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Topic Paper
The Global Landscape of Development Partner Support for Municipal Finance

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Contents

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Purpose of this review

SDC's governance unit is seeking to better frame its engagement on the topic of municipal finance. It wishes to support the SDC offices more effectively in the management of their programmes on municipal finance. In addition, it wants to be able to better influence and support the global policy dialogue on municipal finance. To enable navigating this field more fully and effectively, SDC requested a mapping of relevant development partners/donors that are active in supporting fiscal decentralisation/municipal finance. This includes a stakeholder assessment or a political economy analysis of the various donors themselves and their aims and objectives in the field of fiscal decentralisation/municipal finance. This paper fits well into existing knowledge on SDC's engagement: an analysis of public financial management (PFM) support in decentralisation and local governance programmes and a practical guidance on supporting subnational finance.

SDC is one of two Swiss development partners working on subnational finance. The Swiss State Secretariat for Economic Affairs (SECO) economic development and cooperation division, in particular the macroeconomic support and infrastructure financing sections, are working on this issue from a different angle. SECO has outlined its support in several internal documents: the subnational PFM guidance note, the PIM guidance note and the Urban Value Chain guidance note.

Throughout 2021, SDC's governance and SECO's macroeconomic support sections started to engage in a broad dialogue, supported by a practical guidance, to enhance cooperation on PFM interventions on subnational finance.

1 Background: The role and prominence of municipal finance

Municipal finance has been an important area of support for some international development partners for decades.[1] The field emerged as many developing countries began to pursue democratisation and decentralisation as early as the 1970s. It became increasingly prominent as more countries sought governance and fiscal reforms and more development partners became interested in supporting them. It is probably fair to say that fiscal considerations – at least in terms of genuinely empowering subnational governments – did not receive as much attention early on as institutional/administrative, and in some cases political, considerations in reforming intergovernmental systems. This is likely the case because national finance ministries are almost always cautious about overly devolving revenue powers.

Growing recognition of the critical role of adequate and appropriately structured municipal finance in effective local governance generated rising interest in fiscal decentralisation.[2] Some development partners became very engaged in municipal finance by the 1980s, albeit in different ways. With the adoption the Millennium Development Goals (MDGs), the subsequent Agenda 2030/Sustainable Development Goals (SDGs) and the Financing for Sustainable Development initiative, the emergence of various regional and global financial crises, growing recognition of the urgency to respond to climate change and, most recently, the intergovernmental realities exposed by the Covid-19 pandemic, finance has taken a more central place in the development community. Moreover, rapid urbanisation and better evidence of considerable and unevenly distributed regional and local infrastructure and service delivery gaps is also bringing more specific attention to enhancing the role of subnational governments in sustainable and inclusive development, including finance.

Although the rationale for serious attention to fiscal decentralisation/municipal finance is clear, there are considerable challenges in practice.

1 Examples of synthetic treatments from various perspectives include UCLG (2011, 2015), Bahl, Linn and Wetzel (2013), UN-Habitat (2015), UNDESA and UNCDF (2017), Bahl and Bird (2018), Kim and Dougherty (2019), UNCDF (2022), Faguet (2014), Faguet and Pöschl (2015), Local Development International (2013), Martinez-Vazquez *et al.* (2016), Öjendal and Dellnäs (2013), Rao, Scott and Alam (2014), Rodden and Wibbels (2019) and Scott (2009).

2 This is discussed, for example, in many of the references provided in footnotes 1, 3, 4 and 5.

First, municipal finance is not an independent aspect of subnational governance – it depends on a multidimensional constitutional/legal/administrative framework and the means for its implementation.[3] The scope goes well beyond typical fiscal decentralisation concerns, such as the legal status, expenditure and revenue powers, and autonomy of subnational governments. Municipal finance also depends on developing a more extensive enabling environment, including elements not specific to decentralisation. Property rights, for example, affect property tax policy and administration, and legal provisions for local governance (elections and beyond) and civil society rights (including transparency) are needed to create adequate space to nurture the citizen engagement needed to discipline municipal government performance. These broader elements influence how accountable local governments are likely to be to their constituents in the generation and use of public resources.

Second, the institutional structures and dynamics across – and sometimes even within – countries are extremely diverse.[4] Countries have different numbers of levels of government with varied degrees of empowerment and relationships. Intermediate tiers of government are often more powerful, but in some countries lower tiers have more authority. In addition, other types of subnational jurisdictions, such as capital regions, metropolitan governments (often encompassing multiple autonomous municipalities), and larger cities, may be more heavily empowered, although they may in practice remain dominated by the centre or regional governments and be unable to make major decisions even if they have managerial capacity and a strong resource base. Equally important, subnational governments can be relatively independent in managing their functions and resources, while in other cases the relationship is more hierarchical, such that few significant fiscal decisions can be taken without higher level approval. These realities are highly relevant for developing a feasible path to municipal finance reform – although there are some basic principles that can offer guidance, there is no generalisable formula for improving municipal finance.

Third, municipal finance involves multiple sources that need to be understood as integrated parts of the broader municipal finance system. These include subnational own-source revenues, such as property taxes, business licensing and user charges. Higher-level taxes and non-tax revenues can also be shared with subnational governments on a basis that may be fully determined by the central government or that the municipal government may have some control over (e.g. optional piggybacking on a higher-level revenue source). Intergovernmental transfers are almost invariably important. They can be unconditional or highly conditional, and they may go directly to municipalities or pass through a state/provincial government that has some control over allocation to municipalities in their jurisdiction. Development finance can come from transfers, but it may also come from loans or municipal bonds, any of which can be supported by development assistance. In many cases there has been excessive focus on developing one of these elements of municipal finance without considering its linkages to others. Intergovernmental transfers, for example, may weaken municipal government incentives to collect their own-source revenues or to borrow for public investment even if they have the capacity to do so for a self-financing public service facility.

Fourth, a reform may involve dedicated focus on a single aspect of one source of municipal finance that cannot on its own improve performance of the targeted source. For example, some initiatives to improve municipal property taxation are focused on developing mechanisms for more complete property registration and more accurate property valuation. While undeniably important, such efforts may dramatically increase the property tax liabilities of businesses and citizens who are not even paying taxes at current levels due to weak collection and enforcement mechanisms or dissatisfaction with the services being provided by the municipal government. In such cases, it may be more important to focus initially on improving collection processes and/or enhancing taxpayer education and support measures that lead to better compliance/yields from the existing tax before moving on to more advanced reforms. Similarly, there are cases in which intergovernmental fiscal transfers place conditions on the use of funds for important purposes, but municipal governments may not have adequate funds for important complementary expenditures. For example, a conditional health transfer may be restricted to use only for medical supplies or staff salaries while resources to finance the other essential line item are insufficient.

Fifth, some international development partners do not seem to be particularly inclined to take the contextual and linkage

3 See, for example, Boex and Yilmaz (2010), Smoke (2001, 2015) and UCLG (2008, 2011, 2014, 2015, 2016).

4 Diversity is challenging to document systematically, but there are a number of global overviews, such as UCLG (2008), UCLG (2011), Martinez-Vazquez (2011) and OECD and UCLG (2016/2019), and attempts to compare regions or countries, such as World Bank (2005, 2016), Boex (2013), Smoke (2013, 2019) and Yoshino and Morgan (2017).

considerations outlined above adequately into account.[5] Of course, all development partners officially recognise the importance of context and somehow consider it in programme design. At the same time, much of the work in municipal finance, as discussed more fully below, remains relatively technical and standardised. The persistence of institutional monocropping/isomorphic mimicry with little attention to critical institutional and political realities, long recognised as an issue in development assistance, can compromise the effectiveness and sustainability of development partner support for public sector reform in developing countries.[6] Even if municipal finance reforms that worked in one country can be replicated in others, assessment and adaptation to local context are almost inevitably required. In addition to often pursuing formulaic approaches, development partners not uncommonly contribute to reform fragmentation by focusing on limited elements of municipal finance and not sufficiently considering relationships to or effects on other complementary system elements.

2 Approach of the review

The landscape of development partner activities in municipal finance is complex and diverse. A set of questions was developed to guide the search of websites and publications based on the SDC scope of work. It was not possible to uniformly apply it due to substantial differences in publicly available information. The first cut involved preparing notes on material presented on each development partner website. After reviewing this information and considering SDC interests and what was available, an attempt was made to develop more standardised agency profiles (see Annex 1).

The key issues in each profile were grouped into four main categories: (1) the priority of municipal finance for the development partner; (2) the focal areas of interest and support; (3) agency responsibility for the municipal finance portfolio; and (4) the modalities used/types of programming supported. The types of questions considered in each are summarised here.

1 Priority of municipal finance for the development partner

- **Does municipal finance seem to be a dedicated priority, or it is more secondary to their work?** A secondary focus would be determined, for example, if the development partner is focused more broadly on decentralisation or another aspect of public sector reform/governance, such as civic participation, and their involvement in municipal finance is related to the primary focus.

- Is the development partner focused more on **national level reform** (and multiple agencies or just a Ministry of Finance or Ministry of Local Government, or specific sectoral ministry) or more on **subnational-level reform and support**?

- **If the focus is subnational, are they dealing with all subnational governments**, or just certain types (e.g. states/provinces, metropolitan areas, cities, rural areas, disadvantaged areas, etc.)?

- **What kind of philosophy/framework does the development partner use to guide their work in this area?** Is there a single underlying agency policy/manual on fiscal decentralisation or municipal finance? Alternatively, could there be, for example, various policies (public finance, intergovernmental relations, urban, water, health, etc.) that not integrated across the agency; or a general decentralisation/subnational governance policy that is not specific to finance matters?

- **Is the work in this area pursued through a specialised lens or does it involve multiple sectors?** For example, municipal finance can be approached from a broader finance or governance perspective, or it can be framed from the perspective of urban/city development, climate change, health service delivery, etc.

2 Particular focal area(s) of the development partner in municipal finance

- **General fiscal decentralisation support** (including national intergovernmental fiscal frameworks, legislation, regulation, policies, and oversight) to enable municipal empowerment.

- **Own-source revenues development** (perhaps a more specific focus on property taxes, user charges, etc.).

- **Intergovernmental fiscal transfers** (including compliance or performance-based transfers, a major trend in the municipal finance field).

5 Some discussions include: Litvack, Ahmad and Bird (1998), Romeo (2003), Fritzen (2007), Connerley, Eaton and Smoke (2010), DeLoG (2011), Eaton, Kaiser and Smoke (2011), Smoke and Winters (2011), Dickovick (2014) and Smoke (2015).

6 See, for example: Andrews, Pritchett and Woolcock (2017), Booth and Unsworth (2014), Levy, Fritz and Ort (2014) and Rocha-Menocal (2014).

- **Subnational borrowing** (including borrowing/fiscal responsibility regulations, subnational financial intermediaries, municipal bonds, etc.).
- **Subnational public financial management (PFM)** (general, budgeting, procurement, transparency, auditing, etc.).
- **Civic engagement in municipal finance** (participatory budgeting, consultation on local revenue sources, feedback mechanisms, etc.).
- **Public–private partnerships** (PPPs) (for general management functions, service delivery or for revenue administration).

3 Organisational responsibility for the municipal finance portfolio and collaborative efforts among department(s)/divisions/practice(s)/unit(s) involved in municipal finance

- **Does one group within the development partner manage all municipal finance programming or are multiple intra-organisational actors handling their own activities?** In some cases, there could be a dedicated municipal finance division, or the municipal finance portfolio could be under a general public finance division. In other cases, multiple actors may have programmes that involve municipal finance support; for example, an urban division that supports urban infrastructure finance or a sectoral division that assists with user charges for services they support.
- **If there are multiple actors involved, does any actor have the authority to oversee and coordinate what other actors across the development partnership are doing?** In some cases, the various actors may have to clear activities with a lead actor, and in other cases they may not be required to do so.
- **If various actors are more independent, have they made any voluntary efforts to develop formal partnerships with other actors where appropriate?** For example, an urban division focusing on development planning and infrastructure investment may develop a joint programme with a municipal finance division working on broader fiscal capacity development.

4 Development partner modalities and types of projects and programmes supported

- **Does the development partner provide the counterpart government with municipal finance support primarily through grants or loans?** Some development partners may of course provide both, and they may also provide in-kind technical assistance that they fully manage (in consultation with the counterpart government).
- **Is the development partner providing support that is more targeted at intergovernmental fiscal/municipal finance system development or more on the implementation of municipal finance policies?** System development would tend to be provided to a central government agency, while implementation support could be provided to the central government (to roll out and support municipal finance policies on the ground and to build the capacity of central agencies to manage this process) and/or to municipal governments adopting new finance policies or improving their performance on existing ones. In some cases, infrastructure investment projects can also include dedicated funding to develop municipal capacity.
- **Are there any specific noteworthy modalities or approaches used by the development partner to support municipal finance?** These might include, for example, budget support, performance-based grants, innovative approaches to implementation and capacity building, activities that bridge multiple government agencies with a role in municipal finance, North–South partnerships, and partnerships among development partners, among others.
- **What is the scale of development partner support for municipal finance and what factors influence its form?** The size of projects/programmes varies widely and is influenced by multiple factors, such the use of grants vs loans, modalities employed and an organisation's available resources (human and financial).

3 Challenges in comparing development partner municipal finance portfolios

Although efforts were made to follow the framework and to be as consistent as possible in reviewing the roles of major development partners in supporting municipal finance, it was not possible to produce standardised profiles for these partners. This, of course, also implies that it was not possible to conduct a comprehensive comparison of the partners that provides a strong basis for operational recommendations. Several factors complicate a neat comparison and synthesis. These are summarised here and discussed more fully as needed in the comparative overview of development partners in later sections.

- **The amount and quality of available information on municipal finance activities differs greatly** across and within development partners, and it is also presented very differently. Rarely is there enough information on websites or in official publications to get a strong sense of how much of a priority this area is for the agency, and equally or even scarcer are detailed data on its relative importance in budgetary terms.

- **Very few development partners have official agency-wide policies on municipal finance.** Some broader policies, however, such as those on public finance or fiscal management, or more specific policies on decentralisation, local governance or urban development may be partially focused on finance. In some cases, the policies are specific to internal divisions of the agency rather than agency-wide policies issued by the development partner leadership.

- **Development partner management of municipal finance activities are not uncommonly – especially in larger organisations – spread across different divisions and practices within an agency, but not necessarily in clearly identifiable ways.** A few smaller agencies with mandates more specific to decentralisation have a single division dedicated to subnational finance. More often, responsibility is based in a general public finance or governance division, or occasionally in a dedicated intergovernmental or decentralisation practice.

- **Dedicated municipal finance projects exist but are not necessarily labelled as such**. Related activities may be under (sometimes almost hidden in) more general decentralisation and local governance projects; or they may be included under PFM reforms. Agencies with a strong urban development group have projects that are very important for municipal finance, and some sectoral projects – such as education, health, transport, water, etc. – include key elements of municipal finance (e.g. infrastructure finance, sectoral fiscal transfers, user charges), but they are not framed as municipal finance projects.

- **Some development partner activities outside of the traditional public sector reform and service delivery agenda also have components related to municipal finance.** These could include, for example, community-driven development, social inclusion, rural development, privatisation, and PPPs, among others. Increasingly, programmes and initiatives aimed at pressing high-profile global crises – such as climate change action and pandemic response and preparedness – also include reforms and innovations in subnational, community and intergovernmental finance.

- **The full range of municipal finance-related initiatives across donor agencies are rarely reported in an integrated way.** More commonly they are reported individually by the different divisions and practices. It is not clear in many cases if and how they are coordinated across these divisions and practices, although in some they clearly are not, even by intra-agency actors that are supposed to be taking the lead on municipal finance. Some development partners have also reorganised (even multiple times) in ways that complicate tracing the trajectory of municipal finance initiatives over time because they have moved under different divisions and practices.

- **Public reporting on specific projects and programmes (whether dedicated to municipal finance or just related the field) and their performance is very uneven.** In some cases, there is good quality and detailed information about projects (including a range of documents from early concept notes to final evaluations). In other cases, there are examples of the types of projects and programmes a development partner does with selective documentation. In still other cases, project documents are not available on the websites. Some of the informational imbalances may be due to the fact that a number of development partners heavily contract out their projects to private consulting firms.

- **There seem to be few comprehensive development partner-wide assessments of activities to support municipal finance.** In fact, there are not even many good or recent assessments of overall support to decentralisation and local governance. For example, the last published evaluation of decentralisation by the World Bank's Independent Evaluation Group (IEG) was issued in 2008 – an update that IEG has been working on for more than three years has not been completed. If development partners are not carefully, objectively and regularly reviewing their own overall efforts, it is hard to assess the breadth, strengths, and weaknesses of their portfolios.

Given these various challenges, the comparative review of development partner activities supporting municipal finance provided here must be interpreted and used as tentative and illustrative. The significant variations in the specific priorities and institutional structures of the development partners are not conducive to conducting a comprehensive and systematic comparison of their activities. The situation is further complicated by major differences in the scope and types of support provided for municipal finance and in considerable variations in the volume, detail and quality of information made available by development partners to the public.

4 Development partner municipal finance priorities and practices

It is quite difficult to determine in concrete terms how much particular development partners prioritise municipal finance. Many development partners have 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 (UNCDF), have a stronger general framework, and a few specialist agencies, such as UNICEF, have policies on how to approach decentralised finance in the sectors they work in. UN-Habitat has several general publications on urban and municipal finance, but they do not constitute official agency policy.

Many development partners, such as USAID and the European Commission, have diagnostics or manuals designed to assess decentralisation more generally. These typically have some material about fiscal decentralisation and subnational finance, but again are not statements of official development partner policies or approaches. SECO has developed guidance on subnational public finance management as well as public investment management, which describes its approach to subnational financial matters. Further, it has developed a guidance note on sustainable urban development covering the urban value chain of planning, financing and operating infrastructure.

Larger development partners, especially the international financial institutions, also produce material on municipal finance and intergovernmental fiscal relations, but typically there are multiple publications on this topic, or they are part of a broader institutional strategy rather than a specific municipal finance policy. The African Development Bank is the only international financial institution (IFI) that has a policy to provide agency-wide guidelines on engaging in subnational finance. In the case of the World Bank, a recent internal assessment could not identify a specific World Bank strategy that comprehensively outlines a preferred and consistent approach to strengthening subnational governments, including subnational finance. There are, however, a number of publications, including a review of city financing Africa, a report on urbanisation in South Asia, and a general urban policy document on harnessing urbanisation for growth and poverty reduction with elements of a strategy to enhance subnational finance. These do not, however, constitute World Bank-wide policy statements. The Asian Development Bank (ADB) does not appear to have a specific municipal finance policy, but there is reference to subnational finance in ADB's Strategy 2030.

4.1 Areas of development partner focus

Development partner engagement priorities in the field of municipal finance vary. Table 1 presents a general overview of the types of municipal finance activities that various development partners report they are engaged in. This table, however, cannot be seen as definitive since it is based mostly on a review of secondary material and limited consultations with development partner representatives, and does not include SECO's activities. Moreover, it does not capture the relative priority of municipal finance in these agencies' portfolios, or the volume of resources involved. It is only intended to offer a sense of the breadth of engagement of the various agencies.

MULTIPLE AREAS OF FOCUS

Large multilateral development banks with an abundance of staff and financial resources have the most diverse and multi-sector project portfolios, while UN agencies and most bilateral donors tend to engage in the area through specialised lenses. In 2015, multilateral banks and the International Monetary Fund (IMF) pledged to increase the role of subnational governments in delivering public goods and services in *From Billions to Trillions: Transforming Development Finance Post-2015*, with particular emphasis on (a) strengthening subnational government capacity to raise their own revenues, manage expenditures and manage debt; and (b) developing intergovernmental fiscal transfer arrangements with consideration towards subnational investment needs, strengthening fiscal capacity to meet expenditure needs across levels of government, and delineation of multi-level spending responsibilities. The World Bank, along with all three regional development banks, continues to demonstrate a firm commitment to this broader scope of subnational government financing support.

The World Bank is the most active donor with municipal finance work that spreads across multiple subcategories of the governance and urban development sectors, although most interventions are relatively independent and not coordinated at an institutional level. In the context of strengthening governance and institutions, the Bank employs a variety of instruments and channels to establish, reform and build the municipal finance capacity

Table 1: Development partner engagement in municipal finance

	African Development Bank (AfDB)	Asian Development Bank (ADB)	Inter-American Development Bank (IDB)	World Bank Group (WBG)	International Monetary Fund (IMF)	European Union (EU)	UNICEF	UNCDF	UN-Habitat	UN Women	USAID	GIZ	French Development Agency (AFD)
Areas of municipal finance	**IFIs**					**EU**	**UN agencies**				**Bilateral agencies**		
General fiscal decentralisation support	X	X	X	X	X	X	X	X	X	X	X	X	
Subnational own-source revenues	X	X	X	X				X	X		X	X	
Subnational borrowing and access to capital		X	X	X				X	X		X		X
Subnational public financial management (PFM)			X	X	X		X	X	X	X		X	
Civil engagement in municipal finance				X		X		X			X	X	
Public–private partnerships (PPPs)	X	X	X	X				X	X		X		X
Municipal climate financing	X			X		X		X					
Municipal service delivery and financing	X	X	X	X		X		X	X			X	X
Digitalisation of municipal financing services			X										

Source: Compiled by the authors from development partner websites and publications.

of client countries in areas including subnational PFM, subnational tax administration, and fiscal decentralisation. Interventions generally target national-level institutions more frequently than subnational ones, although they often include dedicated support at the subnational level. In recent years, a concerted effort has been made to increase direct public finance engagements and lending at the subnational level, particularly in larger, middle-income countries like Brazil, Russia, Nigeria and India that are either federal countries or have strong intermediate tiers of government. In the context of urban development, the Bank's municipal finance interventions support cities to make more efficient and effective use of their finances, mobilise own-source revenue, foster investment-friendly environments, and access development finance to meet service delivery and infrastructure needs. The Bank has finance-related activities in multiple service delivery sectors, and it also supports activities to strengthen the financial planning and management of sector-specific services in municipalities, including water, healthcare, education, solid waste and transport. Finally, the Bank provides extensive support in the development of PPPs to enhance the extent and quality of local service delivery. Some of these activities in urbanisation, PPP and sector-specific financial planning and management (except healthcare and education) are supported by SECO.

Much like the World Bank, municipal finance work at the three regional development banks has a broad multi-sector focus. The Asian Development Bank (ADB), for example, has a focus on fiscal decentralisation and strengthening local governance for better service delivery, as articulated in its *Strategy 2030 Plan for Operational Priority 6: Strengthening Governance and Institutional Capacity, 2019–2024*. Towards these goals, ADB prioritises designing incentive-based intergovernmental transfer systems which delineate mandates and functions across levels of government and establishing accompanying performance monitoring systems. Although the ADB's municipal finance scope is narrower than that of the World Bank, its work in the urban development sector covers a wide range of interventions as explained in the ambitious *Strategy 2030 Plan for Operational Priority 4: Making Cities More Livable, 2019–2024*. This document identifies urban financial sustainability as a core priority to be achieved through (a) mobilising funding for cities (via property taxes, land-based financing, user fees, licences/permits, PPPs and debt financing via credit); (b) establishing regulatory policies and frameworks to govern tariffs, transfers and other financial management processes at the national and urban levels; and (c) climate financing innovation. ADB's evident prioritisation of cities as leading recipients of its municipal financing support is reaffirmed through the multitude of city-focused partnerships under the Urban Financing Partnership Facility: an investment financing mechanism through which ADB, along with various bilateral (including SECO) and multilateral donors, co-finances and co-manages four trust funds aimed at financing climate-resilient infrastructure and services in Asian cities.

The African Development Bank (AfDB) municipal finance agenda is well defined and not unlike that of the ADB in that it also prioritises (a) fiscal decentralisation, and (b) mobilisation of funding for infrastructure and service delivery (via land-based financing, property taxes, financial intermediaries, special purpose vehicles, borrowing and PPPs). While most of these own-source revenue mechanisms such as property taxes and land financing are also targeted by other multilateral banks, the AfDB's approach to subnational financial sustainability places great emphasis on strengthening the financial sector and preparing subnational governments to access capital markets via borrowing and debt management to minimise risks in the life cycle of infrastructure investments. This involves building the capacity of local and regional financial institutions, i.e. commercial banks, sovereign wealth funds, pension funds, insurance funds, etc. to provide funding to subnational entities and to build financial markets where they remain severely underdeveloped.

At the Inter-American Development Bank (IDB), fiscal decentralisation priorities closely mirror those of the other development banks in their efforts to address shortcomings in intergovernmental transfer systems and coordinate expenditure functions across government levels, modernise PFM systems at the subnational level, bolster subnational creditworthiness and promote own-source revenue generation via taxes, permits and land-based financing. Notably, the IDB's *Housing and Urban Development Sector Framework Document* prioritises service streamlining for municipal governments through a one-stop-shop government approach to tax, land and permit administration, often via digitalisation.

Aside from the development banks, a few UN agencies, such as UNCDF and UN-Habitat, take a broader interest in municipal finance as essential to reducing challenges to building inclusive and sustainable cities, and using public and private finance to advance development in least developed countries (LDCs). Beyond its mandated institutional focus on urban development, UN-Habitat is also a focal point for local governments within the UN system, making it a key player in the municipal finance space. Since urbanisation rates continue to outpace economic growth in much of the world, UN-Habitat supports local governments in responding to rising pressures to equitably house and provide critical services to growing urban populations. UN-Habitat began a renewed focus on innovative economic and financial policies for urban areas in 2014 to assist them in meeting growing infrastructure and service delivery need.

Its 2020–2023 strategic plan lists 'increased and equitably distributed locally-generated revenues' among its intended outcomes and pledges to support enactment of legal and institutional reforms necessary for local governments to generate additional financial resources. UN-Habitat's activities target enhancing own-source (especially land-based) revenues, improving use of transfers, and increasing opportunities for cities and municipalities to access funding through borrowing, municipal bonds and PPPs.

Like UN-Habitat, UNCDF also puts considerable emphasis on financing sustainable local development. UNCDF was founded as a subsidiary of the United Nations Development Programme (UNDP) to finance infrastructure in LDCs before decentralisation became prominent. Over time, it transitioned to supporting local government planning and finance through innovative pilots in a range of countries. UNCDF provides some support to local revenue generation, but the signature mark in municipal finance is its pioneering efforts in developing performance-based transfers intended to develop local government systems and capacity, which in some countries were expanded and institutionalised by larger development partners with greater resources. In continuing its support to subnational finance, UNCDF has made efforts in recent years to move beyond transfers to supporting other sources of development finance. UNCDF launched its Municipal Investment Financing (MIF) programme with the objective of increasing local governments' access to capital financing through a mix of public and private financial sources. The MIF programme promotes the use of blended finance to narrow the financing gap in cities by using grants and non-grant financing instruments such as loans, bonds or equity. The exact blend of instruments depends on country-specific circumstances, but the MIF programme also actively works towards creating enabling conditions for local governments to access more funding sources to meet their investment needs.

Alongside the MIF, UNCDF supports broader fiscal decentralisation and improves public expenditure management systems at the local level by strengthening fiscal transfer mechanisms to get finances flowing to secondary cities, peri-urban localities and rural areas. It is worth noting here that as UNCDF's parent agency, UNDP used to play a stronger role in fiscal decentralisation, and there was even for a period in the 1990s some competition between the two agencies because UNCDF was able to independently raise substantial funding for its efforts. These days, however, UNCDF generally takes the lead on fiscal and financial matters. UNDP and UNCDF do some joint projects that include fiscal decentralisation and governance, but the fiscal elements of these projects are typically managed by UNCDF.

SPECIALISED FOCUS

Most UN agencies and bilateral development partners are generally, although not exclusively, likely to support municipal finance from a specialised standpoint, either due to an explicit organisational mandate or strategic interests. Multiple UN agencies are involved in municipal finance work in various capacities, although these issues are not evenly prioritised, and their level of involvement is largely dictated by their thematic and/or demographic focus. For entities like UNICEF and UN Women, for example, support for municipal finance is targeted to particular activities that support their mandates to advance the rights and protections of women and girls, and children worldwide. UNICEF has become an active player in the public finance and local governance space in recent years in an effort to bolster the capacity of governments to mobilise and allocate resources for children's social protection and poverty reduction programmes.

Through its flagship Public Finance for Children (PF4C) programme, UNICEF works with national and local governments to address shortcomings in PFM policies and processes, with a particular emphasis on decentralised budgeting, cost-effectiveness, and accountability for children's programmes. At the central level, interventions aim to reform how ministries of finance, line ministries and parliamentarians play their respective roles in ensuring that child-related policy priorities are taken into account throughout the planning, execution and monitoring stages of the budgeting process. At the local level, PF4C efforts assist subnational governments in strengthening their budget submissions by using appropriate costing methods and indicators, as well as making budget data publicly available to enable communities and civil society actors to participate in the budgeting process and hold leaders accountable. Although UNICEF does not generally venture into assisting with own-source revenue generation at the central or local levels, it does occasionally support financing mechanisms for select social services that benefit children via unconventional mechanisms; for example, sin taxes.

Like UNICEF, UN Women is a relatively new participant in the municipal finance space. This agency has concentrated most of its efforts on strengthening budgeting processes as a means of fast-tracking progress towards better development outcomes for the demographic it serves. This is done by supporting finance ministries, sector ministries, parliaments and local governments to incorporate gender equity considerations into all stages of the budgeting process and remain cognisant of the impact of spending choices on existing gender gaps. In decentralised contexts, the efforts of UN Women centre on supporting local governments to overcome obstacles, such as limited capacity to implement gender-responsive planning and budgeting and establish effective accountability mechanisms. To tackle these constraints, UN Women piloted an approach using a multi-faceted strategy that combines technical support with capacity building for local government councils, planners and budget officers, while creating opportunities for women to participate in planning and budgeting for gender-responsive services at the local level.

The European Union's (EU) engagements in local government affairs are frequently initiated with the aim of supporting decentralisation reforms, mostly legal and administrative, but occasionally also financial. EU support for decentralisation focuses on establishing an enabling legal and policy environment and supporting institutional capacity development to enable local authorities to maximise the autonomy granted by law to fulfil their duties. The expectation is to enhance 'the allocation of sufficient financial resources to local authorities according to national legal frameworks, improved PFM, and mobilisation of revenues at the local level'. In this regard, the EU considers fiscal decentralisation a strategic entry point through which it can progressively foster a culture of accountability towards citizen-centred service provision, hence its focus on (a) enhancing the integration of external and domestic revenue sources into streamlined intergovernmental fiscal transfer systems; (b) supporting local tax revenue and development planning; and (c) strengthening the budgeting and spending processes of local authorities. Within the context of support for sustainable urbanisation, the EU recognises the importance of ensuring that land values are appropriately exploited to increase municipal income in order to finance service and infrastructure provision.

Beyond UN agencies and the EU, the emphasis on revenue generation in the municipal finance space is also evident in bilateral donors. USAID municipal finance activities are extensive. GIZ's good financial governance (GFG) approach has the objective of helping partner countries to generate additional domestic revenue and structure their budget processes fairly and transparently. The approach is underpinned by the viewpoint that a well-functioning public finance system is the backbone of every well-organised country and that fair, transparent and effective tax systems enable the state to adequately provide services to all citizens. The GFG approach was conceptualised holistically to combine (a) efficient revenue mobilisation; (b) effective budget planning and execution; and (c) functioning accountability mechanisms. Through GIZ, Germany's development cooperation efforts support good financial governance through public finance reforms in more than 30 countries worldwide, using technical expertise and political economy analyses to inform strategic interventions. The programme has been successful at supporting fiscal decentralisation efforts and raising local revenue in multiple countries including Indonesia, Tanzania, Mozambique, Serbia and Mauritania, primarily through municipal tax administration and collection reforms.

Another bilateral actor supporting municipal revenue mobilisation is the French Development Agency (AFD). A considerable proportion of AFD's engagements under the 'Improving City Governance' pillar centre on building local government capacity and creating sources of income to improve service and infrastructure provision. In doing so, AFD is diversifying its financial instrument offerings by supporting local government access to alternative funding via direct loans, on-lending, financial security instruments, etc. For example, AFD granted its first direct public loan to a local authority through a €120m non-sovereign loan provided as budget support for ecological transition in Barranquilla, Colombia. Overall, AFD's support for cities is channelled through support for territorial development and decentralisation by improving access to financing for their investment programmes.

SECO's approach to subnational PFM takes the intergovernmental fiscal transfer systems as a starting point by distinguishing between deconcentration, delegation and devolution. The degree of autonomy of subnational finances defines its approach to municipal finance, and in particular the relationship with national-level reforms. SECO has notably supported the development and piloting of the subnational Public Expenditure and Financial Accountability (PEFA) diagnostic tool, which underpins its diagnostic-based approach to municipal finance reforms. Its intervention covers the revenue as well as the expenditure side, by supporting the development of fiscal cadasters, property tax reforms and value-capture instruments, and on the expenditure side with a focus on public investment management, alongside interventions along the entire PFM cycle. Working in a holistic manner, fiscal decentralisation reforms support the provision of municipalities with resources for priority investment. However, capacities to budget for, analyse, select, prioritise and prepare investments are often lacking. Therefore, SECO has increasingly strengthened its focus on public investment management, as well as support for project preparation. This includes due consideration of operation and maintenance at all stages of planning and implementation. Through its focus on infrastructure finance and sustainable urban development, a comprehensive portfolio of multilateral and bilateral projects aim at mobilising revenues for municipalities through debt financing, on-lending, PPPs and innovative financing instruments. This is underpinned by its significant engagement on developing local capital markets, including for sub-sovereign entities.

4.2 Organisational management of municipal finance programmes and projects

Many development partners have at least two divisions/departments that manage their main municipal finance interventions, and these are typically the teams whose overall thematic focus is on finance, governance or urban development. These key players seem to operate relatively independently of one another 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 country director is able, for example, to convince public finance and urban development project managers to adjust their efforts to complement rather than partly duplicate or conflict with each other.

The three major regional development banks follow the mostly siloed approach characterised by two main divisions leading all municipal finance efforts from the governance (mainly decentralisation) and urban development perspectives. For example, at the IDB, most municipal finance projects fall under the Fiscal Management Division, which has institutional responsibility for subnational fiscal policy and management, and the Housing and Urban Development Division, which focuses on urban governance and supports increasing cities' financial resources for service delivery and infrastructure development. The two divisions generally do not seem to collaborate. The AfDB and the ADB have similar divisions that cover finance, governance and urban matters, although differently organised and named, that also have some role in municipal finance activities. All of the regional development banks have sectoral groups (e.g. education, energy, health, water, transport, etc.) and specific practice groups (e.g. PPPs, financial markets, climate change and disaster risk management, etc.), but the extent to which they are directly involved in municipal finance is not well documented.

The World Bank is a larger organisation that has operated in a relatively fragmented manner for a long time, a situation that has been complicated by periodic internal reorganisations. The leading World Bank global practices (GPs) that implement most municipal finance projects are the Governance GP and the Urban, Disaster Risk, Resilience and Land GP. The interests of these two GPs frequently overlap in their dealings with subnational governments (particularly in urban areas), which occasionally presents opportunities for collaboration. In recent years, there have been reported efforts to promote inter-division collaboration where possible to reduce duplication and mitigate inefficiency, although the results have been uneven. Despite this sporadic joint project implementation, the World Bank still has no integrated institutional approach or strategy when it comes to its municipal finance engagements and the bulk of its interventions seem to remain at least somewhat fragmented, sometimes even within the Governance and Urban GPs. Moreover, some of the sectoral practices, such as education, health, transport and water, are involved in financing sector-specific infrastructure, sector-specific fiscal transfers, and/or sector-specific user charges without appropriate coordination with the Governance or Urban GPs.

A number of bilateral development partners are also subject to this type of intra-organisational fragmentation in supporting municipal finance. USAID's municipal finance work, for example, is spread across three different departments which operate relatively independently and without much evidence of attempts to coordinate interventions at the global and country levels. The Center for Democracy, Human Rights, and Governance (DRG Center) supports decentralisation processes with an emphasis on citizen engagement in local decision-making processes (e.g. participatory budgeting at the municipal level) while the Center for Economics and Market Development supports economic policy and analysis through domestic resource mobilisation with a significant focus on taxation. From a sector lens, the Center for Environment, Energy, and Infrastructure leads USAID's work on sustainable urbanisation and addresses financing elements of urban development with an emphasis on fostering the financial sustainability required to meet service needs via capital markets and PPPs.[7] All three centres fall under the Bureau for Development, Democracy, and Innovation (DDI), which is the agency's central unit comprised of four centres and five hubs that provide USAID missions around the world with technical assistance and administrative support. This type of excessive fragmentation observed within USAID's structure is not unusual, and there are concerns that it contributes to the inefficiency and coordination challenges that plague the municipal finance development partner landscape.

GIZ has a less complex structure, but there are also a number of divisions that support municipal finance. The sectoral department (FMB) has a governance and conflict unit that includes an urban and regional development sub-unit that works on decentralisation and local finance. In addition, there is a department on sector and global programmes, which has a unit on global policy, governance and cities that has some involvement in subnational finance activities. Other bilateral development partners also have multiple (and sometimes shifting) internal

7 USAID website.

departmental structures that may also engage in fragmented municipal finance activities, but the details of the situation are not well documented or explained in publicly available materials.

Finally, in just a few development partner and IFIs, municipal finance issues are largely addressed by a single department with a singular sector or target demographic focus. The IMF's Fiscal Affairs Department (FAD) provides fiscal policy and management expertise in PFM, tax policy, revenue administration and expenditure policy directly or in close cooperation with IMF area departments (Africa, Asia, Europe, Middle East, etc.). Although the IMF's work primarily targets central banks and ministries of finance, FAD engagements in decentralised countries may involve advice on and/or support to intergovernmental elements of processes like fiscal decentralisation, subnational borrowing and PFM regulation.

In smaller organisations with a specific focus on subnational finance, there can also be a single internal division largely managing municipal finance activities. UNCDF efforts, for example, are primarily managed by the Local Development Finance Group, although there is also an LDC Investment Platform that is involved in financing arrangements. In development partners that are mandated to serve specific target populations, municipal finance issues are usually confined to a single department. In UNICEF, for example, the Social Policy Division is in charge of working with subnational governments to improve the spending and allocation of public resources for social protection and poverty reduction programmes for children.

4.3 Form and scale of municipal finance interventions

Development partner interventions differ in form and scale, but there is limited summary information available to the public that allows a detailed picture to be painted of the municipal finance activities of some of these agencies. In some cases, municipal finance initiatives are embedded in larger finance, governance, decentralisation, urban or sectoral programmes and projects. Since the international financial institutions/development banks typically provide funding in the form of loans (including for subnational investment) to counterpart countries, the largest and most resource-intensive projects are generally funded by them. 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 IFIs.

As the main multilateral development bank, the World Bank has some of the biggest municipal finance projects and programmes. These are typically financed by loans (often with grant components, especially for technical assistance and capacity building) intended to fund ambitious structural overhauls in the areas of fiscal decentralisation, PFM and tax administration reform. These not uncommonly include national components (to develop frameworks, regulations, and intergovernmental processes) and subnational components to help subnational governments to implement and adapt (as necessary and allowable) the frameworks to local situations. Certain initiatives may include the financing of public infrastructure investments that also support the adoption or improvement of municipal financial practices, such as the use of PFM systems or the collection of property taxes and user fees. In some cases, the support is progressively rolled out over time through a series of projects and programmes. In some cases where the situation is fragile, there may be dedicated aspects of an initiative to deal with a specific challenge.

An example of World Bank support for large-scale reforms through a series of large loans for multi-series projects is the three-part Bangladesh Local Governance Support Project, which since 2006 has invested over $700m in supporting the country's transition from a centralised public sector to a more decentralised one under which local governments receive enhanced resources and discretion in deciding spending priorities through a participatory process. An example of World Bank support for a country facing a difficult transition that requires significant investment in building central and local government capacity to meet extremely challenging governance and service delivery demands is the 2019 Eshteghal Zaiee – Karmondena (EZ-Kar) Project for Afghanistan. This was supported by a $150m International Development Association (IDA) grant to Afghanistan in 2019 to support cities dealing with a high influx of displaced people and returnees. The project sought to help municipalities respond to the displacement crisis by strengthening municipal PFM systems, investing in critical urban infrastructure, and fostering an enabling environment through municipal-level regulatory and process reforms (e.g. improving government-to-business services like issuing licences, permits and certifications, business registration, paying taxes, etc.).

The regional development banks do not provide as much detailed information on their websites regarding their projects and programmes as the World Bank does, and they do not often operate at quite the same scale, but they also provide sizable loans to support member countries' ambitious municipal finance and urban development reforms. Other multi-lateral development partners, such as UN agencies and the EU, do not operate at the same scale as the financial institutions. They tend to provide support through grants according to their own principles and operational practices rather than through loans, and sometimes their innovative pilots are mainstreamed by a development bank. Detailed information about the scale of the projects is generally not readily available, which is particularly true of most of the bilateral development partners. The information available to the public on the websites and in the publications tends to be general, selective and illustrative rather than comprehensive.

4.4 Development partner modalities and innovative approaches to municipal finance

Given the enormous variation in the priorities, approaches and portfolios of development partners that support municipal finance and the challenges of accessing comparable information, it is not feasible to provide a comprehensive comparative overview of how they do business. It is, however, possible to offer illustrative examples of the major types of modalities they use and their attempts to innovate in how they support municipal finance. Some of these initiatives are undertaken by individual development partners and others are collaborations.

USING RESULTS-BASED FINANCING

Some type of results-based financing has become common in development partner support to subnational government reform, including municipal finance. This approach can be used to incentivise general local government compliance with procedural and reporting requirements as well as for more specific purposes.

UNCDF has been a leader in this area. UNCDF's Local Climate Adaptive Living Facility (LoCAL), for example, uses performance-based grants to increase climate change resilience at the local level by integrating adaptation mechanisms into subnational planning and budgeting processes. This innovative approach uses core fiscal decentralisation, local planning and PFM principles to enhance infrastructure and subnational government capacity to combat climate change. To avoid creating redundant funding channels, the performance-based LoCAL grants utilise existing transfer systems and cover the additional costs of making local climate-resilient investments.

UNCDF employs a rigorous vetting and assessment process before and during grant design and disbursement processes, which typically entails scoping out the recipient country's institutional and sectoral arrangements to influence the transfer formulas, performance measurement criteria and eligible climate-related infrastructure investments. The ultimate selection of investments is tailored to each local government's climate and economic vulnerabilities, and a minimum set of PFM and governance conditions must be met. At the outset, the LoCAL programme is piloted to test out its feasibility and effectiveness before a second phase is rolled out in additional subnational areas. The third and final phase involves scaling up the initiative at the national level, having gradually adapted it based on lessons learned during earlier pilot stages. Technical and capacity-building support is provided throughout all stages, and once fully rolled out, the aim is for the LoCAL infrastructure to become the primary subnational climate resilience system through which local-level climate finance is channelled. UNCDF is currently implementing LoCAL in over 20 countries.

ENHANCING MUNICIPAL LENDING MECHANISMS

Improving local government development finance is an increasing priority for several major development partners. One example in this area is South Africa's INCA Municipal Debt Fund (IMDF). This is a joint venture special purpose vehicle (SPV) involving a partnership among AFD, the Swiss State Secretariat for Economic Affairs (SECO) and INCA Portfolio Managers (IPMs) to improve the supply of urban infrastructure in intermediate South African municipalities through a responsible investment policy, with priority given to essential urban services and diversification of the municipal finance sector. The goal is to fill a market gap by enabling secondary municipalities with good credit quality to access financial resources.

The effort is a response to the National Treasury's push for development banks to have a leverage effect on private finance. AFD gave a market signal by providing a loan of R500m (about €30m) to the SPV. Investors, including AFD, benefit from a guarantee on first losses, financed by SECO, covering 5 per cent of the amounts committed. The fund is managed by IPMs, and their goal is to raise nearly R1,500m (€85m) in the first funding period. On the project implementation side, technical assistance is provided using resources from the INCA Capacity Building Fund (created in 1998) to enable IPMs to provide technical assistance to targeted municipalities in municipal finance analysis and long-term financial strategising. The project's two main objectives are (a) to improve the supply of urban infrastructure in intermediate cities through a responsible investment policy, with priority given to essential urban services; and (b) to contribute to the diversification of the municipal finance sector by creating a new window and mobilising long-term financing from institutional investors.

SECTOR-SPECIFIC INNOVATIONS IN FINANCING INSTRUMENTS AND MONITORING

Some development partners have developed initiatives to diversify the financing of local service delivery and improve the monitoring of results, and UNICEF has been quite active in this area. In Indonesia, for example, UNICEF has supported successful utilisation of resources mobilised through non-traditional approaches to funding child-focused services and programmes. The UNICEF field office in Aceh works with Baitul Mal Aceh (an independent local government unit under the Aceh Provincial government responsible for collecting and managing Islamic tax) to provide capacity development for local actors in designing and implementing appropriate child-focused programmes which can be funded by Islamic tax revenue.

In Kenya, UNICEF supports establishing blended financing modalities to fund service provision via PPPs at the county level, the only subnational tier of government in the country. This county-level PPP model, known as FundiFix, provides maintenance services to rural water supplies in Kitui county, along with a Water Services Maintenance Trust Fund which subsidises the maintenance service costs with a blend of government and donor funds.

In Uganda, UNICEF partnered with the Budget Monitoring and Accountability Unit (BMAU) of the Ministry of Finance, Planning and Economic Development to develop a framework to monitor implementation of national priority programmes affecting children. The initiative tracks decentralised budget allocations in education, health and water, with findings published in the annual Social Service Delivery Equity Atlas. The Equity Atlas maps per capita expenditure on health, education, water, and the environment at district and sub-region level, along with outcomes like school completion rates, antenatal care visits and water functionality. The framework was integrated into BMAU's routine work and serves as a platform to improve budget transparency and accountability, as well as to identify and alleviate implementation constraints to improve service delivery.

SUPPORTING INTEGRATED MUNICIPAL FINANCE

Although many development partner initiatives to support municipal finance remain fragmented, there have been efforts to pursue the development of a more integrated approach. UN-Habitat piloted its Integrated Municipal Finance Programme with some projects in Kenya. One of the initial efforts was a revenue enhancement initiative targeting the rapidly urbanising county of Kiambu. This sought to introduce a development levy/fee payable to the county government by private developers, with the payments ultimately going either towards the expansion and upgrading of central systems (water/sewage treatment) or towards integrated neighbourhood treatment systems. These payments are a precondition for approving construction permits. Over the course of developing the fee initiative, financial institutions that expressed a willingness to provide interim financing requested guarantees of a return on their funds, which ultimately led to the decision to establish a Sustainable Urban Infrastructure Fund (SUIF) to function as a revolving fund for infrastructure development in Kiambu. The SUIF is a special purpose vehicle overseen by a public board and is designed to facilitate the financing of infrastructure development by guaranteeing interim investment funds against bank guarantees provided by private developers as part of the conditions for receiving building permits. Fees are partly used to replenish funds utilised for infrastructure development and partly to recoup investments.

DEVELOPING CROSS-COUNTRY LOCAL GOVERNMENT PARTNERSHIPS

A number of development partners try to support subnational governments in developing countries by establishing and nurturing partnerships with subnational governments in wealthier countries and in peer countries. The EU, for example, created the PLATFORMA initiative for European local and regional governments to be more involved in development cooperation through collaboration and knowledge-sharing programmes between European municipalities and local and regional governments in developing countries. The impetus for the initiative was a recognition that in light of globalisation, decentralised cooperation is a useful complement to national and EU development policies and programmes. PLATFORMA became a key programme through which European local and regional governments entered partnerships with their developing country counterparts to exchange knowledge and experiences in various areas, including municipal finance. One case is a partnership between local governments in Benin and municipalities in Belgium. The latter assisted the former in strengthening their capacity to mobilise and generate their own resources by creating practical tools, geared towards generating both internal resources (mainly fiscal) and external resources.

There have also been efforts to promote South–South cooperation, such as the Decentralized Cooperation to Democratize Cities Project (2012–2015). This was a peer-to-peer project involving Brazilian and eight Mozambican cities, funded mostly by the EU and the Government of Norway, with participation from Cities Alliance and the City of Barcelona. The National Association of Local Governments of Mozambique (ANAMM), Frente de Prefeitos (association of Brazilian municipalities) and UCLG implemented the project with technical support from Architects Without Borders and the University of Lleida by facilitating exchanges among local government peers from both the cities. This peer-to-peer project focused on sharing applicable technical tools with Mozambican cities for strategic urban planning, inclusive cadastre development and participatory budgeting.

5 Potential lessons/ideas for future municipal finance interventions

The landscape of development partner support for municipal finance is large and diverse to the extent that it is difficult to synthetically review its characteristics, successes and weaknesses. Even though it is not possible to offer definitive and comprehensive recommendations about gaps and areas for future productive engagement, there are a number of areas in which development partner support to municipal finance seems to merit more effort and experimentation. Some of the issues identified are extremely complex and difficult to deal with, and how to contribute to filling these gaps would require careful consideration, often tailored to specific contexts. Thus, the points raised here are not intended to be recommended areas for SDC to focus on, but they can provide a basis for discussing what might add value, what is possible, and what SDC might have the interest and expertise to support. Some of these points are largely based on the impressions of the team that prepared this paper, while others have been raised more broadly in the fiscal decentralisation literature.

First, although there are clearly efforts to support municipal finance in a more integrated way relative to past development partner programming, there is considerable room for deeper and more productive action on this front.[8] The elements of municipal finance must work together – and reflect other aspects of the intergovernmental system – in a particular country. Fragmentation persists in at least three forms that could often be better addressed individually and collectively by development partners.

- **The relationship among elements of specific sources of municipal finance is not always sufficiently appreciated.** For example, improving property valuation in property tax reform may be less effective if there are weaknesses in collection and enforcement. Similarly, the effects of a general revenue-sharing fiscal transfer that is intended to be equalising may be offset by origin-based tax sharing and/or conditional transfers that reinforce fiscal inequalities among subnational jurisdictions.
- **Inadequate integration among the main instruments of municipal finance can generate challenges.** The incentives embedded in the formulae used to allocate intergovernmental fiscal transfers, for example, may undermine the motivation of municipal governments to collect their own independent sources of revenue. Similarly, generous infrastructure development grants can weaken the incentives for creditworthy municipal governments to borrow, even for revenue-generating projects. National borrowing frameworks can also discourage repayment of municipal debt if central governments guarantee these loans.
- **Even a strong and technically sound focus on municipal finance may not adequately incorporate co-dependent elements of the subnational and intergovernmental governance system.** These elements include, for example, development planning, PFM, civil service/human resource management and civic engagement, all of which work together in improving decision making, service delivery, accountability and outcomes. Some specific instances of consequential lapses on this front are noted below.

Second, the effectiveness of municipal financial management is often challenged by the structure of the municipal finance system, both generally and within municipal service delivery sectors.[9] A mix of actors – national ministries and agencies, subnational departments, external development partners – is often involved in municipal finance and financial management in varied ways. The blend and behaviour of these actors can create challenges for downstream players who manage service delivery and service facilities. Fragmented funding may be conditionally targeted for the same or different purposes. Without overall coordinated management of the various sources and sufficient municipal government control over and capability in administering their own-source revenues, there may be fund shortages and/or redundancies for specific categories of expenditure, even more

8 This point is made in many of the references provided in footnotes 1, 3, 4, 5 and 8.

9 A review of these issues and how they affect fiscal management and performance is presented in Smoke and Loeffler (2021) along with an assessment of the health sector in four African countries.

difficult to manage if some funding sources are off-budget (as a non-trivial share of development partner funding continues to be). Moreover, even if funding sources are complementary for budgetary purposes, separate reporting channels to different fund providers may impose significant administrative burdens on municipal administrators and service delivery staff and complicate keeping proper track of resource flows. Such a situation is not conducive to effective municipal finance. There is an enormous need for action on this front, but it may involve multiple national ministries, multiple levels of government, multiple development partners and other actors, so a lot of preparatory groundwork and negotiation may be required. Creating diagnostics to document the nature of the problem and raise awareness about it could be feasible and productive starting points.

Third, strengthening the linkage between municipal finance and development planning for infrastructure investment is key for sustainable development.[10] The challenge is twofold. First, priority infrastructure projects identified in municipal development plans might not be provided for in the capital investment budget. Second, priority projects that are financed in the capital budget may not be allocated funds for operations and maintenance in the annual recurrent budget – municipal asset management is largely neglected in municipal finance in developing countries, and the 'build-neglect-rebuild' paradigm is still a common subnational finance challenge in many countries. Some urban programmes supported by development partners try to link planning and budgeting, but often in the context of specific infrastructure projects (or packages of projects) funded by a specific donor initiative. These efforts do not always result in sound institutionalised practices that are ultimately essential for municipal finance systems to meet their developmental goals. This is not an easy area to engage in, but progress on this front could have an important impact on municipal finance and service delivery. Identifying cases where these challenges have been alleviated could be a useful step in understanding how to develop more effective remedies.

Fourth, although development partners often value civic engagement, there are significant opportunities to increase its linkages to municipal finance given its core relevance for fiscal accountability in a decentralised system.[11] There has, of course, been considerable attention by development partners to popular mechanisms like participatory planning and budgeting. Not uncommonly, however, these are not central to finance system reforms because they are not managed by development partner municipal finance teams but by other teams that specifically deal with, for example, general decentralisation, civic engagement, community development, social inclusion, gender, etc. Even if civic engagement is part of municipal finance reforms, with some significant exceptions, they are not necessarily very influential in municipal spending decisions and almost never connect to the revenue generation side of municipal finance. One of the most fundamental concerns in fiscal decentralisation is the linkage between revenues and expenditures. Weak local revenue compliance in developing countries often occurs because local businesses and citizens believe they are not getting public service benefits commensurate with what they are expected to pay. There are instances in which public education campaigns and negotiations with specific non-governmental actors have been productive in increasing municipal revenue generation. For example, a municipal government might work with an industry membership association to get its support for increases in property tax collections to finance a loan needed to build a new road into an industrial area, or it might negotiate increases in market fees with a market vendors association in return for providing better market facilities, improved sanitation, better electrical access, etc. There would seem to be considerable space in this area for productive support, yet there does not seem to be much evidence of substantial development partner engagement.

Fifth, the effectiveness of municipal finance could be enhanced by strengthening relationships among neighbouring subnational governments, especially in more densely populated areas.[12] When adjoining municipalities do not have the resources or technical capacity to provide some essential services independently, there may be opportunities for them to work together in generating revenues, delivering service and accessing development finance for infrastructure. Not uncommonly, there are institutional arrangements (of uneven quality and effectiveness) to facilitate such relationships in major metropolitan areas, and there may be service-specific agencies (e.g. for water service delivery) that span multiple jurisdictions, but such mechanisms otherwise do not seem to be very prevalent in developing countries. Interjurisdictional cooperation would, of course, have to be appropriately tailored to the

10 Considerable literature in urban and regional planning raises this issue. Some recent summaries are provided in Romeo and Smoke (2016) and Smoke (2018).

11 Reviews of selected experiences with participatory budgeting mechanisms are found, for example, in: Brinkerhoff and Azfar (2010), Goldfrank (2012), Blair (2013), Lund and Saito-Jensen (2013), Baiocchi (2015) and Cabbanes and Lipietz (2018).

12 Interjurisdictional cooperation is a major theme in the fiscal decentralisation literature. A good recent overview is provided in De Mello (2019).

intergovernmental structures and municipal finance legal framework and capacity in a particular country, but they have proven successful in some higher-income countries and may be worth considering in some lower- and middle-income countries.

Sixth, some prominent approaches framed as municipal finance innovations may need some creative rethinking if they are to be sustainably effective. An obvious case is performance-based transfers.[13] The idea of using fiscal transfers to create incentives for municipal governments to behave in desirable ways that serve the public interest is hardly new – conditional transfers have long been used to ensure that municipalities spend on public functions that serve national priorities; for example, services with benefits that extend beyond municipal boundaries or that ensure provision of basic needs to disadvantaged populations. But the use of transfers to ensure local government compliance with basic responsibilities, such as preparing a budget on time, promoting civic engagement in local governance, submitting accountability reports in a timely manner, or attaining certain specific results in local service delivery, is a more recent phenomenon promoted by several development partners seeking both better performance in client countries and better value-for-money from their own aid expenditures. To date, there has been more documented success with compliance-based grants than grants that actually target improved service delivery, and the targets used to measure performance tend to be simplistically measured and static. Municipal governments should not be paid in perpetuity for producing a sound budget on time: it is their legal responsibility to do so. How can these grants move beyond compliance and cover relevant aspects of performance? How can performance be measured and over what time period given that different municipalities are at different starting points and have dissimilar capacities to meet their fiscal responsibilities? Should performance targets be at least partially negotiated with local governments, an approach that would place more responsibility on them for meeting the targets that they agreed to? How should performance targets progressively increase over time? How can these grants be better linked to other elements of the municipal finance system? Although some development partners have extensively used performance-based grants, few have systematically or deeply addressed most of these considerations, which seem critically important if these grants are to be expected to enhance municipal finance and governance progressively and sustainably over time.

Seventh, there is considerable scope for development partners to give more attention to how small and medium-sized enterprises (SMEs) and the informal sector are treated in municipal finance regimes.[14] Such actors may not be heavily affected by municipal revenue generation activities, either by virtue of their economic position in the local community or as a result of conscious municipal policy decisions to treat them more favourably. Tax incentives may help SMEs to develop and expand, so they may be important in improving the earnings and financial condition of these entities. The presence of too many tax incentives for SMEs, however, can increase the cost of tax planning and compliance for small firms, and larger enterprises may try to operate in a way that allows them to benefit from preferential treatment of SMEs. Informal sector operators rarely pay major local taxes, but they are often subject to regulatory and service payments, such as licensing fees and charges for market access and use. A common problem in developing countries is that these fees and charges are arbitrarily set and capriciously enforced, creating considerable inequities in the treatment of informal sector operators. At the very least, subnational governments must create a fair basis for determining these fees and ensure that they are consistently and fairly levied and enforced. Although fees can impose burdens on informal sector operators, they can generate benefits in terms of legitimacy, and vendors are often willing to pay market fees, for example, if they have access to more sanitary facilities that improve their business and working conditions. In addition, informal sector organisations may be able to partner with local governments in fee collection and be allowed to keep a portion of the proceeds to benefit their membership. There has been some research on these issues, but the tax treatment of SMEs and the informal sector does not figure prominently in development partner municipal finance programmes. Some partners may have specific livelihood practices that focus on such matters, but they should also be a direct concern for municipal finance. Appropriately bringing SMEs (and even some informal sector operators) into the tax net can benefit them and the revenue yields of local governments – revenue that can be used to provide better services that benefit municipal residents.

13 Performance-based transfers (general and/or sector-specific) are discussed, for example, in: Shah (2010), Steffensen (2010), Lewis and Smoke (2012), Shah (2013), Mukherjee (2014), and Fan *et al.* (2018).

14 There is not a large municipal finance literature on this topic but some relevant materials can be found, for example, on the OECD, World Bank, ADB and IFC websites.

Finally, and related to some of the above points, there could be many productive benefits realised if more emphasis was placed on how to implement municipal finance reforms/development partner programmes more strategically and sustainably, including taking political economy realities into account.[15] In practice, there has typically been more attention to the normatively desirable design of such initiatives than to how to make them work on the ground. Where implementation strategies exist, they tend to be less well developed than the designs, perhaps perfunctory and/or rigid, and they may end up not being followed. The pace of implementation may be too slow or too fast, over-standardisation may not allow for appropriately asymmetric treatment of very different municipal governments, and capacity-building efforts may be driven exclusively by central mandates rather than local needs and insufficiently linked to the rollout of reforms. This is not to say that all of these issues apply to all reforms and donor interventions – some of the efforts and innovations discussed earlier have attempted to address a number of them. But in many cases, benefits could likely be realised by more strategic implementation that is contextually adapted, and pragmatically and systematically sequenced with appropriate capacity development linked to particular reforms and municipal needs. Exactly how to think about implementation depends on the specific context in which municipal finance interventions are being used. There is no magic formula, and this is not easy terrain to navigate, but development partners can constructively look for innovative ways to deal with implementation more effectively. There is much room for creativity and experimentation on this front.

It must be recognised, of course, that there are considerable challenges involved in addressing many of the difficult gaps and deficiencies in development partner support to municipal finance covered in this concluding section, no matter how clear the potential value of remedial action is. For example, even though overly specialised approaches to municipal finance reform/support can generate fragmentation that may result in policy incoherence and create contradictions in the organisation and operation of intergovernmental and municipal fiscal systems, the factors and dynamics underlying this situation are often strong and complex. Some inconsistencies reflect the common division between technical/fiscal and governance/political aspects of pursuing municipal finance development or any other aspect of public sector reform. Such reform is also shaped by the institutional priorities of development partners and how they align with the political economy landscape in client countries. These complications are real, but they do not lessen the need to seek pragmatic common ground in providing support for municipal finance so that it can more effectively fulfil its potential promise in contributing to development and other public interest goals at the national and local level.

15 How to approach the implementation of decentralisation is considered, for example, by: Shah and Thompson (2004), Ebel and Weist (2006), Martinez-Vazquez and Vaillancourt (2011), Bahl and Martinez-Vazquez (2013), Dafflon and Madies (2013), Smoke (2014, 2015) and Boadway and Eyraud (2018).

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