activities. Furthermore, for African cities, financing is primarily required for adaptation, which, on a global scale, is underfinanced. More generally, the overall amount of climate finance available for Africa is very small: in 2019, from the total recorded USD 622 billion of climate flows, only 3% went to Africa. Furthermore, within Africa, this was then unequally distributed, with 40% reaching only five countries. An important part of this is a demand issue related to the fact that there is not a sufficient pipeline of prepared projects in this space to be able to attract climate finance (Haas et al., 2023).

The only city under analysis that is making strides towards accessing climate finance is Lagos. This is since, as a state government, it has the legal authority to issue government bonds and thus is now in the process of collating projects for a green bond, that it wants to issue over the coming year (FSD Africa, 2022). To date, the federal government in Nigeria has issued two sovereign green bonds for the equivalent of 25.69 billion Naira (FSD Africa, 2022). Although the sovereign bonds have not directly benefited Lagos, the state has benefited from a corporate green bond issuance in 2019, valued at 15 billion Naira, that financed infrastructure development in Lagos, including the construction of a flood defence for Victoria Island as well as an increased solar generation infrastructure for the wider metropolitan area. The state has now set up its own green bond programme with the aim of issuing a state-level bond in the coming years.

Although there need to be changes to the global climate finance architecture to make it more compatible with the needs of African cities (Buchner et al., 2021; Meattle et al., 2022), there is also still significant work required at the country and city levels, on both the legislative and administrative fronts. Advancements in those areas would contribute significantly to enabling many African cities to borrow more generally and access climate finance more specifically.

6. Conclusion

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.

This paper provides an overview of the insights and learnings on municipal financing from ACRC research conducted in ten African cities. In particular, it examines the functional assignment of different sector responsibilities, and the expenditures related to them. It also explores the sources of funding and financing necessary to realise the expenditures under a city's remit, namely the different types of revenues, including intergovernmental fiscal transfers, own-source revenues and development finance, as well as borrowing.

The review of the different functions 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 functional 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 functions, such as 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.

In terms of revenues, intergovernmental fiscal transfers tend to be the most important source of revenue for the majority of cities across Africa, including most ACRC cities. While these 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, important political and administrative challenges remain.

Municipal borrowing is increasingly being explored as a way to finance urgently needed capital investments, but 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.

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