

Financing urban infrastructure

Urban infrastructure investments in water, sanitation and solid waste are far below the estimated levels needed to reach the Millennium Development Goals. In order to provide good services to urban citizens, the share of resources allocated for urban infrastructure will have to increase if reforms and growth are to continue.

Present spending on urban infrastructure is lower than in the 1970s. This contributes to a situation where 40% of the urban population in sub-Saharan Africa lack access to safe water and 80% lack basic sanitation. Urbanisation increases the vast infrastructure backlog. Poor people in urban areas contribute significantly to economic growth but get less than their fair share of public spending on services.

Key Issues

Health and environment

Ensuring access to water, sanitation, waste management and urban transport are large responsibilities for local governments. These services are also crucial for peoples' health and the urban environment.

Institutional aspects

Local authorities must be able to develop and maintain infrastructure and to mainstream the urban poor's needs to budgets and investments. This involves establishing funding and having access to government grants and loans. Many municipalities and municipal utilities are not "creditworthy". Having access to affordable long-term debt, working capital and equity finance is critical to enable municipal investments. This requires sound public investment planning, policies and a regulatory framework, as well as local management and project implementation capacity.



Modernising this sewage treatment plant on Sri Lanka is one of the undertakings of the water utility in Colombo, which endeavours to improve the city's waste water collection and treatment.

PHOTO: SARA STENHAMMAR

may need to be approved by central government, and borrowing may be restricted. With limited resources, local governments tend to spend their funds on recurrent costs. Little is available for capital investments. Traditional urban infrastructure financing comes from central budgets, where towns get subsidies or credits from governments or financial institutions based on sovereign guarantees. Projects are often implemented by parastatal organisations or separate units, leaving towns without clear duties for servicing debts or maintaining assets. User charges rarely cover operation or maintenance costs. Towns and utilities have few incentives or capacity for infrastructure improvements and this results in underinvestment. Modern sustainable approaches to financing aim to leverage capital based on municipal utilities balance sheets. To do this local authorities or utilities must build capacity, reform and develop their organisations into sound businesses with realistic attitudes toward service costs and prices.

Decentralisation reforms

Many countries are decentralising in order to bring public resources, officials, political power and accountability closer to people. Without a transparent system of resource transfer from central to local governments, municipalities face great difficulties in providing adequate services. Along with rational transfers, municipalities need a few high yielding revenue sources, e.g. property taxes. Rationalising the system of transfers and enhancing the tax base by rationalising revenue sources are important in the decentralisation process.

Private capital

Public sector budgets are under pressure in most developing countries and governments have limited possibilities of providing guarantees or budget funding. Therefore expectations on private sector financing infrastructure are high, but un-

Investment needs and costs

The financing needs and costs for infrastructure investments remain high. For many developing countries, 10–16% of GDP is required for investments in order to reach the Millennium Development Goals for water and sanitation. Available resources must increase. The share of domestic budgeting can increase, the private sector can be encouraged to invest and donors can provide soft funding. Income generated from water and sanitation user fees can increase and potentially be reinvested.

Local authorities

In most developing countries, municipalities account for only a minor share of public expenditures. Municipal budgets

fulfilled. In the 1990s, only 5% of investments in water and sanitation, globally, were financed privately. High risks and a low financial rate of return on invested capital make infrastructure projects unattractive to international private investors. Local investors are often too few, too poor and technically unskilled for major investments. Many countries have initiated reforms to support decentralisation processes and increase private sector participation and public-private partnership. This still means risk-sharing for governments, and it is crucial to ensure the public is not short-changed in these deals. In the long term, the costs for services will be paid by consumers.

Strategic areas for support

Investments need to link with policy reforms, institutional strengthening and capacity building at local government and utility level. Strategies for development partners working with municipal infrastructure need to adapt to local situations. Sida's role involves working with banks and financing institutions and acting as mediator and facilitator at all levels. The following issues are important:

- Enable access to capital markets through soft funding and grants to blend with loans
- Support development programmes where a group of municipalities act and borrow collectively.
- Support policy reforms and institutional and capacity development in local governments and utilities.
- Strengthen local governments' ability to plan, budget and monitor revenues and expenditures.
- Support capacity building of local utilities, town councils and asset holders in the preparation, implementation and revision of comprehensive

development plans for improved performance and service delivery and for physical investments that are accessible and affordable for poor people.

- Strengthen effective cost-recovery for operations, maintenance and reinvestments in urban infrastructure, complemented with effective mechanisms and targeted subsidies for the poorest and most vulnerable.
- Strengthen municipal planning and development of infrastructure services that are inclusive, participatory and take into account the specific needs of men and women, boys and girls.

To be aware of

Poorly functioning transfer systems can provide perverse incentives to local governments. For example, if rehabilitation is a capital expenditure paid for by central government, this discourages local authorities from improving revenue collection and encourages maintenance neglect.

If civil society is weak and can not hold local officials accountable and if the systems for financial planning and control are weak, decentralisation does not necessarily lead to more efficient and responsive service delivery to the urban poor.

When the local administrations and utilities have limited responsibilities and authority, there is seldom skilled staff in place. Before entering into complex investment preparations, there need to be persons in place who have the formal authority to act and to take part in the capacity building.

Examples of Sida support

Tanzania. Support for rationalizing the system of transfers, one of the key objec-

tives under the Tanzania Local Government Reform Programme.

Gattjina, Russia. Support to the municipal administration and its utilities for energy and water, to improve the performance and prepare and implement investments.

St. Petersburg, Russia. Improved services through reforms, institutional strengthening of the municipal water utility combined with investments in the water and wastewater infrastructure.

Dhaka, Bangladesh. The water utility of the capital Dhaka has developed a comprehensive water plan. Sida supports the utility in preparing for investments and expansion of water services financed by concessionary credits and user fees.

Colombo, Sri Lanka. The water utility is undertaking major improvements in waste water collection and treatment. Sida has supported project development and also extended a concessionary credit for the investments.

Sida references

Available at www.sida.se

Fighting Poverty in an Urban World, Sida Policy (2006)

Urban Issue Paper on Municipal Utility Reform

Urban Issue Paper on Public Environmental Management

Urban Issue Paper on Urban Solid Waste Management

Urban Issue Paper on Urban Transport

Urban Issue Paper on Urban Water Supply and Sanitation

Published separately

Tannerfeldt, G and Ljung, P (2006) *More Urban – Less Poor, An introduction to urban development and management*, London, Earthscan

REMINDERS

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| <input type="checkbox"/> Are there regulation and policy reforms undertaken, initiated or planned that support municipal responsibilities for urban services and investments? | <input type="checkbox"/> Are the regulatory and legal frameworks sufficient to safeguard long-term sustainability and, even more importantly, is there evidence that regulations are actually implemented? | <input type="checkbox"/> Have the roles of different private and public actors been properly defined? |
| <input type="checkbox"/> Are management structures for municipal and urban services and investments appropriate in terms of efficiency, accountability, transparency and anti-corruption? | <input type="checkbox"/> Have sufficient measures been taken to enhance capacity building of relevant actors? | <input type="checkbox"/> Do the investment planning and preparations target service delivery and physical investments that are accessible and affordable for poor people? |
| | | <input type="checkbox"/> Do the investment planning and preparations include proper assessments of the environmental impacts? |