Managing the Impact of COVID-19 on City Finances

Mahesti Okitasari, Richa Kandpal, and Upalat Korwatanasakul

The COVID-19 pandemic has emphasised the importance of strengthening cities’ financial resilience to navigate and recover from socioeconomic adversity. The better-equipped cities are to plan and manage their finances, the faster cities will build back better. Local policymakers and financial managers must chart an effective and sustainable financing path appropriate for their local contexts.

Recommendations:
• Conduct fiscal optimisation and crisis budgeting to improve own source revenue.
• Adapt budgeting formats and link urban planning with investments to facilitate long-term financial planning.
• Undertake comprehensive finance reviews to inform policy and increase budget transparency and accountability.
• Introduce e-government tools in city financial management and participatory budgeting.
• Leverage public–private and civil society partnerships for public service provision.

The Impact of COVID-19 on City Finances

Since the onset of the pandemic, many cities have struggled to manage the financial effects of declining revenue and increased spending (UNU-IAS; UCLG ASPAC 2021). Own-source revenue (OSR) across regions and income groups is estimated to have decreased significantly after the outbreak due to reduced economic activity and the implementation of tax relief measures (World Bank 2021). Cities have been deferring property taxes, utility fees, and other fees while losing other sources of revenue, such as city tax from tourism and income from public transit systems. For example, Vancouver delayed property tax payments by 60 days, and Kochi Metro (Kerala, India) sustained a USD 37 million loss in 2020. Consequently, cities face declining capital investments and service delivery risks. The pandemic also drove local governments to reprioritise their programmes, leading to resource reallocation. This will likely stall progress on the SDGs and hinder efforts to meet climate commitments (World Bank 2021).

Many city financial management measures depend on national and subnational (e.g., province and state) strategies, including those relevant to fiscal and debt rules. Cities with limited autonomy (e.g., the scope of responsibilities assigned through decentralisation) have been less able to respond quickly during the pandemic (UN-Habitat 2022). Fiscal decentralisation does not necessarily...
improve social outcomes, yet cities reap the benefits from decentralisation when governance works well (IMF 2022). Regardless, cities rely on national and subnational financial support to absorb the staggering non-recoverable losses driven by rising spending and falling revenue in the short term. However the increasing scale of transfer payments to narrow local fiscal gaps — one of the common national strategies for managing financial issues related to COVID-19 — is unsustainable due to budgetary pressures on central governments (IFC 2021). Shrinking inter-governmental transfers can lead to a more substantial impact on cities’ revenues and slower recoveries (World Bank 2021).

Efforts are needed to promote sustainable city finances to avoid financial collapse, recover from socioeconomic pressures, and deliver sustainable development actions. While financial risks remain high and cities’ financial positions (including the extent of fiscal decentralisation) determines the performance of city finances (World Bank 2021), a longer-term agenda that provides fiscal resilience should be considered (UN-Habitat 2021). This policy brief offers recommendations for local policymakers and financial administrators to manage the short- and medium-term impacts of the COVID-19 crisis on city finances by improving fiscal policy effectiveness and building robust financial management systems.

Fiscal Optimisation & Crisis Budgeting

Crisis budgeting requires local governments to produce a budget responsive to financial and policy changes and funding trade-offs between sectors. It should also provide stability despite high uncertainty. Strategically aligning budgets with priorities and embracing activity-based budgeting are recommended, including suspending or scaling back ongoing lower-priority activities, cutting overhead costs, and prioritising essential activities. Crisis budgeting should be accompanied by efforts to strengthen financial management and improve capital expenditure efficiency.

**Recommendation 1: Conduct fiscal optimisation and crisis budgeting to improve own-source revenue.** In designing a crisis budget, financial administrators must consider the timing, size, and duration of revenue deficits when weighing long-term risk against enacting short-term expenditure cuts or revenue enhancement (FEMA 2021). Tools for addressing revenue shortfalls — such as increasing utility and service fees — should be carefully considered as they burden citizens more. Policymakers must also work towards fiscal optimisation to improve own-source revenue in the long run, particularly in cities with a low tax revenue base. While this may depend on the level of flexibility embedded in the conditionality provisions set by the national government, there are some strategies within local government purview. Medium-size cities with a narrow tax base — constrained by the informal economy and limited fiscal decentralisation — can invest in updating existing databases and improving tax collection efficiency. Simplified and seamless tax administration systems contribute towards the formalisation of the informal sector. Moreover, land-based finance, e.g., land and property taxes, can provide a fair and efficient taxation resource, create a virtuous cycle of development, and, in turn, optimise OSR (UN-Habitat 2021b). Political leadership is key to ensuring the successful implementation of local fiscal and tax reforms.

Long-term Financial Planning

Long-term financial planning is crucial to financial recovery as it ensures the government’s solid financial foundation and fiscal resilience (DiNapoli 2017). It helps administrators to navigate uncertainty and project financial impacts. A multi-year financial plan allows policymakers to monitor city finance, calculate steps to reduce financial risks (DiNapoli 2017), and link long-term investment needs to long-term urban planning with necessary investments (UN-Habitat 2021b). Balaka (Malawi) aligned its investment plans with the Local Authority Performance Assessment, resulting in improvements in project quality.

**Recommendation 2: Adapt budget formats and procurement procedures, and link urban planning with investments to facilitate long-term financial planning.** Long-term financial planning requires policymakers to amend budgeting formats, including budget scope, legal structure, and approach (input or output budgeting). In determining the budget format, policymakers should consider their legal requirements and discretion, budgeting objectives, available resources and data, and capacity for implementation. It is recommended to (i) design leaner operating budgets, such as through priority-based budgeting and operational cost reduction; (ii) introduce a multi-year budgeting process to adapt to revenue changes and evolving spending needs; (iii) set up special emergency accounts; and (iv) adjust public procurement procedures. Financial administrators must incorporate scenario planning in budgeting to proactively respond to future crises. These measures should be aligned with national sustainable development strategies and local long-term investment needs. As a start, policymakers must link long-term financial planning with the potential of urban planning, and design financial plans based on public infrastructure investment mechanisms (e.g., land value finance) to ensure long-term investment needs are embedded in municipal budgeting cycles (UN-Habitat 2021b). In cities with poor and informal
pockets, this can finance long-term infrastructure debt for infrastructure in such areas, effectively meeting their social objectives and creating positive impacts on other sectors.

**Budget Transparency & Accountability**

Financial management review focuses on balancing government spending and revenue, and contributes to a better understanding of fiscal autonomy and reactivity to expenditure needs and revenue shortfalls. The review should investigate local governments’ financial health and ability to deliver services, factoring in additional pressures from crises such as the pandemic. In the medium to long term, making audited accounts and financial plans publicly available will help to improve cities’ creditworthiness and financial management. Depending on city size, such improvements are necessary to set up loans to finance large capital investments or to issue municipal bonds. Regardless of city size, improved accounting and financial management transparency lead to a virtuous cycle of trust and further revenue generation (UN-Habitat 2021b).

**Recommendation 3: Undertake comprehensive finance reviews to inform policy and increase budget transparency and accountability.** Financial administrators may set their preferred audit approach; however, they should include an assessment of steps taken by the government, levels of financial risk across sectors, cost pressures and income losses, and reserve levels. Cities should involve a local audit office to undertake a comprehensive financial review whenever possible. The results of a comprehensive finance review should inform policy, financial plans, and management to facilitate local transparency and accountability. The finance review should be complemented with foresight fiscal analysis to allow the development of well-informed fiscal emergency plans. A city’s ability to accurately forecast revenues facilitates project payment planning and matching revenue-expenditure flows (UN-Habitat 2021b).

**Digital Financial Management & Participatory Budgeting**

The application of digital technology in financial management can also enhance government efficiency and budget resilience (Korwatanasakul, Srivunnabood & Majoe 2021). The COVID-19 pandemic has accelerated the digitalisation of city governance and public service delivery. Policymakers should leverage this experience to upgrade digital services for city finances and to enhance interaction between citizens and government. Leveraging information and communications technology (ICT) for public finance can help cities undertake participatory budgeting (PB) to improve equity and democratic participation. Furthermore, PB provides benefits, such as better budget allocation, improved fiscal sustainability, and administrative efficiency. PB is particularly suited for cities in countries with decentralised systems and those undergoing decentralisation reform. For instance, large cities use digital participatory platforms (e.g., Bologna, Lisbon, and Madrid) or tools for open budgets (e.g., Palo Alto and Philadelphia) (UN-Habitat 2021c). These tools can also contribute to cities’ social resilience by improving governance and budget transparency, effectively mitigating risks and impacts of natural, health, and economic shocks (UN-Habitat 2021c).

**Recommendation 4: Introduce e-government tools for city financial management and participatory budgeting.** In designing financial management, cities should avoid overly complex ICT systems. ICT that supports essential functions (e.g., budget execution, revenue and expenditure management) is sufficient, especially for small and medium-sized cities. Cities with low capacity for financial management can apply ICT for OSR automation (e.g., Kisumu, Kenya) and digital accounting (e.g., Hargeisa, Somalia). There are various approaches for PB: digital platforms, artificial intelligence, mobile apps, and social media. Each tool has strengths and limitations, and should be applied appropriately to the local context. Policymakers can adopt a hybrid strategy, combining digital platforms with offline tools to maximise community engagement (UN-Habitat 2021b). The introduction of e-government tools involving public participation should be supplemented by programmes to develop digital literacy and reduce the digital divide. It must be tested and adjusted to reveal possible drawbacks and develop contingency plans, including mitigating cybersecurity risks.

**Public–Private & Civil Society Partnerships**

Public–private partnerships (PPPs) can be leveraged not only for large-scale infrastructure projects but also in communities of all sizes. PPPs provide benefits such as upfront cost reduction and increased efficiency (FEMA 2021). Partnerships involving local governments and civil society organisations are critical to public service delivery, especially social services (FEMA 2021). During the pandemic, such partnerships have increased community connectivity and fast deployment of project implementation, including social and food security measures. In 2020, Maringá (Brazil) developed the Economic and Social Development Recovery Plan in partnership with the Brazilian Micro and Small Business Support Service to boost the economy with multi-stakeholder engagement.
Recommendation 5: Leverage public–private and civil society partnerships for public service provision. As the projected costs of responses to the pandemic are highly uncertain and complex, adopting less rigid regulations and protocols for PPPs can encourage the private sector to quickly initiate and manage collaboration, as observed in cities in China (Wang et al. 2022). This includes reducing the time and steps required to issue permits and simplifying public procurement. During crises, policymakers should set more specific and consistent goals for partnerships. This strategy is particularly appropriate for large cities experienced in managing complex PPP operations. For smaller cities, support from higher levels of government is needed. Regardless of city size, policymakers must map all civil society and community organisations in their cities to define the scope of partnerships and ensure the representation of all groups. This will aid in mobilising resources for service provision and contribute to delivering SDG Target 17.17 on encouraging and promoting effective public, public–private, and civil society partnerships.

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