



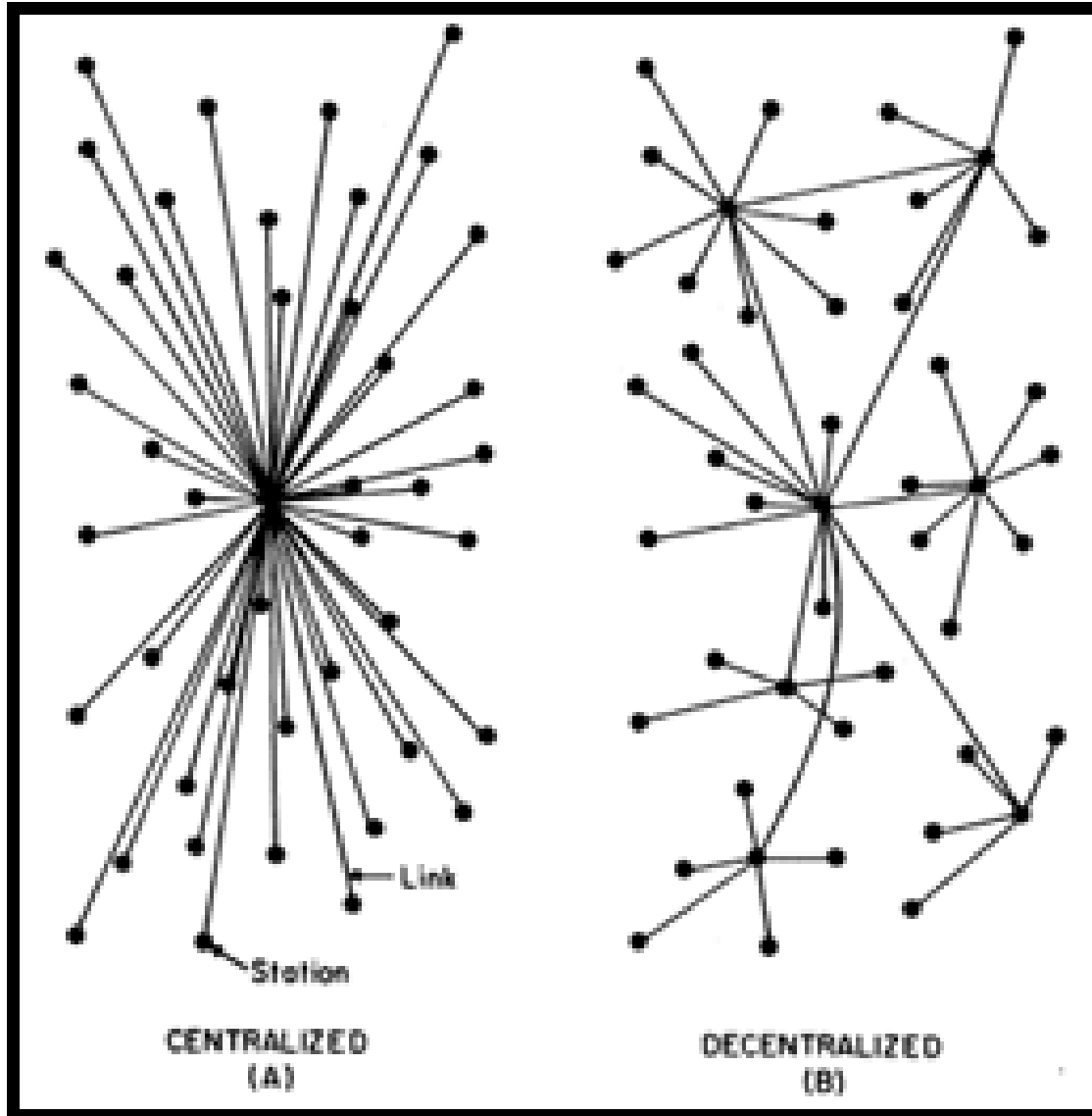
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# Basics of how Cities are Financed

**Mike Keshishian – EGAT Urban Programs**  
**Dec 17<sup>th</sup>, 2010**  
**Washington, D.C.**



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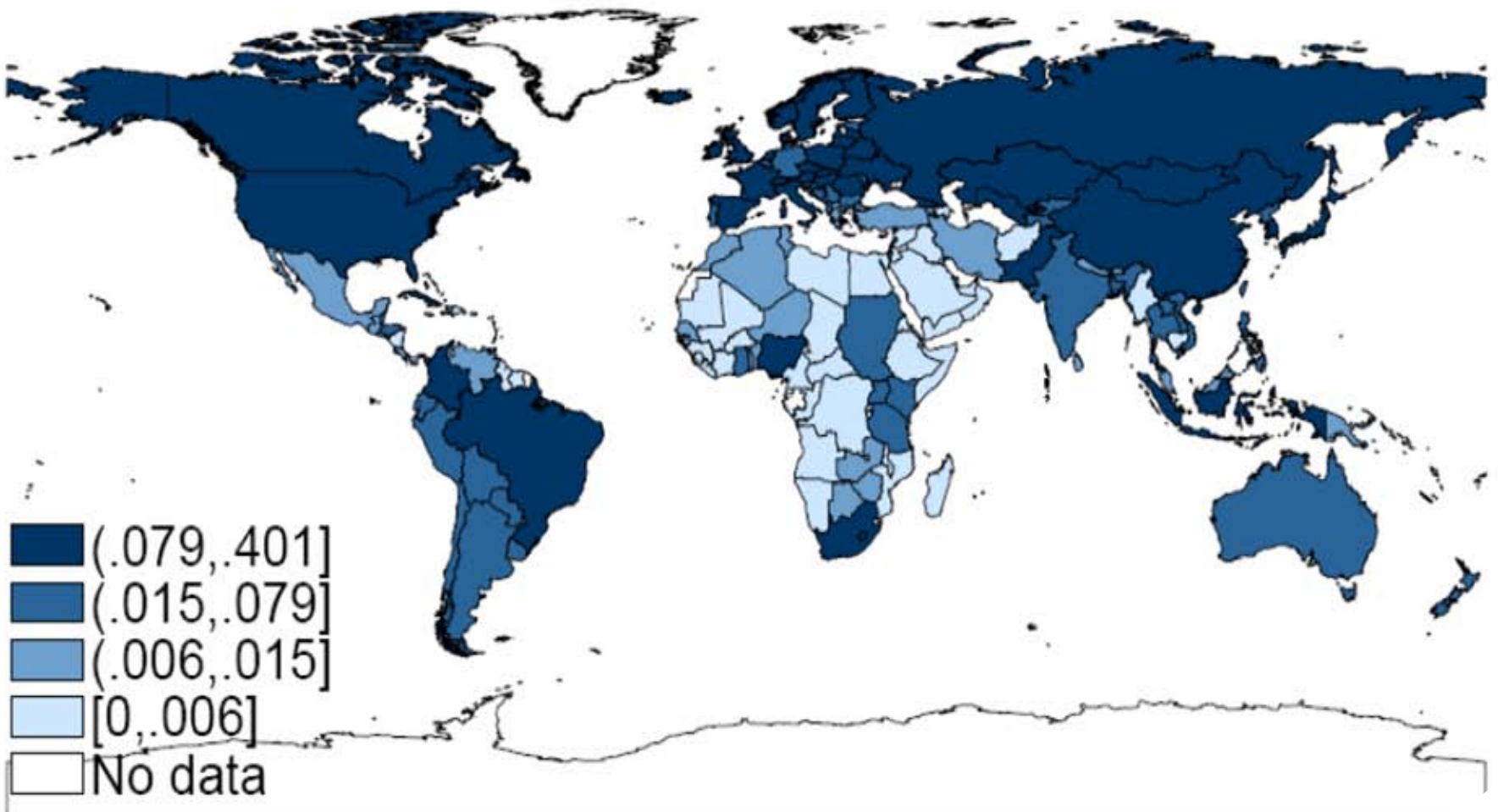
## What is Decentralization?

- The process of dispersing decision-making governance closer to citizens
- The transfer of authority and responsibility for public functions from the central government to local governments
- The Principle of Subsidiarity - matters ought to be handled by the smallest, lowest or least centralized competent authority.



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## Index of Decentralization — World Map (Decentralization and Corruption, Ivanyna and Shah, 2010)





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# The Three Dimensions of Decentralization

1. Political
2. Administrative
3. Fiscal



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## Political Decentralization

Greater political authority to the local level via:

- Establishment of directly elected local government
- Authorization of participatory processes
- Ability to produce local legislation on local matters



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## **Administrative Decentralization**

- Full or partial transfer of a range of functional responsibilities to the local government level such as
  - Health care service
  - Operation of schools
  - Management of road maintenance



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# An Example of Administrative Decentralization

## The Nine Functions of Senegalese Local Governments

1. Land management
2. Environment and management of natural resources
3. Health, population and social action
4. Youth, sports and leisure
5. Culture
6. Planning
7. Territorial management
8. Education (pre-primary and primary schools)
9. Urbanization and housing





## Financial or Fiscal Decentralization

- Shifting of some financial power to the local level
- Greater budget independence for local jurisdictions
- Greater authority to generate own source revenues



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## Typical Sources of Municipal Funding

- Property Tax
- Permitting/Construction Fees
- Amusement Tax
- Sale of Municipal Property
- Sales of Natural Resources
- Market Tax
- Municipal Property Rentals
- Parking Fees
- Solid Waste Disposal Fees
- "Import Tariffs"
- Credit
- Intergovernmental Transfers





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## Sources of Operating Revenues of Subnational Governments in the Philippines, 2007 (Min of Finance) (in Pesos)\*

|                                 |               |
|---------------------------------|---------------|
| Market receipts                 | 1,568,806,000 |
| Electrical light and power fees | 738,108,000   |
| Mayors' permit fees             | 659,004,000   |
| Hospital fees                   | 657,528,000   |
| Rents                           | 368,598,000   |
| Building permit fees            | 361,172,000   |
| Garbage fees                    | 337,992,000   |



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## Intergovernmental Transfers

- Funding transferred from the national to the local level
- By far the largest source of income for most developing country local governments
- Usually a share of a national tax



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## Estimated Own-Source Revenues as percentage of total subnational government revenue\*

| Country            | Percentage |
|--------------------|------------|
| Cambodia (2003)    | -5         |
| China (2003)       | -5         |
| Indonesia (2002)   | 15.4       |
| Philippines (2002) | 31.1       |
| Thailand (2002)    | 10.9       |
| Vietnam (2003)     | -5         |

\*Taliercio - "Subnational  
Own-Source Revenue:  
Getting Policy and  
Administration Right"  
2003



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## Equalization Formulas

- Used to redistribute income from richer cities and/or the national government to poorer cities
- Own-source revenues, distance to markets, altitude, and many other variables can be part of the formula
- Can create disincentives for own-source revenue generation
- The lack of Equalization Formulas can lead to abuses



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## Armenia's Equalization Formula (according to the Law on Financial Equalization)

$$ENC_i = WM^{SC} \times SC_i + WM^{TAC} \times TAC_i + WM^{SQC} \times SQC_i + WM^{MAF} \times AC_i + WM^{CNS} \times CNS_i + WM^{CPAS} \times CPAS_i$$

**ENC<sub>i</sub>** – the regulatory coefficient of expenditure needs of the i-th community.

**WM<sub>n</sub>** – the weight of the n-th expenditure coefficient of the i-th community

**SC<sup>i</sup>** – the scale coefficient for the i-th community;

**TAC<sup>i</sup>** – the factor of the transportation accessibility for the i-th community;

**SQC<sup>i</sup>** – the coefficient of municipal services quality in the i-th community;

**AC<sup>i</sup>** – the altitude coefficient of the i-th community;

**CNS<sup>i</sup>** – the coefficient of the number of settlements included in the i-th community;

**CPAS<sup>i</sup>** – the coefficient of population age structure for the i-th community;