POLICY BRIEF #03

FINANCING EMERGENCIES IN CITIES AND REGIONS: ONGOING LESSONS FROM THE PANDEMIC

Emergency Governance for Cities and Regions

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UCLG United Cities and Local Governments | metropolis | LSE Cities | LSE The London School of Economics and Political Science

THE INITIATIVE

This Policy Brief is part of the Emergency Governance Initiative (EGI) led by United Cities and Local Governments (UCLG), the World Association of the Major Metropolises (Metropolis) and LSE Cities at the London School of Economics and Political Science. This Initiative investigates the institutional dimensions of rapid and radical action in response to complex global emergencies. The EGI aims to provide city and regional governments with actionable information and appropriate frameworks, knowledge and resources to navigate the new demands of leading responses to complex emergencies.

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This is the third in a series of quarterly publications that complement the more data-driven Analytics Notes. Policy Briefs focus on forward-looking propositions, reform agendas, governance innovations and critical perspectives.

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FOREWORD

Serge Allou *and* ***Mathilde Penard****, UCLG World Secretariat, reflect on the current state of municipal finances and the most important challenges on the road towards decentralisation.*

The current pandemic is a powerful reminder that the localisation of financing is instrumental to achieving global development agendas. Adequate funding is key for cities and regions to provide an immediate response to their communities while paving the way for sustainable and inclusive development. Yet, worldwide, local and regional governments only account for 24% of total public spending, a small share that hides wide disparities between low- and high-income countries.[1]

The crucial role that local and regional governments play in sustainable development – even more apparent in times of crisis, as we are witnessing now – is hampered by institutional and regulatory challenges that clearly affect their financial capacity to deliver on their responsibilities. In many regions, political, legal, fiscal and administrative decentralisation is not always accompanied by the corresponding resources. This mismatch between spending responsibilities and financial and human resources is most acute in developing countries.

As a result, a large number of local and regional authorities lack sufficient local revenues to cover their operational expenses and invest in long-term services and infrastructure. On the one hand, many of them have weak fiscal autonomy, with limited capacity to generate own-source revenue (taxes, fees, charges), set tax bases and rates, or create new taxes that reflect the developments of the New Economy. On the other, local and regional governments are not always provided with stable, predictable and flexible fiscal transfers from higher tiers of government. This is partly due to the conditions attached to these transfers, leaving them little leeway to decide on spending allocations according to local priorities.

Combined with these trends is the limited access to credit and capital markets. Most cities and regions, particularly in the Global South, do not have access to borrowing either because they are legally prevented from doing so, or because their investment projects do not meet the feasibility, bankability and risk criteria imposed by lenders.

All these challenges predated the COVID-19 crisis and are likely to persist into the near future unless there is a radical rethinking of the financial architecture across all levels of government. What the COVID-19 pandemic has brought about is a deepening of existing financial shortcomings, putting additional pressure on already strained local and regional budgets, both in the short and longer term.

The resources of a majority of local and regional governments have been severely affected by the non-collection of taxes, charges and user fees due to the cessation of economic activities and the sharp drop in household incomes. This is particularly challenging in low- and middle-income countries where local and regional authorities are highly reliant on elastic sources of revenue and where there is a prevalence of informality and poverty. At the same time, all of them have incurred extraordinary expenses to provide operational emergency responses, which have weighed heavily on their finances.

This 'scissor effect' has led many municipalities and regions to (re)prioritise their spending and sometimes take difficult decisions, such as suspending capital investment, reducing regular municipal or regional services, or laying off temporary local staff, which could result in a higher bill in the long run. The COVID-19 pandemic has created increasing uncertainty about local revenues: municipalities and regions will face continuing difficulties in raising their own revenues and additional funds, and there are risks that transfers will also be affected as national governments face their own budgetary constraints – which may tempt them to recentralise certain functions. This lack of visibility over future local revenues, combined with record sovereign debt levels, will almost certainly further reduce the possibility for local and regional governments to directly access external financing.

In what ways have local authorities responded to the crisis? What solutions have been developed to address the emergency while ensuring the continuity of services to communities? What role should local and regional governments be given in the future as key emergency responders and enablers of the recovery process? Under what conditions (of fairness, transparency, and accountability) will they be recognised and given the space they need as key players in the pursuit of a better future? How can we inform action to mobilise the resources that are needed for this? Building on the growing body of knowledge and evidence generated under the Emergency Governance Initiative, these are all questions which this Policy Brief hopes to shed some light on.

Progress on decentralisation processes may either suffer... or gain from this global crisis. The road ahead remains open.

[1] In 2016 local and regional government expenditure in Africa was on average less than US$300 PPP per capita, compared to almost US$6,000 PPP per capita on average in OECD countries. Source: World Observatory on Subnational Government Finance and Investment. http://www.sng-wofi.org/

1. INTRODUCTION

The pandemic has been a stark reminder of the challenges currently facing government officials at all levels: **we are now living in an era in which emergencies are occurring with increasing frequency and severity.** Complex emergencies such as those related to climate breakdown, global health risks, and extreme social justice crises present unique governance challenges and exert significant strain on public finances. At the subnational level, issues around financial autonomy, stability and flexibility can exacerbate this strain.

During the COVID-19 response, **city and regional governments have been facing a 'scissor effect'** of mounting expenditures associated with the health, economic and social impacts of the virus, and a simultaneous decrease in revenues due to the economic disruption.

Despite the enormity of this challenge, there is a **lack of information and policy guidance in relation to emergency finance for cities and regions.** In July 2020, the EGI conducted a systematic review of online COVID-19 resources identified as having a subnational governance component and found that very few provided policy guidance related to finance. City and regional officials surveyed by the EGI in the same period identified finance and resources as the area where additional information and examples of best practices would be most beneficial.

This Policy Brief is designed to address this gap. It presents an analysis of the main trends that have been developing in subnational finance during the emergency, and outlines lessons that could be taken up at various levels of government to improve the financial response of cities and regions during future emergencies.

One year on from the emergence of the virus, and with much of the world still in the grip of crisis, now is a good opportunity to reflect on the emergency response so far and to draw lessons that will be relevant not only for the continued management of this pandemic, but for the response to future emergencies.

MAIN FINDINGS

– The pandemic has amplified many of the existing financial challenges faced by subnational governments. **Some of the main barriers include rigid budgets and spending rules, the high volatility of local tax revenues, and limited access to financial markets.**

– In responding to the emergency, **city and regional governments have had to reprioritise expenditures and cut existing budgets** to deal with growing expenses and reduced revenues. Borrowing to finance the response efforts appears not to have been a common strategy.

– **Enhanced fiscal autonomy may enable subnational governments to respond more effectively in emergency contexts,** but new mechanisms need to be developed to diversify sources of emergency finance at the local level.

– **Greater financial flexibility is essential in emergency contexts.** This includes granting city and regional governments more discretion and responsibility while trusting them to be fiscally prudent within solid accountability frameworks.

– Stable multi-level **governance systems that foster proactive collaboration rather than competition are an important precondition for effective crisis response,** including when it comes to resource allocations.

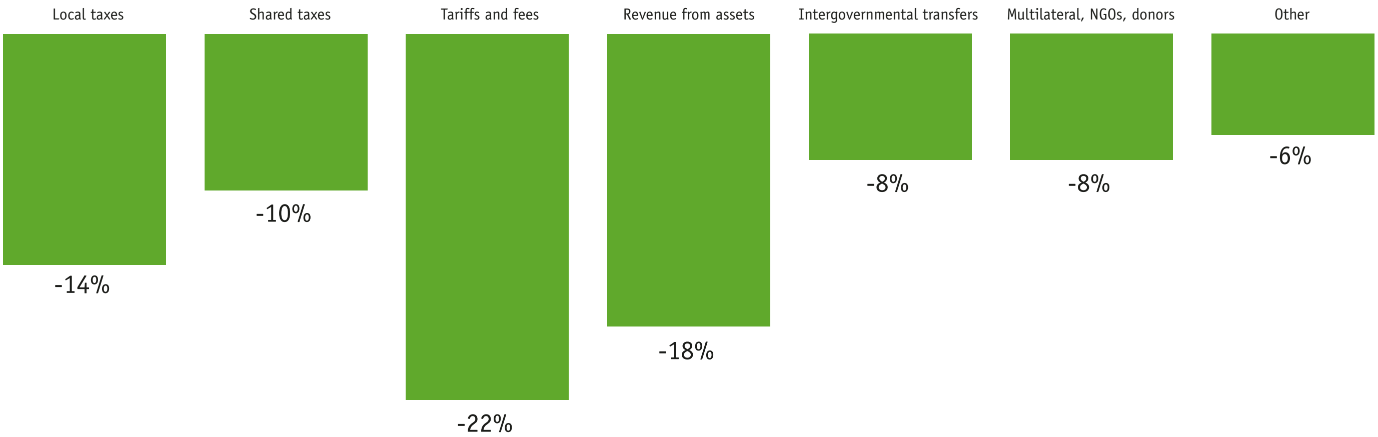
– The uneven impacts of the current health emergency are a stark reminder that **we need to develop more solidarity-based financial mechanisms to address inequalities both within and between cities, regions and countries.** Finance is an essential lever that can further entrench existing imbalances or act as a catalyst for a transition to a more just society.

– The recovery from the current crisis is deeply intertwined with responses to other complex emergencies that are unfolding in parallel, most significantly the climate emergency. **Financial decisions taken in response to COVID-19 are likely to have significant impacts on the ability of subnational governments to respond to future crises.** Ensuring that major budget shortfalls do not jeopardise longer term sustainable development goals is therefore an important priority.

BOX 1: SCISSOR EFFECT IN NUMBERS

- The EGI conducted a survey of 33 municipal finance officials in 22 countries across all continents in November and December 2020 to explore the impact of the COVID-19 emergency on subnational budgets. On average, respondents reported a **10% decrease in their overall revenue and around a 5% increase in expenditure**.
- As Figure 1 shows, own-source revenues were most impacted. On average, cities and regions in the sample faced a **22% drop in tariffs and fees**, an **18% drop in revenue from assets** and a **14% drop in local taxes.**
- **Revenues from intergovernmental transfers and multilateral and donor funding also decreased**, although to a lesser extent, with an average of an 8% drop for both sources.
- In a survey of 300 European cities and regions, the European Committee of the Regions (CoR) and the OECD found that **90% of subnational governments expected a decrease in revenues as a result of the pandemic, and 85% anticipated an increase in expenditures**, particularly in the areas of social services, social security and support to SMEs.
- A survey conducted by UN-Habitat, UNECA, UCLG Africa, UNCDF and Shelter Afrique predicted that **in Africa, local governments could lose between one and two thirds of their financial resources**.

Figure 1. EGI Survey: Average income loss since the COVID-19 outbreak across different sources of revenue



2. EXACERBATION OF EXISTING FINANCIAL CHALLENGES

The severity of the health crisis and resulting pressure on public finances has led to a **drastic deterioration in the fiscal positions of subnational governments.** Whilst the experience of the 'scissor effect' has been widespread, the extent of this effect varies markedly between regions and countries.

Although many central governments have allocated additional resources to subnational governments, these grants have largely been insufficient **to address the revenue-expenditure gaps** and, in some cases, city and regional governments have not received any extra support. Measures open to subnational governments to bridge their budget shortfalls and increase expenditure to the levels necessary for an effective emergency response are limited at the global level, and longstanding issues constraining subnational finances have been exacerbated.

2.1 BUDGET RIGIDITY

In mounting a response to the emergency, amidst the pressure of falling revenues and rising expenditures, many subnational governments have been constrained by **tight fiscal rules which limit their accumulation of debt and dictate the allocation of funds to pre-determined sectors.**

For instance, as outlined in Analytics Note 3, states in the US are required by the constitution to balance their budgets. However, between March and August 2020, state tax collections were on average 6.4% lower than the same period in 2019. As a result, they were forced to make budget cuts, tap into reserve funds, or find new revenue streams in just a few months.

Similarly, most OECD countries require subnational governments to balance their budgets and, in many countries, they are only permitted to borrow for the purposes of financing public investment. However, in some cases these **fiscal rules have been temporarily lifted or loosened by the central government** in response to the emergency. In a survey of European cities and regions, conducted by the EU CoR and the OECD, 46% of respondents said that some fiscal rules had been relaxed, and a further 18% said that a relaxation of fiscal rules was planned.

Furthermore, cities and regions are also limited in the extent to which they can direct funds towards priorities of their own choosing. Intergovernmental transfers, which regularly make up a large proportion of subnational revenues, often come with restrictions. **Between 70 and 80% of central government transfers are** non-discretionary funds that are earmarked for particular spending priorities, usually within one sector. This leaves city and regional governments with little flexibility to direct funds towards their own emergency response priorities, and it can make spending on cross-sectoral responses more difficult.

2.2 VOLATILITY OF TAX REVENUES

Whilst intergovernmental transfers tend to be less flexible, subnational governments generally have more autonomy to direct their own-source revenues towards their expenditure priorities. However, the **primary sources of own-source revenues - local taxes, tariffs and fees, and asset revenues - are themselves vulnerable to the economic impacts of** complex emergencies.

As shown in Figure 1 on the previous page, revenue loss from tariffs and fees represented the most significant loss amongst the EGI survey sample. Revenue from assets and local taxes was also badly impacted, whereas revenue from donors and intergovernmental transfers remained more stable.

This also relates to fiscal decentralisation: as subnational governments with higher levels of fiscal autonomy are more reliant on own-source revenues, this would imply that they faced greater drops in revenue. This has in fact been supported by the CoR-OECD survey, which found that **subnational governments in medium and highly decentralised countries were more likely to have anticipated moderate to high revenue losses as a result of the pandemic**, compared to subnational governments in countries with low levels of fiscal decentralisation.

It is important to note that this is not always the case, particularly in relation to lower income countries where national revenues are under extreme strain; and in relation to countries where there is serious political tension between national governments and subnational governments. In these contexts, intergovernmental transfers may not be so reliable (see Box 2).

2.3 LIMITED ACCESS TO FINANCIAL MARKETS

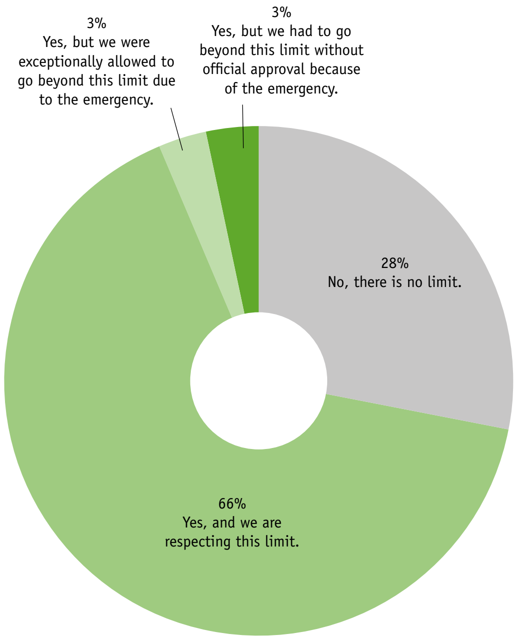
In bridging budget shortfalls, subnational governments are often constrained by the extent to which they can borrow from financial markets. Of the 33 city and regional governments surveyed by the EGI, 72% had some sort of legal ban or limit on their accumulation of debt (see Figure 2). These limitations were only relaxed in response to the emergency in a small number of cases.

Even when city and regional governments can borrow, **subnational governments do not have the same access to financial markets as national governments** and cannot just as easily access capital to rectify their budget deficits. This is particularly the case for smaller jurisdictions and those in lower-income countries where the financial markets are less developed or less willing to engage with cities and regions.

In order to borrow money with low transaction and interest rate costs, cities and regions must prove they are creditworthy, which often depends on their ability to predict future earnings and collect own-source revenue. Stability and predictability of intergovernmental transfers and a certain level of fiscal autonomy are preconditions of this. In some lower-income countries, opaque or ad hoc accounting practices **are significant barriers to proving creditworthiness** and accessing financial markets.

In the context of global complex emergencies such as the COVID-19 pandemic, access to finance may be even more constrained as economic shocks reverberate around the world at the same time. Since the outbreak of the pandemic, **there have been numerous national and subnational credit rating downgrades.** Colombia, Mexico, Argentina, Guatemala, Nigeria and South Africa have all been downgraded by at least one rating agency since April, which has subsequently led to subnational government downgrades.

Figure 2. EGI Survey: Limits on accumulation of debt by subnational governments

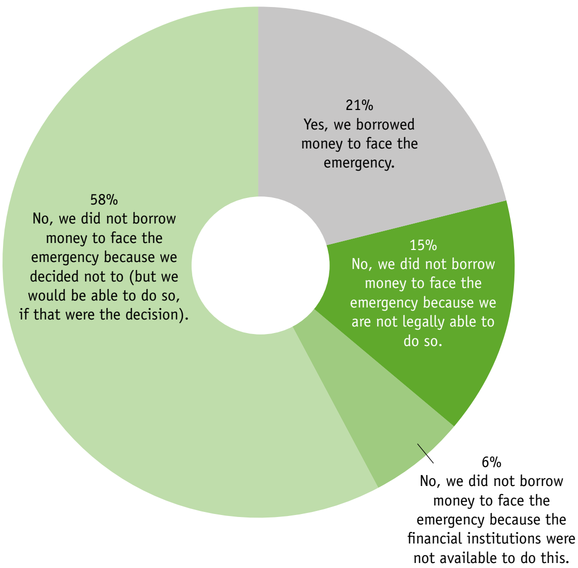


3. RESPONDING TO FINANCIAL PRESSURES

3.1 LIMITED BORROWING

In line with the constraints on borrowing and limited access to financial markets faced by subnational governments, evidence indicates that only a **few subnational governments have substantially increased their borrowing** to manage the expenditure-revenue gap. As illustrated in Figure 3, just 21% of respondents to the EGI survey borrowed money to finance the emergency response. This finding is supported by the earlier CoR-OECD survey of 300 cities and regions from across the European Union. At the time of the survey in June and July 2020, only 15% of responding jurisdictions had already applied for additional borrowing, although a further 24% were planning to do so in the future.

Figure 3. EGI Survey: Subnational governments' increase in borrowing in response to the emergency



Interestingly, the majority of respondents who did not borrow money in the EGI survey said that their decision was not due to legal constraints or limited access to financial institutions, and that they would have been able to access new loans if they had chosen to. There may be a number of reasons for this, but it is likely that subnational governments are **reluctant to take on loans to cover emergency expenditure that is not likely to lead to a return on investment**, and to commit to servicing increased debt with uncertain future revenue streams.

3.2 REPRIORITISING EXPENDITURE

Without significant increases in borrowing, **many cities and regions have had to redirect funding from pre-emergency expenditure priorities** to finance the sharp increase in emergency response expenditure. A survey of 19 cities conducted by the U20 found that 86% planned to re-prioritise their budget allocation to address their budget deficits.

Figure 4 shows the shift in expenditure priorities amongst the 33 cities and regions who responded to the EGI survey. The sectors of **culture and sports were deprioritised the most**, with 19 jurisdictions diverting funds from these areas. Public works and infrastructure investments were also frequently deprioritised. The largest increases in expenditure were in the areas of personal protective equipment (PPE) provision, cleaning and hygiene, health and social services.

3.3 BUDGET CUTS

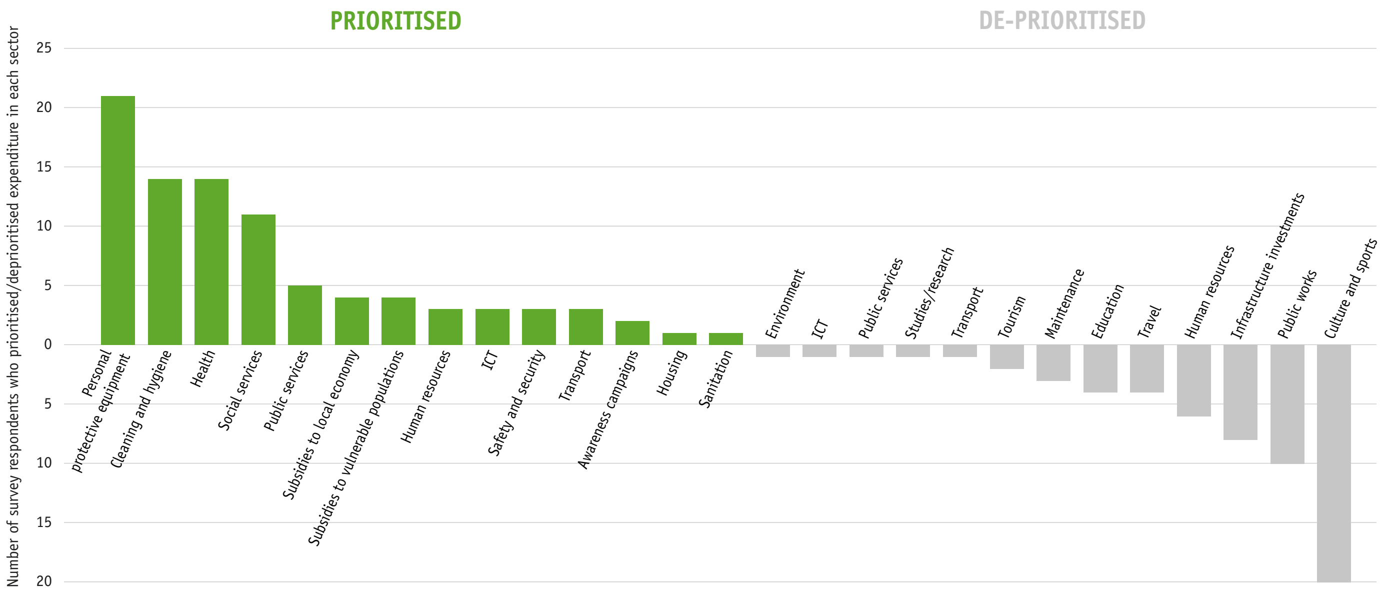
Falling revenues and tight legal frameworks have led many subnational governments to make **cuts to their overall budget, despite the financial demands of the emergency response**. Of the 19 respondents to the U20 survey, 82% said that they planned to reduce their overall expenses to address their budget shortfall. In the US, a survey of over 1,100 municipalities conducted by the National League of Cities found that 74% of them had already started to make budget cuts. One consequence of this was that by October 2020, US states and localities had furloughed or laid off 1.2 million workers.

Besides the economic and social damage of furloughs and redundancies, **budget cuts at the subnational level can also shift the responsibility for essential services** from the public to the community sector and to the private sphere of unpaid work, which can have a detrimental impact on social mobility and inequality. During complex emergencies, the official emergency response is typically supported by **a hidden subsidy of unpaid work** carried out by community networks and domestic carers.

For example, at the outbreak of the COVID-19 pandemic, community organisations and mutual-aid networks emerged in cities and regions across the world to support the emergency response. In Thailand over 1,400 food pantries sprang up, providing a space for people to donate food and supplies to those in need. In Brazil, G-10 Favelas, an organisation of entrepreneurial leaders from informal areas, stepped in to coordinate the production of essential equipment and the provision of essential services. Most importantly, in domestic settings which are typically less visible, millions of people took on new caring responsibilities, often alongside their paid work in response to the extra pressures on primary care facilities and the closure of childcare centres and schools. This unpaid work relieved governments at both the national and subnational level of considerable additional expenditure. In the UK it has been reported that care provided by families during the pandemic saved the central government approximately £530 million every day.

Much of this unpaid work has been done by women and girls, who typically carry out more than three-quarters of unpaid care work globally. **The unpaid subsidy is often higher in lower income countries**, where limited access to health and sanitation increases the time intensity of household and caring tasks.

Figure 4. EGI Survey: Expenditure priorities during the emergency



4. LESSONS FOR FUTURE EMERGENCY RESPONSES

As we have seen, the COVID-19 pandemic has left governments and communities across the world facing unprecedented financial pressures. But this is not the first costly emergency, and it will most certainly not be the last. As urban leaders adjust to the new post-COVID reality, it will be important to reflect on **the lessons that have been learned in relation to the financing of the emergency response**, to ensure city and regional governments have the right tools and processes in place to enable them to build financial resilience and improve their ability to respond to future emergencies. This is particularly urgent given that the **recovery from the current crisis is inextricably linked to responses to other complex emergencies** that are unfolding in parallel, most significantly the climate emergency. While we may be able to overcome the worst of the current health crisis within the coming year, the climate emergency, as well as the social and economic emergencies precipitated (or exacerbated) by the pandemic, mean that local governments will have to keep finding new and innovative ways to fund their response to these challenges.

At the same time, it is important to acknowledge that experiences have been extremely varied, and prescriptive recommendations about the way forward in such a heterogenous financial landscape are not advisable. Some core observations nevertheless provide an important entry point into a wider conversation about the principles that underpin the financing of complex emergencies.

This section draws on desktop research and the survey findings, in addition to interviews with global finance experts and local elected officials.

4.1 AUTONOMY TO TAKE ACTION

With their greater proximity to citizens, subnational governments are often more attuned to local needs and vulnerabilities. In the context of COVID-19, this has enabled them to design rapid and locally-tailored response strategies, despite severe resource constraints. In many countries, effective management of the emergency at the local level has illustrated the **need for subnational governments to be rewarded with a greater share of national budgets**, enhanced powers to make their own decisions, and increased agency to steer the recovery to promote more sustainable urban development.

Perhaps paradoxically, evidence detailed in Section 2 suggests that more decentralised city and regional governments relying significantly on own-source revenues actually experienced greater financial distress than those mostly dependent on intergovernmental transfers. This is because local revenue sources - such as consumption taxes and fees - have tended to be particularly affected by the current emergency. But there has been widespread international recognition of **the importance of trusting local and regional governments and empowering them to make key spending decisions** during the health crisis. The need for cities and regions to remain flexible when allocating funds has renewed debate about the importance of fiscal autonomy in emergency contexts.

"In several cases, we have seen that central governments have been very supportive of the need for local governments to have more access to financing as well as authority to deal with the crisis".
Tehmina Akhtar, Deputy Director, UNCDF

The vulnerability of subnational own-source revenue has highlighted the need to develop additional tools and processes so that subnational governments have the autonomy to source extra funding when it is required in emergency situations. Levels of trust and cooperation between tiers of government also vary greatly from country to country and can easily break down in the face of financial strain. For many city and regional governments, therefore, the diversification of sources of emergency funding (and control over how to spend it) remains an important priority.

BOX 2: FREETOWN, SIERRA LEONE – THE IMPORTANCE OF DIRECT ACCESS TO EMERGENCY FUNDS

The city of Freetown has taken considerable steps to develop greater fiscal autonomy by broadening its own-source revenue base. Recent innovative reforms of the property tax system have almost quadrupled the number of property owners that are taxed, and the percentage of the budget coming from own- source revenues has increased from 50% to 63% over the past year. Despite this, the overall budget remains very constrained, with 92% of the activities related to the 'Transform Freetown' strategic development objectives funded through external grants and donor funding.

During the pandemic, a decision by the central government to suspend tax collection resulted in the city collecting almost no tax. This, coupled with delays in the arrival of intergovernmental fiscal transfers, put Freetown in a precarious position and their reliance on donor funding to deal with the health emergency increased significantly.

"What really matters most to us is our own-source revenue, and certainly for COVID, it was almost fully supported by donor funding."
Mayor Aki-Sawyerr

One major challenge for cities like Freetown is that a large proportion of donor funding tends to be channelled through national governments, with local governments lacking authority to shape spending priorities. In cases where there are tensions between tiers of government, this can pose a serious risk to effective service delivery during an emergency.

A common objection to greater local fiscal autonomy tends to centre on the risk of 'fiscal irresponsibility', a concern that may be heightened in emergency contexts. This demonstrates the importance of **safeguards that ensure that there is transparency and accountability** across all levels of government.

"It is important for local governments to be able to negotiate access to national resources ringfenced for emergencies but also ensure there is accountability in the use of those funds. Monitoring, reporting and verification systems should be built in."
Omar Siddique, Head of Office and Chief Technical Advisor, UN-Habitat

As countries move from response to recovery, **large sums of money are being invested that will shape cities' resilience to face future challenges** in significant ways, and they understandably want a seat at the decision-making table. For example, the mayors of nine European cities bypassed their national governments and appealed directly to the president of the European Council to ensure that part of the EU recovery funds would go directly to them.

As important as it is to ensure that subnational governments are able to make decisions about local spending priorities, responding to complex emergencies - and in particular the climate emergency - will require **cooperative systems of multi-level finance**. No city, region or country will be able to tackle these challenges alone. This is why it is so essential for national governments to support cooperation across municipalities and regions to help minimise disjointed responses and competition for resources during a crisis.

Developing new or innovative funding and financing mechanisms for subnational governments will enable them to take **rapid and radical action in the face of complex emergencies**, which typically require unforeseen expenditures that go beyond existing operating budgets. Institutional frameworks should be developed so that cities and regions can access emergency credit at favourable rates. Subnational Development Banks, for example, could play an important role in this respect and unlock local finance for local investments, including emergency response elements. Other mechanisms could include expanded own-source revenues (e.g. road pricing, land value capture mechanisms etc.); targeted urban investment funds (e.g. Global Urban Resilience Fund, City Climate Finance Gap Fund, International Municipal Investment Fund, etc.); facilitating access to global funds such as the Green Climate Fund; and new tools such as climate and sustainable infrastructure bonds, resilience bonds and debt-for-climate swaps. While these innovative approaches are beginning to emerge to tackle the financing of the climate emergency, similar measures should be developed to enable cities to respond to other complex emergencies.

4.2 FLEXIBILITY TO FACE EXCEPTIONAL CIRCUMSTANCES

Emergency finance mechanisms and principles are necessarily different from 'business as usual' rules of operation and received wisdom about how budgets should be spent. This highlights that **a certain degree of flexibility is essential** in enabling cities to make changes to their customary procedures, allowing them to be creative with the resources they have, and reducing the pressure on them to balance the books at all costs.

In terms of immediate emergency responses, one of the main areas where greater flexibility can play a critical role relates to **ringfenced spending and allocation requirements**. Subnational governments have had to make difficult decisions regarding the reallocation of funds, prioritising the areas of greatest urgency (see Figure 4). For cities with high levels of fiscal autonomy, this may have been a relatively straightforward internal negotiation. But for others that rely heavily on intergovernmental transfers, it can be a challenge to free up ringfenced spending and redirect it for other uses without clear support from central government.

"There has been a real squeeze on the flexibility of local and regional governments to act. Without flexibility, there is very little that you can do other than obey orders."
Flo Clucas, Finance Spokesperson, CEMR

In most countries, there exist somewhat rigid rules about subnational finances, including limits on borrowing, a requirement to balance operating budgets, and prioritise paying off any deficits in the next financial year. While such systems are designed to avoid financial problems, corruption, and fiscal mismanagement, the unprecedented scissor effect caused by the current emergency calls for a relief from such statutory obligations. Without such flexibility, many cities and regions could face a calamitous collapse in service delivery in the coming financial year, forcing them to lay off staff and make other cuts that will have long-term repercussions in terms of their ability to operate.

Cities and regions are increasingly thinking about innovative ways to **increase their borrowing capacity, which can be one way to respond more flexibly to a crisis**. While subnational borrowing has so far not been widely used in the COVID-19 response (in part due to the difficulty of recouping any of the health-related expenses), borrowing can certainly play a critical role in supporting some types of emergency responses. There are encouraging signs when it comes to planning ahead for future emergencies, including work done to expand the use of Subnational Pooled Financing Mechanisms (SPFMs) that provide joint access to private capital markets (bank finance and bonds), as well as the development of funds that offer advantageous terms such as the newly approved ERBD Solidarity Package which provides liquidity support to municipal clients.

Cooperative financing mechanisms are especially important for smaller cities and regions that may face difficulties proving their eligibility for borrowing on their own, and for those in lower-income regions where financial markets are less developed. One important development in this area is the newly established Africa Territorial Agency, a cooperative institution aiming to facilitate access to financial markets for African cities and local authorities. Whilst enabling greater subnational borrowing is clearly desirable and efforts to establish such mechanisms should be accelerated, this will not be a quick fix. In many cases it requires the development of fiscal capacity and creditworthiness over time.

At least in the short term, **grants and other types of donor funding are likely to remain vitally important** to emergency responses in low-income contexts. Many subnational governments in low-income countries have very small budgets and limited manoeuvrability to respond to sudden crises, but targeted emergency grants greatly increase their ability to respond in flexible ways. A number of subnational governments swiftly developed COVID-19 emergency funds to attract philanthropic finance, which have proven critical to ensuring a flexible response. For example in early March, even before the first case of the virus was reported in Sierra Leone, **the city of Freetown developed and shared a** COVID-19 response and preparedness plan **with the international community to mobilise financial support**. This resulted in donations of over US$4m to the response efforts.

At the national level, granting city and regional governments **more discretion and responsibility in times of crisis – and trusting them to be fiscally prudent within solid accountability frameworks** – could play an important role in future emergency response and recovery efforts. Looking ahead, subnational governments may also want to consider alternative sources of financing that afford them more flexibility and facilitate preparedness for other emergencies, while providing protection from unexpected economic shocks. This might include private investments that come with no allocation requirements (such as social impact bonds), creating community banks to finance infrastructure, and exploring the creation of contingency or reserve funds.

4.3 STABILITY TO WEATHER UNCERTAINTY

It is vitally important that cities and regions are able to increase their expenditure during emergency periods without diminishing their future fiscal sustainability. Expanding the subnational fiscal space - through measures outlined in sections 4.1 and 4.2 - is central to this.

However, fiscal space alone is not enough to ensure financial stability in the context of an emergency. It is also extremely important that cities and regions are able to spend emergency resources in the most efficient way possible, and this necessitates a **clear division of responsibilities as part of a robust multilevel governance system**. This extends from general pandemic management to emergency finance and resource allocation. Interviews conducted for this research repeatedly highlighted the importance of effective co-ordination between different levels of government, especially given the proliferation of new responsibilities in an emergency context.

A **proactive and coordinated response** to the crisis has clearly shown itself to be the most effective means of curbing the spread of the virus. Mobilising and financing an effective response benefits hugely from having **pre-established emergency or disaster frameworks** that have either already earmarked funding for response efforts, or have at least clearly defined the institutional structures and processes required to channel money to where it is needed.

"In places that have previously experienced a health emergency, the share of responsibilities between local government and central government tends to be more clearly defined. In terms of effectively dealing with the pandemic, this has reduced areas of contestation and enabled coordinated action."
Tehmina Akhtar, Deputy Director, UNCDF

The major difference between the current health emergency and other emergencies - such as the climate emergency or complex social emergencies - is that local governments were largely taken by surprise when coronavirus swept across the globe. This meant that **emergency finance had to be mobilised in a reactive way**, often without much time to prepare, and it came in incremental waves as the scale of the emergency became clear. Naturally this has, at times, led to a disjointed, delayed or incoherent response.

With respect to the climate crisis there is also an evident need to act swiftly, but the time horizons for action are slightly longer. The current health crisis is an important reminder that subnational governments need to think through the different scenarios and prepare for the various impacts, including identifying stable sources of finance to address these longer term emergencies. But the ability to plan effectively requires stability.

One of the challenges to this is that the support available to subnational governments to allow them to respond to an emergency is not always easy to access, with different grants and funding streams scattered across many different jurisdictions. Finding ways of **streamlining these funding sources would increase their uptake and effectiveness**. For example, UNCDF introduced a new e-grants platform to make discretionary emergency grants available to local governments as quickly as possible, helping to reduce the administrative burden of accessing much-needed finance. As we witness a proliferation of new financial instruments to deal with emergency responses, it is important to keep in mind the capacity constraints that local authorities experience, which may prevent them from taking full advantage of these funding sources.

"We have found that robust systems for allocating funding to the local level are effective under pressure as well. Where intergovernmental fiscal transfer systems work you can get to the ground really quickly in an emergency, but in contexts where they are not working, it is harder to respond effectively."
Tehmina Akhtar, Deputy Director, UNCDF

At times, even reprioritising existing budgets or delaying certain spending decisions may not be sufficient to address the major funding shortfall facing subnational governments. This can lead to difficult decisions that could impact long-term financial stability. One example is the **liquidation of assets to bridge the immediate funding gaps.** While this may help to address current issues, disposing of assets risks undermining the long-term ability of local governments to sustain reliable local revenue streams. If subnational governments are selling assets under duress, they may not be receiving a fair market value for them. Longer term, this could jeopardise their ability to respond effectively to other emergencies. For example, if they are forced to sell housing stock or other infrastructure, this means they have less control in ensuring that these assets contribute to climate resilience and sustainable development in the future. This issue is likely to be compounded by the **de-prioritisation of investment in infrastructure and public transport** since the start of the pandemic.

There is a real risk that austerity politics, which has had catastrophic impacts on local public services following the 2008/2009 global financial crisis, will see a resurgence as governments scramble to stabilise their budgets. The **hidden costs of austerity are considerable**, and will likely exacerbate existing inequalities while also reducing the ability of local governments to invest in ways that will enable them to tackle other complex emergencies.

4.4 FINANCIAL SOLIDARITY

At the beginning of the pandemic, the idea that the coronavirus was a "great equaliser" briefly gained traction. This has, of course, been disproven, with lower-income countries and marginalised poorer communities suffering the greatest losses both in terms of lives and livelihoods. All complex emergencies share a commonality in that they **disproportionately affect the most vulnerable members of society**. The uneven impacts of the current health emergency are a stark reminder of the urgent need to develop better mechanisms to address these inequalities. Finance is an essential lever that either further entrenches existing imbalances or acts as a catalyst for more just societies and a driver of greater intergenerational solidarity.

Even within nation states, there has been a significant divergence in the extent to which subnational governments have been financially impacted by the current crisis. The asymmetric spread of the virus, and varying levels of economic exposure to developments such as the decline in global tourism, have meant that some regions have suffered much more than others. When comparing global regions, the unequal impact of the pandemic is of course much more significant. Without targeted action, inequality both within and between states will become much more extreme in the aftermath of the pandemic.

However, with political will for radical action, the current crisis has the potential to **accelerate societal and economic transformations** that are urgently needed to address not only rising inequality, but also ecosystem collapse and climate breakdown. If cities and regions commit to building back better, the response to the COVID-19 emergency can be synergised with the response to the climate emergency.

"COVID-19 is different from the previous negative financial impacts we've experienced. It is not just a demand side shock but it really is the first health catastrophe that's prompting the restructuring of urban economies."
Omar Siddique, Head of Office and Chief Technical Advisor, UN-Habitat

One of the major lessons from the COVID-19 emergency has been that behavioural responses to global challenges can be both massive and rapid, and this applies equally to the general citizenry and to governments. The speed and scale of resource mobilisation and the development of safety nets shows that **with sufficient determination, major changes can be accomplished very quickly.** As a proof of concept, this is a hugely important finding that can shape approaches to financing other emergencies.

However, the pandemic has also demonstrated that **unilateral action in the face of grand global challenges is highly ineffective.** Greater collaboration and solidarity (across countries, within countries and between individuals) is vital to ensure we emerge from this crisis stronger and better prepared to face the uncertainties of the future. Globally, we seem to be lurching from emergency to emergency, and so we must start radically **rethinking some of the financing orthodoxies** that are constraining our ability to respond to emergencies, and develop new solidarity-based emergency finance measures.

Solidarity-based measures will require a **redress of some of the** asymmetric impacts **of emergencies** through equalisation mechanisms at both local and national levels. These could be in the form of concrete measures such as redistributive taxation and monetary grants. However, knowledge-sharing initiatives and advocacy support through multilateral networks are also important in fostering solidarity, empathy and mutual support, thereby laying the foundations for concrete measures to emerge. The Live Learning Experiences, hosted by UCLG, for example, raised the profile of the challenges facing cities in their response to the COVID-19 emergency and provided a platform for joint learning and engagement.

However, with the current fiscal restraints on subnational governments, there is a limit to what can be achieved without the support of national governments. **Legal frameworks and institutional structures must provide the enabling conditions for solidarity-based mechanisms** to develop at both city and regional levels. Subnational governments must have the autonomy, flexibility and financial stability they need to respond decisively to emergencies not only when they emerge in their own jurisdictions, but also to support other subnational governments who may be experiencing even more severe impacts of the emergency. As we have seen with COVID-19, and will no doubt continue to see with the climate emergency, **complex emergencies will persist until they are comprehensively tackled at the global level.**

As we emerge from the worst of the pandemic, it is critically important that the **capability of subnational governments to respond to future emergencies is strengthened**. The state of emergency will not end with this pandemic. Throughout the next few decades, the climate emergency will demand transformative and coordinated action on a global scale, and city and regional governments are uniquely placed to design locally tailored, democratic response strategies. To do so effectively, however, they must be able to finance these strategies. COVID-19 recovery plans offer a unique opportunity for national governments to invest in, and reform, subnational financing systems so that cities and regions are prepared for the next global shock.

BOX 3: COMPLEX EMERGENCIES AND THE GENDER GAP

Complex emergencies are not gender neutral. Women have been disproportionately affected by the COVID-19 emergency – in terms of their income, health and safety and in both public and private spaces. Furthermore, with the acceleration of remote working, independent working and online access to essential services precipitated by the pandemic, the consequences of the gender gap in digital inclusion have become even more critical. At the same time, women and girls comprise the majority of healthcare workers, are over-represented in the informal economy, and take on most unpaid care and domestic work.

As is often the case with major crises, the COVID-19 emergency represents an opportunity for change. Municipal finance systems, and the transfer and sharing of resources between central and local and regional governments, can be reviewed to create a more gender-responsive financial context. There are many tools and reforms that cities and regions can implement, including funding specifically aimed at the reconciliation of paid and unpaid work; lines of credit for women to develop entrepreneurial projects or redesign public spaces with a gender perspective; ex-ante gender impact assessments; publicly available gender budget statements; and gender audits of government expenditure. This opportunity to rebuild, recover, but also respond to future emergencies in ways that foster gender equality should not be squandered. Beyond the goals of fairness and justice, responding to the COVID-19 emergency in ways that promote gender equality is also critical from an economic point of view.

However, addressing the gender gap requires resources, and if the budgets of cities and regions are strained, this might fall by the wayside and jeopardise progress on gender equality and economic recovery. Local and regional governments need support. But they also need to recognise that they have a crucial role to play in implementing policies that will prevent women and girls from being the most affected demographic in future emergencies. If local and regional governments succeed, the COVID-19 crisis could be a watershed moment that will help us prepare for other complex emergencies such as climate change. If the initiative is not taken, it will be a lost opportunity to transform the economic, urban and social structures that have enabled and reinforced some of the deepest inequalities in society.

LOOKING FORWARD

Written by Billy Cobbett, Director of Cities Alliance

Although drafted in the midst of the ongoing pandemic, this is a timely document that allows us to reflect on the different ways in which sub-national governments have responded to the health emergency, and to highlight some of the lessons already learned. Unsurprisingly, the Policy Brief shows how local government resources have been negatively impacted, with increased demand compounding decreasing revenue amidst a sharp drop in affordability.

There is also an enormous asymmetry between different local government realities: what is a shocking drop in revenue, capacity and services in one city – a real and unprecedented emergency – would almost certainly count as a significant improvement in the daily reality for citizens in other cities.

If nothing else, this pandemic has laid bare very deep inequalities within cities, and between cities: *Your emergency is my daily life*. While public resistance to vital regulations and changes in social behaviour differed markedly between countries and political systems, for hundreds of millions of residents of the world's poorest cities, compliance with globally-standard regulations was, quite simply, not possible.

In all cases, the pandemic has demonstrated the human cost of undervalued and under-resourced systems of local and regional government. In the worst cases it has also been used as a useful cover and distraction to cynically implement regressive policies – by all tiers of government.

That is why it is so essential that all governments look beyond the immediate and necessary management of the crisis, and resolve to address long-standing, structural problems.

At the core of the solution lies a challenge that pre-dates the pandemic: the need for a wholly new and positive relationship between the different tiers of government and, at the local level, a similar re-engagement between the local government and its citizens, both private and corporate. The evidence very clearly shows that the most effective responses consistently occurred in those countries which have put in place a system of multi-level government based on a rational and consensual allocation of duties, responsibilities and resources.

While welcoming innovations from the world's leading cities, the limits of unilateral action - by any tier of government - are made clear in this Policy Brief: indeed, how could it be otherwise?

The existential dangers of the crisis are very real for local governments and their citizens, when the increase in sovereign debt and the reduction of revenue is used to justify the further reduction of services and support, just when the very opposite is called for: investments in people, in institutions and in infrastructure, laying the foundations for the permanent and long-term solutions that are needed to respond not only to emergencies but also to the larger and equally urgent question of each city's future.

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