



AFRICITIES SUMMIT

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« Building local coalitions for effective implementation of the Millennium Goals in African Local Governments »

THEMATIC SESSION “rethinking financial policies”

Recommendations

How will the investment needs of African cities be financed?

800 million people live on the continent of Africa. 290 million of them are urban dwellers. According to the United Nations, the rate of urbanization in Africa could reach 50% around 2020 and 54% in 2025; worldwide, the rate of urbanization is expected to be 61%. Along with increasing urbanization, the average city size is also growing. Globally, the number of urban areas with at least one million residents has climbed from 83 in 1950 to 325 today, and could exceed 540 in 2015. 68 of these cities, representing 224 million residents or 40% of the total urban population, would be located in Africa.

Although this exponential growth entails unprecedented investment needs, this demand is exacerbated by delays that the continent’s cities have accumulated in terms of transportation, housing, and access to potable water.

What financing mechanisms could respond to these needs, which are becoming increasingly critical each day? This is the key question to which this cross-cutting thematic session has attempted to provide some potential solutions.

Yet, in view of the presentations and discussions, it appears that the response to this question will depend on local governments demonstrating clear revenue streams which can be used to leverage scarce government grants with domestic market resources. This revenue stream would in turn require policy actions including the following::

- (i) Rational and predictable fiscal transfers to cities with clear alignment between responsibilities and financial powers;
- (ii) An enabling framework which links city financing with private financial markets, thereby providing a systemic lending relationship.(“subsovereign” loans);
- (iii) Possibility of having context-specific mechanisms matching the needs of small cities, medium-sized cities, or capital cities;
- (iv) Actions at the city government level relating to framework by which they raise resources and pay for the capital and maintenance cost over time.

Recommendations to governments

- 1/ To promote a progressive process of organizational and fiscal decentralization

This precise definition of the roles assumed by public entities implies the implementation of real financial transfers that contribute to operations and investments in accordance with context-specific modalities and ensure sustainable financing of local governments. In particular reduce the gaps between increased responsibilities and inadequate authority.

Comprehensive decentralization strategies and compensation mechanisms could be set up to allow municipalities to adapt their own resources to fit their new responsibilities. The State should thus focus on developing a contractual policy as a channel used to finance local government investments, in order to ensure joint responsibility in the implementation of cross-financing.

2/ To increase the size of local government markets

Local government markets are often limited due to the fact that most key infrastructures and services are controlled by central agencies (national water utility, national department of sanitation, national power company, etc.), which are, in most cases, the leading public investors in cities. This inevitably causes functional and geographic fragmentation and makes commercial financing difficult. Refocusing the role of the State with respect to local governments' administration and finance from a control to an enabling function would promote the growth of local government markets over the medium term while adding to the effectiveness of SFIs.

3/ To promote new contractual tools

Arrangements such as city and urban contracts offer at the minimum opportunities to test the ability of local governments to take on increasing amounts of responsibility, and potential alternatives to the legislative and regulatory process of decentralization. These tools can thus support the decentralization processes and the development of local government markets.

4/ To develop sustainable credit mechanisms to finance local government

As the World Bank suggested in Yaoundé (Cameroon) in 2003, governments could not only supervise, but also ensure the sustained development of credit mechanisms to finance municipalities (a Tunisian or Senegalese example of blend (loan/grant) financing, multi-year investment scheme, support measures...).

Yet the sustainable development of these mechanisms for municipalities in developing countries relies largely on the adoption of the concept of local government financing, as opposed to project financing, where risk assessment emphasizes borrower risk without, however, underestimating project risk.

5/ To encourage the use of specialized financial institutions

The use of specialized financial institutions (SFIs) to address local governments' financing needs is currently the prevailing model in less advanced and middle-income countries located in Africa, North Africa/the Middle East, and South America.

These SFIs generally combine credit operations and technical assistance to local governments in terms of investment planning and, more broadly, institutional capacity building. At this stage, this option is still considered to be the best approach to address local governments' needs.

6/ To promote public/private partnerships at the local level.

Governments could thus flesh out regulations and laws pertaining to subcontracting by local governments. Currently, references to these types of partnerships rarely appear in the texts that govern local government markets, so the public/private contractual framework remains

relatively underdeveloped. Including this option in the statutes of local governments could enable them to make use of the private sector for local investments and the management of local public services.

Recommendations to local governments

1/ To improve management practices and transparency in financial disclosures, and enhance its viability

To access sources of financing other than those controlled by the State, local governments must provide solid indications that they are improving the way they manage their resources. Thus, the implementation and widespread use of both analytical accounting tools and annual accounting provisions would contribute to enhance the management and the strategic vision.

2/ To ensure sustained financing for the maintenance and upkeep of municipal plants

This measure would help lend credibility to the quality of local governments' management while also making it easier for them to borrow.

The corresponding financing plan shall features financing costs and revenues losses, either direct or indirect.

Local investment helps to increase municipal assets, which, in turn, helps to produce services that can generate revenues from duties and taxes. This income can subsequently be used to cover additional borrowing-related costs.

3/ To obtain access to loans facilities

Large cities should create conditions that would make it more likely for them to obtain a loan (accumulation of savings, transparency of accounts, good management practices, a multi-year public investment program, etc.). The act of borrowing implies the ability to make valid forecasts. Immediate access to important loans for communities that are not enough prepared could lead to a vicious circle.

4/ Ensuring better communication

As the top level of territorial structures and the leading local public authorities, local governments should pay close attention to their community relations policies. Thus, they should discuss their actions more openly and provide users/tax payers with explanations regarding the financial implications of their needs and demands.

5/ To improve allocation programming and absorptive capacity

Currently, allocation more than resources is still the core issue associated with local government investment. Although this may seem paradoxical given the magnitude of existing needs, there is evidence that access to resources is not the most critical difficulty. In many countries, available financing resources outstrip the existing absorptive capacity due to the small number of operators, inadequate project development, and the fragility of the network of businesses.

Recommendations to cooperation agencies

1/ To acknowledge the growing importance of urban development financing, in which local governments are key players, and to adapt their support to the partner countries' needs and contexts.

Financing local governments reflects an extensive, complex type of clientele whose main parameters reveal the countries' diverse economic conditions, not to mention a wide range of political, legal, and administrative traditions.¹

2/ To ease the access to financial market for well-prepared local governments

This access to bond market is still used relatively sparingly, due to complex requirements (ratings, multiple actors, supervisory agreements, guarantees) and high cost (financing profile, disintermediation). This method of disintermediation can be eased by credit enhancement or guarantee funds. In countries where banks and other financial establishments are often excessively liquid, this kind of mechanism is often seen as a good solution. Further still, instruments such as take out financing which lengthens maturities would make the financing of essential infrastructure such as water and sanitation more easy to pay for.

The idea to create a guarantee fund managed directly by the local authorities (or their associations) at the international level can be raised.

3/ To promote private subcontracting at the local level

Development partners should support any government initiative designed to implement and renew specific regulations covering public/private partnerships at the local government level.

4/ To coordinate their assistance and support

More generally speaking, as it was suggested in Yaoundé, development partners should coordinate all their activities in this sector. Many potential actions might be considered: less competition, greater cohesiveness among development activities targeting cities, increased coordination among partners in terms of the products being offered, etc.

Recommendations to the Municipal Development Program (MDP)

To accelerate the formation of the Local Finances Observatory as recommended at Yaoundé 2003 in order to ensure a more effective information and data dissemination and carry out comparative analyses:

1/ the effective implementation of the Local Finances Observatory might serve as a first step in developing a tradition of evaluation, identification and dissemination of good practices;

2/ to build a database containing information on the cost, rate structures, and financing of basic services.

Furthermore, the session recommended to:

3/ track the performance of national governments in the decentralization agenda;

4/ provide a monitoring framework for Intermediaries to judge performance with reference to linkages with domestic markets.

¹ Other data play a key role in the structure of financing systems: the allocation (or lack thereof) of water/electricity facilities to municipalities, whether the urban network is more or less balanced, the size of the cities, any disparities between the largest and smallest, richest and poorest cities,...