Inter-Agency Policy Brief:

Breaking the SDG finance gridlock through strengthening local government finance

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Acknowledgements

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Key Messages

- Local and regional governments are key implementers of the 2030 Agenda for Sustainable Development and are at the forefront of responding to many global crises. They bring a fresh, underutilized and often more integrated perspective to development finance.
- Strengthening and fully harnessing local government fiscal space and policy space can turbocharge the SDGs as it lifts constraints on both the revenue and the expenditure sides at the national and subnational levels.
- Investing into local infrastructure must become a key policy priority at the national and local government level to make meaningful progress towards the SDGs.
- Expanding local and regional governments' access to diverse financing options through strengthening their creditworthiness, access to guarantees and blended finance can help promote sustainable infrastructure investment at the local level
- Improving capacities to implement public financial management and public infrastructure asset management is critical to achieving the SDGs and sustain progress for generations to come.
- International cooperation should put greater focus on the vast development opportunities of working through and with local government finance.

BACKGROUND

The 2015 Addis Ababa Action Agenda, particularly paragraph 34 on subnational finance, marked a significant milestone in global discussions on local development finance, as it was the first time that UN Member States explicitly acknowledged the importance of enhancing municipal and subnational government capacities for funding and financing public services in a negotiated outcome document on Financing for Development.

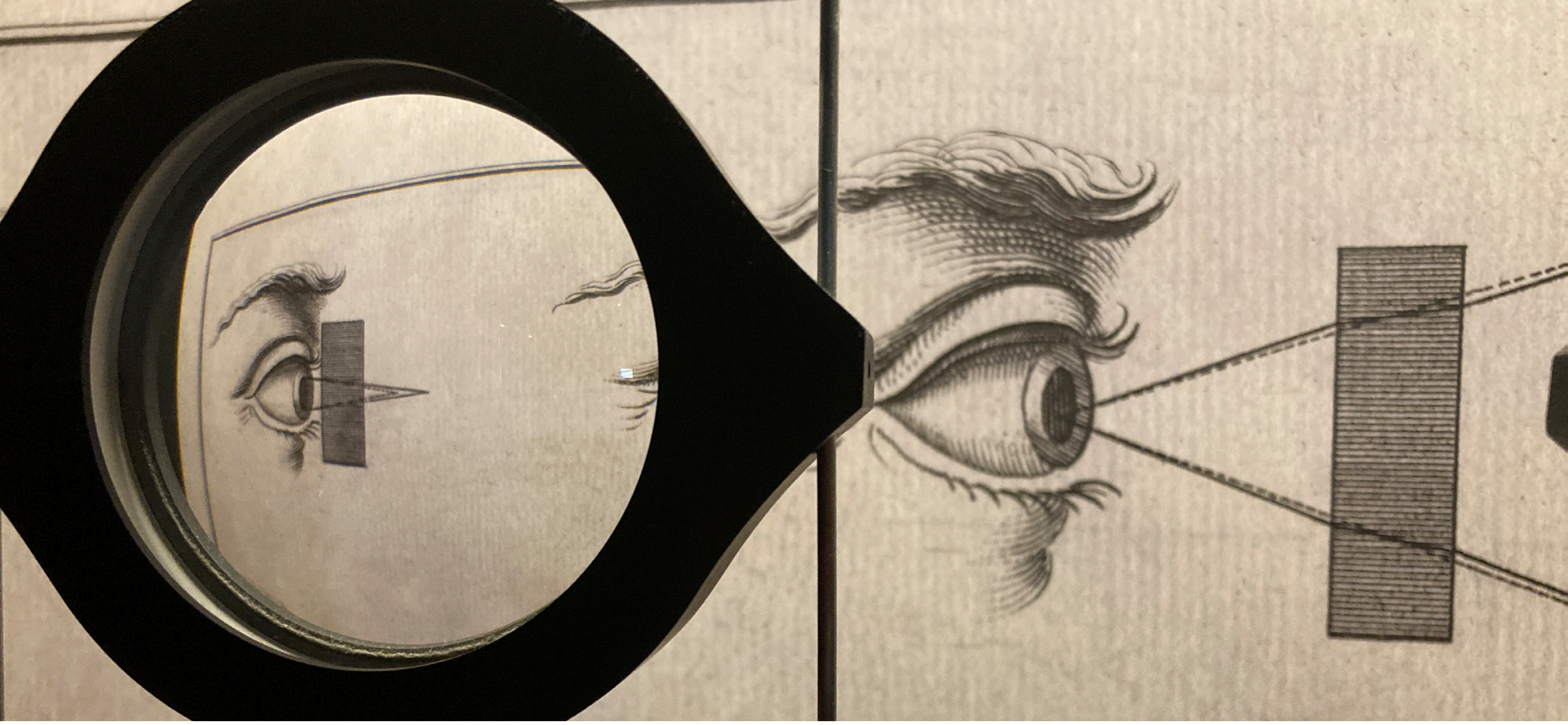
Since then, local governments across the globe have made significant strides in accountability, transparency and sound public financial management practices and have been at the forefront of climate action.

This policy brief argues that (1) following the Addis Agenda the case for strengthening local government finance as an accelerator of national development has become stronger, (2) local and regional governments have continued to innovate on development finance (3) the Fourth International Conference on Financing for Development on 30 June-3 July 2025 in Sevilla, Spain (FFD4) provides a real chance to break the gridlock on development finance for achieving the SDGs by strengthening local government finance.

* Under the term "local government" we refer to all types of sub national government (cities, municipalities, counties, provinces, states, regions, etc.

The brief is structured as follows **around three sections:**

1. **Why is local government finance fundamental for SDG implementation?**
2. **How do we strengthen local government finance? Challenges and solutions**
3. **Key ingredients for transformative local development finance**



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SECTION ONE

Why is local government finance fundamental for SDG implementation?

Despite the different arrangements for territorial financing, administration and governance in each country, cities and regions are usually in charge of core responsibilities that are central to providing public infrastructure, services and quality of life to citizens.

This includes services/areas such as primary education and health to housing, transport, land use, drinking water, sanitation, water management (irrigation, drainage, flood protection), clean energy, waste management and climate change resilience.

Given local governments' proximity to the citizens, they are also committed to the principle of leaving no one, and no place, behind.

These responsibilities and competencies place local governments at the heart of the national development agenda[1]. However, they often receive inadequate fiscal support from central governments while facing severe constraints, including lack of revenue raising authority, lack human capacities and technical know-how and often insufficient incentives to effectively use their existing authority in generating own-source revenues. This reality poses a severe limitation to sustainable and inclusive development, particularly given the pressures of rapid urbanization in many developing countries and the need for resilient and sustainable built environments everywhere in the face of climate change and growing risks of natural disasters.

Local and regional governments are key implementers of the 2030 Agenda for Sustainable Development. They are responsible for approximately 65% per cent of the SDG indicators, depending on the country's framework and distribution of responsibilities across different levels of government.

[1] Jackson D (Ed) "Local Government Finance is Development Finance" UNCDF, 2022 source https://digitallibrary.un.org/record/3972316?v=pdf

Strengthening the fiscal, financial and institutional capacities of local governments accelerates national development.

Three inter-linked factors illustrate that strengthening local government finance can accelerate national development:

1.1 Local governments are already responsible for a large part of public investment and their role becomes even more important as countries develop.

1.2 Investment through local governments boosts sustainable economic development across the country and helps mitigate territorial inequalities.

1.3 Local governments contribute to creating trust in the public sector and reduce the potential for conflict.

1.1 Local governments are already responsible for a large part of public investment and their role becomes even more important as countries develop

Local governments represent a significant share of **public investment**, which is critical to meet the SDGs and targets. They account for 60% of total public investment in the OECD region and 39,5% worldwide (OECD/UCLG, 2022). Through institutional reforms and increased capacity, local governments have assumed greater responsibilities in key public services and environmental protection and infrastructure notably in education, social protection.[2]

Hence, they are already critical development finance actors.

A clear example of local governments' comparative investment advantage is in the field of of climate resilience, adaptation and mitigation. OECD local governments are responsible for 64% of climate and environmental related public infrastructure investment.[3] Most adaptation is inherently local, connected to topography, weather patterns and the built environment.[4] Towns and cities are responsible for 70% of global emissions[5]. At the same time, they are deeply affected by the adverse impacts of climate change and require substantial financial support for climate adaptation measures in order for countries to secure their resilience.[6] Therefore, there is a powerful case for focusing climate finance at the local level both in developed and developing countries. [7]

Strengthening the fiscal viability and access to public and private funding and finance where local governments have competitive advantages is thus a prerequisite for sustainable development and inclusive private sector growth. Where public investments and expenditures through local governments are more effective and efficient than through national government agencies, central governments could review the volume of their fiscal support to local governments and identify how to better deploy their funds through the local governments route as a platform for national development.

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[2] OECD/UCLG, 2022, Synthesis Report World Observatory on Subnational Government Finance and Investment.

[3] OECD (2019), "Financing climate objectives in cities and regions to deliver sustainable and inclusive growth", OECD Environment Policy Papers, No. 17, OECD Publishing, Paris, https://doi.org/10.1787/ee3ce00b-en.

[4] The 2023 Annual Report of the Local Climate Adaptive Living Facility indicates that 44% of all investment identified by the facility is related to locally specific changing rainfall patterns and 18% related to agriculture largely due to changes in crop viability as weather patterns change. https://www.uncdf.org/article/8796/uncdf-local-annual-report-2023

[5] Source: World Bank https://blogs.worldbank.org/en/sustainablecities/cutting-global-carbon-emissions-where-do-cities-stand

[6] For example, over 25 developing countries proposed at COP 28 that priority is given to channel climate finance to the local level through mechanisms such as the UNFCCC recognized Local Climate Adaptive Living Facility, in alignment with ISO 14093. This is a Non-Market Approach under article 6.8 of the Paris Agreement. Source: https://www.uncdf.org/article/8550/at-cop28-senegal-becomes-25th-country-to-back-declaration-for-simplified-and-consistent-access-to-climate-finance-with-local

[7] World Bank and UNCDF, 2024, Local Governments Climate Finance Instruments - Global Experiences and Prospects in Developing Countries. Source https://www.worldbank.org/en/events/2024/07/10/local-governments-climate-finance-instruments-global-experiences-and-prospects-in-developing-countries

1. 2 Investment through local governments boosts sustainable economic development across the country and helps mitigate territorial inequalities

The differences in human development between UN member states remains very large, yet gaps in income inequality between countries has been narrowing – indicating some progress in global development since the 2015 Addis Ababa Action Agenda. [8]

Unfortunately, inequalities within countries have been on the rise since the 1980s (figure 1). Those growing imbalances can be caused by an increase in territorial inequalities, where resources and human capital tend to concentrate in major cities or economic nodes, leaving the rest of the population behind.

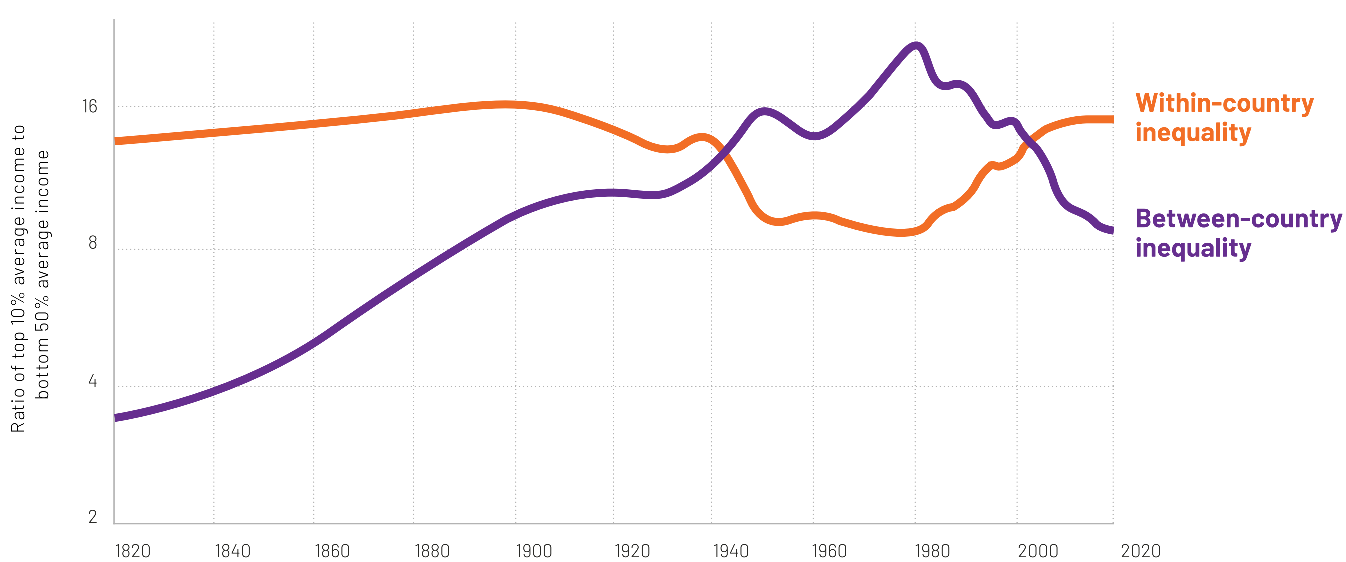
Local government finance is an effective vehicle for redressing this challenge, and in some cases has demonstrated significant economic and social benefits.

Denmark, for example, has successfully redistributed the wealth generated from the Zealand region to historically less developed areas such as North Jutland. Similar policies are employed in other developed and developing countries.

In many countries there is an implicit understandingthat wealth generated from any one part of the territory contributes to the overall provision of infrastructure and services across the country. Capital cities, or regions rich in natural resources, contribute to the fiscal resources shared with poorer regions.

However, many countries do not sufficiently valorize and target local government finance as a powerful tool to address regional imbalances and support poorer local and regional governments. At the same time, the effectiveness of public funds provided to creditworthy cities could be improved with additional incentives to raise more of their own resources —releasing fiscal space that may be better used for less well-off local governments.

Figure 1



Source: UCLG GOLD VI Report (2022)

[8] Chancel et al., "World Inequality Report 2022."

1.3 Local governments contribute to creating trust in the public sector and reduce the potential for conflict

The effective management of public funds and the efficient delivery of services significantly strengthen the legitimacy of institutions at all levels. However, many countries have experienced a decline in public trust in government and state agencies. This erosion of trust complicates the pursuit of development goals and thedissemination of accurate information during crises.

Local government can play a key role in rebuilding such trust, which is often more tangible at the local than national level as shown in the figure below.

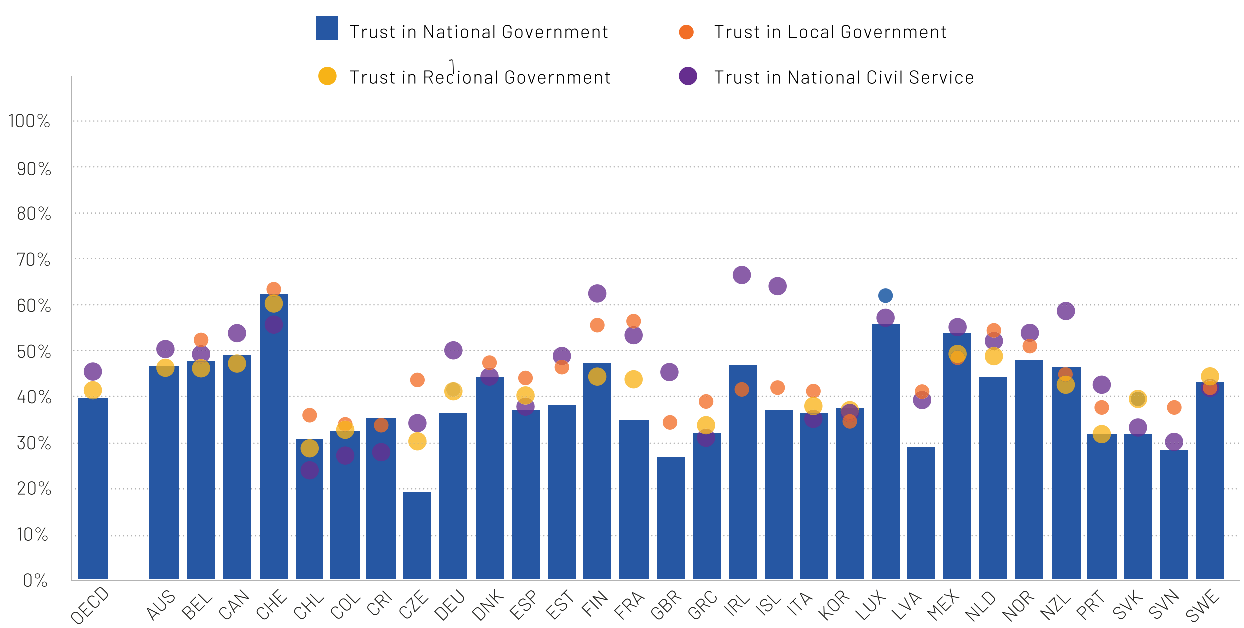
Evidence shows such trust further increases when there is a direct connection with increases in local taxes and fees and improved local infrastructure and services. Strengthening accountable local government institutions is thus an essential tool for fostering a positive relationship between citizens and the state at all levels.[9]

Increasing public confidence in local government institutions is essential for creating a positive relationship between citizens and the state at all levels. Local government can contribute to rebuild trust at a time when confidence in the public sector is declining in many countries.

Transparent financial management requires institutions to ensure accountability. Critical elements include open elections, inclusive and participatory processes, transparent and easy-to-understand decision

making and budgeting, sustainable procurement, protecting whistleblowers, clear procedures to redress grievances, open recruitment of public officials, etc.

In addition to the increased trust in public institutions, there is also evidence that the introduction of these policies has an effect on peacebuilding and conflict resolution.



Source: OECD Survey on Drivers of Trust in Public Institutions – 2024 Results

[9] Jackson, D, "Who won and who lost? The role of local governments in post-conflict recovery" in The imperative of good local governance : challenges for the next decade of decentralization, United Nations University 2012

Credits: UNDP Kigali

SECTION TWO

How do we strengthen local government finance? Challenges and solutions

The previous section outlined how local government finance is a key driver for sustainable development and accelerates the implementation of Agenda 2030. However, local governments are still underfunded, particularly at a time of rapid urbanization and increase of local needs, globally. Sustainable investment in urban development is especially lagging in low-income countries, where towns and cities are growing the fastest.

This section discusses the key obstacles that impede the deployment of local government finance to full effect while offering concrete solutions to move forward. Removing these structural obstacles will significantly increase the opportunity for sustainable development at national and local government levels. This should be a core objective of the financing for the development agenda.Strengthening local capacity, as well as local fiscal space and policy space can lift constraints on both the income and the expenditure sides

2.1 Strengthening local capacity, as well as local fiscal space and policy space can lift constraints on both The income and the expenditure sides

2.2 In developing countries, urbanization is increasingly happening without the required capital investment – investing into urban infrastructure must become a key policy priority at the national and local government levels

2.3 Strengthening the public financial and public infrastructure asset management capacities of local governments is critical to achieving the SDGs

2.4 Channeling international cooperation and official development assistance through local governments is an opportunity for the SDGs

2.1 Strengthening local capacity, as well as local fiscal space and policy space can lift constraints on both the income and the expenditure sides

THE CHALLENGE

Local governments' capacity in fiscal and financial matters is closely related to their autonomy in managing their own resources. Two key aspects impact local autonomy:

ONE: The scale of funding, as fiscal transfers are often inadequate and local resource mobilization/own resource mobilization frequently small.

TWO: Legal authority, as local governments need the authority to allocate funds, sign contracts, and, when creditworthy, invest with borrowed capital.

Local autonomy permits them to prioritize public services and investments that best address citizens' needs and local development priorities. Local autonomy is often limited by the source of funding, particularly when transfers from central governments are earmarked for specific purposes or when there are legal and technical limitations on raising fees and taxes.

Additionally, the scale of funding can hinder autonomy, as fiscal transfers are often inadequate and local resource mobilization/ own resource mobilization are often minimal. Limited autonomy can hinder the ability of local governments to respond effectively to challenges and opportunities.

While there are remarkable disparities among countries, both in terms of share in GDP and share in total subnational revenue, a study in 116 countries[10] observes how more than 50% of total subnational revenue comes from central government grants, accounting for 4.1% of national GDP on average, but less than 2% of GDP in most least developed countries, suggesting that an increase in the proportion of GDP allocated to local governments may be an indicator of development.[11]

Overall, the inadequacy of local governments budgets in the developing world remains staggering, with some major cities in developed countries being able to spend 1,200 times more on their citizens than some capital cities in LDCs, as shown by the table below.

CITY BUDGETS

CITY	COUNTRY	POPULATION	EXPENDITURE	BUDGET PER CAPITA (USD)
Hangzhou	China	12,520,000	37,163,592,241	2,968
Montreal	Canada	1,780,000	4,774,705,650	2,682
Wellington	New Zealand	212,700	563,821,734	2,651
Liverpool	United Kingdom	496,784	711,363,809	1,432
Santander	Spain	172,044	215,771,468	1,254
Medellin	Colombia	2,569,000	2,132,913,930	830
Budapest	Hungary	1,756,000	1,311,058,665	747
Seville	Spain	1,967,436	1,142,335,585	581
Montevideo	Uruguay	1,381,000	626,638,680	454
Belize City	Belize	66,000	23,562,000	357
Guatemala City	Guatemala	923,392	212,530,202	230
Hang Tuah Jaya City	Malaysia	188,857	25,099,638	133
Kampala	Uganada	1,876,834	204,621,715	109
Tangerang	Indonesia	2,274,000	231,756,364	102
Tanga	Tanzania	393,429	30,386,621	77
Nairobi	Kenya	4,397,000	314,280,077	71
Kathmandu	Nepal	856,767	54,654,206	64
Las Terrenas	Dominican Republic	25,696	1,500,000	58
Rourkela City	India	692,000	30,394,678	44
Honiara	Solomon Islands	92,344	2,843,435	31
Kumasi	Ghana	440,000	5,736,250	13
Freetown	Sierra Leone	1,056,000	2,281,218	2

Source: UNDP 2025

[10] OECD/UCLG, 2022, Synthesis Report World Observatory on Subnational Government Finance and Investment

[11] Alvergne C and Zhang N "Decentralisation and Graduation in the Least Developed Countries" in Local Government Finance is Development Finance, UNCDF 2022

The fact that local governments continue to rely on fiscal transfers across the globe attests to the important role these transfers play for local development finance in developed and developing countries alike. But their low share of GDP in poor countries as well as the extremely low city budgets in LDCs and developing countries compared to the developed countries referenced in the table above, make the case for significantly increasing both fiscal transfers and own source revenue collection in developing countries, especially in LDCs.

Yet, it is not just the amount of revenue available at the local level that matters. It is also the discretion and ability of local governments to plan, budget and manage these resources that is fundamental to accelerating impact. Often revenue raising responsibilities that could be decentralized are not, and even if they are, legally, they are not exercised and implemented in practice. Moreover, revenues are mostly earmarked to some extent, either transferred from central government for a specific purpose or raised locally but ring-fenced to a particular use. Untied and unconditioned resources, on the other hand, provide local governments with the ability to truly shape the future of the towns and cities they are accountable for.

THE SOLUTIONS

Key solutions for strengthening local fiscal space and policy space of local governments in developing countries are therefore tied to the design and implementation of local own source revenue generation mechanisms and fiscal transfers from central governments.

There are two main avenues for increasing the income of local governments. **Firstly**, raising more revenue through the collection of taxes and fees and **secondly** receiving more transfers from regional and / or central government.

Raising local revenue: there are well-established and recognized key mechanisms underlying effective own source revenue generation[12]. These include revenue adequacy, equity, as well as visible correspondence between payments and citizen's benefits. Local governments often manage a large infrastructure asset base, which provide opportunities for revenue if effectively managed.

Many local governments are increasing their own source revenues by applying these mechanisms. There are improvements in the administration of user fees, local taxes, land and property taxes and business licenses. Innovative approaches use technology and smart design as well as effective infrastructure asset management to boost own source revenues. For example, enforcement, digitalization and automation of payments increase the percentage of collected charges. Smart and creative design of local taxes and fees can have a large impact on the collection rates. National legislation needs to adapt and evolve to allow local government to expand their revenue base with clear and imaginative incentives and transparent systems.[13]

Reliable, transparent and adequate intergovernmental fiscal transfers, accelerate the positive influence of local governments on sustainable development. Predictable funding enables long-term planning, effective partnerships with other agencies and with the private sector and needs to be based on local governments' needs, priorities, functions and mandates.

Transparent formula-based allocations of fiscal transfers are key, and can be extended, so that fiscal transfers act to distribute resources across the territory smoothing out regional disparities. In all of this, it remains important that fiscal transfers are designed and applied in a way that still sufficiently incentivizes increased local revenue collection or even borrowing, where local governments are creditworthy.

Solomon Islands is a positive example of how the UN supported local governments to reform their intergovernmental fiscal transfers towards higher performance, shifting away from random,

[12] Smoke P "Why Theory and Practice are Different: The Gap Between Principles and Reality" in Subnational Revenue Systems. International Centre for Public Policy. 2013
[13] Fleck L ""Towards a Framework for Own Source Revenue Optimization" in Local Government Finance is Development Finance, UNCDF, 2022

negotiated transfers to formula- and performance-based transfers.[14]

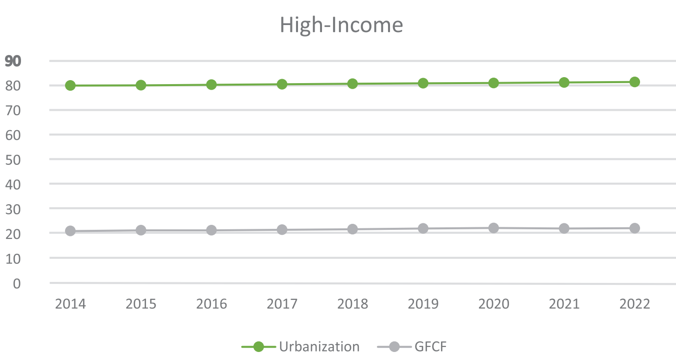
2.2 In developing countries, urbanization is increasingly happening without the required capital investment – investing into urban infrastructure must become a key policy priority at the national and local government levels

THE CHALLENGE

Urbanization is a global trend for developing countries, but capital investment lags behind. As the table below shows, most developed countries have reached a percentage of 80% of citizens living in towns and cities accompanied by a stable rate (20%) of capital investment. As these countries developed, urban growth was accompanied by the necessary investment (in transport, energy, water and sanitation, housing). A key challenge now is to boost the resilience of their built environment in the face of a changing climate.

The first chart shows stable urbanization rates and levels of capital investment in developed countries. However, the picture is different for urbanizing low-income countries in the second chart. The picture is of declining capital investment as urbanization is increasing. This is a sharp contrast from those countries that have completed a phase of urban growth whilst increasing living standards. For example, in China and South Korea GFCF reached over 40% of GDP to provide sustainable infrastructure to growing towns and cities. In developing countries, in contrast for Nigeria, GFCF fell as the cities grew.

Consequently, in many developing countries the expansion of towns and cities is not followed by the necessary investment in urban infrastructure that improves productivity and resilience. This means that countries are not benefiting from the advantages of urbanization and are becoming locked into poorly planned, unsustainable and low productivity urban spaces. An additional problem is that sovereign balance sheets already have large amounts of debt on their books and fluctuating interest rates combined with depreciating currencies make it difficult to service existing loans, let alone borrow more for infrastructure investment.



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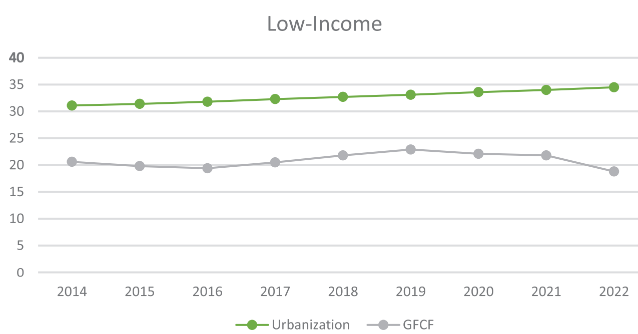
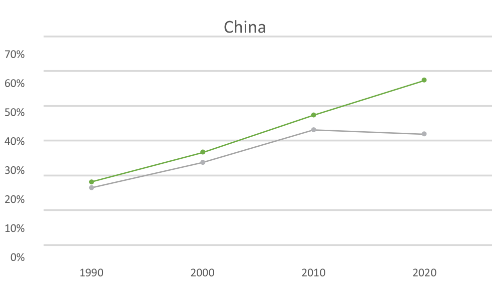
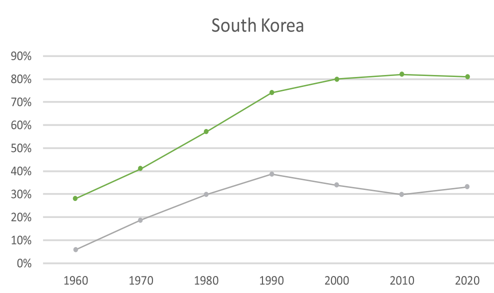


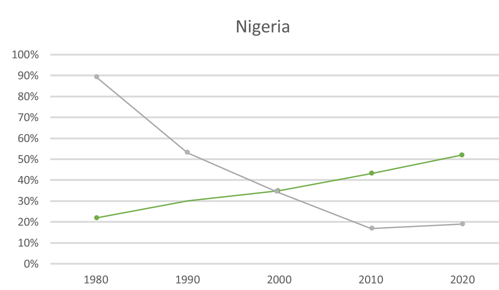
Source: UNDESA



Source: UNCDF



Source: UNCDF



Source: UNCDF

[14] Steffensen J "The Untapped Potential of Intergovernmental Fiscal Transfers" in Local Government Finance is Development Finance, UNCDF, 2022

THE SOLUTIONS

There are national and subnational level pathways to resolving this issue. At the national level, focusing on enhancing domestic resources mobilization and reducing sovereign debt are key strategies to bolster the capacity of national governments to provide greater fiscal support to local governments.

These issues are beyond the scope of this paper, but they remain central to the FFD4 agenda. They include efforts to strengthen tax policies, improve international tax cooperation, improve debt-restructuring systems, promote debt relief and suspension initiatives, and considering debt repayment pauses for countries facing liquidity crises. Additional bold ideas to revamp the debt resolution architecture are also under discussion.

Strengthening local government access to finance is another pathway, particularly by exploring alternatives to sovereign-backed financing, such as leveraging and deepening **domestic capital markets**.

Considering the correlation between fixed capital formation and sustainable urbanization, it is important that local governments can improve their access to capital, including through guarantee mechanisms and unlock concessional lending from financial institutions, as well as subnational, national and multilateral development banks.[15]

In most developing countries (and in some richer countries), capital markets do not offer investment outlets that channel resources towards local infrastructure. One potential solution are bonds that enable pension funds and individual savers to earn interest from taking a stake in growing towns and cities.

This approach has several advantages: it reduces dependency on foreign currency borrowing, broadens and deepens the pool of national capital and, if carried out at scale, it can strengthen domestic currencies and therefore reduce the burden of servicing international debt.

Strengthening municipal bond markets can provide critical financing for local governments to meet necessary local public services and infrastructure investment needs.[16]

Alternatively, **equity financing** can be an option. Under this model the investor takes a direct stake in the ownership of the project, rather than lending to it and increasing exposure to debt.
The upside of this is that it limits the reliance on borrowing. Whilst not suitable for all infrastructure investments it can work well for investments with revenue streams that can be partially earmarked for the equity investor.

This includes sectors such as transport and digital infrastructure. The potential downside is that if not properly designed the model can produce 'standalone' projects that are inadequately integrated into the urban fabric. This kind of investment requires ''city friendly" funds that understand and respect local government financial arrangements and political cycles and promote holistic urban planning and management.

Blended finance tools, including guarantees and credit enhancements can strengthen local government access to finance.

These are tools that reduce the risk associated with new or innovative financing models or that bridge the gap between the rate of return required by investors and the rate of return delivered by critical infrastructure. In effect blended finance is a form of public subsidy that encourages private investment. Well-designed tools with fair risk-reward structures between investor, investee and guarantor can be key for creating the critical mass of resources required to foster environmentally sustainable, productive and livable cities.[17]

At the global level, the European Fund for Sustainable Development Plus (EFSD+) Guarantee – Sustainable Cities Window was established to support cities through guarantees for infrastructure investments that address the demographic, climate/

[15] Jackson D "Analysis and Investment Agenda for a Liveable Healthy Planet in Local Government Finance is Development Finance, UNCDF, 2022
[16] Platz D, Balakrishnan S, Newton L and Chan C "Leveraging City Financing Needs with Domestic Capital" in Local Government Finance is Development Finance, UNCDF 2022
[17] The European Union and the United Nations Capital Development Fund are working towards a "Sustainable Cities Guarantee Facility" to demonstrate this potential. Source: https://www.uncdf.org/article/8268/efsd-guarantee-facility-for-sustainable-cities-advisory-council-holds-inaugural-meeting-in-nairobi

environmental, and economic challenges. A key advantage of such multilateral guarantee facilities is that they can enable local government borrowing without adversely affecting sovereign balance sheets, particularly if multilaterals are willing to take on most or all of the risk. As mentioned earlier, increasing local autonomy is a pre-requisite for these solutions to work.

While these tools are being utilized more and more, most local governments in developing countries will still need a spectrum of development finance sources, including fiscal transfers. Where local governments are not quite ready for subnational borrowing, special financial intermediaries can play a key role to help launch them on a path to creditworthiness.[18]

2.3 Strengthening the public financial and public infrastructure asset management capacities of local governments is critical to achieving the SDGs.

Addressing constraints on local government revenue and expenditure combined with opening access to capital markets are solutions that cannot be fully realized without a concomitant increase in (1) public financial management capacity and (2) public infrastructure asset management capacities.

Public Finance Management (PFM)

THE CHALLENGE

According to the CEPA principal of subsidiarity[19], central authorities should perform only tasks which cannot be effectively performed at a more intermediate or local level. If a government chooses to implement the subsidiarity principle, it should be accompanied by effective capacity development of the local government, in the areas of Local Public Financial Management (PFM) and infrastructure asset management (IAM-see next section). PFM refers to the set of laws, rules, systems and processes used by local authorities to mobilize revenue, allocate public funds, undertake public spending, account for funds ,and audit results. Local PFM arrangements are comparable to central government arrangements albeit with a more limited scope, especially within the planning and budgeting process, debt management and tax administration. More specifically, the nature and scope of these processes directly depends on the degree of decentralization, that is, the degree to which local political, administrative and fiscal decision-making powers have been delegated from the central government to the local government.

Major PFM reforms are difficult and complex undertakings that require time, political and institutional commitment to fully come to fruition. Effective reform requires drafting new laws, restructuring longstanding practices, transforming political and administrative cultures, building institutions, and strengthening capacities. The experience of many developing countries highlights the difficulty of coupling PFM reform to administrative, political and fiscal decentralization processes. On the one hand, slow transfer of responsibilities to local governments may become a disincentive to local capacity-building: where the central government continues to manage the overall administrative affairs for the day-to-day operation of local governments, there is little reason for local authorities to strengthen their PFM processes and capabilities. On the other hand, transfers of responsibilities can progress too quickly: as additional funds and powers are transferred to newly established local leadership and administrations with limited capacity, fiduciary risks as well as the threat of misuse of funds may increase.

THE SOLUTIONS

PFM reforms have great potential to help local authorities deliver enhanced governance and improved service delivery in an accountable and efficient manner. PFM reform usually aims for timelier budget authorization and execution, improved accounting and reporting systems in local governments, increased own-source revenue generation and more robust internal and external audits. In general terms PFM reforms tend to deliver results when three conditions coincide: (i) a strong political commitment to their implementation; (ii) well-tailored reform designs and implementation models according to the institutional and capacity

[18] Smoke P "Re-imagining the role of Special Financial Intermediaries in Subnational Development Banks" in Local Government Finance is Development Finance, UNCDF 2022

[19] The principle of subsidiarity is one of the principles of effective governance adopted by the United Nations Committee of Experts on Public Administration (CEPA)

context; and (iii) strong coordination arrangements—led by government officials—to define, implement, monitor and guide reforms. Performance based systems can address the challenge of different capacities across different local government units.

Tools like the Public Expenditure Financial Assessment (PEFA) and Tax Administration Diagnostic Assessment Tool (TADAT) are ways of assessing this capacity locally. Proactive efforts should be made to boost the ability of local governments to efficiently raise, manage and deploy resources. One way to achieve this is to integrate increasing local financial management capacities into the objectives of policies that target skills and labor market development. Local governments serve as a base for fostering leadership and skills that have a wider societal impact by broadening and deepening the quality of public services, including their capacity to engage with the citizens and with the private sector.

A positive side effect of increasing the public financial management capacities of local governments is the benefit to the private sector both from a more diversely skilled workforce and from the increased demand for services such as audit, accountancy, legal, engineering and design. There are three ways that investing in local PFM capacity can quickly pay dividends. In the first place the increase in own source revenue receipts and the increase in public financial management efficiency can result in a net gain in local fiscal space. The gains in local revenue can pay for the technical assistance support to achieve them. Secondly, increased infrastructure and service provision meets citizen demand and contributes to development goals, Finally, renewed social contract and trust between citizens and the state resulting from palpable improvements in quality of government services.

Importantly, transparent public financial management at the subnational level require institutions and processes that ensure better accountability and fair competition among different levels of government.[20] Critical elements include open elections, inclusive participatory processes, transparent and easy-to-understand decision making making and budgeting, sustainable procurement, protecting whistle blowers, clear procedures to redress grievances, open recruitment of public officials etc. In addition to the increased trust in public institutions, there is also evidence that the introduction of these policies influences peacebuilding and conflict resolution.[21]

Infrastructure Assets Management (IAM)

THE CHALLENGE

While roles and responsibilities of local governments in the infrastructure sector differ from country to country, depending on their level of decentralization and the role of the private vis-à-vis the public sector, most local governments across the world at least partially own and/or manage portfolios of physical and infrastructure assets that may include land, natural resources, buildings, including public housing, schools and health facilities, roads, electricity grids, water and sanitation systems, solid waste facilities, street lighting, and vehicles and equipment, among others. Consequently, some form of managing infrastructure assets typically constitutes part of local governments' responsibilities. Yet, existing infrastructure assets are frequently not adequately managed over their entire lifecycle and across infrastructure portfolios, while new ones are often built or acquired without putting in place an IAM framework and corresponding policies and actions, as well as an enabling policy and institutional environment that ensure these assets are managed sustainably.

This omission can be extremely costly. Under budgeted and under-maintained in frastructure assets are more likely to fail, disrupting essential services like transport, water and sanitation or solid waste management. Underinvestment in maintenance of infrastructure has been estimated to cost some developing economies up to 2 % growth in GDP. Underbudgeting and a lack of planning of activities of infrastructure asset management also has profound financial implications. Contrary to common belief, the actual construction or

[20] There is consistent evidence that performance based local finance systems increase effectiveness of local public financial management and increase impact of local investment. See Steffensen J "The untapped potential of intergovernmental fiscal transfers in "Local Government Finance is Development Finance, UNCDF op cit

[21] This is also continual evidence that transparent local government finance processes encourage post conflict reconciliation. Jackson, D "Who won and who lost? The role of local governments in post-conflict recovery" in The imperative of good local governance: challenges for the next decade of decentralization United Nations University, 2013 provides a framework for assessing this effect. Recent positive examples include the success of the Local Development Fund in Somalia. https://www.delog.org/news/details/local-government-rising-somalias-fiscal-decentralisation-success-story

acquisition cost of an infrastructure asset only contributes to 15 % to 30 % of overall expenditures; 70 to 85 % of costs are incurred over its lifecycle once it is built or acquired. Despite that there is often a missing link between development planning and budgeting. Often, priority projects are not even included in the capital budget. If they are, operation and maintenance costs and estimates for repair or replacement costs are not included in the annual recurrent budgets.[22]

THE SOLUTIONS

There are a range of reasons for the lack of systematic approach to IAM in the public sector. Funding is one key constraint as it is often easier for governments to access private or public funds for the construction of new infrastructure than to access new funds for maintenance needs, and to get and maintain public support for that. At the same time, it is typically perceived that maintenance activities—a key component of IAM—can be delayed making IAM a likely target of fiscal tightening measures.

This challenge can best be addressed through a whole-of-government approach based on an integrated, multidisciplinary set of strategies, policies and actions a local government needs to design and implement to sustain public infrastructure assets. IAM engages public sector officials across disciplines to ensure that such assets are monitored and managed to provide inclusive, sustainable, and reliable public services for all. Introducing IAM as new government discipline similar to PFM can help local governments officials across the globe to manage infrastructure assets more sustainably, resiliently, and inclusively for current and future generations. Through coordinated and evidence-based decisions on planning, sequencing and designing asset interventions (from operating and maintenance, repair/replacement to disposal or selling of assets) for existing public infrastructure assets and future infrastructure infrastructure investments, public sector officials- working as a team- can maximize their service value, resilience and revenue potential in support of the SDGs for current and future generation.

The United Nations Department of Economic and Social Affairs (UN DESA) in collaboration with the United Nations Capital Development Funds (UNCDF) and United Nations Office of Project Services (UNOPS), has developed and field tested a range of tools included in the UN Handbook on Infrastructure Asset Management[23] to show how local governments can assess their policies and practices against good asset management practices and identify gaps and specific actions to close them. It stresses that infrastructure asset management must be embedded in a framework based on clear principles and objectives that reflect community needs and national development priorities, consider each pillar of infrastructure asset management (demand, life cycle and financial management) and follow a portfolio approach that maximizes the benefit and value of an entire collection of infrastructure assets.

2.4 Channeling international cooperation and official development assistance through local governments is an opportunity for the SDGs

THE CHALLENGE

Development cooperation largely bypasses local governments despite their essential role in achieving the SDGs and their potential as effective development partners. This can be a missed opportunity because providing additional development aid towards local governments in close collaboration with central governments could in many cases greatly increase the development impact of development international cooperation.

The 2019 OECD report "Decentralised development co-operation" states that only USD 1.87 billion or 1.3% of total bilateral Official Development Assistance (ODA) is provided in support of cities and regions in developing countries.[24]

[22] Platz D, Balakrishnan S, Newton L and Chan C "Leveraging Local Assets for Sustainable Development Goals" in Local Government Finance is Development Finance, UNCDF, 2022
[23] https://financing.desa.un.org/document/un-handbook-infrastructure-asset-management
[24] Decentralised development co-operation, OECD, 2019

THE SOLUTION

The low proportion of international cooperation that is directed to the local level is limiting the effectiveness of development aid to overcome the bottlenecks referred to in this paper. Greater flows of ODA and DFI finance to the local level in full alignment and coordination with national frameworks, needs and priorities would have an exponential effect on accelerating achievement of the SDGs and human advancement beyond 2030.

Decentralized cooperation, between local governments, remains one of the most effective ways for cities in the developing world to access not only direct financial resources but also the capacities, knowledge, and public management skills essential for continually improving / innovating public service delivery.

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SECTION THREE

Key ingredients for transformative local development finance

- Sound and transparent systems for financial transfers from national to local and regional governments to accelerate sustainable development and climate action that are:

  - based on local and regional government's needs, priorities, functions and mandates.
  - aimed at adequate, timely and reliable resource and enhance their ability to raise revenue and manage expenditures.

- Appropriate policies and capacities that enable local and regional governments to expand their revenue base through mechanisms such as land and property taxes, cadastres, local taxes, fees and service charges while ensuring appropriate fiscal, political and administrative decentralization based on the principle of subsidiarity.

- Strengthened local capital markets that help local and regional governments invest in public service infrastructure, supported by:

  - Strong PFM and debt management capacities.
  - Local government-oriented guarantee facilities that help manage currency and other risks.
  - Domestic and external guarantee mechanisms for local governments to unlock access to local and international capital markets.
  - Equity investments in sustainable sustainable infrastructure that limits debt exposure whilst adhering to principles of holistic urban planing and management.

- National and subnational development banks that are technically and financially equipped to help design and finance LRGs pipelines of projects. Guarantee mechanisms to support city led investments and mitigate sovereign contingent liability

- Increased public sector capacity to manage and maintain public infrastructure assets to provide inclusive, accessible, resilient, sustainable, and affordable public services for all.

  - Strategies, policies and practices that ensure that all public infrastructure assets are managed holistically and effectively over their entire lifespan for current and future generations.
  - Capacity to plan and budget for the human, material and financial needs to maintain infrastructure sustainably.

- Strong North-South, South-South and triangular regional and international cooperation, as well as subnational, decentralized and city-to-city cooperation to contribute to subnational investment, developing capacities and fostering exchanges of financing solutions and mutual learning at all levels and by all relevant actors.