

The Global Landscape of Development Partner Support for Municipal Finance



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This is an executive summary of a longer paper with the same title,¹ summarising the key findings as well as possible ways forward. Municipal finance has been an important aspect in public sector reform support for some international development partners for decades. Growing recognition of the critical role of adequate and appropriate municipal finance in effective local governance has generated continued interest in fiscal decentralisation on global development agendas and by many development partners. The Swiss Agency for Development and Cooperation (SDC) governance unit is seeking to rethink and improve its engagement on municipal finance. In order to navigate this field more fully and effectively, SDC requested a broad mapping and review of relevant development partners that are active in supporting fiscal decentralisation and municipal finance.

The rationale for supporting municipal finance is clear, but there are challenges in practice:

- **First, municipal finance is not independent of broader subnational governance** – it depends on a multidimensional constitutional/legal/administrative framework and means for its implementation.
- **Second, institutional structures and dynamics across countries are extremely diverse**, so municipal finance must be designed to work in specific contexts.
- **Third, municipal finance includes multiple sources that may work with or against each other**, so single revenue sources should not be considered and designed independently.
- **Fourth, many reforms focus on one aspect of one source of municipal finance that cannot on its own improve performance**, so the elements must be considered together.

Despite these and other potential challenges, a review of the experience of major development partners can provide ideas about how to make progress.

Key findings

Priority

It is difficult to determine the degree to which municipal finance is a priority area for most development partners. Many have relevant publications, including practitioner manuals about or with some reference to/relevance for municipal finance, but few have developed dedicated agency-wide policies intended to guide all of their activities in this field. A number of smaller agencies that specifically focus on finance, such as the UN Capital Development Fund, have a stronger general framework, and a few specialist agencies, such as UNICEF, have clear policies on how to approach decentralised finance in the sectors they work in.

Activities

Development partner activities in municipal finance vary. Large multilateral development banks with considerable staff and financial resources have more diverse and multi-sector portfolios, while UN agencies and most bilateral donors tend to engage in the area through somewhat more specialised lenses. For entities like UN Women and UNICEF, for example, support for municipal finance is targeted to particular activities that respectively support their mandates to advance the rights and protections of women/girls and children worldwide.

Internal actors

Many development partners have at least two divisions that manage their main municipal interventions, typically the teams whose overall thematic focus is on finance, governance or urban development. These key players seem to operate relatively independently with limited, if any, overall collaboration and/or coordination at the institutional level. There is more likely to be some degree of integration at the country level if a partner's country director, for example, is able to convince public

¹ Smoke, Paul and Kevine Uwayo, Jocelyne (2022) *The Global Landscape of Development Partner Support for Municipal Finance*, Bern: SDC Governance Network.

finance and urban development project managers to adjust their efforts to complement rather than partly duplicate or conflict with each other.

Scale

Development partner interventions differ in scale, but there is often limited summary information available to paint a detailed picture of the volume of their municipal finance activities. In some cases, municipal finance initiatives are embedded in larger finance, governance, decentralisation, urban or sectoral programmes and projects. Since the major development banks typically provide finance in the form of loans, the largest and most resource-intensive projects are generally funded by them, often significantly for subnational investment. Non-bank multilateral and bilateral development partners tend to use grant financing more than loan financing, so they rarely have initiatives at the scale of the development banks.

Approaches

Most development partners use a range of approaches to support the countries they work in. Given the diversity of development partner preferences and information availability, it is not possible to do a credible comprehensive comparison of the approaches used to support municipal finance. Technical assistance, capacity development and investment support are among the key areas of intervention, often focused on specific goals and functions. Some partners have moved beyond narrower operations to initiatives based on a more integrated approach, and various innovations, such as performance-based financing, have become increasingly common. Other efforts have included nurturing partnerships between subnational governments in wealthier countries and countries in the global South and/or between subnational governments in peer global South countries.

Possible future municipal finance interventions

A number of areas/aspects of development partner support to municipal finance merit more effort and experimentation. For the reasons explained above, it is not possible to offer definitive, universal or comprehensive recommendations about gaps and areas for future productive engagement, but some general observations can be made.

1 Although there are clearly already efforts relative to past development partner programming, there is considerable room for deeper and more productive action to support

municipal finance in a more integrated way.

Coordination of the elements of municipal finance is necessary for the overall intergovernmental fiscal system to work effectively.

- 2 The effectiveness of municipal financial management is often compromised by the structure of the intergovernmental system, both generally and within municipal service delivery sectors.** Action will typically involve multiple national ministries, levels of government, development partners and other actors, so a lot of preparatory groundwork and negotiation may be required. Creating diagnostics to document the nature and extent of opportunities and challenges and raise awareness about them could be a feasible and productive starting point for reform.
- 3 There would be great benefits to creating stronger linkages between municipal finance and development planning for infrastructure investment, which is the core of sustainable development.** Infrastructure projects prioritised in municipal development plans need to be reflected in the capital budget, and priority projects that are financed in the capital budget require operation and maintenance fund allocations in the annual recurrent budget.
- 4 Although development partners often highly value civic engagement, this critical accountability process rarely plays a particularly influential role in municipal finance.** There are significant opportunities for and benefits from increased civic engagement in municipal finance given its core relevance for fiscal accountability in a decentralised system.
- 5 The effectiveness of municipal finance could be enhanced by strengthening relationships among adjoining subnational governments.** This is especially needed in more densely populated areas, where there may be productive opportunities for contiguous local governments to work together in financing and providing certain types of public services.
- 6 Some prominent approaches framed as municipal finance innovations may need some creative rethinking if they are to be sustainably effective.** Many performance-based grants, for example, are actually administrative compliance grants, and it would be helpful to move beyond compliance in a way that promotes improved service delivery performance.

7 There is considerable scope for development partners to give more attention to how small and medium enterprises (SMEs) and the informal sector are treated in municipal finance regimes.

Given the importance of these sectors in the local economies of many developing countries and their implications for more inclusive development, there is a strong justification for appropriately including them in the local finance net in a way that creates incentives and opportunities for them to prosper.

8 Finally, there could be many productive benefits realised from more emphasis on how to implement municipal finance reforms/

development partner programmes more strategically and sustainably, including taking political economy realities into account.

In practice, there has typically continued to be more attention given to normatively desirable technical design of such initiatives than to how to make them work on the ground given political dynamics and other potential constraints on reform. There is no magic formula for navigating this difficult territory, but development partners can assist countries to constructively experiment and look for creative ways to deal with implementation for sustainable reform more effectively.

This Executive Summary was written by Paul Smoke (New York University/Robert F. Wagner Graduate School of Public Service) and Jocelyne Kevine Uwayo (Independent Consultant) and is summary of a longer paper with the same title. The views and opinions expressed are those of the authors and do not necessarily reflect the positions or policies of the Swiss Agency for Development and Cooperation (SDC), New York University or the Institute of Development Studies (IDS).