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MEETING OF THE AD HOC GROUP OF EXPERTS ON WAYS AND
MEANS OF ESTABLISHING OR STRENGTHENING FINANCIAL
INSTITUTIONS FOR HUMAN SETTLEMENTS FINANCING AND
INVESTMENT

Report of the Executive Director

SUMMARY

In accordance with decision 3/11 of the Commission on Human Settlements, the Executive Director has prepared a report on a meeting of a high level ad hoc group of experts which was convened to study ways and means of establishing or strengthening financial institutions for human settlements financing and investment and mobilizing finance, in order to help solve settlements problems, particularly in the developing countries.

This document is divided into two parts. The first part presents a summary of the background to the meeting and the considerations to which the attention of the Ad Hoc Group of Experts was directed. The annex contains the actual report of the Ad Hoc Group of Experts.

The report focuses attention on the financing of settlements infrastructure and services. It examines the question of ensuring a better utilization of existing resources in the sector and increasing the flow of funds to the sector. It discusses some of the implications of the distinction made between capital investments and current expenditures, the question of the overlapping of responsibilities between different levels of government, and the importance of management tools and capabilities and hence of training and technical assistance. It examines and stresses the existing and potential role of financial intermediaries, and in particular of development institutes. It recognizes that although national funding must play the primary role, such funding can and should be supplemented by increased multilateral and bilateral aid flows. Recommendations for action at the local, national and international levels are offered, and the role of the United Nations Centre for Human Settlements (Habitat) is outlined.

1. During the period 1978-1979, the United Nations Centre for Human Settlements (Habitat) convened a series of regional meetings to consider and develop new and innovative approaches to human settlements finance and management. These were the African Regional Meeting (Nairobi, October 1978), the Latin America and Caribbean Meeting (Mexico City, November 1978), the Asia and Pacific Regional Meeting (Manila, June 1979) and the Western Asia Regional Meeting (Al-Ain, United Arab Emirates, November 1979).

2. The subject of human settlements finance and management was also given high priority at the third session of the Commission on Human Settlements (6-15 May 1980). In his introductory statement, the Executive Director noted that efforts to improve human settlements financing had hitherto been focused mainly at the national level. Investment policies tended to be concentrated on such development elements as highways, railways, electric power systems, irrigation schemes, ports and industrial installations. Since the benefits of those facilities were spread nationwide, it had been accepted that they should be financed and provided by a central government. It seemed, therefore, that there was a good case for applying the same reasoning to central government involvement in questions of settlements financing.

3. In its decision 3/11, the Commission on Human Settlements, noting that there was a shortage of reliable information on the financing of human settlement development in developing countries and the problems caused by current practices, and aware that unless new and innovative ways of raising funds were found fiscal resources constraints would continue to impair the abilities of the developing countries to solve the massive problems relating to human settlements and that failure to generate required funds would constitute a serious obstacle to the national economic and social development of those countries, decided to request the Executive Director:

(a) To give priority attention to the development of human settlement finance and management, with a view to providing public-finance information at national and subnational levels in developing countries, exploring methodologies and techniques for development strategies for financing public services and disseminating that knowledge as obtained;

(b) To convene a high level ad hoc group of experts, not exceeding 10 members, to study ways and means of establishing or strengthening financial institutions for human settlement financing and investment and mobilizing finance, in order to help solve settlements problems, particularly in the developing countries;

(c) To submit the report of the ad hoc group of experts to the Commission at its fourth session.

4. As a consequence of that decision, the Executive Director convened an ad hoc group consisting of 10 members which met in Nairobi from 19 to 23 January 1981. The group of experts was selected so as to include international bankers, executives of development institutions, municipal administrators and other international and national specialists experienced in dealing with the problems of urban public finance. Five members of the group were from developing countries (Brazil, Ghana

India, Papua New Guinea, Philippines), four were from industrialized countries (Belgium, France, Germany, Federal Republic of, United States of America) and one was from the World Bank. The meeting was chaired by Mr. Willi Engel, Director, Kreditanstalt für Wiederaufbau (Federal Republic of Germany).

5. The Ad Hoc Group of Experts was directed to focus its attention on the financing of settlements infrastructure and services, and in particular on the obstacles impeding the flow of funds to this sector for both capital investment and current expenditure outlays at the international, national and local levels.
6. In its report the Ad Hoc Group of Experts examines the existing and potential role of financial intermediaries, particularly national development finance institutions. It recognizes that, although national funding must play the primary role, such funding can and should be supplemented by increased multilateral and bilateral aid flows.
7. Nearly all developing countries have national investment or development banks or institutions of some kind. Most such banks and institutions are established to promote private or public investment in industrial enterprises in accordance with the national development plan, while others are created specifically to finance certain sectors.
8. The specific recommendations made by the Ad Hoc Group of Experts in this regard include a proposal to the effect that consideration be given to the extension of the activities and operations of existing institutions either through the creation of specialized departments or through the formation of new subsidiary companies for the purpose of financing urban infrastructure projects. National or foreign contributions to the equity capital of such companies could be sought at the outset or at a later stage in view of the ensuing multiplier effect of the funds committed.
9. In order to encourage development finance institutions to extend their operations as proposed, the Ad Hoc Group of Experts recommends that the United Nations Centre for Human Settlements (Habitat) should co-operate with the World Federation of Development Financing Institutions, as well as with the regional associations of development finance institutions, in order to promote such activities among their members.
10. Specialized financial intermediaries have already been established in several countries for the purposes of public sector investment. A major contribution of these institutions has been the promotion of local government and decentralization through the provision of an alternative channel for the financing of urban development. Such institutions have proved specially relevant to the needs of small and medium-sized cities which, as a result, do not need to rely solely on grants from higher levels of government or on their own tax revenues to finance urban projects.
11. In the report, the Ad Hoc Group of Experts draws attention to the fact that there is a lack of knowledge and information about existing financial intermediaries in developing countries specializing in the provision of human settlements infrastructure and services. It is therefore recommended that the United Nations Centre for Human Settlements (Habitat) should assist in the acquisition and dissemination of knowledge on this subject, review the experience of the institutions in question and disseminate the findings among developing countries. This might be achieved through the compilation of a comprehensive directory of such institutions, with the co-operation of the regional development banks, the World Bank and national Governments themselves.

12. At the national and subnational levels, the report examines in some detail the question of intergovernmental relations, the overlapping of responsibilities, local government revenue administration and the need for technical assistance and training programmes. Specifically, the report recommends that national Governments should establish high-level commissions to re-examine relations between the different levels of government and to recommend basic reforms where necessary. Particular attention should be paid to structuring the system in order to encourage the mobilization of additional resources for human settlements financing, to rechanneling more resources towards the provision of urban services and to encouraging the more efficient management of services provided in urban areas.

13. As the report points out, although national Governments bear the major responsibility in this respect, determined action at the local level can make a significant contribution in terms of improving the provision of urban services. Indeed, without such action at the municipal level, it is difficult to envisage the improvement in administrative competence and creditworthiness that is a necessary precondition for the effective utilization of a better designed institutional framework.

14. The need to improve finance management, project execution and project operation has been fully recognized in several studies conducted by national and international agencies. Some of the most critical problems in this field concern: the lack of adequate planning and programming processes by which priorities can be correctly established; the need, when programming activities and financial resources, to indicate revenue sources and control the cash flow; and the analysis, evaluation and efficient administration of urban development projects.

15. The report recommends that national, regional and local governments should introduce specific programmes to improve the managerial capability of personnel engaged in the financing and administration of urban development and that both national Governments and international agencies should assist in the provision of technical assistance in these areas.

ANNEX

Report of the Ad Hoc Group of Experts on Ways
and Means of Establishing or Strengthening
Financial Institutions for Human Settlements
Financing and Investment

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LETTER OF TRANSMITTAL

Nairobi, 23 January 1981

To the Executive Director
United Nations Centre for Human Settlements (Habitat)

Sir,

The Ad Hoc Group of Experts on Ways and Means of Establishing or Strengthening Financial Institutions for Human Settlements Financing and Investment has the honour to submit its report on the meeting held in Nairobi, Kenya, from 19 to 23 January 1981. The meeting was convened in response to an invitation from the Executive Director, United Nations Centre for Human Settlements (Habitat).

At its third session, held in Mexico City from 6 to 15 May 1980, the Commission on Human Settlements requested the Executive Director, inter alia, to convene a high level ad hoc group of experts, not exceeding 10 members, to study ways and means of establishing or strengthening financial institutions for human settlements financing and investment and mobilizing finance, in order to help solve settlements problems, particularly in the developing countries, and to submit the report of the ad hoc group of experts to the Commission at its fourth session.


The meeting focused its attention principally on the financing of settlements infrastructure and services, and in particular on the obstacles impeding the flow of funds to this sector for capital investment and current expenditure at the international, national and subnational levels. Recommendations have been made for action at all three levels.

It is our confident hope that the report, its conclusions and its recommendations will be of help to the Commission on Human Settlements, as well as to national and international financial institutions involved in the financing of human settlements development.

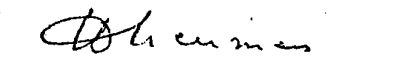
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In conclusion, we should like to express our appreciation to the United Nations Centre for Human Settlements (Habitat) for the excellent arrangements made for this meeting and for the organization and conduct of the work of the Ad Hoc Group of Experts.

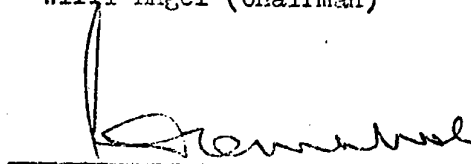
Accept, Sir, the assurances of our highest consideration.



Willi Engel (Chairman)



Henri Neuman



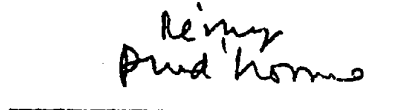
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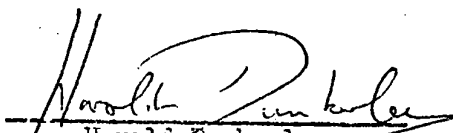
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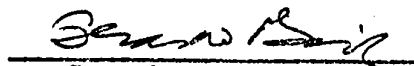
Roy Bahl



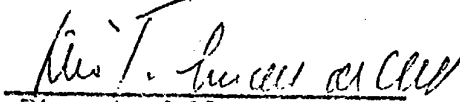
Remy Prud'homme



Harold Dunkerley



Gerardo Sicat



Diego Lordello de Nello



Meg Taylor

INTRODUCTION

1. The Ad Hoc Group of Experts met at the Kenyatta Conference Centre, Nairobi, from 19 to 23 January 1981. The Group included international bankers, senior executives of national development finance institutions, municipal administrators, university professors and other specialists experienced in dealing with the problems of urban public finance. The list of participants is provided in appendix I.
2. The Group of Experts was directed to focus its attention on the financing of settlements infrastructure and services, and in particular on the obstacles impeding the flow of funds to this sector for both capital investment and current expenditure outlays at the international, national and local levels.
3. In his opening statement, Mr. Arcot Ramachandran, Executive Director, United Nations Centre for Human Settlements (Habitat), noted that, regrettably, Governments had had little success in mobilizing financial resources and directing them to the informal housing sector. Although many families did manage to build some kind of housing structure for themselves, they could not individually cope with their basic needs in respect of water supply and waste disposal services and could deal with transportation problems only in a most limited way. Most of the burden must therefore fall on the public authorities responsible for building and operating human settlements.
4. However, the installation of infrastructure cost money, and the question then arose as to what the price would be and who would pay. In many developing countries, the resources of national and local governments could almost certainly be managed more efficiently. In many instances, more revenue could be raised through the adoption of more rational user charges for services and the introduction of tighter controls for recovery systems for land and house advances. It would also be useful to clarify the division of financing responsibility among the various levels of government.
5. The international community had an important role to play in promoting the formulation of comprehensive management and financing plans, identifying overlapping responsibilities at different levels and fostering co-ordination among all the sectoral agencies contributing to settlements programmes.
6. The method of work adopted by the Group was to examine and consider four basic discussion papers, taking each one in turn. Each paper was presented by a member of the Group. Comments and observations on each paper were then presented by the other participants, and a general discussion followed. The list of documents is given in appendix III.

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7. A fifth paper written by a UNCHS (Habitat) staff member, entitled "Mobilization of urban finances in a time of rapid inflation", was also distributed to members of the Group prior to the meeting as additional background material but was not the subject of a special presentation.

8. The agenda adopted by the meeting provided for each paper to be presented and discussed in one half-day at either a morning or an afternoon meeting. It was thus planned to complete discussion of the basic papers by the end of the second day and to arrive at certain general conclusions.

9. However, it was noted that the last two papers to be considered (those by Mr. Neuman and Mr. Engel) were to a large extent complementary. They were therefore presented consecutively, with discussions on both papers taken together at the following meeting.

10. Following its examination of these four basic discussion papers, the Group began the task of summarizing its conclusions and drawing up recommendations. To facilitate its task, the Group decided to group its recommendations under five separate headings:

- (a) Intergovernmental relations;
- (b) Local revenue administration;
- (c) User charges;
- (d) Role of specialized institutional arrangements;
- (e) Management capability;

11. The agenda for the meeting is reproduced in appendix II.

I. THE FINANCING OF LOCAL PUBLIC SERVICES IN DEVELOPING COUNTRIES

12. The Ad Hoc Group of Experts first considered a report on "Human settlements finance and management" (HS/C/3/5) in order to examine the situation currently prevailing with regard to the financing of public services in developing countries.

13. The principal issues raised in the report were whether and how more resources could be mobilized for the financing and delivery of local services and in what way and to what extent the relationship between national and subnational governments could be reorganized with a view to delivering more and better services with the resources available.

14. As slum and squatter settlements grew, and as the demands for infrastructure and services increased, the financial and management problems of large cities became seemingly insoluble. There were increasing shortages of those services which local authorities were typically responsible for providing.

15. There was usually some local autonomy in service provision and financing. However, since the governmental system in most developing countries was centralized, control over available resources ultimately lay with the central government. In rural areas, central governments delivered and financed most services directly, whereas in urban areas local governments were generally financed through a system of grants or shared taxes. These were then supplemented by additional sources of revenue such as property taxes and various licensing fees and charges. However, the fact remained that, in most urban areas in developing countries, local authorities found themselves responsible for a whole host of services with insufficient financial resources at their disposal.

16. Accurate data on local government finances was very scant and varied widely between different cities. A paper on "Urban finance in developing countries" (by J.F. Linn) submitted for discussion at the meeting provided a statistical overview of some dimensions of urban finance systems in developing countries. Much of the data was drawn from ten case studies carried out in various cities in India, Colombia, Jamaica, Tunisia, Indonesia, the Philippines and Korea. ^{a/}

17. As a starting point for the discussion of urban finances in developing countries, the report considered the relative importance of subnational governments. It was found that, in those developing countries with a large subnational government sector, the average share of subnational government spending on total government spending was 46 per cent, whereas in those developing countries where subnational government was relatively unimportant, the average share was only 6 per cent. The first group of countries was dominated by Latin American countries, and the second by African countries. The analysis indicated that urban governments in fact played an important role in the provision of urban services in many of the large cities of developing countries, and local government might therefore have an important impact on the development of such cities.

^{a/} These case studies were initiated and supervised by Roy W. Bahl, Douglas H. Keare and Johannes F. Linn in the context of a World Bank study of urban finances in developing countries.

Discussion

18. One of the most striking phenomena observable in cities in developing countries was the extensive overlap of responsibilities between subnational and national authorities. It was clear that a far greater degree of decentralization was essential in some developing countries if local authorities were to overcome the difficult financial situation in which they found themselves.

19. Virtually all urban governments in developing countries were responsible for providing a range of basic services, for example markets and abattoirs, street lighting, garbage collection, fire protection, libraries and cemeteries. In some countries they were also partly or fully responsible for providing physical infrastructure in the form of roads, potable water supply, sewerage systems and drainage works. Telephone and electricity services, on the other hand, were typically the responsibility of higher level (state or national) government agencies. However, there were wide variations between countries.

20. The meeting concluded that, in certain developing countries, the whole process of financing local public services had to be rationalized. In particular, decisions had to be taken on which services should be financed by whom, on the taxing powers that local authorities might be given, on the kind of credit arrangements that might be established to enable local authorities to raise funds for infrastructure projects and on the possibility of making much greater use of the resources and creative initiative of private enterprise.

21. Among the constraints inhibiting the greater use of existing resources at the local government level were the lack of effective procedures for the collection and assessment of property taxes. Tax collection procedures were not well outlined and penalties were not effective. Assessments were often not up to date, there was a shortage of trained personnel and in many cases the enumeration of properties was incomplete. The meeting concluded that there was a clear need for the provision of technical assistance and the introduction of training programmes for surveyors and assessors, financial forecasters and planners.

22. It was noted by the meeting that the paper on "Human settlements finance and management" (HS/C/3/5) dealt almost exclusively with the larger cities and did not take into account the particular problems of smaller towns. However, the pressure on metropolitan areas would be eased if Governments managed to keep the population in rural areas. This might mean that considerably more investment would have to be directed towards rural areas, not only for the creation of employment opportunities but also for the improvement of living conditions in the smaller towns and rural areas themselves.

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23. In that connection, the opinion was expressed that, in order to achieve the largest possible gains in terms of the development of the economy, investments must seek the highest productivity and rate of return. However, because of the infrastructure, state of development and ancillary services found in larger cities, productivity in those cities was greater. Nevertheless, it was considered that the creation of adequate infrastructure and facilities throughout the developing countries was virtually impossible to achieve with the means currently available.

24. In that connection, the Group concluded that it was difficult to decide at what stage in the growth of an agglomeration economies of scale turned into diseconomies. It nevertheless seemed that a significant degree of decentralization was desirable.

25. Turning to the question of the self-financing of public services through the use of benefit or usercharges, the Group concluded that, given the size of the problem of financing local services and the limited volume of external aid flows, that approach was not only inevitable but also very desirable from the point of view of efficiency. Self-financing in that context was taken to mean the covering not only of the current costs of providing a service but also of the capital costs.

26. In most developing countries, raising the self-financing capability implied that local government administration had to be improved. The shortage of qualified personnel called for training courses, particularly in management, accounting and budgetary and financial planning.

27. In those cases where public services were operated by local authorities but capital investment decisions were made by a higher level of government or by its agency, sufficient attention was often not paid to current expenditures. That frequently led to the overspending of capital, if such spending was financed by grants, and the achievement of less than optimal operating costs by local authorities. The combining of responsibilities for capital expenditure and operating costs was another problem that had to be examined by all levels of government involved in order to increase operational efficiency.

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II. FINANCING INFRASTRUCTURE AND SERVICES THROUGH FINANCIAL INTERMEDIARIES

28. The Ad Hoc Group of Experts examined and discussed possible ways in which existing institutions in developing countries might be strengthened or new institutions created as a means of mobilizing additional financial resources for human settlements development. The Group considered a paper on that subject submitted to the meeting. b/

29. As stated in the paper, virtually all developing countries had public or public-interest investment or development institutions whose role was generally to contribute to the development of a productive economy through financing, technical assistance or some kind of creative association, provided that that role was consistent with the fundamental requirements of the institutions' objectives, by-laws and policies. Such institutions operated in the market under stipulated or agreed conditions, either with their own resources or with borrowed funds, in such a manner as to safeguard the public funds entrusted to them.

30. The satisfactory discharge of their responsibilities in fact implied not only making investments providing durable value and overall profitability but also identifying and selecting sectors and projects in conformity with government plans, policies and recommendations.

31. Several possible methods existed for financing projects related to urban infrastructure and services depending on the priority given to such projects in local economic and social development plans. These methods would, however, be greatly facilitated and improved given:

(a) The establishment and maintenance of detailed inventories of related problems and possible solutions by the state or by state-instituted specialized study centres;

(b) The development of plans and programmes at both the national and local levels for the realization of concrete projects;

(c) The initiation of pilot projects with potential widespread applications.

b/ H. Neuman, How investment or development institutions can be strengthened or otherwise motivated in order to assist in financing infrastructure and services in urban areas.

32. Possible forms of participation by investment or development institutions would involve be:

(a) Specialized departments, or preferably subsidiary companies, created specifically for the purpose of urban planning and development, the purchase and exploitation of poorly developed or abandoned land, the construction of housing within an overall urban plan and the creation or reorganization of associated activities and services such as commercial or recreational facilities;

(b) National or foreign equity or other contributions, which could be sought at the outset; such shareholdings might be turned over at a later date, or the company could be transformed into a co-operative society with the recipients of the dwellings provided becoming members;

(c) The promotion of local or national enterprises specializing in specific fields such as the production of construction materials; this would provide employment, accelerate the search for new technologies and produce new materials; it might also create upstream industries that would provide the primary materials needed for the production of construction elements (for example, cement factories and wood-working assembly shops).

33. The investment capacity of local authorities could be improved through the creation of "communal" finance institutions such as those developed in European countries. c/ Such specialized central institutions offered considerable advantages: they made better use of the capital market than local entities; they adjusted better to market conditions and might even be able to influence them; they offered money lenders the security of an established institution; and they could borrow funds from abroad more easily.

Discussion

34. It was noted that foreign lenders often had difficulties in finding an appropriate agency in the developing country as a counterpart through which investment funds could be channelled. Local authorities did not as a rule have the necessary borrowing capability and know-how, which meant that the need for some kind of financial intermediary was even greater. In certain cases, therefore, it might be necessary to strengthen existing institutions, extend their area of activity into urban development or even create new intermediaries specifically for public-sector investment.

c/ For instance: Crédit Communal de Belgique (Belgium); Caisse des Dépôts et Consignations (France); the Public Works Loan Board (United Kingdom).

35. In determining the kind of financial intermediary best suited to the task at hand, however, it was first of all necessary to be clear about those urban measures or facilities which it was intended to finance. In that connection, basic infrastructure and services could be grouped into two broad financial categories:

(a) Those facilities and services that could usually be made self-financing by means of adequate user charges, namely:

Water supply;

Electricity;

Telephone;

Housing;

Mass transportation;

Markets and abattoirs;

(b) Those facilities and services that did not lend themselves easily to specific user charges and must generally be financed by general revenue from rates and taxes, namely:

Health, education and welfare;

Highways and roads;

Street lighting and sign posts;

Refuse collection and cleansing;

Parks and recreation centres;

Cemeteries;

Fire protection;

Law enforcement.

III. INTERNATIONAL FINANCING OF INFRASTRUCTURE AND SERVICES

36. In discussing the question of international financing for human settlements development, the Group had before it a paper which noted that the term "development financing institution" included not only local, regional, supraregional and international institutions, but also banks specializing in the financing of certain sectors. ^{d/} Such institutions might be state-owned, private or partly private and partly public. They differed in terms of size, organization, regional extension, degree of specialization, methods of financing and development strategy. They could best be characterized as "institutions in long-term investment financing".

37. For banks specializing in the agricultural sector or in mining, the financing of urban infrastructure projects was obviously ruled out. However, in developing countries, there were few development financing institutions which specialized in urban investments to the exclusion of all other objects of financing. It might therefore be worthwhile to set up more specialized institutions for the financing of investment in some of the larger agglomerations where such institutions did not already exist.

38. The paper suggested that one particular activity of outstanding importance was the active prevention of the excessive growth of agglomerations through measures to render alternative centres so attractive as to divert the inevitable flows of migration to them. The provision of a sufficient number of jobs, however, was no longer enough; socio-cultural values must also be adequately taken care of.

39. Apart from seemingly better job opportunities, capital cities offered many attractions. The advantage of being close to the centres of influence and decision-making, better educational facilities, a higher standard of living and a concentration of entertainment was an additional incentive for urban migration. However, unrestrained immigration and uncontrolled settlement in the slum areas at the fringes of large cities might have a snowball effect: as slums were upgraded to normal living quarters, uncontrolled settlements would appear again on the new outskirts.

40. Unfortunately, central governments were often not even aware of many minor projects such as urban infrastructure projects in small market towns which might be of considerable socio-economic importance. Yet it was precisely those projects which in many cases could counteract undesired migration to agglomerations.

^{d/} W. Engel, International lending to development financing institutions in developing countries for the promotion of measures in urban areas.

41. Foreign lenders were generally prohibited from engaging in the direct financing of projects in less developed areas without contacting the central government first. In any case, it was the central government which decided on aid priorities, and the lender depended on the central government as borrower or guarantor of its loan.
42. On the other hand, foreign financing of development banks had had a far greater impact on the less developed areas of developing countries, the reasons for that being, firstly, that development banks were able to indicate viable projects for investment both to their own Governments and to international lenders, secondly that many Governments had enacted legislation providing for a general guarantee for loans taken up abroad by development banks, and thirdly that the distribution of a large number of minor credits could be organized most effectively through a development bank.
43. The financing of the public sector by development banks had thus far been very limited, and the public sector was normally financed through the budget. However, when development-bank financing was available, the relevant ministry with its various authorities usually acted as borrower and project sponsor, using budget funds in combination with foreign loans for the financing of closely-defined programmes.
44. The paper then went on to discuss the question as to why developing countries should not be able to do likewise, why hospitals, water supply systems, schools, sewerage systems and refuse disposal facilities should not be financed both from the budget and from loans and why specialized development financing institutions should not be entrusted with extending credits for public investment, particularly in peripheral areas.
45. It was suggested in the paper that specialized institutions geared towards providing development credits to local authorities would create new access for international lenders for the financing of such things as water supply and sewage disposal in small communities, refuse collection in medium-sized towns, the erection of market halls, slaughter-houses and bus terminals and the construction of schools.
46. Such projects could not be supported directly by the international financial community, and financing via central governments hardly ever benefited the peripheries. However, if a special institution was created to catalogue demand in the peripheries and provide assistance in terms of planning and financing, it could raise the peripheries out of obscurity.
47. The essential characteristics of such an institution would include the following:
- (a) It would probably have to be state-owned;
 - (b) Its functions would have to be clearly defined, but it should be permitted to finance all projects for which local authorities were responsible;

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(c) Planning activities should not replace planning by local authorities but should supplement it;

(d) For project planning and appraisal, the institution would need a relatively large technical staff in comparison with that of a normal development bank;

(e) One function of the institution which would be of importance for the economy as a whole would consist in promoting a certain standardization of particular investments, leading to a lowering of investment costs and increasing benefits for municipalities;

(f) A further task of importance for the economy as a whole might consist in selecting labour-intensive methods for the implementation of projects so as to create jobs in the peripheries.

Discussion

48. In the discussion that followed, it was noted that, in some countries, central governments had already created municipal development institutions with both loan and technical assistance functions. e/ Some other countries had given special attention to the problem of financing urban development through similar arrangements. In Brazil, for example, the National Housing Bank (BNH) had become an urban development bank, such was the variety of infrastructure projects it financed through about twenty different programmes and credit lines. Several other Brazilian federal institutions, including the National Development Bank, two regional development banks, the Bank of Brazil and the Federal Savings Bank, maintained special credit lines or programmes for the same purpose. In Mexico, the powerful Banco Nacional de Obras y Servicios Públicos (BANOBRAS) was the main financing agency for urban development projects. Colombia also had several programmes and specialized institutions, one of the most important being the Instituto

e/ For instance: Banco Municipal Autónomo (BANMA) in Honduras; Instituto de Fomento Municipal (INFOM) in Guatemala; Fundación para el Desarrollo de la Comunidad y Fomento Municipal (FUNDACOMUN) in Venezuela; Liga Municipal Dominicana in the Dominican Republic; Servicio Nacional de Desarrollo Urbano (SENDU) in Bolivia; Instituto de Desarrollo Municipal (IDM) in Paraguay; Fondo de Desarrollo Municipal (FODEM) of the National Bank of Panama; Banco de Desarrollo in Ecuador; the Housing and Urban Development Corporation (HUDCO) in India.

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de Crédito Territorial. In India, besides HUDCO, there were several institutions at the subnational (state) level which specialized in urban development financing, including the Calcutta Metropolitan Development Authority (CMDA).

49. Those institutions had already financed a large variety of municipal projects relating to, for example, streetpaving, markets, abattoirs, public lighting, water supply and sewerage systems. They also supplied technical assistance to municipalities.

50. A large number of development finance institutions in developing countries concentrated on industrial development, and it was felt that such institutions should perhaps be able to utilize the great amount of expertise they had built up and broaden their interests to include urban development. While it was recognized that large amounts of international capital would probably not be available (on either soft or market terms) for the direct financing of urban infrastructure and services, the Group concluded that the catalytic effect of introducing a relatively small amount of seed capital through the medium of new or existing financial intermediaries could produce a valuable multiplier effect.

51. The Group concluded that, in order to promote the extension of the activities of development financing institutions towards public sector investments, the World Federation of Development Financing Institutions, as well as the regional associations of development financing institutions, should be invited to co-operate through the dissemination of information among their members.

52. It was also concluded that there was a considerable lack of information and knowledge concerning existing financial intermediaries engaged in financing urban infrastructure projects. It would be helpful if a comprehensive listing of such organizations and their experience could be reviewed and made available to developing countries.

IV. RECOMMENDATIONS

53. In order to focus its discussion, the group purposely concentrated on the provision of urban services, defined rather narrowly. The many aspects of housing finance, finance for local private enterprises and the promotion of the production of construction materials for local urban investment were not considered. Within the field of the provision of urban services, two aspects were distinguished, namely the better use of existing resources, particularly management resources, and the mobilization of additional resources.

54. In formulating its recommendations, the Group had a number of considerations in mind, which, taken together, formed a context for the proposals. The Group considered that that context was important in determining the relevance of particular recommendations to conditions in individual countries.

55. Attention was focused primarily on the large number of secondary towns and cities of the developing world. Those urban centres were usually expanding very rapidly in terms of population and urban service requirements. Most suffered from poor administration and were isolated from the centre; they had very limited access, if any, to national capital markets or foreign assistance. In the least developed countries, such problems were particularly acute. Importantly, more than one level of government was almost always involved in the provision of the necessary services. Those circumstances suggested the potential usefulness of intermediary institutions. Larger cities, particularly capital cities or the cities of more developed countries, shared many of the problems of the smaller urban centres but could draw attention to the issues involved more easily. Such larger cities were also likely to have more direct access to finance and greater capacity and responsibility for planning and implementing their local programmes. They therefore had less need for intermediary agencies. Nevertheless, it was recognized that they also might benefit from specialized institutions ensuring better creditworthiness and providing channels for finance and technical co-operation in specific fields.

56. To determine the appropriateness of a particular institutional framework for the financing of local urban services, it was necessary to know something of the general objectives of the central government and municipalities involved with regard to local autonomy or decentralisation. Clearly, such objectives might differ considerably from country to country according to political and social traditions, the size of the country and its stage of development. The maintenance of a relatively centralized system might, for instance, be considered appropriate where population and distances were small or where administrative skills were particularly scarce. However, the Group's attention was focused on the more typical case where current policy was to stimulate a greater degree of local participation in mobilizing resources and expanding public services.

57. It was recognized that national Governments bore the primary responsibility for improving the current framework for preparing, implementing, financing and monitoring the provision of urban services. National Governments were responsible for major institutional changes and for determining the allocation of domestic resources and foreign aid between the provision of urban services on the one hand and competing claims from other sectors on the other.

58. Although national Governments bore the major responsibility in that respect, determined action at the local level could make a significant contribution in terms of improving the provision of urban services. Indeed, without such action at the municipal level, it was difficult to envisage the improvement in administrative competence and creditworthiness that was a necessary precondition for the effective utilization of a better designed institutional framework. Non-government or autonomous agencies, including private enterprises, could also make important contributions. In that respect as in others, the recommendations were to be seen as a package in which the various elements should be mutually reinforcing.

59. In that connexion, it was noted that, given the size of the urban service requirements resulting from the extremely rapid growth of the developing countries' urban population, which might rise by as much as one billion in the last quarter of the century, foreign co-operation could not be expected to account for more than a tiny proportion of total requirements. Hence, the Group concentrated on identifying areas where such co-operation could have a catalytic effect without creating undue dependency or diverting attention from required national action.

60. It was in the context of the above considerations, therefore, that the Ad Hoc Group of Experts made the recommendations set out below.

A. Intergovernmental relations

61. There is a need to re-examine and reform the system of intergovernmental (national/subnational) relations in many countries. Among the important questions to be dealt with in this regard are: how much autonomy should local governments have in planning and carrying out their fiscal activities? What division of taxing authority and expenditure responsibility best fits the development goals of the nation? Do existing intergovernmental transfer programmes have reinforcing or offsetting effects and do they encourage the mobilization of more resources by local governments? In the distribution of central government assistance, what trade-offs are desired between equity in the distribution of resources among regions and cities and the increased mobilization of local government revenues?

62. In most countries, the inter-governmental system has been developed on a piecemeal basis, often without regard for the co-ordination of all the various elements. If such piecemeal systems work in terms of mobilizing more resources for human settlements financing and encouraging the more efficient management of human settlements activities, it is probably more by accident than by design.

63. With this general shortcoming in mind, and recognizing that there are substantial differences in national objectives and "styles of governance", it is recommended that:

(a) High-level commissions should be established to re-examine relations between the different levels of government and to recommend basic reforms where necessary. Particular attention should be paid to structuring the system in order to encourage the mobilization of additional resources for human settlements financing, to rechanneling more resources towards the provision of urban services and to encouraging the more efficient management of services provided in urban areas. Central governments and international agencies should share in the cost of this effort, and international agencies should take the lead in providing technical assistance. Pilot studies and experience in candidate countries could help international agencies in developing a methodology and technical expertise in this field. In any case, the existing system of central-local transfers must be rationalized. The greater use of formula or cost-sharing grants may stimulate local tax efforts, but the use of such programmes will have to be balanced against the need to provide an adequate flow of resources to lower-income regions;

(b) Capital or project grants and loan programmes for local government projects should be harmonized. The use of grant funds to supplement revenues from income-generating projects should be encouraged as a method of stimulating local authority participation in income-generating projects;

(c) Though countries may differ in their preferences when choosing between increasing local government taxing power, making greater use of shared taxes or providing grants, the final choice should aim at providing an elastic source of local government revenue, i.e. one that will grow in response to income, inflation and the cost of providing local public services. The system should also encourage local government fiscal planning by providing for an assured flow of annual revenues. Grants determined in an ad hoc manner on a year-by-year basis are undesirable.

B. Local revenue administration

64. Local government revenue administration is a serious problem in most developing countries. Property tax collections below 50 per cent of collectibles are not uncommon, taxable property values are often long out of date and other tax and non-tax revenues generally available to local authorities tend to be cumbersome to collect. While the underlying problem is partly due to the division of taxing powers between central and local governments - the revenues allotted local governments are usually quite difficult to collect - there is much room for improvement even under present conditions.

65. To mobilize additional resources for financing local public services, it is recommended that:

(a) Emphasis should be placed on improving property tax administration, since the property tax is the major source of revenue for local government. Central governments should provide loans or matching grants for local governments to enable the latter to identify properties, improve records and update assessments. International agencies should participate with funding and technical assistance;

(b) The provision of grants or loans by central government to improve local tax administration (e.g. for property tax mapping, the improvement of records, the revaluation of property) should be encouraged. Cadastral surveys and tax mapping can be seen as very lucrative investments in terms of the revenue return they may ultimately generate. All such programmes should involve a matching contribution from the local government concerned and should benefit from technical and financial assistance from international agencies;

(c) Local authorities should be given some leeway in establishing local tax rates (e.g. they should be allowed to increase rates up to a fixed ceiling). This may actually encourage more efficient tax administration and increased resource mobilization as local governments see the potential benefits to be derived from heavier taxation.

(d) Collection efficiency for all local revenues should be increased by making the penalties for non-payment much more severe (e.g. by linking the size of the penalty to the rate of inflation). This requires central government legislation and more vigorous local government enforcement. Local governments should be induced to increase enforcement efforts by means of incentive grants or loans, increases in man-power and the provision of detailed instructions on collection procedures. Local governments can also improve collection rates by organizing aggressive public awareness campaigns - particularly in the smaller municipalities - and by providing monetary incentives for improved collection performance in small areas (e.g. villages, barrios). In the case of larger cities, the more extreme remedies (e.g. the sale of delinquent property by auction) should be promoted. The central government should review the possibilities for expediting court action;

(e) Training programmes for local authority assessors and treasurers should be instituted and expanded. Central government funding and programme design will be necessary, perhaps with inputs from international agencies;

(f) Local governments should make much greater use of special assessments or betterment taxes. Central governments should produce firm implementation instructions, perhaps turning to international agencies for technical assistance;

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(g) International agencies should take the lead in developing programmes to share knowledge on these matters. International agencies have worked extensively in these fields and are in a position to provide information on what works in a given situation. Specialized technical working groups should be organized to begin analyzing current practice in at least the following areas: property tax collection, valuation and record keeping; the implementation of special assessments and betterment taxes.

C. User charges (or self-reliance)

66. User charges are not a panacea. For some services they are not practicable. For others they are not acceptable without some compensatory action being taken to prevent the very poor from being excluded from essential services. Nevertheless, in many other cases, user charges have much to offer:

(a) They make it possible to expand the supply of a given service in a well-managed manner, avoiding the resistance often met in the case of tax-financed services;

(b) They induce resource-saving behaviour;

(c) They make it possible to administer the services they finance over the relevant area;

(d) They provide the entity entrusted with the supply of the service with important information on the demand for the service;

(e) Finally, for those services that are subject to congestion (e.g. street parking), user charges improve the utility derived from the service.

67. It is therefore recommended that:

(a) National and local governments should give serious consideration on a case by case basis to the introduction of user charges as an alternative to the provision of free and tax-financed urban public services;

(b) Services financed by user charges should be provided by separate, government controlled enterprises or by local governments themselves, as appropriate; each of the two systems has merits and drawbacks; what is important is that the system selected should retain both the separate accountability to be found in an autonomous enterprise and the co-ordination with other services to be found in a local government;

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(c) Special attention should be paid to the fee schedule in existing or proposed user-charge schemes; the effects of possible schedules on income distribution should be analyzed (and compared with the effects of alternative schemes) so as to make it possible to select those schedules that reconcile, as much as possible, the various economic and social consequences of a user-charge scheme;

(d) Expenditure on urban public services that lead to an increase in land or property values should, as far as possible, be recuperated through betterment levies or other self-financing schemes;

(e) Central and local governments should, where appropriate, establish closer relationships with the private sector, including both private enterprises and voluntary agencies, without relinquishing the control that is their responsibility.

D. Role of specialized institutional arrangements

68. While most urban development financing in developing countries has been based on current revenue sources and carried out by the traditional governmental agencies, in the last two decades or so several countries have established specialized institutional arrangements to deal with this question. As indicated in the report, such arrangements have taken different institutional forms.

69. A major contribution of the institutions in question has been the promotion of local government and decentralization. The revival of local government that has occurred in some countries over the last two decades has been heavily dependent on these institutions. Such institutions provide an alternative channel for resources for urban development, especially for small and medium-size cities, which as a result do not need to rely solely on grants or on their regular revenues to finance urban projects, particularly those of a self-financing nature.

70. The overall record of these institutions and projects is generally positive. Some have derived their initial capital from foreign sources and national counterpart funds and have received a second or even a third loan from the same sources. In most cases, however, they could effectively channel a substantially greater volume of resources than is available from these sources.

71. In view of the great potential of these arrangements as alternative sources of finance for urban development, as well as the quality of the services which specialized intermediaries such as development institutions can provide, it is recommended that:

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(a) Consideration should be given to the extension of the activities and operations of existing development finance institutions in developing countries for the purposes of public sector investment through the creation of specialized departments or the formation of subsidiary companies, or to the establishment of new specialized financial intermediaries;

(b) Existing institutions should be strengthened by national governments, in particular by increasing the institutions' financial capability on the basis of national sources; in connection with this recommendation and the preceding one, central governments should consider setting up a commission to consider the adequacy of the existing system of intermediaries and to examine ways of adopting it;

(c) International and bilateral financing institutions should promote the establishment of such arrangements and should give financial and technical support in those cases where such support is indispensable;

(d) Municipal development institutions should accept responsibility for preparing projects for small municipalities and other municipalities which cannot easily avail themselves of such a service through other channels, even if the service is charged as a pre-investment expense. They should also consider providing local governments with technical assistance in general as one of their inherent functions in order to enhance the financial and managerial capability of actual and potential borrowers;

(e) Consideration should be given to allocating funds derived from shared taxes and grants-in-aid for use as collateral for municipal development institutes and similar agencies in order to protect them against default; consideration should also be given to creating reserve or compensation funds to complete such guarantees;

(f) Government loan institutions and programmes should be operated in such a way as to maintain their financial viability and good standing as borrowers;

(g) The standardization of particular types of investment should be promoted whenever appropriate so as to lower costs and increase efficiency;

(h) Such institutions should, in conjunction with national Governments, explore possible changes in legislation on local government with a view in particular to enhancing the financial position and reducing the indebtedness of local authorities;

(i) Intermediary urban financing institutions, unless created specially to meet the needs of capitals and other larger cities or to serve special needs such as financing public transport, should cater in particular to the needs of smaller cities. Particular attention should be paid to the needs of the poorer sections of the population;

(j) Regional co-operation should be encouraged through the creation of regional associations designed to seek solutions, exchange experience, jointly prepare projects and obtain funds for project implementation;

(k) In order to encourage existing development finance institutions to engage in the financing of infrastructure and services in urban areas, the United Nations Centre for Human Settlements (Habitat) should co-operate with the World Federation of Development Financing Institutions, as well as with the regional associations of development finance institutions, in order to promote such activities among their members;

(l) The United Nations Centre for Human Settlements (Habitat) should assist in the acquisition and dissemination of knowledge and information concerning existing financial intermediaries in developing countries specializing in the provision of human settlements infrastructure and services at the subnational level; it should review the experience of these organizations and disseminate the findings among developing countries.

E. Management capability

72. The need to improve the management of financial resources, project execution and project operation in developing countries has been fully recognized in several studies conducted by national and international agencies. As far as urban development is concerned, some of the most critical problems in this field concern: the lack of adequate planning and programming processes by which priorities can be correctly established and continuity of planning guaranteed; the need, when programming activities and financial resources, to indicate revenue sources and control the cash flow; the elaboration, analysis and evaluation of urban development projects and the efficient administration of projects, both during their execution and afterwards.

73. In order to cope with these problems, it is recommended that:

(a) National, regional and local governments should introduce specific programmes to improve the managerial capability of personnel engaged in the financing and administration of urban development; they should also introduce salary policies consistent with that objective;

(b) Special attention should be given to the development of skills related to project preparation, analysis and evaluation; attention should also be given to the possibility of seconding personnel from central government agencies for this purpose;

(c) National Governments should provide lower-level governments with technical assistance in these areas; international agencies should also be prepared to assist in this matter;

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(d) Planning should proceed, on an ongoing basis instead of sporadically;

(e) International and bilateral institutions and programmes should aim at assisting Governments in the improvement of managerial capability in the field of urban development in general and in the field of financing urban projects in particular;

(f) Budgets and programming should incorporate modern techniques so as to make them meaningful management instruments rather than mere legal formalities.

Appendix I

LIST OF PARTICIPANTS

A. Experts

Mr. Albert Adomakoh
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Mr. Gerardo Sicat
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Ms. Meg Taylor
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B. UNCHS (Habitat) Secretariat

Mr. Jerrold Voss, Deputy Director, Research and Development
Mr. J. de Goede, Chief, Shelter and Community Services
Mr. Dominick Sarsfield, Inter-Regional Adviser
Mr. Uwe Lohse, Human Settlements Officer

Appendix II

AGENDA

Monday 19 January

- 9 a.m. Opening address Mr. Arcot Ramachandran
- 9.30 a.m. Morning session
Discussion paper No. 1 :
"Human settlements finance and
management" Mr. Roy Bahl
- 2 p.m. Afternoon session
Discussion paper No. 2 :
"Urban finance in developing
countries" Mr. Harold Dunkerley

Tuesday 20 January

- 9 a.m. Morning session
Discussion paper No. 3 :
"How investment or development
institutions can be strengthened
or otherwise motivated in order
to assist in financing
infrastructure and services in
urban areas" Mr. Henri Neuman
- 2 p.m. Afternoon session
Discussion paper No. 4 :
"International lending to
development financing institutions
in developing countries for the
promotion of measures in
urban areas". Mr. Willi Engel

Wednesday 21 January

- 9 a.m. Morning session
General debate on discussion papers
- 3 p.m. Afternoon session
General discussion period

Thursday 22 January

9 a.m. Morning session
Drafting of report and recommendations

2 p.m. Afternoon session
Drafting of report and recommendations

Friday 23 January

9 a.m. Morning session
Finalization and approval of report

Appendix III

LIST OF DOCUMENTS

"Human settlements finance and management" (HS/C/3/5).

J. F. Linn, Urban finance in developing countries.

H. Neuman, How investment or development institutions can be strengthened or otherwise motivated in order to assist in financing infrastructure and services in urban areas.

W. Engel, International lending to development financing institutions in developing countries for the promotion of measures in urban areas.

W. Parmena, Mobilization of urban finances in a time of rapid inflation.