FINANCE

Did you know that only 65 percent of the world's local authorities knows in advance the amount of funding they will receive from higher governments for their local budget?

It is ironic that while cities generally contain a high proportion of the most prosperous enterprises and consumers, municipal authorities have such a shortage of funding to meet their responsibilities. It is also ironic that municipal authorities, at least in theory, control changes in land use and determine or influence the siting of roads that can often increase land values by more than 100-fold or even 1000-fold, yet are unable to recapture this "unearned increment" for public purposes. This is often the result of controls on city authorities imposed by central governments and the low priority given by central government to adequate funding for city governments.

Global Forum '94

The financial health of cities

Municipal finance addresses the financial health of cities, the management of revenue and expenditure, and the cost-effective delivery of public services. Good governance ensures the efficient mobilization and use of financial and human resources for the provision and delivery of high quality public services. The main sources of municipal revenue include:

(a) Local Taxes, broadly made up of property taxes, or rates on land and buildings; business, sales or value-added, service and/or entertainment taxes; poll and motor taxes;

(b) User-charges, which include rents, fines and fees for permits and licenses;

(c) Income from investments;

(d) Inter-governmental transfers, subsidies and grants-in-aid from central government; and

(e) Borrowing, including through revenue and general obligation bonds.

The relative proportions of these varies among cities over time and also depends on the degree of fiscal autonomy of municipal government.

Property taxes and head taxes

Broadly speaking, local taxes plus central-to-local government transfers account for more than 60 percent of total municipal revenue in most countries. A large proportion of local revenue in many developing countries, with few exceptions, consists of governmental transfers - 84 percent in the case of Indonesia. In the cities of developed countries, prop-

www.brookings.org/press/REVIEW/summer2000/glaeser.htm
www.brookings.edu/press/REVIEW/summer2000/ellen.htm
www.globalpolicy.org/globaliz/econ/copen.htm
fbc.binghamton.edu/iwsovty.htm

erty and related taxes normally account for the largest share of revenue. Property tax is a major source of municipal revenue, for example, in Ireland, the Netherlands and New Zealand. It is generally acknowledged that efficient valuation, assessment and tax collection is key to maximizing local revenue[1].

Municipalities in Belgium, Italy, Russia and the Scandinavian countries assess, impose and collect income (poll or head) taxes from city residents. For developing countries, taxes (mainly property taxes) account for as little as 12 percent of total local government revenue, as is the case of Mexico. Such low property tax revenues are largely the result of institutional weaknesses, such as inadequate comprehension of local taxation schemes by local government officials and tax payers, lack of personnel to enforce collection and a general absence of adequate administrative tools, including records and maps. Yet, studies have suggested that property tax is a particularly appropriate means of strengthening local government, because of its local base.

Borrowings and returns

As a source of revenue, borrowing is employed by well-established municipal governments, mainly in the developed countries that not only have political and fiscal stability, but possess investment assets to serve as collateral. In contrast, borrowing is hardly ever a source of revenue for local government in developing countries, because the sovereign state may be perceived as unstable by bond raters, because central government will not grant approval or because municipalities lack collateral assets and are therefore perceived by lending institutions as high risks.

Maximizing the local revenue base

The *Habitat Agenda* suggests that new forms of municipal finance are needed for urban economic development and meeting the costs of infrastructure and services. It calls upon governments "to provide an enabling framework to: (a) enhance national and local tax collection capabilities and expenditure controls to contain costs and enhance revenues; and (b) facilitate and rationalize local authorities' access to national, regional and international capital markets and specialized lending institutions, including *inter alia*, through measures to establish independent municipal credit rating and credit systems."

The basic aim is to broaden, strengthen and maximize the usually under-exploited local revenue base including the informal economy. Increased tax revenue is often easier to secure than access to capital markets and lending institutions.

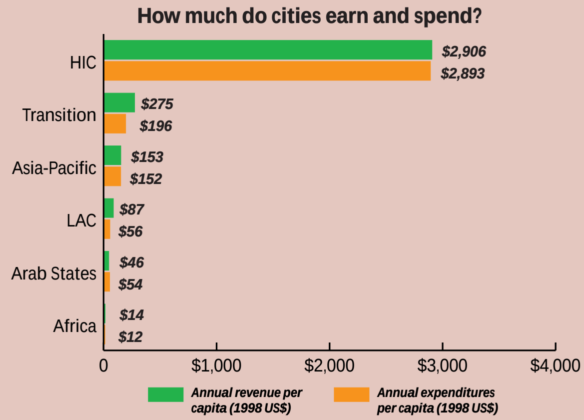
The effective collection of existing taxes is generally easier and more financially productive than introducing new taxes. It is therefore not enough simply to increase the taxation powers of local government. Administrative and technical capacities also have to be upgraded. Expanding the local revenue base should be the first consideration in enhancing urban finance, with streamlining and strengthening mechanisms of collection the priority.

bestpractices
www.bestpractices.org

Area-Based Assessment of Property Tax - Patna, India

The Patna Municipal Corporation has initiated an area-based, simplified assessment of property tax. The new method has minimized discretionary and *ad-hoc* assessments, while increasing acceptance and tax compliance. The model - based on classification of location, construction and use - facilitated a tax reduction between 9 and 44 percent of annual value. Despite the reductions, the absolute tax revenue increased fourfold. The Government of India has now ordered all state governments to change to the Patna assessment model, as it increases revenue while ensuring equity, fairness and acceptability.

www.urbanobservatory.org
urbanindicators98



Local government incomes vary enormously. Total local government revenue per person in highly industrialized cities is 208 times that of African cities. The level of income is partially dependent on the level of local government's autonomy. More independent municipalities will be able to raise their own resources and set taxes. Local government capital expenditures also vary dramatically across cities and regions.