Tapping into World Bank Knowledge Products:

Municipal Finance, A Learning Program for Local Governments

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The World Bank (WBIUR)
RETHINKING CAPACITY BUILDING OF LOCAL GOVERNMENTS: A NEW PARADIGM
WBIUR Perspective: Not Business as Usual

• Contributing to knowledge base and dissemination ➔ E-Learning Curriculum: Repository of knowledge + Taking stock of do’s and don’t dos + a “Position” on key sectoral issues

• Facilitating connectivity and working with partners ➔ Practitioner exchanges + City to City Dialogues: collective action learning around a concrete reform agenda

• Regional/ Country Engagement: “Hands on” capacity building ➔ Piloting tools for cities
How it comes together

Example: *Strengthening Local Government Capacity in South-East Europe*

**E-learning**
- Global curriculum: e-Institute
- Regional Partner: CEU
- Local Partners: NALAS + NLGA
  *for marketing, dissemination, translation*

**City-to-city dialogue series**
- Municipal finance (e.g. revenue improvement, expenditure mgmt, public asset mgmt, performance measurement)
- Urban planning & land management
- Urban service delivery

**Hands-on capacity building**
- Direct link with operations
- LGs to engage in self-assessments
WBI’s urban curriculum: With an Edge...

- Focus is on basic concepts but more importantly on innovations, best practices and how-to methodological tools
- E-Institute launched in July 2011 with a number of deliveries reaching hundreds of participants around the world
- Delivery is scaled up through various modes:
  - E-Institute (2 deliveries per year)
  - Regional training partners
  - Bank projects
  - Face-to-face (leadership and governance)
MUNICIPAL FINANCE: A LEARNING PROGRAM FOR LOCAL GOVERNMENTS
Municipal Finance, A learning Program for LGs........

• **Takes side:** It takes the side of mayors, municipal practitioners and staff. Few publications on this topic target local level decision-makers and financial staff in such a direct and pragmatic way. The content and key messages are geared to respond to daily concerns and issues faced by cities and municipalities in the management of their finances. Municipalities have made it clear that they needed to have access to global knowledge and were seeking to be part of a larger community of practice.

• **Takes position:** A lot has been learned on what works and what does not and yet every time we talk about finances, engage in policy discussions or project preparation, we tend to reinvent the wheel. Structured around eight chapters/modules, the E-program reviews lessons learnt on inter-governmental relations, metropolitan finance, financial management, revenues management, expenditures management, public assets management, external funding and Municipal Finance performance measurement. It spans the arc from decentralization to transparency and accountability and travels less chartered waters of assets management, credit worthiness, response to financial crisis, reporting mechanisms to various levels of governments and civil representation.

• **Takes action:** Not only, does it provide cutting-edge knowledge on many technical issues, it also guides local governments through the maze of existing instruments. In particular, it provides a framework for self-assessment (Municipal Finance Self-Assessment) to help municipalities assess their own situation, connect the dots and move forward on the path of reforms. In a democratic society, where open government and open data have become accepted norms, there is an abundance of social media tools ready to capture citizens voice demanding accountability and transparency from their governments. It is essential that local governments be prepared to present and articulate as genuinely as possible their current situation, their bottlenecks and their perspectives for the future.
The task of getting Municipal Finances right is daunting, but, reachable. There is no doubt that the world is getting more complex. Municipal officials are not only dealing with the day to day business which comes with running a city, but they also have to increasingly address issues of social inclusion, local economic development, job creation, crime and violence, climate change, floods, droughts, and natural and man-made disasters. They need to welcome increasing numbers of urban dwellers, dealing with increasing number of informal settlements, and bearing the costs of infrastructure provision and service delivery in increasingly sprawling cities.

When it comes to solutions, there are no quick fixes, no one size fits all. However, we have today a greater understanding of what works and what does not.
Take away message 1

**Good intergovernmental relations matter:**

- **Decentralization, the good and the bad:** There has been a wave of decentralization policies in many parts of the world, bringing local governments closer to their constituents and thereby more responsive to their needs. But, no match between transfer of technical responsibilities and transfer of financial resources.

- **Transfer formulas, Equity and Performance issues:** This E-learning helps share experiences about the intergovernmental transfers, promoting formula based as opposed to ad-hoc allocation of central government transfers and points that introducing incentive mechanisms is not always the best way to incentivize collection of local own-source revenues and may contribute to increased dependency of LGs on transfers.

- **The intergovernmental finance relations generate the governance framework, the playing field,** thereby setting them right is of upper most importance for managing revenues, expenditures, assets, and external resources and for measuring performance.
Take away message 2

Financial management practices matter:

• Financial management concepts and techniques help local governments in utilizing their limited financial resources in an efficient and transparent manner and thereby enable them to function accountably. Budgeting, accounting, and financial reporting are the pillars of good financial management.

• Modern information technology, introduction of computerized financial management systems, and using other ICT instruments have accelerated the information flows, and data security; but more importantly these have shifted the functions of the three pillars from mere recording of data to daily strategic management of cities, and timely informing long-term strategic decisions.

• While financial management has myriad tools and techniques, it is important to recognize that these tools are relevant only if local governments use them to fulfill their core mandate of providing local services in an efficient, effective and sustainable manner. Though all financial management concepts and tools are important, local government managers are better off adopting first simple but fundamental tools and techniques and gain proficiency in their practice before moving to more sophisticated and complex tools and instruments.
Take away message 3

**Revenues matter:**

- **Local governments have to learn to do more with less.** In many countries, local revenues amount to less 10 percent of public revenues and there is little willingness on the part of many central governments to empower LGs with additional sources of revenues or to pay much attention to the administration and collection of municipal fiscal revenues.

- **Strategic choices have to be made in order to target key revenues:** Be aware of vulnerability risks. The 2008 financial crisis has showed the high level of vulnerability (many revenues are tied to land transactions). Regardless of central policies, in many developing countries, local governments would be able to collect significantly larger revenues by improving revenue policies on taxes, fees, and charges. A main message to take away is that improving local revenues depend on the local circumstances, but there are always revenue opportunities whether expanding the basis of taxes and fees, or collecting rigorously fees from market services, or establishing the culture of taxing/charging beneficiaries of new infrastructure development, or collecting land based revenues, or using assets for strategic revenue generation and development.

- **Revenue collection is key.** Municipalities should explore alternative ways to capture tax base and fees billing through instruments such as Street Addressing which provides an opportunity to set up a spatially referenced database, street index, and connect with fiscal registers.
Expenditures matter:

- **Prioritization of expenditures is key.** Expenditure management should be seen as a cycle driven by the policies which the local government aims to achieve. After an agreement on the final policy agenda and strategies, it is essential to mobilize and allocate adequate resources and then proceed to implement the planned activities. Great deal of negotiations. Capital Investment Plan. Need to think about a vision for the city (a city program) rather than a set of projects.

- The major areas of saving expenditures requires tight and daily control of operating expenditures (salaries and hiring staff), competitive procuring bulk products and services (fuel, energy, maintenance, banking), competitive procurement in designing and implementing capital investment projects; and forceful contract management. Local governments in the developing world often try to avoid using competitive procurement; because it is often long and painful process. But, with better expertise and human capacity managing competitive procurement becomes faster and less complicated.
Public Asset Management matters:

- **Municipal governments across the world control large portfolios of physical assets** (land, buildings, infrastructure, and vehicles and equipment), which is the lion share of local public wealth. Thus, good management of assets is critical for quality and sustainability of local services (e.g. roads, water, schools); for local economic development (e.g. land for private production and business); and for quality of life of citizens.

- **Good asset management generates multiple benefits**: savings or additional revenues for the local budget, better quality of assets and services, and better trust between people and the government.

- **The primary asset management tools and procedures include**: inventorying assets; using transparent procedures for allocating assets for private use; aligning/classifying assets according to their role in delivering services; using market value of assets for decision making; establishing a depreciation fund for financing asset replacement; monitoring key performance indicators (e.g. costs and revenues); planning operating and maintenance expenses ahead when acquiring new capital assets;

- **Municipal staff need to gain expertise** and pay attention to regulatory framework, procedures and analytic tools, and real estate markets.
External funding matters:

• Local governments investment needs are often much greater than what their annual operating surplus can finance. Thus, they need external funding that can be raised through: borrowing, bond issuance, private-public partnerships, and grants or philanthropic aids. Municipalities borrow funds directly from banks or indirectly through issuing bonds.

• The capacity of the municipality to borrow is a function of its creditworthiness which depends on economic and financial situation and guarantees or other enhancement tools. Creditworthiness analysis and credit rating are valuable tools to demonstrate that the municipality has the capacity to re-pay a loan or bond on time. But, for this to happen, prudent use of external resources is crucial since it may jeopardize the fiscal situation of a city in years ahead.

• External resources should be used to finance the priority projects identified in the city’s capital improvement plan; and liabilities should never exceed the level of the expected revenue flows. While project selection is always a political process, participatory dialogue and good feasibility studies supported by analytical techniques (cost benefit, net present value, and internal rate of return analysis) play an important role in ranking projects and supporting informed decisions.
Municipal Finance Performance Measurement matters:

• **Measuring municipal financial performance is important** because it provides an opportunity to: have a clear picture of the financial situation; support dialogue with stakeholders (central government, financial partners, or citizens); it provides for data and ratios useful to inform prioritization of investments; finally it helps evaluating the level of efficiency and effectiveness in using of public funds.

• **In a democratic society where open government and open data** have become accepted norms, there is an abundance of social media tools and instruments ready to capture citizens voice demanding accountability and transparency from their governments. It is essential that local governments be prepared to present and articulate, as genuinely as possible, their current situation, their bottlenecks, and their perspectives for the future (projections).

• This will also help municipalities making their case to central governments regarding transfer allocation and guarantees; preparing well packaged bankable projects; and being accountable to their own constituents on the use of public funds.

• **With these objectives in mind, the Municipal Finances Self-Assessment (MFSA)** presents a unique opportunity to equip local governments with a tool which makes it easy for them to connect the dots between responsible fiscal and financial discipline, sound financial management, capacity to finance recurrent and capital expenditures and to attract private and credit financing with a clear visibility on a path to reform.
ADDRESSING ACCOUNTABILITY AND TRANSPARENCY: MFSA
MFSA Key objectives

• To promote financial self-assessment at the municipal level as part of the change management process of local public administration (empowerment)
• To encourage technical and financial departments to work together on strategic and capital investment planning anchored in financial realism (prioritization)
• To monitor and act on a set of key actions aiming at improving mobilization of local resources, rationalizing public expenditures and improving financial management practices (reform)
• To help local governments better communicate their financial situation to central governments (negotiation platform for transfers and credit guarantees) (accountability)
• To help local governments better communicate with their citizens (transparency and accountability on use of public funds)
• To help local governments better package their investments needs and financial absorptive capacity with financial partners (banks, donors..)
• To share common indicators/benchmarks with other municipalities nationally and internationally
MFSA: From City Profile to Municipal Finance Improvement Plan

Steps | Objectives
--- | ---
1. **City profile**
   1. Summarize through key data the institutional position of the city
   2. Complete with urban audit (EU framework)
   3. Mention the main stakes

2. **Basic database for financial self-assessment**
   1. Put together basic data to perform self-evaluation
   2. To involve the different municipal departments

3. **Steps**
   - **Generic financial / accounting framework**
     1. Ability to generate growth savings and operating surplus
     2. Capital investment effort
     3. Credit worthiness

4. **Historical analysis**
   1. Detailed revenue and expenditure structure and trends
   2. Dependency from grants and external financing
   3. Level of service provided

5. **Ratio analysis**
   1. Review of economic & financial performance through main indicators
   2. Comparison with other LGU

6. **Financial projections**
   1. Which vision of development
   2. Impacts of political choices on future accounts
   3. Fix the financing needs (loans)

7. **Financial management assessment**
   1. Level of municipal autonomy
   2. Budget credibility
   3. Reporting: comprehensiveness, transparency, predictability

8. **Finance Improvement Action Plan**
   1. Key measures to adopt to improve financial management and financial performance
Summarize through key data the institutional/administrative situation of the city, its demo-eco position and the main urban development issues.
Step 3: financial position (big picture)

Assess:
- Ability to generate growth savings and operating surplus
- To promote Capital Investment effort
- To strengthen Credit worthiness
Step 5: Performance measurement through Ratio analysis

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Indicator (definition)</th>
<th>Objective</th>
<th>Comparative index (benchmark)</th>
<th>City Index</th>
<th>Graph with mention of the benchmark if possible</th>
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<tbody>
<tr>
<td></td>
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<td>2008</td>
<td>2009</td>
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<td><strong>STOCK RATIO</strong></td>
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<td><strong>Credit worthiness</strong></td>
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<td>1</td>
<td>Operating Savings before interests / Current actual revenues</td>
<td>The LG has the capacity to borrow and to invest</td>
<td>&gt; 0.3 (or 30 %)</td>
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<td>2</td>
<td>Net Operating Surplus (after debt service including capital repayment) / Current actual revenues</td>
<td>The LG has the capacity to borrow more</td>
<td>&gt; 0.2 (or 20 %)</td>
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<tr>
<td>3</td>
<td>Cash (end of the year) / current liabilities (divided by 365 days)</td>
<td>The LG ability to meet its short-term obligations</td>
<td>90 days</td>
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<td><strong>Indebtedness</strong></td>
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<td>4</td>
<td>Debt outstanding / operating surplus (capacity to clear its debt)</td>
<td>The LG capacity to clear its debt with operating surplus</td>
<td>&lt; 10 years</td>
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<td>5</td>
<td>Debt service / Total current revenues</td>
<td>The annual debt burden is correct regarding current revenue</td>
<td>&lt; 10 %</td>
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<td><strong>Fiscal autonomy</strong></td>
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<td>6</td>
<td>Own tax receipts + unconditional grants / Current actual revenues</td>
<td>The LG has the ability to increase its revenue</td>
<td>&gt; 80 %</td>
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<td>7</td>
<td>Tax pressure (Tax receipts/Tax potential)</td>
<td>The LG favors development expenses</td>
<td>&lt; 70 %</td>
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<td><strong>Capital investment effort</strong></td>
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<td>8</td>
<td>Capital investment expenditures / Current actual revenues</td>
<td>The LG favors development expenses</td>
<td>&gt; 40 %</td>
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**Stock ratios**
- Credit worthiness
- Indebtedness
- Fiscal autonomy
- Capital investment effort
- Level of services
- etc.

**Flow ratio**: Margin ratio

**Comparison ratios**: based on revenues and expenditures items

**Benchmarks**: To base on country specificities (national database ?)
Step 6: Financial Projections

- The 5Y financial projections are performed with the objective to measure impact of decisions on finance capacity and credit worthiness.
- The main condition is to start with reliable and relevant historical data and formalize through assumptions the impact of policy decisions (expenses, borrowing, tax pressure, etc.)
- Usually, several assumptions and scenarios are tested: past trends projections and projections on the basis of significant changes.

|-----------------------------------|----------------------------------------|------------------|-------|----------------------|------|------|------|------|------|
Step 8: Municipal Finance Improvement Plan

The objective is to translate lessons learnt from the different steps of the MFSA into a few actions to be implemented by the municipality to improve its financial situation and its financial management.

**IMPROVE FINANCIAL SITUATION**

- **On the revenue side**
  - Grant regulation (index, criteria, etc.)
  - Tax sharing regulation
  - Local tax regulation & collection

- **On the expenditure side**
  - Budgeting process
  - Costs effectiveness

**IMPROVE FINANCIAL MANAGEMENT**

- **Improve accountability and transparency**
  - Policy-based budgeting
  - Control of budget execution
  - Participatory budgeting

- **Improve capital investment financing**
  - Town planning
  - Physical development
  - Financial capacity
The way forward...

- Municipal Finance: A Learning Program for Local Governments
  E-Institute Urban Curriculum
  Delivery: twice a year (first delivery planned for May-June 2013)
  [Http://einstitute.worldbank.org](http://einstitute.worldbank.org)

- Municipal Finance: A Handbook for Local Governments (currently with the World Bank Office of the Publisher. Publication date: July 2013)

Suggested follow-up actions:

1. Get greater participation from the region in upcoming E-Learning Curriculum (municipal cohorts)
2. Develop partnerships with regional institutions for translation and delivery.
3. City to City Dialogue (sustained dialogue on key technical issues and reforms)