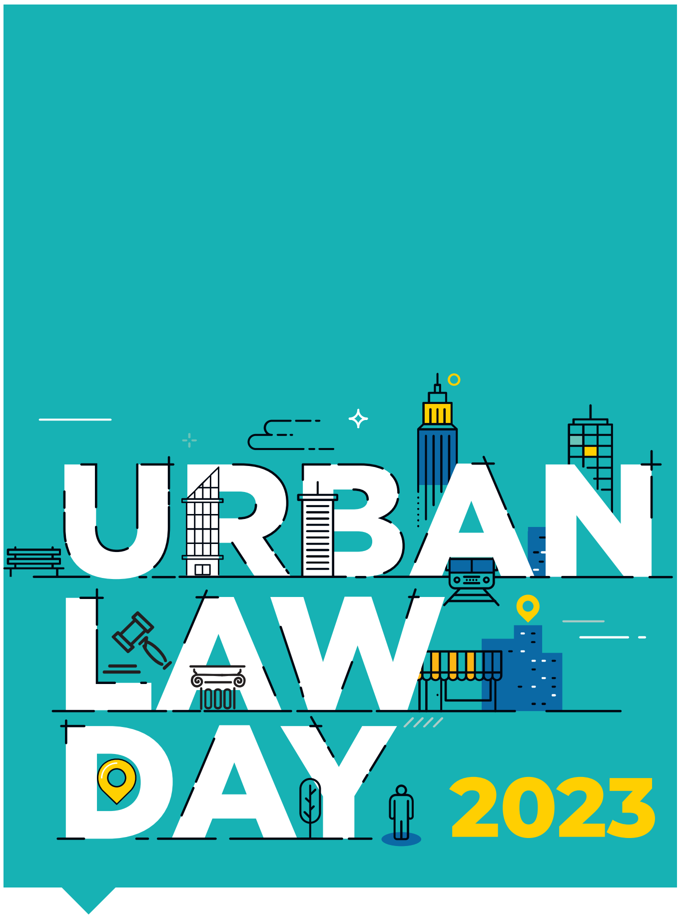

URBAN LAW DAY 2023

Rules of the game: Fiscal sustainability in cities

A REPORT

DATE

Tuesday, October 31, 2023

9.00am – 10.00am (Eastern U.S. time)
/16.00pm – 17.00pm (Nairobi time)

ORGANIZED BY

Fordham university

IN COLLABORATION WITH

UN-Habitat

World Cities Day October 31, 2023
BETTER CITY, BETTER LIFE
Financing sustainable urban future for all

Urban OCTOBER
31 DAYS OF PROMOTING A BETTER URBAN FUTURE

UN-HABITAT

PANELISTS/DISCUSSANTS

Matt Glasser

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Stephen Berrisford

Lead, Cities Practice at Pegasys Global

Prof. Nestor Davidson

Fordham University School of Law

Professor Clay Gillette

New York University

Anne Amin

Legal Specialist, UN-Habitat

BACKGROUND AND INTRODUCTION

To celebrate World Cities Day (31st October 2023), UN-Habitat and the Fordham University Urban Law Center (US) organized an Urban Law Day Roundtable Discussion in line with this year's theme: Financing Sustainable Urban Future for All. A panel of urban legal and fiscal scholars discussed the role played by urban legislation in setting the rules of the game for fiscal sustainability in cities.

The Sustainable Development Goals (SDG 11 and 17) and paragraph 15 of the New Urban Agenda, outline a commitment by States to support effective, innovative and sustainable financing frameworks and instruments enabling strengthened municipal finance and local fiscal systems to create, sustain and share the value generated by sustainable urban development in an inclusive manner.

Across the world, municipal finance systems rest on the rules of the game (i.e., policies, constitutions, laws, and regulatory frameworks) that comprise the following four key components:

(a) expenditures;

(b) revenues;

(c) financial management;

and (d) borrowing.

The relative strength or weakness of these components determines whether a local government can deliver public goods and services to meet the basic needs and preferences of its population.

It should be stressed that country circumstances, and the concrete characteristics of municipal finance systems within these five components, vary widely. In some countries, municipal finance systems function fairly effectively across all five dimensions. At the other extreme are countries in which systems and capacities are weak in all areas. An appraisal of the strengths or weaknesses of these components can help national, subnational, and local governments identify interventions that can improve the performance of their respective municipal finance systems.

The rules of the game are key elements that enable or constrain the ability of local governments to manage fiscal health as they define a jurisdiction's powers and governance framework, coupled with the will and capacity of leaders to implement them.

Formulating a sustainable fiscal system that leads to a more prosperous, healthy, and equitable future for the world's municipalities begins by distilling core "rules" that have the potential to maximize a municipality's ability to link growth and develop.

The Urban Law Day explored the above concepts and promoted learning, knowledge sharing and exchange of information and experiences which will better inform the creation of "fiscally sustainable cities" that are more equitable and prosperous.

Opening remarks

Anne Amin *(UN-Habitat)*

Municipal finance is relevant for the achievement of the SDGs and the New Urban Agenda in several ways. First, the lack of adequate resources has a direct impact on the provision of services. In such cases, informal settlers and the poor are hit the hardest. Second, the way revenue sources are determined, assessed and resources are collected has Human Rights implications. For example, the identification of a tax base and setting a tax rate inevitably places an obligation on urban residents. If this obligation is not equitably placed, it may result in a burden that is disproportionately carried by some people. Third, the budgeting process i.e., determining how, where and on what the resources are going to be spent affects people. Budgeting needs to be transparent, participatory, accountable, and inclusive in both the process and the outcome if Human Rights are to be promoted.

Law, by setting the rules of the game, plays a fundamental role in that they enable or constrain the ability of national and local governments to manage and collaborate to strengthen their fiscal health.

Indeed, most local governments are often inhibited by law from raising resources locally. They may not have the power to levy taxes as the law gives this mandate to national, provincial, or regional governments. Legal frameworks, particularly in developing countries, also limit municipal borrowing, restrict the ability of municipalities to reallocate funds among budget categories, and place caps on certain types of expenditures. Furthermore, tax administration at the hands of the national governments might constrain local governments in capturing their revenue base if data sharing is not trickled down to the local level. Hence, laws ought to improve the collaboration between both the local and national level by harmonizing tax collection systems and develop an environment of collaboration.

UN-Habitat believes that formulating a sustainable fiscal system that leads to a more prosperous, healthy, and equitable future for the world's municipalities begins by distilling core "rules of the game" that have the potential to maximize a municipality's ability to link growth and develop.

Mr. Matt Glasser *(Centre for Urban Law and Finance in Africa)*

Mr. Glasser started by explaining how his use of the word ‘municipal’ is meant as a general term to refer to local government. In different localities different names are used.

He then stressed that his remarks are mostly directed at long-term borrowing for infrastructure, and thus not at short-term borrowing or financing operational expenses.

Long-term municipal financing of infrastructure is dependent on three main factors:

1. capable and credit-worthy borrowers. That means that the municipality must have adequate, stable and predictable revenues in order to reassure lenders. Creditworthiness is subjective, and sometimes based on credit ratings. Moreover, the municipality must have the legal authority to borrow.
2. investors and lenders with capital to lend, such as domestic banks, insurers and pension funds. In the absence of these, borrowers may have to rely on development finance institutions or international investors. Sustainable infrastructure development, especially in the Global South, is difficult because there are plenty of financiers, but most municipalities do not engage in long term strategic planning to prioritize the municipality's most urgent needs. The demand side is generally weak.
3. a conducive legal and regulatory framework to lay out the rules of the game for all parties involved. This requires a clear delineation of borrowers' powers, including revenue-raising powers, and clear remedies for lenders and investors in the event of financial problems or default.

A sound regulatory framework requires sound financial management at the municipal level. Without this, lenders are reluctant to take the risk because of the lack of transparency of municipal finances. Moreover, the process of borrowing for infrastructure must be clear and relatively straightforward. Municipalities' legal authority should include the power to pledge future revenue and otherwise give security to ensure that borrowed money is paid back. Finally, remedies in case of threatened or actual default should be explicit, along with a predictable method to resolve financial problems and disputes. The roles of political actors, courts, creditors, etc. must be laid out clearly.

Mr. Glasser gives the example of South Africa, where financial mismanagement has become entrenched in many cities. As a result, lenders have become increasingly cautious about extending new credit. New private sector investment has significantly diminished and been replaced by public sector and foreign investment.

Other regulatory issues that hamper the availability of municipal finance for infrastructure are the rules and regulations that some investors (such as banks, pension funds and insurance companies) are subject to. In many cases, loans to local governments are either not permitted at all or are severely limited.

To achieve sustainable infrastructure financing, local governments need to be strengthened and equipped with the capacity to manage their finances in a transparent way and to develop long-term finance strategies. Municipal finance professionals are essential to enable municipalities to engage meaningfully with prospective lenders and investors.

Furthermore, attracting the right parties to invest is important. For example, banks usually prefer short-term borrowing, which is less suitable.

Other actors such as pension funds and insurance companies prefer long-term lending, so it is imperative that these actors are attracted.

Mr. Stephen Berrisford *(Cities Practice at Pegasys Global)*

Mr. Berrisford emphasized the important linkages that are present between planning law on the one hand, and fiscal sustainability on the other. After elaborating a bit on his past professional experiences, he explained how he is now working on the intersection between finance, law and institutions. This intersection is essential to allow effective policy reform to improve social and environmental conditions. Spatial planning must be linked to investment, capacity building, policy and governance to bring about positive change.

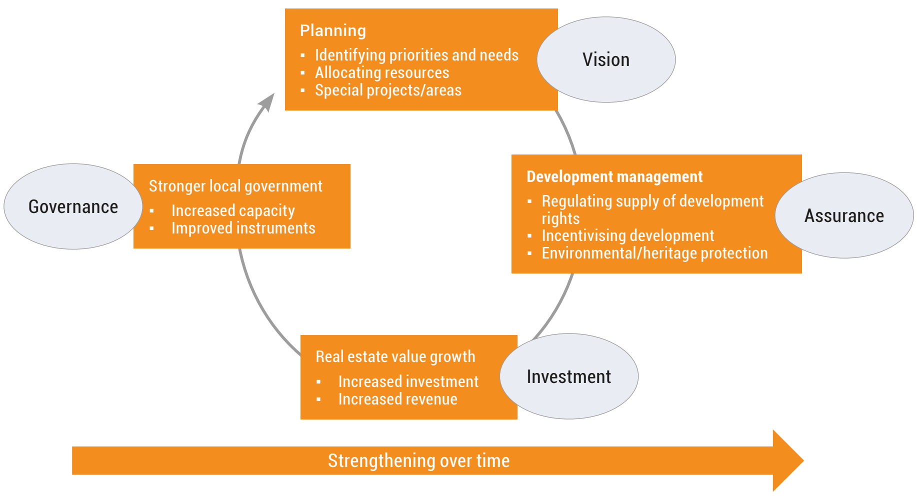
The focus should not just be on policymaking, but also on implementation which is quite significant. If you want to bring about change, it happens through the investment of money. Therefore, fiscal sustainability is key.

Pegasys Global uses a diagram called the 'virtuous cycle of urban planning and sustainable local government'. It is a cycle consisting of four steps:

1. long-term planning based on identified priorities and needs, and allocated resources.
2. development management that will give investors assurance. Various instruments exist that municipalities can use to realize the vision of a plan and assure stakeholders of the financial competence of local policymakers.
3. good management leads to the growth of real estate value which in turn leads to increased tax income.
4. the increased municipal income can be used to improve local governance, which is the cycle of how financial sustainability is created.

In many cities, the parts of the cycle do not all hang together, or one of the parts is weak.

Virtuous cycle of urban planning and sustainable local government



As mentioned earlier, the implementation of plans is what should be the focus. This means that, first, the vision of the plan ought to be reflected in a regulatory instrument. Secondly, the plan should be implemented through infrastructure investment, which can be financed by land value capture, charges and levies on infrastructure, and climate finance. A third angle is the development of publicly owned land since this is essentially free. Municipalities are sitting on assets that do not yield any return. Developing them would greatly increase the financial strength of that government. Another perspective is the designation of special zones for investment, which are exempt from regulations, infrastructure costs, etc. Finally, effective implementation requires a united force made up of all government actors lining up behind one plan which everyone will follow. This is difficult almost everywhere, not just in under-capacitated states.

One problem that often hampers implementation is that the systems and capacity that are required for implementing a spatial plan as well as the associated costs that come with this are not considered.

Infrastructure investment opportunities to implement plans can be financed with land value capture as well as other instruments to extract money from them. However, the amount of value creation from plan implementation does not always line up with the costs associated with the project. Expectations of land value capture are also often overstated, since the capacity to manage such instruments to extract money is lacking.

All in all, two elements are the most important. First, relationships between different levels of government as well as engagement with other stakeholders is vital, and perhaps even more important than formulating legislation. For the implementation of spatial plans, it is essential to engage with the local political economy. Secondly, fiscal sustainability forces us to reflect on the implementation process. It demands that we emphasize the importance of multidisciplinary teams, implementation as an iterative process, formal and informal capacity building, testing of scenarios, and learning from best practices.

Prof. Clay Gillette *(New York University)*

Professor Gillette discussed user fees. User fees are prices that the government charges for a service whose distribution is controlled by the government. Ideally, this should be a benefit-based fee, meaning those who use more of the service and thus gain more benefit should pay more.

User fees generally refer to goods and services that are incurred voluntarily (although with some commodities, such as water, this is contentious). They raise a variety of issues relating to municipal finance, as they are not based on one's ability to pay and are therefore distinct from taxes.

A justification often used for imposing user fees, is their tendency to force more efficient allocation of user fees. However, this justification does not apply in developing nations, where user fees are too expensive for some members of society.

The general theory of user fees is that they prevent problems arising from public goods provision. Public goods that are accessible without a fee give nobody an incentive to provide them. This leads to lacking service provision.

Privatization of these services also leads to issues, such as monopolization and high costs. A user fee can be used to cover the marginal cost of production of the service. For example, with food inspection or power plant inspection, the government might tell the operator to pay for this inspection. The producers may object that they do not benefit from this regulation. However, the public is more receptive to such regulations since they provide an assurance of safety. Such user fees are therefore justified.

Professor Gillette provides six main reasons why and situations when user fees are appropriate.

1. If goods are paid for through a fee that reflects the full cost of production, goods will be allocated efficiently. Therefore, user fees promote the efficient allocation of goods and services in theory.

2. User fees are distributionally neutral. The payer gets a proportional benefit and pays the associated financial burden. Hereby, all users internalize the full cost.

3. Apart from efficient allocation, user fees allow public officials to determine how much of a service is necessary to provide. They indicate whether a service is worth its cost, thereby revealing preference without requiring a public vote.

4. To achieve their objectives, user fees must be accurately calculated. If too much is charged, the service will be undersupplied compared to the demand. If too little is charged, that means that some users are subsidizing others. However, in some cases, such subsidizing may be useful and beneficial because user fees can lead to positive externalities (such as with garbage collection). Relating to this, it is important to note that the socially optimal amount of service provision may not align with the economically optimal amount.

5. Some services are not susceptible to user fees since they do not allow to charge individual benefits. Nevertheless, some elements of the service may allow people to reap individual benefits, for which payment could be demanded.

6. Some services are susceptible to user fees, but it would be inappropriate to charge them since the goal of the service is to be redistributive. Such would be the case for daycare centers that allow parents to go to work.

In the context of developing countries, it is important to note that user fees are inherently regressive. That is to say that they require the poor to pay a larger share of their income than the wealthy. However, they can still be suitable in developing countries, although perhaps not at the full cost of production. User fees send signals to officials regarding the number of services required.

They are inherently linked to a specific service, and thus provide clarity to policymakers. Moreover, user fees are an appropriate way to provide citizens with the incentive to participate in the democratic function. This is of course a very important goal.

CLOSING REMARKS

Prof. Nestor Davidson (Fordham University)

Professor Davidson asked the panelists one final question to reflect on and respond to. The question posed was: 'Is there something universal we can say about the need to strengthen local authority or strengthen oversight by higher levels of government, or is it contingent on the financial mechanisms in place?' The three panelists gave their final reflections regarding this question.

Mr. Matt Glasser

The United States is very unique, because here, most citizens feel like they have the right to talk to municipal officials, participate in hearings and referendums on financial issues. Generally, there is a lot of public participation. That means that there is a linkage between what the council does and what the citizens want, so there is good downward accountability, which is critical. In India, for example, this is not the case, because local governments there are more responsive to the state government and the elected city council does not have as much power as the municipal staff or the commissioner.

Government oversight of financial management is much more important than borrowing. Adequately enforcing financial management rules will lead to the borrowing automatically taking care of itself. Planning for physical space is intimately linked to planning for finance. Creating systems of accountability and using a multidisciplinary approach reflecting the priorities of the community is the most important thing.

Prof. Clay Gillette

Responding to Mr. Glasser's comments on public participation in municipal matters, Mr. Gillette said that, in fact, people do not show up at the city council because they are not interested. Therefore, lack of public participation remains a major issue. He also added that local governments do not have a monopoly on value capture. In some instances, interest groups are more powerful, connected, and interested in capturing newly created value. This is a problem with no generic solution.

Prof. Berrisford

You cannot do urban planning without thinking about municipal sustainability, also in a financial sense. This requires a confluence of decision making on both those areas. Moreover, downward accountability is very hard to achieve in many parts of the world, because of a lack of willingness from the powerful and the state.

However, in many countries, this accountability is expressed by the community through other means, such as withholding user fees, protesting, et cetera. Understanding these informal ways of expressing your interests and political desires is very important.