

## Municipal finance and localizing the SDGs

### 1. Introduction

This brief outlines the critical role of municipal finance in achieving the Sustainable Development Goals (SDGs). SDG 11 identifies local governments as critical agents for realising inclusive, safe, resilient and sustainable communities. Without adequate resources, the potential and capacity of local governments to realise this objective and other relevant SDGs is limited. The challenge is: How to equip local governments with adequate revenue raising and spending powers in a way that enhances local autonomy, responsiveness and accountability. The brief gives an overview of the different sources of revenue for local governments and some of the key challenges confronting effective local revenue mobilisation.

### 2. Financing local government: Some of the key guiding principles

<ul style="list-style-type: none"><li>• Revenue assignment must be informed by expenditure assignment</li><li>• A clear assignment of functions to local government is required</li><li>• “Finance follows function”</li></ul>	
<b>Role of national government</b> <ul style="list-style-type: none"><li>• Address externalities and undertake the redistribution and stabilization function</li><li>• To promote cohesion, solidarity, equity and equality</li><li>• The national government requires lucrative taxes such as income tax, custom exercises and corporate tax</li></ul>	<b>Role of local government</b> <ul style="list-style-type: none"><li>• Local government often assigned functions of a local nature</li><li>• Define role in line with the principle of subsidiarity, among other relevant considerations</li><li>• Local government often assigned immobile taxes, which are often minor taxes barring property tax</li></ul>
<b>Intergovernmental grants are required to address vertical and horizontal imbalance</b>	

### 3. What does the African Charter on Decentralisation (2014) say on financing local government?

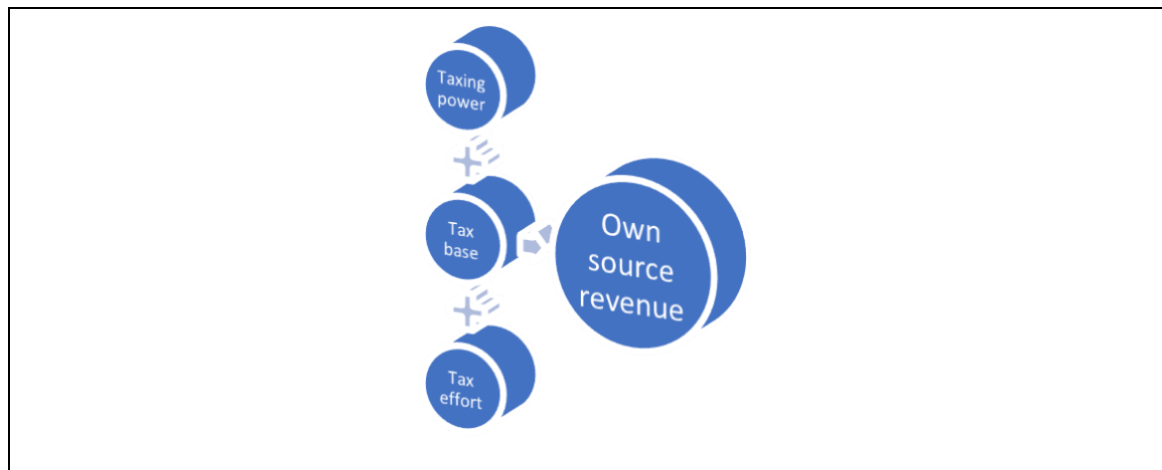
*Article 7(1) – “Central governments shall adopt legislation, measures and establish relevant mechanisms to give local governments the authority to mobilize and disburse resources at the local level for local economic development.”*

*Article 16(5)(a) “Central governments shall enact national legislation which strives to entrust local governments with the full responsibility to manage financial resources at the local level.”*

### 4. Own-source revenue

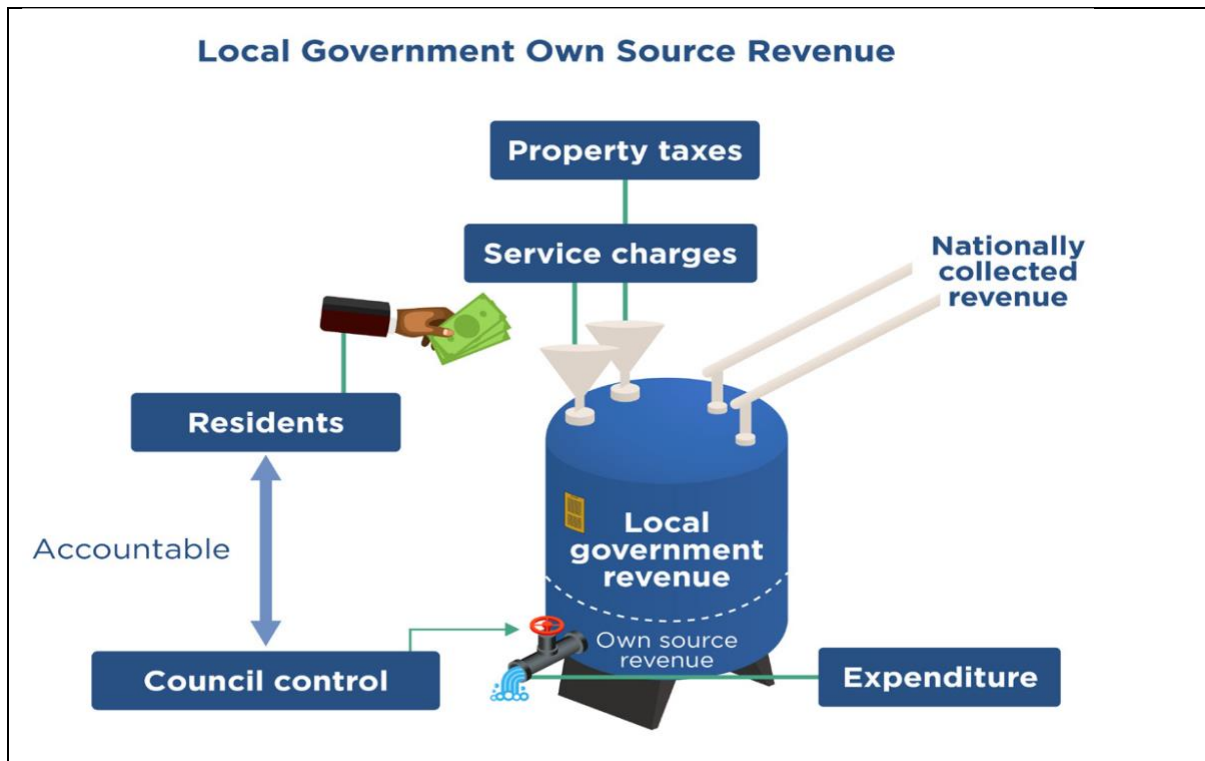
The ability of a local government to raise its own revenue depends on three interrelated factors:

- Taxing power: The authority to levy taxes and impose charges as well as to determine tax rates and fees.
- Tax base: The economic activities, services, or properties that can be taxed.
- Tax effort: The administrative capacity and political will to effectively collect the revenue that is due to a local government unit.



Fiscal decentralization has been a common public sector reform programme on the African continent over the past few decades. The objective of fiscal decentralization programme is generally to equip local government with necessary instruments to mobilise and spend revenue for service delivery and development purposes. Evidence from the region however show that local governments continue to struggle to mobilise sufficient revenue to meet their service delivery and development requirements. Some of the major obstacles to effective local revenue mobilization through include:

- Weak taxing powers,
- No or limited control over tax rates,
- Inability and unwillingness of consumers of services to pay for services delivered by local governments,
- Limited capacity to collect revenue, and
- Reluctance to collect for political and other reasons



Source: De Visser J, Steytler N & Chigwata T (2021)

## 5. Borrowing and debt

Debt can be a good instrument for financing capital and infrastructure projects with a long-life span. Local governments can also borrow on a short-term basis for bridging purposes, among other use. The African Charter on Decentralisation (article (16)(5)(f)) provides that –

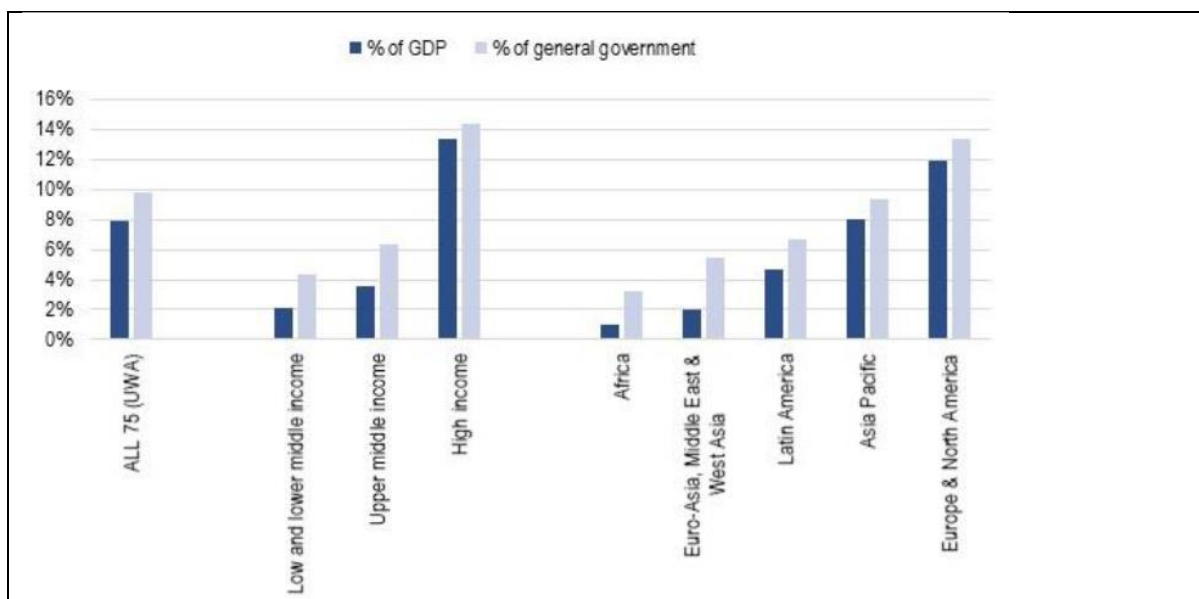
*Conditions under which local governments shall gain access to loans, financial markets, and development assistance shall be defined by law.*

This provision recognises two key issues: (1) the need to equip local governments with borrowing powers; (2) the requirement for national government to regulate the exercise of such powers. International literature recommends that central governments must implement a hard budget constraint to discourage poor local fiscal behaviour. Access to private financing is particularly encouraged. The question of whether a local government unit is creditworthy is particularly important to access private financing.

In practice, local governments in Africa undertake the least borrowing in the world. This is due to a variety of reason such as:

- Absence of borrowing powers,
- Highly demanding borrowing requirements, and
- The lack of municipal credit worthiness

**Subnational government debt by income country group and world region as a percentage of GDP and general government debt**



Source: OECD & UCLG, WOFI (2022)

## 6. Alternative revenue sources

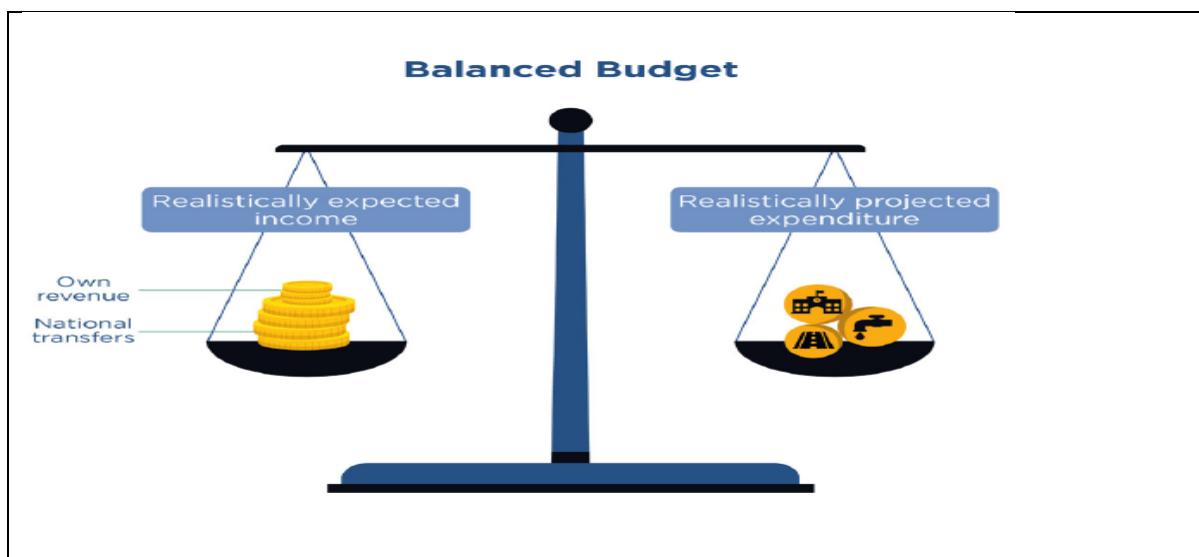
Given the immense demand for service delivery and development in the African region, alternative revenue sources should be considered to mobilise additional resources. Public-Private Partnerships (PPPs) and similar options are a potential viable revenue and resource source.

*With respect to PPPs, although there have been some positive experiences, the evidence especially from developing countries, is decidedly mixed. This is because for PPPs to generate better value for money than strict private-sector provision, they require careful structuring, which is expensive and requires capacities that do not yet exist in many local governments and municipalities. In poorly regulated contexts, delivering public infrastructure and services through private finance may also raise the cost of services beyond what low-income populations can afford.*

Source: CEPA strategy guidance note on Strengthening municipal finance and local finance systems (2023)

## 7. Budget autonomy

Budget autonomy entails the discretion which local governments enjoy to determine their expenditure priorities and budgets. It enables local governments to respond effectively to the needs of their communities. Article 16(5)(b) of the African Charter Decentralisation stresses the need for central government to exercise oversight over municipal resources without undermining budget autonomy. However, budget autonomy should be exercised responsibly by, among other things, ensuring that the municipal budget is balanced.



Source: De Visser J, Steytler N & Chigwata T (2021)

In practice, many local governments in the region lack budget autonomy. Requirements for central approval of budgets and the vetoing of local decisions are some of the major impediments to budget autonomy. Municipal budgets are often not balanced giving rise to budget deficits. The financial sustainability of many local governments remains a huge concern.

## 8. Public finance management

Local autonomy must be exercised responsibly by ensuring that there is efficient, effective, transparent and accountable use of resources at the local level. A good system for planning, budgeting, accounting, procurement and auditing is therefore a necessity. This is recognised by article 16(5)(g) of the Africa Charter on Decentralisation –

*Local governments shall implement accounting, auditing and management systems for the effective, efficient and transparent management of financial resources in strict compliance with national financial and accounting laws, norms and standards.*

In practice: the call for more funds to local government is often not matched by equal commitment to account for the funds. Corruption and maladministration, among other ills of decentralisation, are common in many local government systems. If these challenges are not addressed the SDGs will even be more difficult to realise.

## 9. Key takeaways

- The localization of the SDGs and the broader Agenda 2063 is unlikely to succeed without well-resourced and well-managed local government systems.
- A careful balance between own-source revenue and intergovernmental grants is required.
- Equip local governments with budget powers to enhance their ability to respond to the needs and preferences of their communities.
- A good local public finance management system and a commitment to transparency and accountability is a necessity.

## **10. Resources and materials**

- Astrid Haas. CEPA strategy guidance note on strengthening municipal finance and local finance systems.
- De Visser J, Steytler N and Chigwata T. 2021. Fact sheets on Decentralisation in Africa: A short guide
- OECD. 2019. Making Decentralisation Work: A Handbook for Policy-Makers. OECD Multi-level Governance Studies.
- Boex J, Williamson T and Yilmaz S. 2024. Fiscal Decentralization, Local Public Sector Finance, and Intergovernmental Fiscal Relations: A Primer on Multilevel Government Finance. Washington, DC: Local Public Sector Alliance / World Bank.