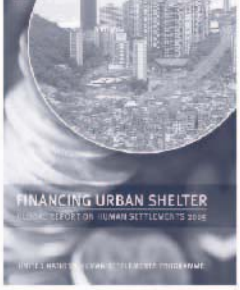


Embargoed until 12 Sept. 2005
GRHS/05/F8

LOCAL AUTHORITIES AND MUNICIPAL FINANCE

Financing for urban shelter cannot be separated from the overall process of financing for urban development. The last few decades have seen an increasing shift to decentralization and the raising of revenues by local authorities. A comparative analysis of global trends shows that there is a broadening of locally generated revenue; the strengthening of local financial management; partnerships in the financing of capital investments and an increase in the access to long-term credit by municipalities.

However, despite these encouraging signs, developing countries suffer from the lack of financial management skills at the local level. At the same time, most local budgets reflect immediate needs and political expediency rather than long-term urban planning or pro-poor investments. Most developing countries lack funding for maintaining existing assets. Thus, ‘preventive maintenance’ has to increasingly become ‘crisis management’. The undue importance laid on operating expenditures often leads to the deferment of expenditures on maintaining existing assets.

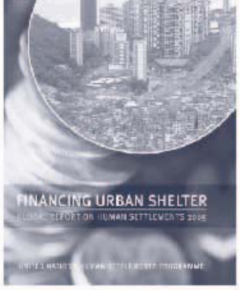
An interesting development has been the process of participatory budgeting which encourages accountability and transparency in municipal budgets and financial management, especially in the allocation of scarce local resources and their utilization.

However, the experience in many countries has shown that decentralization policies do not necessarily lead to responsible financial management, as demonstrated by budget deficits, accumulated debts and the inability to repay loans. Accountability for performance is a cornerstone of good governance and a major tool in financial management. It places as much emphasis upon transparency as upon financial management. Demands for greater accountability and transparency by voting and taxpaying constituencies have combined with the constraints on the financial resources available to the public sector to exert political pressures for improving municipal financial management. Indeed, increasingly, mayors, councils and city managers are held accountable for financial outcomes, as well as for the qualities of the services they deliver and the projects they implement. Reforms of existing systems and the introduction of newer concepts and techniques have provided useful alternatives in financing and operating public services.

In both developing and advanced economies, privatization has resulted in revenue-producing services, including water supply and solid waste management, being gradually taken over in the larger urban centres by specialized multinational firms serving many local government units. However, formal privatization in many cities has not benefited lower income communities, which underscores the need for the public sector to have a role in the delivery of essential services.

Decentralization and the privatization of services are facing a number of constraints in developing countries, as opposed to advanced and transitional economies. Developing economies have not been able to enact and implement successful decentralization policies that redistribute resources effectively. While privatization has forced governments to examine entrenched practices and to consider alternatives for their modification or replacement with considerable success, it is not a panacea.

The major challenges that must be addressed include the large numbers of smaller, financially weak municipalities; asymmetrical decentralization; retrenchment of central transfers; weakness of local revenue sources; lack of strong domestic capital markets; impediments to the development of municipal credit institutions; inadequate capacity and rules for sound financial management at the local level; lack of mechanisms to finance urban investments; and lack of funds for maintaining existing assets.



PARTICIPATORY BUDGETING, BRAZIL

The emergence and spread of participatory budgeting (PB) in Brazil is rooted in the legal mandate requiring popular participation in local decision-making. Municipalities introduced mechanisms ranging from the presentation of budget proposals for public comment to the actual involvement of residents in decision-making. Participatory budgeting was first instituted by the city of Porto Alegre in 1989 and gave the city international recognition as a leader in
popular democracy' in local governance.The concept has now been adopted by approximately 180 Brazilian municipalities and is spreading beyond Brazil in Latin America to cities in Argentina, Uruguay, Peru, Ecuador, Colombia, Bolivia, Mexico and Chile. More recently, cities in other parts of the world are adapting the process to their own situation.

PB allows residents to have a voice in the annual allocation of capital investments. It is based on the delegation of statutory executive powers regarding the preparation of the municipal budget and has to be initiated by the mayor. There is no similar delegation of authority from the legislative branch, and the city council remains the statutory authority approving the municipal budget.

The PB concept embodies four key features:
1 It ensures representation of residents in each sub-area within the jurisdiction in the decision-making process.
2 It requires municipal officials to report on what has been accomplished with the previous year's budget and to provide estimates of revenues and expenditures for the upcoming year in order to determine the budget envelope for capital investments.
3 It is structured to ensure transparency through direct popular participation and an open voting system.
4 It ensures objectivity through the use of quantitative criteria for the prioritization of funding requests and the allocation of resources.

Participatory budgeting is primarily an instrument of empowerment and social inclusion.
Source: Serageldin et al, 2003a,b.

TAMIL NADU URBAN DEVELOPMENT FUND (TNUDF), INDIA

The Tamil Nadu Urban Development Fund (TNUDF) has evolved from a municipal trust fund to one established and managed by the public and private sectors.The initial fund – the Municipal Urban Development Fund – was financed entirely by the public sector to reduce the massive backlog of infrastructure investment and improve the delivery of basic urban services. It was launched in 1988 with a concession loan from the International Development Association (IDA).

In 1996, with the aim of achieving managerial efficiency and attracting private capital for urban infrastructure, it was converted into an autonomous financial intermediary. Established as a trust fund with private equity participation, it was the first public–private partnership in India that provided long-term municipal financing for infrastructure without guarantees. Instead of merely channeling public funds, its purpose is to attract financing from the private sector. It also manages a separate grant fund owned by the state government to finance poverty alleviation projects.

The TNUDF is managed by a private corporation: Tamil Nadu Urban Infrastructure Financial Services Ltd. Financial institutions have committed to contribute an amount equal to 44 per cent of the initial contribution of the Tamil Nadu state government.The fund's management board comprises representatives from the state government and participating financial institutions. Borrowers are required to follow conservative financial management practices and to meet performance targets, including for debt service reserves and making appropriate sinking fund contributions.

The TNUDF's debt financing depends mainly upon the surpluses of the municipal borrowers, a situation similar to revolving funds in Europe and the US. The TNUDF is making an important contribution to capital investment needs for large, lumpy and non-revenue generating projects. For many small local governments that are unable to access the markets directly, the fund provides a pooling mechanism and indirect access to the market, together with enhanced credit. Such arrangements can be especially useful for sewerage projects that require substantial funds with repayment periods of 20 years or more. Despite these constraints, the fund is quite creative, launching new financial products to tap the capital market for special purposes, such as the Water and Sanitation Pooled Fund.
*Source:*World Bank, 2004d; Singh Maini, 2004; World Bank, 2003b; Freire et al, 2004. Research on this case was also undertaken by the Center for Urban Development Studies (CUDS) team member Shannon Bassett.

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