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The role of inter-governmental transfers in financing Africa's cities

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Financial transfers from central governments to subnational governments in African cities can be successful in aiding urbanisation and development. However, these inter-governmental transfers need to be sufficiently sized, transparent, predictable, and based on feasible conditions to be effective.

Inter-governmental transfers (IGT) are the transfer of finance between different levels of government, often from central to lower (subnational, city, or local) tiers. They are a critical component of financing sustainable urban development in fast-growing and often scarcely resourced African cities—on average constituting 61% of subnational government revenues. Yet, in many countries, IGTs fail on four fronts: adequacy of size, transparency of calculation, predictability of delivery, and conditionality of spending. If this failure is not reversed, cities will likely witness low public good and service delivery, lost productivity and the urbanisation dividend—so crucial in raising socioeconomic living standards elsewhere in the world—left unachieved. As a consequence, recent discussion at the 9th Africities conference in Kisumu, Kenya saw IGT frequently be the point of contention between city and central governments—not just with the four failures above, but with further failures to utilise transfers meaningfully at local level.

Successful transfers should be sufficient for the scale of urbanisation, predictable for public service planning, and timely for delivery, yet many recipients of transfers believe they do not meet these criteria. For example, anecdotal evidence from discussions with a West African Capital City Mayor in 2019 highlighted that the City Council, three-quarters of the way through the year, had only received 20% of the 'already low' budget for transfer. Similarly, a Horn of Africa Capital City Mayor outlined that rather than the 50% of transfer set out in legislation, the city only gets 20% in practice. Similar stories are found across the continent. Big city mayors are not alone in this difficulty—legislators from a secondary city in central Africa indicated the city cannot trust transfers, relying on local revenue collections for service delivery instead.

IGT underpins and drives urban development in African cities

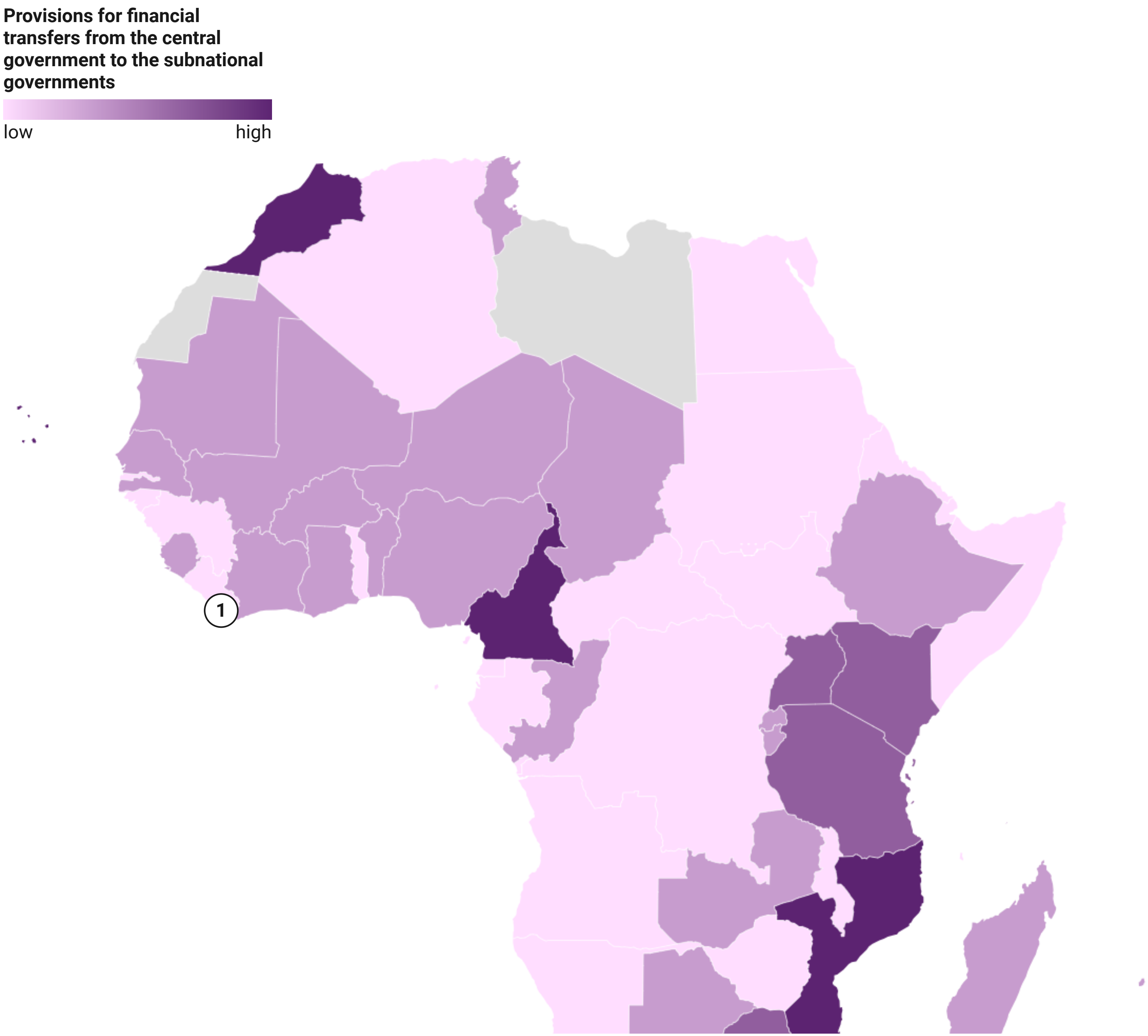
Inadequacy and inefficiency of IGT is a big issue for growing cities. Despite improvements in local revenue generation seen in places like Kampala, Hargeisa, and Mzuzu, in most subnational government cases, IGT represent the largest tranches of financing. Whereas, on average they constitute almost two-thirds of subnational government revenues in sub-Saharan Africa, local taxes stand at only 21%. Indeed, in Ethiopia it was shown that subnational—or own-source—revenues can only finance a quarter of annual expenditure. Thus, achieving near-term financing of urban development in fast-growing, low resource cities is highly reliant on this source of revenue.

Despite their importance, knowledge of what works is limited, with local government finance—particularly transfers in developing countries—still marginal in economic research. Recent evidence is beginning to bridge the empirical divide, such as new enquiry from Cities Alliance mapped in the figure below which shows the status of the current IGT situation in the continent. It draws from qualitative evidence examining the institutional conditions and displays the '*provisions for financial transfers from the central government to the subnational governments*' throughout Africa. Continent-wide, 22 countries (or 40%) report resources are 'not transferred or transferred erratically and irregularly'. Only three countries (or 5%) score the highest, indicating clear, predictable, transparent, and unrestricted IGT flows.

Figure 1

Financial transfers from the central government to the subnational governme

Index based on adequacy, transparency, predictability and conditionality



1

Index ratings:
Amounts of the transfers to subnational governments and their distribution among subnational governments are clear and predictable, according
- 4 Amounts of the transfers of resources to subnational governments and their distribution among subnational governments are clear and predict
3 Amounts of the transfer of resources to subnational governments or their distribution among subnational governments are predictable accordin
Resources are not transferred or are transferred erratically and irregularly - 1

Map: Harman, O. (2022). The role of inter-governmental transfers in financing Africa's cities. International Growth Centre. • Source: City Enabling Environmen
Datawrapper

Note: The figure uses qualitative evidence to highlight the range of provisions for financial transfers between the central and subnational governments *across the African continent. The index used to score these provisions includes dimensions like adequacy, transparency, predictability, and conditionality. Click here to see the map in full screen.*

Factors driving the efficacy of IGT

To understand what works, policymakers can draw from the existing small body of more geographically dispersed literature. One theme of enquiry looks at **politics**—specifically the politically motivated targeting of IGT. For example, in India, evidence contrasts transfer distribution from the Planning Commission—a political body, to that from the Finance Commission—an independent body. The former distributes more to swing states, and the latter shows no partisan impact. Similar studies in Argentina see geographical areas well-represented at national congress benefit more. Transfers based on formulas, even with mechanisms to help in accountability of monitoring or procedures for disbursement of funds, do not eliminate politically driven transfers. Research from Ghana evidences this with political elites targeting swing local authorities with higher levels of transfer.

In addition to political targeting, other studies look at the **incentives** that the structure of IGT directly or indirectly motivates. At Africities, Kenya's Commission on Revenue Allocation shared that they previously included 2% of total IGT to incentivise own-source revenue collection. When this incentive was removed from the transfer system, subnational governments previously collecting KES 3 billion annually dropped in size—the next years' resultant revenue collection was 30% less. Similar evidence from Ghana shows if incentives are not present or—worse still—incorrectly thought out in IGT, the transfer can discourage instead of encouraging own-source revenue generation. Other mechanisms intended to keep local government accountable can also lead to unintended consequences. For example, after decreased rainfall led to lower municipal revenue in Mali, the government bestowed lower transfers, again affecting tax revenues, starting a vicious cycle reducing local government finance. Every West African CFA franc (XOF) lost at the municipal level compounded to a reduction in six transferred from the state. Further to incentives on transfer amounts, introducing incentives on transfer actions—aiding public officials to act in the public interest— emerges as an important new channel for establishing accountability.

The need to expand evidence-base in low-income countries

While literature is developing, there remains limited evidence from low-income countries, particularly in the African context. However, demand is present. The 9th Africities showed that policymakers still want evidence on three key areas:

1. how incentives within IGTs play out at the local level
2. what best practices exist to ensure predictability of delivery—whether this be ringfencing or timely redistribution
3. how transparency of funds calculation can be improved, needed for sufficiently planning new local public goods and services foundational for the functioning of new legislative 'cities'

In the coming years, IGTs will remain crucial for Africa's growing cities. With this current evidence shared and new enquiry specified, the financing of cities can aim to be more adequate, transparent, predictable, and unqualified—bolstering the urban centres' ability to act as national drivers of prosperity.

For more detail on financing fast growing cities, please see Cities that Work or reach out to the author for the forthcoming paper on the subject.

Suggest reading

Delbridge, V., O. Harman, D. Jangia, with, A. Haas and A. Venables (2021) "Secondary cities leading innovation on municipal finance reform: Evidence from Malawi." IGC Enhancing the financial positions of cities case study series.

Harman, O., A. D. Jensen, F. Naeem, M. Saab, S. Wani and N. Wilkinson (2021). "COVID-19 and taxes: Policies for the post-pandemic recovery."

More from IGC

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Victoria Delbridge, Tewodros Makonnen Gebrewolde

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