

Discussion Paper – July 23, 2018

Urban Economy & Municipal Finance in the Kingdom of Saudi Arabia: **Evidence from Buraydah and Dammam**



Saudi Reforms and Vision 2030

The geographic, cultural, social, demographic and economic advantages of the Kingdom of Saudi Arabia (KSA) have made KSA a key international player and economic world power. Historically, oil and gas have been the country's primary exports, but KSA has begun investing in other strategic sectors of the economy. This push towards economic diversification is supported by Saudi Arabia's Vision 2030, which was adopted as a development roadmap for in the Kingdom of Saudi Arabia. In its aim is to facilitate economic development in new industries and foster innovation and competitiveness in other sectors.

In order to build the institutional capacity and capabilities needed to achieve Vision 2030, the National Transformation Program 2020 (NTP) was launched. NTP utilizes innovative methods to identify challenges, seize opportunities, adopt effective planning tools, engage with the private sector, implement reforms, and evaluate performance.

The objective of the Saudi reforms proposed in the NTP is to support economic growth and diversification. The reforms are aimed at strengthening public finance, introducing new tax mechanisms, and attracting private investment into strategic economic sectors. One example of these reforms is the White Land Tax, introduced in 2015,

which aims to create a more stable, diversified, and sustainable public finance base. The White Land Tax requires owners of empty urban plots designated for residential or commercial use to pay an annual tax of 2.5 percent of the land value. The land tax is levied on 10,000 square meters of urban land. The tax has been adopted in the cities of Riyadh, Jeddah, and Dammam. In addition to improving the own-source revenue base of municipal governments, these reforms also support the New Urban Agenda (NUA) - a framework for sustainable urbanization.

To achieve the NUA, UN-Habitat developed three-pronged approach, which is designed around the three fundamentals of urban development: (1) planned city extension, (2) municipal finance, and (3) legal framework.¹ UN-Habitat and Saudi Arabia's Ministry of Municipal and Rural Affairs (MOMRA) jointly launched the Future Saudi Cities Programme (FSCP). FSCP is addressing urban sprawl and development in 17 municipalities in Saudi Arabia, two of which are Buraydah and Dammam. FSCP promotes KSA's Vision 2030 and provides a foundation strategic urban planning framework that follows international best practices.

This paper examines the urban economic components and municipal finance of Buraydah and Dammam and recommend alternative sources of revenue that will help the municipalities meet their goal of generating 40 percent of their revenue locally (as proposed in the NTP) by 2020.

¹ Salat and others (2017).

Urban Economy and Municipal Finance in Buraydah and Dammam

The city of Buraydah is the capital of the Al Qassim region. Buraydah is also the headquarters of the Governor, the Local Council, and regional branches of government departments. Dammam is the capital of Eastern Amanah and is governed as a municipality (a.k.a. Amanah) headed by a mayor.

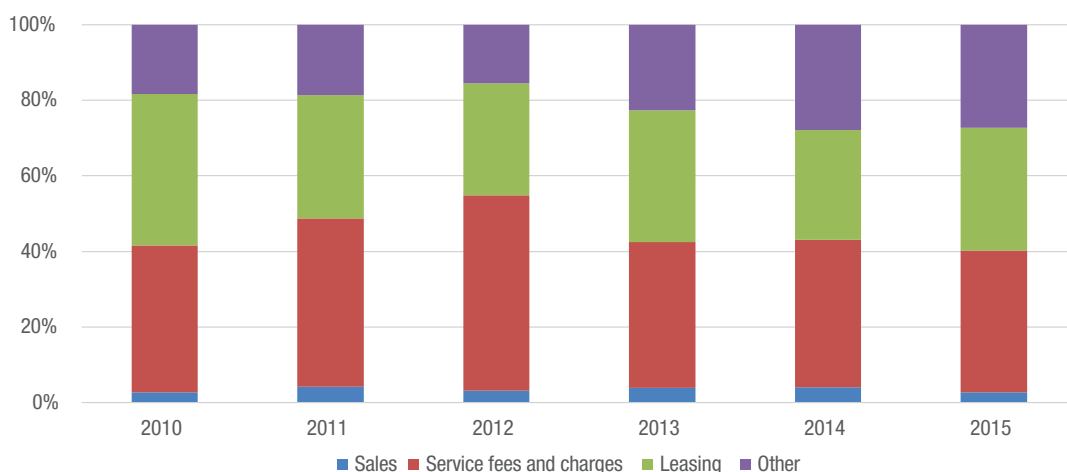
The central government finances a large share of the public services and infrastructure at the local level. Baladiyahs² prepare project proposals and submit them to municipal governments to prepare for the budget proposals. Municipalities send these proposals to MOMRA and the Ministry of Finance (MoF). The MoF allocates funds to ministries and agencies (e.g., emir, regional councils) taking into account additional factors such as population. Municipalities spend the amount received on the activities included in the line-item budget proposal.

MOMRA introduced new municipal fees to increase municipality's own sources of revenue. In 2016, Buraydah and Dammam generated 15 percent and 19 percent own-source revenue, respectively. Fines, leasing of government land, and advertisements are the primary contributors to own-source revenues in both cities.³ The difference between own-source revenue and the municipal budget is usually filled by intergovernmental transfers, leaving municipal governments heavily reliant on financial resources from the central government.

As shown in Figure 1, the Al Qassim Province Amanah (Buraydah) maintained relatively consistent levels of own-source revenues from sales, service fees and charges, leasing, and the miscellaneous sources (i.e. other).

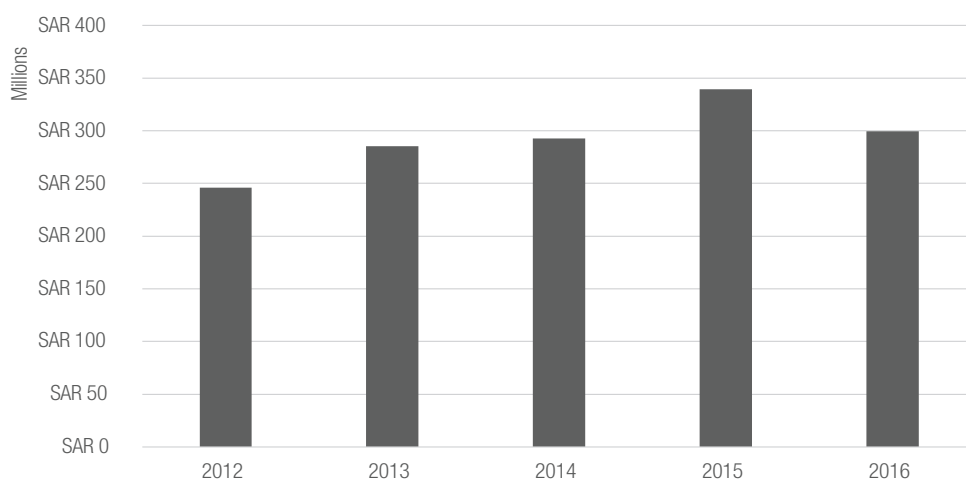
In the Eastern Province (Dammam), own-source revenues increased between 2012-2016 (see Figure 2), even with a marginal decline in revenue in 2016. Despite the general increasing trend in own-source revenue, municipalities continue to fall short of the NTP goal of 40 percent own-source revenue. To address this issue, UN-Habitat recommends introducing new tax policies and financing strategies.

Figure 1. Al Qassim Province (Buraydah) Own-Source Revenue by Source Category, 2010-2015



Source: Ministry of Finance, Saudi Arabia (2016).

Figure 2. Eastern Province (Dammam) Own-Source Revenue, 2012-2016



Source: Ministry of Finance, Saudi Arabia (2016).

² A Baladiyah, in Arabic, is a political subdivision equivalent to a city or municipality.

³ Data provided by the Ministry of Finance, Kingdom of Saudi Arabia.

Policy Recommendations

The government should explore alternative revenue sources for development activities that will reduce their dependence on central government financial support. Introducing new financing instruments at the municipal level promotes efficient and sustainable urban development by providing a stable and predictable revenue source that addresses current and expected expenditures.

Land-Based Financing Mechanisms

Buraydah and Dammam should consider land-based financing tools. Land-based financing fosters strategic and sustainable urban planning by promoting densification, reducing land speculation, and urban sprawl. Betterment levies are one land-based financing tool recommended by UN-Habitat. Betterment levies promote communal sharing of increased land values that arise from infrastructure development.

Infrastructure investments in public transportation and social infrastructure (for residential and/or commercial use) offer a unique opportunity to improve urban accessibility, increase density, and create opportunities for mixed land use. The projects proposed in Buraydah (transportation network) and Dammam (waterfront development) will

increase the surrounding property values.⁴ Beneficiaries would pay a one-time charge equivalent to the land value gains resulting from the public infrastructure project. This is an effective financing tool for the local governments that contributes to cost recovery for projects that require large capital investments.

New high-value infrastructure creates residential, commercial, and business development areas while creating job opportunities and improving public service provision. As shown in the case studies in Table 1, new infrastructure and infrastructure upgrades increase land values and generate positive community externalities.

Municipalities should ensure transparency, communication, and accountability in the proposal and implementation of betterment levies. By doing so, municipal governments can help build a broader public understanding of the concept, which will help local governments gain community support for betterment levies on certain public projects. In addition, local governments should analyze the costs and benefits of land-based financing (Table 2) tools, which will help public officials develop proactive solutions, anticipate potential issues and bottlenecks and seize opportunities. Table 2 shows some of the factors that local governments should consider when conducting their cost-benefit analyses for land-based financing tools.

Table 1. *The Impact of Infrastructure Development on Land Value*

Case Examples	Key Findings
London, England	The Crossrail Property Impact Study (2012) estimated that capital values in the areas around central London Crossrail stations would rise by 35 percent for residential properties and 27.5 percent for office properties; outperforming the baseline projections.
Dubai, United Arab Emirates	The impact of public transportation on property values for dwellings and commercial properties is about 13 percent and 76 percent, respectively, within an area of 1.5 km
United Arab Emirates Cairo, Egypt	Urban development that included retail facilities resulted in a price premium of 15 – 20 percent
	Schools increased residential land prices by approximately 13 percent
Bogotá, Colombia	Walkability within a residential community increases home values by up to 9 percent
	Research suggests that for every additional 5 minutes of walking time to a public transportation station, rental prices fell by 6.8 - 9.3 percent

Source: GVA (2018); Mohammad and others (2017); Colliers International (2017); Rodríguez and Targa (2004).

Table 2. *Factors in Land-Based Financing Cost-Benefit Analysis*

Benefits	Costs
Alignment of Saudi reforms with New Urban Agenda (4th pillar)	Effort to enable and support legal framework and local governance
Efficient and reliable source of local revenue	Different administrative functions and tasks involved
The incentive for efficient land development and mixed land use	Length of the start-up process
Increased density and economic agglomeration	Investment in diagnostic tools for land information, monitoring systems (e.g., fiscal cadastre), and data collection
Stimulate the development of specific infrastructure (e.g. public transport, educational and health and social infrastructure).	Effort needed to combine urban planning with infrastructure investments
Alternative investment incentives (e.g. PPPs).	Investment in capacity building and training
Increase in civic awareness and accountability	Investment into communication systems and civic participation

Source: Farvacque-Vitkovic and Kopanyi (2014); United Nations Human Settlements Programme (2016).

⁴Walters (2016). This instrument has “a long tradition of being implemented in Colombia” with the first implementations going back to the passage of Act 25 in 1921. Medellín was one of the first cities to use this funding instrument. It is estimated that more than 50 percent of Medellín’s main road grid was paid by betterment levies.



Public-Private Partnerships

Public-private partnerships (PPPs) are effective financing tools that facilitate public sector engagement with the private sector. PPPs bring in private sector expertise in the provision of high-quality public goods and services. In Buraydah, the primary industries in the agriculture, tourism, and manufacturing sectors would benefit from private sector collaboration with publicly funded services and infrastructure. Moreover, PPPs would help address the current gaps in the agriculture sector by facilitating innovation, improving marketing, and reducing coordination costs in intranational and international trade.

Saudi Arabia established the public-private partnership body, the National Centre for Privatization, housed in the Ministry of Economy and Planning. PPPs in Buraydah and Dammam aim to (1) increase land values through development projects; (2) increase local own-source revenues; (3) collaborate with the private sector on publicly funded projects and services; and (4) create an attractive environment for national and international investment.

City Prosperity Initiative

UN-Habitat introduced the City Prosperity Index (CPI), a new approach that redirects urbanization towards an urban future that is economically, politically, socially, and environmentally prosperous. CPI introduces a multidimensional framework that provides guidelines for measuring and leading local development monitoring performance. The six dimensions of CPI are productivity, infrastructure development, equity and social inclusion, environmental sustainability, and urban governance.

References

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Conclusion

The three-pronged approach is based on the fundamental principles behind sustainable urbanization: planned city extension, municipal finance, and legal framework. Land-based taxes provide a number of financing mechanisms that support urban development while simultaneously reinforcing and relying on strategic urban planning and strong legal frameworks.

The privatization of public infrastructure and the expansion and upgrading of public services, as proposed in the 2020 National Transformation Program, are creating opportunities for the private sector. Collaboration between the public and private sector through PPPs.

Betterment levies diversify local own-source revenue. For betterment levies to be effective there must be a proper register of properties around major public projects (fiscal cadaster). The levies must be used in a way that benefits not only the landowners but also the public, and this is a form of land value sharing.

Municipal governments with sustainable own-source funding mechanisms are better equipped to engage in local economic development projects adapted to their local context. Local governments that are financially self-sustaining are also more accountable and responsive to their constituents and better prepared to engage in context specific urban planning and design.

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