



Decentralization and Local Governance Network

Sustainable Municipal Finances – Online Discussion Consolidated Reply

Topic: Own Revenues and Borrowing

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After two weeks of fruitful exchange, we are on the final week of this interesting e-discussion. I thank you all who are taking the time to contribute with inputs and insights to the discussion and for sharing the experience SDC is making on Municipal Finances in different parts of the world. We are almost ready to finalize the e-discussion and to open the doors to the F2F exchange in Sarajevo.

To close the discussion, I would like to invite all of you to follow the results of the learning project regarding Own Revenues and Borrowing. An abstract from the synthesis paper is attached and the discussion framework is the following:

Promoting increase in own revenues has, however, considerable potential not only to improve the fiscal base for local service delivery but also to contribute to effective and accountable relationships between local government and its citizens. The link between own-source revenues and accountability is dual. Dependence on own-source revenue promotes accountability and higher levels of accountability also make citizens more willing to pay for services. While donor grants, fiscal transfer systems and borrowing encourage upward accountability, own revenues have the potential to strengthen the accountability to those who have elected the local council. For local governments (increasing) taxes is not a topic on which to win the next elections. Therefore, the demand for support on this issue is limited resulting also in less engagement of donors on this topic. Experience of SDC in supporting programmes on improving municipal own revenues in the form of taxes seem to be limited when looking at the case studies. Similarly, SDC's experience in regard to supporting mechanisms which allow municipalities to borrow money is also very limited.

-) Do you agree with these conclusions? Share your experience
 - A) In your opinion, why SDC has little experience regarding the promotion of own revenues and municipal borrowing?
 - B) What can SDC do to promote increase in municipal own revenues and to support mechanisms which allow municipalities to borrow money?
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Responses were received from:

1. [Parfait Randrianitovina](#), SAHA and [Annette Kolff](#), Intercooperation, Madagascar
2. [Tommaso Tabet](#), SDC, Bangladesh
3. [Petar Vasilev](#), SDC, Serbia
4. [Norbert Pijls](#), Intercooperation, and [Limani Merita](#), SDC, Kosovo
5. [Celestine Krösschell](#), Helvetas, Switzerland
6. [Marc DeTollenaere](#), SDC, Mozambique
7. [Oksana Garnets](#), DESPRO, Ukraine

[Analytical Summary](#)

[Responses in Full](#)

Analytical Summary

Contributors agree that local own government revenues are important for improving service delivery and the accountability relationship between citizens and local governments. The SDC experience in Bangladesh shows that it is advisable not to start revenue raising support with a focus on taxes, but with a focus on participatory planning and budgeting. People are willing to pay taxes if they know they will get the services they need. Much of the SDC experience focuses on support to provide transparent information on fiscal issues to the general public. In Madagascar this happens through a mechanism of participatory planning and budgeting at the municipal level. Citizens can voice their opinion both on revenues and expenditures foreseen in the budget. SDC also supports processes to improve the basis for and practice of tax assessment. This is done for example through capacity building to update the cadastre on which property tax is based (Kosovo) or the identification of taxpayers through taxpayer identification numbers. In Serbia, capacities were built for a billing and administration system for local taxes.

There seems to be hardly any SDC experiences in supporting borrowing of municipalities. Borrowing by municipalities in fact is illegal in many countries. There is experience in Serbia, though, in supporting municipalities to prove their credit-worthiness.

Responses in Full

[Parfait Randrianitovina, SAHA, and Annette Kolff, Intercooperation, Madagascar](#)

From Madagascar we would like to share the following:

Concerning own- source revenues:

Our experiences with municipalities who manage to increase their own source revenues confirm that services (quality and quantity) improve. It is important to ensure transparency and downwards accountability. The population is only ready to pay their taxes if they are satisfied with the services meeting their demands. Especially if the municipality adopts a participatory budgeting/planning, the population is better aware of the financial limitations of their municipality and are to a certain extent motivated to pay taxes and to contribute to the realisation of investment oriented projects in their locality.

Like in other countries political pressure also at local level, hampers an effective tax system as this affects the popularity of the elected representatives. However the local government can focus on the education of the citizens (éducation citoyenne) to create awareness and mobilise the support of the administration (line department) to execute the tax recovery.

In a given situation with resource poor municipalities the scope to effectively mobilise own –source revenues is very limited. Often the costs for setting up a system are higher than the revenues to be obtained. Reason the more municipalities preferred to look for other financing mechanisms and logically external support by donors is not demanded (not appropriate). For municipalities with abundant resources (mining, tourism, and industries) it is another story.

Support programmes of SDC can focus on: citizen education, facilitation of the collaboration between local governments and the administration, capacity development for participatory budgeting/planning, support of local governments to improve transparency on their finances, policy dialogue for fiscal reforms in favour of decentralisation...

Concerning borrowing:

We have no experience on this topic. In principle the Malagasy law allows local governments to borrow money. However in practice the municipalities (rural and urban) till now never borrowed from commercial banks or other financing agencies. Their capacity to pay back is extremely weak and the possibility for the central government to provide the required guarantees is absent. Logically the municipalities look for other options (public private partnerships, grants from donors, etc).

SDC could support feasibility assessments and eventual policy development at national level.

Tommaso Tabet, SDC, Bangladesh

Dear all, nice discussion! Has nicely simplified a complex issue Then made it complex again by raising the issue of sub-national borrowing! My suggestions:

- A. Yes we do. What we have discovered from local governments in Bangladesh (SHARIQUE; Horizontal Learning Programme /WSP, DASCOH, etc.) is that the trick to LG's rising own source revenues.... is not to focus on own source revenues. Rather if LG's focus on giving citizens voice in LG expenditure choices but then linking this at the back end to raising revenues Then it is a win/win. Basically make sure that the basic services provided by local governments are "demand driven", thus responding to a clearly "expressed" need.

Since few years our colleagues at WSP (Water and Sanitation Programme, strongly supported in Bangladesh by us) have launched a peer-to-peer learning process for local governments, and basically by appreciative inquiry spotted, described, analysed and summarised many "Best Practices". We can share the "fiches" and tell more during the meeting in Sarajevo, but we have clear examples and evidence supporting this (see one example in the attached file)

- B. OWN REVENUES: The promotion of own revenues tend to be dominated by bean counters ... but there we (SDC) might have an opportunity to link accountability processes to the raising of own source revenues. I don't think we are doing that bad in the promotion of own revenues.

BORROWING: In many countries, local governments are not permitted to borrow because they can incur liabilities that ultimately become liabilities for the central governments. So it is the central government to decide. Municipal borrowing may then be allowed from government lending institutions (including donors, multilaterals, development banks etc) ... but these can fall under political pressure to lend to non-bankable projects ((yes, everyone wants to stay in power and get re-elected...)) thus transferring the bad projects risk to the government lending institution.

- C. INCREASE MUNICIPAL OWN REVENUES: SDC can make the link between accountability processes and the raising of own source revenues (which can easily accompany greater accountability. This might be an additional challenge for our implementing partners...).

BORROW MONEY: Not sure here ... complex issue. But as Switzerland (and our banking experience) we should be able to "sell something". For instance, best to just advocate for the imposing of a hard budget constraint on local governments?

Petar Vasilev, SDC, Serbia

In 2006, the national government in Serbia adopted the Law on local self governance financing, as a part of fiscal decentralization process that introduced collection of own taxes in municipalities on the local level. In the seven municipalities, the Municipal Support Programme - MSP (SDC funded) undertook development of accounting and billing systems and infrastructure from the scratch. Today, all seven MSP municipalities successfully operate with their new systems. In 2006 tax collection rate on the local level was 0%. Through the assistance provided by the MSP tax income by municipalities has increased up to 80% and constitutes some 5-25% of municipal budgets, respectively.

A clear MSP success story was – in collaboration with an Standing Conference of Towns and Municipalities-GTZ pilot project – to support city of Uzice and the two neighbouring municipalities Arilje and Pozega in building up a fully IT-based LTA system, comprising of both hard- and software components. The inter-municipal working group (IMWG) on financial management and fiscal decentralization (FM/FD) played an important role in this. The IMWG FM/FD is consisted of middle management/ experts from the financial sectors of 7 municipalities, who discuss application of financial aspects of the relevant laws on the local level. The work of this group has also been facilitated by the MSP.

Today the first Serbian multi-municipal IT-based local tax administration system is successfully in operation. The three municipalities jointly agreed upon the legal frame, received trainings from the central tax authorities, defined software specifications, and created the database and 13 property register and are now successfully operating the system.

Naturally, deficits in local tax and revenue generation continue to exist due to difficult economic reality of Serbia. Important laws that will impact municipal finances are still pending, for instance on public-private partnerships and on LSG properties; others still have ambiguities, like the one on regional development. Municipalities complain that those powers and duties, which result in additional expenditure, have been quickly decentralised, but others that would allow them to create additional revenue, like property management, are being delayed. These misbalances, together with unclear legislation and institutional gaps on the meso level, are the main current challenges for LSGs to further increasing their locally generated resources.

Obviously, one of the most important success indicators for MSP support to its municipalities is the increase in their capacities to win external funding. The precondition for the municipalities to apply for donor or 3rd party funding is to have a complete set of the required documentation, from municipal development plans to action plans and finally to concrete project proposals. The second pre-condition is the mastering of project cycle management, mostly under the lead of the project development centres (PDC) in the municipalities.

From 2008 to June 2010, the seven municipalities succeeded in roping in projects of a total value of around € 25m. Of this, more than € 13m came from foreign, i.e. donor and project sources⁴, and around € 11.5m from domestic funds.

Norbert Pijls, Intercooperation and Limani Merita, SDC, Kosovo

A. I fully agree with the conclusion that own source revenues and accountability and two sides of the same coin. I have to disagree about SDC's limited experience with it. In Kosovo this is the main topic of our interventions in the field of municipal finance. However, since we only recently started we are only now gaining experience with what approaches and solutions are implementable and sustainable. Our strategy for this year is to update the municipal property registry with newly build objects (train municipal staff to register new objects with GPS pods, controlled entering data in central database, assist in billing, enforcement of payments by conditioning certain municipal services [like car registration] to proof of payment of property taxes). This will most likely increase the tax base for property tax with 20% and hopefully lead to a sustainable increase of a similar percentage of the own revenues coming from this source.

Regarding municipal borrowing this is not yet legally allowed in Kosovo. Municipalities do not yet have the financial strength and experience to engage in such financial constructions. However, I do consider the issue very relevant to allow them to raise sufficient funds for bigger projects.

B. Regarding own revenues I think there is no excuse not to engage in them, since the technical solutions to increase them are relatively simple, do not costs a lot of money and at the same time can contribute very sustainably to improving financial independence of local governments. In Kosovo we do the interventions with local consultants.

Assisting in making municipal borrowing possible is quite difficult since it needs cooperation with

Ministries of Finance (to determine minimum threshold conditions for municipalities), with banks (to help them understanding the nature of the borrower and develop tailor made loan products for municipalities) and - most of all - with municipalities in order to develop strong multi annual financial planning and execution (and tackling the question how to deal with the 4 year limitation of political representatives [who want to get the loan right now to start building and prefer to have the financial disaster later when they might not be in office anymore]).

- C. Promotion of technical assistance in the field of own revenues can be done easily by developing a manual that categorizes the own revenues and shows per category options for sustainable increase. Once SCD decides to go for it, it can even be filled by other donor experiences. At the same time SDC should assess if the Swiss contractors (Intercooperation/Helvetas/Caritas) have sufficient expertise available to assist municipalities with this. Promoting TA to municipal borrowing requires a similar approach.

[Limani Merita, SDC, Kosovo](#)

As Norbert said, SDC in Kosovo through LOGOS project is supporting municipalities to increase their own source revenues. I would like to share something which was very important at the stage of planning for the intervention in this field; and that the coordination with other relevant actors in the sector (especially with other donors). The interventions in own source revenues are very important and sensitive for municipalities, and as such double and parallel interventions should be avoided.

[Celestine Krösschell, Helvetas, Switzerland](#)

Interesting that you point out the link between raising local revenues and accountability; in our Helvetas workshop in 2009 on accountability, one of our lessons learned was this point. We learned this from one of the two mayors that attended this workshop. When he presented the accountability measures he put in place, he had noted that people were now more willing to pay taxes. The mayor was from Benin.

[Marc De Tollenaere, SDC, Mozambique](#)

Below a few last comments and one additional suggestion: in this learning project we have not touched upon result measurement. How do we monitor/assess if municipal finances are becoming more sustainable? Any experiences on this topic (international or SDC)?

- A. Increasing own revenues will be a central objective of the next phase of our municipal development programme. Therefore all municipalities will have to install an electronic Municipal Management System that was piloted in the current phase (in most municipalities records are not connected through a system and partially done in handwritten form) and all municipalities will need to get updated territorial plans and cadastres. The goal is that this will lead to increased revenues and rationalized expenditures. We make that assumption on the basis of an analysis we did jointly with the World Bank on the revenue potential of 7 municipalities. This study found that municipalities only collect 10 to 20% of the house tax (the main potential source of income). The municipalities analysed raise between 2 and 8 CHF of municipal taxes per capita per year and even without changes to the existing legal framework it was found that revenues can easily double. At the same time our programme, together with the World Bank, will start a more active campaign to increase fiscal transfers (currently a total of 1% of the state budget – very low in comparative perspective). This should reduce the need for external financing in the medium term (well a decade is short term) and thus gradually evolve towards more sustainable municipal finance. Curious to see how the mayors will deal with this. In the past they were certainly keener to increase their own revenues and rather go for fiscal transfers and external support, but now we have some strong evidence that they can/should do better.
- B. There is a level of pressure (context and internal) to get demonstrable results and then you better

aim for service delivery as directly as possible. Taking the promotion of own revenue route is longer and more straining, but the fact that we are focussing on this in a learning project by itself could indicate that things are moving

- C. See answer to question 1. Municipal borrowing is very complex in the Mozambican context. Debts incurred by local governments need to be approved by national parliament. So far, only the capital city, Maputo, managed to get a soft WB loan approved.

Oksana Garnets, DESPRO, Ukraine

In fact the experience on the issues discussed this week is pretty limited in Ukraine. DESPRO Project does not have it at all as far the project is working in rural areas with villages and small towns. Whereas, according to the Ukrainian Budget Code only cities of certain size are eligible to borrowing resources. Besides the spheres for which money could be borrowed are also limited – primarily big infrastructure projects. The procedures of getting the loans are extremely complicated and needs approval at the level of central government.

Many thanks to all that have contributed to this online discussion!

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