Rebuilding Local Fiscal Space

Exploring the Impact of the COVID-19 Pandemic on the Fiscal and Economic Health of Selected Subnational Governments

– Results from Preliminary Data Collection –

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<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AFD</td>
<td>Agence Française de Développement (French Development Agency)</td>
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<tr>
<td>BD</td>
<td>Bangladesh</td>
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<tr>
<td>CG</td>
<td>Central government</td>
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<tr>
<td>DACF</td>
<td>District Assembly Common Fund</td>
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<tr>
<td>FY</td>
<td>Fiscal year</td>
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<tr>
<td>GH</td>
<td>Ghana</td>
</tr>
<tr>
<td>IFGT</td>
<td>Intergovernmental fiscal transfer</td>
</tr>
<tr>
<td>IGFTS</td>
<td>Intergovernmental fiscal transfer system</td>
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<tr>
<td>IMIF</td>
<td>International Municipal Investment Fund</td>
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<tr>
<td>LDC</td>
<td>Least developed country</td>
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<tr>
<td>LED</td>
<td>Local economic development</td>
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<tr>
<td>MD</td>
<td>Moldova</td>
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<tr>
<td>MX</td>
<td>Mexico</td>
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<tr>
<td>ODI</td>
<td>Overseas Development Institute</td>
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<tr>
<td>OSR</td>
<td>Own source revenue</td>
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<td>PBGS</td>
<td>Performance-based grant system</td>
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<td>SNG</td>
<td>Subnational government</td>
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<td>UCLG</td>
<td>United Cities and Local Governments</td>
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<td>UG</td>
<td>Uganda</td>
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<td>UNCDF</td>
<td>United Nations Community Development Fund</td>
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I. Background & Introduction

1.1 Background

Over the course of 2020, the COVID-19 pandemic has rocked the world’s economy, causing pain, tragedy and hardship at many levels and effecting seismic changes on how most people live and work. The scale and scope of the pandemic is such that anybody reading this report in 2021 will almost certainly have been personally affected by it. Rarely, if ever, has there been a phenomenon that touched almost every human being on the planet within such a short space of time. Many previous events have the label “world” or “global” attached to them but in fact did not have the same reach because parts of the planet were isolated from them by their geography, their politics or their history.

Economically, the pandemic has created the sharpest and swiftest drop in global economic activity ever recorded. This contraction has reduced revenues for all levels of government (central and subnational governments), households, and for private enterprises. Again, the speed and scale of this slowdown is unprecedented.

We have all lived through the events described above and are still coming to terms with what they mean. Looking ahead to 2021, whether or not the forthcoming vaccines will be effective, and things will return to “normal” or whether the pandemic continues prevail for some time, some things are already clear:

First, there have been winners and losers. Online platform providers, remote conferencing software providers, streaming services, delivery services and other businesses that do not require face to face customer interaction have clearly benefited from the pandemic. Many of these require internet coverage, devices that can access the internet and the ability to pay for services online. These new pre-conditions for participating in economic activities have highlighted a digital divide.

Second, the pandemic has also highlighted a social, economic and physical divide. In many towns and cities, in particular, but not exclusively in developing countries, the urban fabric incorporates a large sector of street commerce both formal and informal. This includes transportation, street sellers, markets, shops and stores and light processing and value addition such as mechanics, tailors, and ironware welders. In addition to its contribution to the national economy, this “street sector” constitutes a social safety net that connects the urban and rural economies (in many developing countries) and enables citizens to hustle out a living and support their families without recourse to state aid. The sector provides a vector for social interaction that is important for a healthy society. More importantly, this sector is a major contributor to fiscal revenue, largely at the local government level. What is clear is that this “street sector”, especially due to restrictions on social distancing etc., has been a loser from the pandemic and the consequences of this loss will become more apparent in 2021.
Third, the geographical scope of value chains has shrunk and many governments and policy makers have been reminded of how far the new global economic model has evolved. Attention is now being paid to the local de-industrialization of the last 20 years and governments are seeking to rebuild a domestic capacity to produce basic food and consumer produce, garments and basic pharmaceuticals, equipment of protection against spread of viruses, etc. within their own national economies.

Fourth, the virus has shown that the social and economic response requires localized but well-coordinated action across different departments and agencies, not just the department of health. It has further emphasized the importance of intergovernmental coordination and support. Variations in outcomes between towns and cities in the same country and the role of local leadership, local autonomy and local finance in producing these outcomes are important to examine and understand in order to identify appropriate strategies and tools for future mitigation and recovery.

Finally, the fiscal space has contracted significantly. In 2021, governments will have less money to spend at a time when there will be greater demand for their services. This may have political consequences and there is a risk that citizens will lose faith in the ability of their governments to provide them with appropriate levels of services. This might result in further privatization of public services with consequences for those less able to pay.

The loss of fiscal space at the national level is being addressed by debt forgiveness programmes and other measures. National governments will do all they can to rebuild their fiscal position and credit ratings, some of which have already been reduced.

The UNCDF supported “Rebuilding Local Fiscal Space Initiative,” which this report is contributing to, seeks to understand the impact on and provide support to subnational governments (SNGs) and their fiscal space in the light of the COVID-19 pandemic. The crisis has shown that SNGs are indispensable actors and hold the key to accelerating recovery nationwide. Yet there is a huge risk that SNGs will be left out of the thinking about the recovery, while it is a national imperative to support SNGs to enable them to respond effectively.

Experiences so far have shown that interactions and collaboration between central governments and SNGs in responding to the COVID-19 challenges vary greatly across countries as well as across SNGs.

Four core factors have been identified to impact on the SNG fiscal space due to COVID-19:

1) Loss of own source revenues;
2) A non-conducive intergovernmental fiscal transfer system with insufficient tools and instruments to respond;
3) Loss of local economic development and
4) Increase in costs of service delivery and additional mandates for SNGs.
The way in which these factors have evolved and how the central government and SNGs have responded in light of the pandemic provide a range of challenges as well as good practices. These insights and lessons learned will be important for strengthening the response going forward, including both the current immediate response phase and the future medium- to longer-term recovery phase.

**Objectives of the Initiative**

The overall aim of the initiative “Rebuilding Local Fiscal Space” is to provide tools and recommendations on improving local fiscal space in light of the challenges caused by COVID-19, through a case-by-case review and analysis of the core factors affecting fiscal space in a range of selected (very different) sub national governments (SNGs). The focus of the initiative is on the four factors mentioned above (and further detailed below), which contribute to the loss in fiscal space. It covers a review of possible measures to rebuild local fiscal space, accelerate national economic recovery and restore trust in public institutions, all of which are core responsibilities of both central and local governments. The initiative will highlight and seek to measure and understand the four factors and will work with central and SN governments on strengthening the four factors to accelerate fiscal and economic recovery.

**Phases of the Initiative**

The initiative has three phases, which may be adjusted in timing and scope during the course of the exercise.

1. **Phase I**: The diagnostic phase from October to December 2020, consisting of a stock-take of the impact of the COVID-19 pandemic on the fiscal and economic health of five (originally six) SNGs, which was completed by this report;
2. **Phase II**: The design and testing of new mechanisms and tools to enhance fiscal space and strengthen local economies of the SNGs based on the results of phase one. The initiative will assist the selected SNGs in addressing the challenges identified, and in following-up on priority measures to improve fiscal space and kick-start recovery. This phase will be prepared in early 2021, to prepare for its launch in the second quarter of 2021;
3. **Phase III**: Stakeholder engagement to validate the revenue mechanisms developed and piloted in phase two, with the aim of securing adoption and roll-out by the central governments and SNGs. This phase will be launched at the end of 2021/beginning of 2022 depending on the initial results of phase II.
### Main factors affecting the fiscal space of SNGs

#### Table 1: Overview of the factors impacting fiscal space

<table>
<thead>
<tr>
<th>Factors</th>
<th>Relevance</th>
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<tbody>
<tr>
<td>1. Loss of own source revenue (OSR)</td>
<td>Since the onset of the COVID-19 pandemic, SNGs around the world are faced with a potential loss of own source revenue (OSR) due to the contraction in the street economy, but also related to the reduction in property taxes and other fees due to defaults and business closures. At the same time, the spread of the online platform services has led to new economic models that require the support and provision of local services in order to function but do not yet contribute fiscally to these services. The study aims at determining the extent of this potential impact on various SNGs, and how it has been addressed in the SNGs selected for this initiative.</td>
</tr>
<tr>
<td>2. Intergovernmental fiscal transfers (IGFTs)</td>
<td>Intergovernmental fiscal transfers (IGFTs) are a fundamental part of SNG revenues. Yet during the pandemic many central governments may have held back these payments and there is a risk that they will be reduced further in 2021 and/or that IGFT systems are non-conducive in design and implementation arrangements to respond to the current challenges. One of the factors to review has been the extent to which the IGFT system has adjusted to the new expenditure assignments, and whether new transfer schemes/tools have been developed and deployed.</td>
</tr>
<tr>
<td>3. Loss of local economic activity</td>
<td>Local fiscal space is not just about taxes, fees and transfers. It is also about local economic development and jobs, about creating a conducive environment for local business activity, and about fostering the kind of economic growth that adds value to a local economy and development. The pandemic has both highlighted the risks of growth without local economic development and accelerated the reduction in local economic development through the growth of online platforms and the “new gig economy”. This study aims to determine how far this has gone and what can be done to mitigate the risks and address future challenges in the various SNGs.</td>
</tr>
<tr>
<td>4. Changes in the SNG expenditures levels and composition due to COVID-19.</td>
<td>This study reviews the potential impact of the COVID-19 pandemic on the SNG’ expenditures (level and composition), contributing to the shrinking of the fiscal space, including factors such implications for the expenditures on the health care system, new costs of prevention, protection, logistics, etc.</td>
</tr>
</tbody>
</table>
Partners

The study has been carried out as a collaboration between the Overseas Development Institute (ODI) and Dege Consult ApS (www.dege.dk), and led by a team of international consultants (Gundula Löffler, Jesper Steffensen and Lars Engen) supported by a core team of UNCDF experts, coordinated by Jaffer Machano and Nan Zhang, and with overall guidance from David Jackson.

The initiative is led by the Local Development Finance Practice at UNCDF which is a center of excellence and an innovative fund for local government finance and local economic development finance in the world’s least developed countries (LDCs). It has 25 years of experience in promoting and supporting transformative investment through local governments and domestic banks in LDCs by piloting and scaling up innovative financing mechanisms and policies in the public and private sectors. The Practice adopts a transformative impact financing approach to promote service delivery, infrastructure investment and local economic development that retains value within the local territory. This builds local fiscal space and local fixed capital formation. UNCDF has delivered measurable impact in areas such as job creation, women’s economic empowerment, clean energy, resilience to climate change and strengthened food security, which contributes to local economic growth, peacebuilding and more importantly, improvement in people’s quality of life at the grassroots level.

UNCDF is working closely with its partners in the United Cities and Local Governments (UCLG) with which it has created the Malaga Global Coalition for Municipal Finance, a coalition for a global financial ecosystem that works for cities and local governments. This coalition is advocating for necessary policy reforms, regulatory changes, fiscal architecture and financial mechanisms & products at both global and national levels. The coalition is also collaborating on practical actions to elevate and mainstream municipal finance through its financial instrument, the International Municipal Investment Fund (IMIF). UNCDF is working closely with its partners in development finance institutions such as the Agence Française de Développement (AFD).

1.2 Selection of Subnational Governments and Methodology

The study was carried out as a desk review, but with close contact to the participating SNGs, of which five out of the originally six potential candidates were covered throughout the review¹. The participating SNGs were:

1) Kumasi Metropolitan Assembly, Ghana;
2) Chandpur Municipality in Bangladesh;
3) Telita Municipality in Moldova;
4) Gulu Municipality (since July 1, 2020 it is constituted as a “City”) in Uganda;
5) Chiapas State in Mexico.

¹ The sixth SNG, Chefchaouen Municipality in Morocco, did contribute actively during the webinar in November 2020, but did not provide data input for the analysis.
The selection was conducted through a combination of criteria such as previous UNCDF engagement, wish to ensure that various types of SNGs are included (e.g. smaller and larger) as well as geographical diversity, and possibilities for following-up with downstream engagements and support. In terms of size of the SNGs, the sample population size varied from Telita Municipality with only 1,099 inhabitants to Kumasi with 1,076,192 as the biggest city, and Chiapas State with 5,217,908 inhabitants.

The study was carried out between the last week of September and the third week of December 2020. It reviewed the fiscal and economic situation of the current fiscal year (FY) and the three FYs prior as well as the trends and developments between March and September 2020, compared to the same period in the year prior to the impact of COVID-19.

Phase I of the initiative was conducted through the following steps:

1. Engagement with the SNGs mentioned above to agree on their interest to participate in the initiative (UNCDF).
2. Design of a detailed standardized survey for the SNGs to complete. This entailed a questionnaire with both quantatitative and qualitative elements, an spreadsheet template to collected fiscal data, and a tool for cross-SNG comparison (consultancy team);
3. Sharing of standardized survey with SNGs (UNCDF);
4. Submission of inputs from the SNGs and several rounds of dialogue with the SNGs to clarify questions and responses, and provide further information, including e-mail exchanges and video conferences to discuss improvements in data quality and coverage (SNGs and consultancy team with some assistance from UNCDF);
5. Data analysis and synopsis of initial findings in a detailed power-point presentation (consultancy team);
6. Presentation of the initial findings in a virtual conference (webinar) on November 17, 2020 (consultancy team and UNCDF);
7. Further interactions with selected SNGs through e-mail and video conferences and submission of final inputs and clarifications to data by some SNGs (SNGs and consultancy team);
8. Final reporting (consultancy team).

As mentioned above, the survey encompassed quantitative as well as qualitative data capturing. In terms of the fiscal data, a trend analysis of budgeted and actual revenues and expenditures (size and composition) over a three to four-year period was conducted for each of the participating SNGs.

Since the fiscal year (FY) varies across SNGs, the questionnaire, spreadsheet template (see annex) and findings refer to FY N to denote the current fiscal year, and to FY N-1, FY N-2, and FY N-3 to denote the three previous fiscal years. The following table specifies the fiscal years for each participating SNG.
Table 2: Overview of the SNG fiscal years

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Chiapas, Mexico</th>
<th>Kumasi, Ghana</th>
<th>Telita, Moldova</th>
<th>Chandpur, Bangladesh</th>
<th>Gulu, Uganda</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal Year (FY) N</td>
<td>FY 2020 (Jan-Dec)</td>
<td>FY 2020/2021 (July-June)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiscal Year (FY) N-1</td>
<td>FY 2019 (Jan-Dec)</td>
<td>FY 2019/2020 (July-June)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiscal Year (FY) N-2</td>
<td>FY 2018 (Jan-Dec)</td>
<td>FY 2018/2019 (July-June)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiscal Year (FY) N-3</td>
<td>FY 2017 (Jan-Dec)</td>
<td>FY 2017/2018 (July-June)</td>
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</table>

All financial data was collected in local currency (nominal) and converted into US$, in relevant areas when data is compared across SNGs, by applying the prevailing exchange rates. Whenever source of information is presented without references, the data, graphs and tables are based on the submission of data from the 5 SNGs in October-December 2020.

1.3 Structure of the Report

The report is structured as follows: Each factor outlined in table 1 above is reviewed separately following the same organization (sections 2-5). Each section first describes the situation prior to the COVID-19 pandemic and the historical trends in the three years prior to the current Fiscal Year (FY). Then, the impact and challenges related to COVID-19 are analyzed. In the following, the responses by the SNGs and possible ways forward are discussed. Finally, some tentative recommendations on how to strengthen the current situation and adopt additional initiatives to mitigate the challenges and improve the fiscal space are offered.

The concluding Section 6 summarizes the main findings and conclusions and outlines the overall recommendations, which will be explored in greater detail during phase II of the initiative. These recommendations are general and will be further detailed through subsequent interactions with each of the SNGs in the next phase. Although the SNGs vary greatly, showing significant differences in context, functions, size, capacity, level of autonomy, history and intergovernmental arrangements, attempts are made throughout the review to compare factors across the SNGs to share experiences and generate common lessons learned and new innovative ideas.
2. Factor 1: Loss of Own Source Revenue

2.1 Introduction to the Factor

Since the onset of the COVID-19 pandemic, subnational governments (SNGs) around the world are faced with a potential loss of own source revenue (OSR) due to the contraction in their local economy, but also related to a drop in yields from property taxes and other fees due to defaults and business closures. This potential loss in OSR stems from a combination of several factors that affect the ability and willingness of taxpayers to pay: local businesses struggle to make a profit as they are forced to close down or operate under strict social distancing rules to limit contagion, and lockdowns and curfews induce people to leave their homes only for the most urgent errands. Furthermore, the pandemic has caused many people to lose their jobs making it more difficult for them to meet their tax obligations. In addition to the contracted local economy resulting in decreased OSR yields, increased expenditure demands put additional pressure on SNGs to bring in adequate revenue yields without overly squeezing already struggling local businesses and other taxpayers. This section of the report describes the impact that the measures taken to mitigate the spread of the pandemic have had on the OSR yields of the SNGs in the sample.

2.2 Current Local OSR System Before the Onset of the COVID-19 Pandemic

This section of the report describes the local OSR system of the SNGs before the onset of COVID-19. This helps establish a baseline for each of the SNGs, to better understand the fiscal position they were in prior to the pandemic. In pre-COVID-19 times, local own source revenue (OSR) varied in the importance and role it played for the overall revenue of the SNGs in the sample. Graph 1 below shows the overall revenue composition of the five SNGs averaged over the two fiscal years prior to the start of the pandemic.

**Graph 1: Revenue Composition**

*Chandpur, Gulu: FY 2017/18 – FY 2018/19; Chiapas, Kumasi, Telita: FY 2018 – FY 2019*
As the graph indicates, only two SNGs – Chandpur (59%) and Kumasi (50%) – get over half of their overall revenue from local own sources, while for the other three SNGs – Chiapas (5%), Gulu (9%) and Telita (17%) – local own revenue plays a somewhat less important role. The relative reliance on OSR by the SNGs with respect to their overall revenue intake is an important factor to keep in mind for the remainder of this discussion.

Exploring the pre-COVID-19 trends in OSR for each of the SNGs in more detail, a few observations can be made. The following graphs shows the per capita own source revenue yields in USD – both budgeted and collected – for the past two to three fiscal years before the start of the pandemic. Looking at the trends for the different SNGs (graph 2), quite a bit of fluctuation can be observed between the years. Per capita OSR in Chandpur and Telita was going up, while it was going down in Gulu and Chiapas, with no observable trend in Kumasi. Furthermore, while the differences between budgeted and collected (actual) yields in Chandpur, Kumasi and Telita were minimal, Gulu showed a considerable shortfall in collected compared to budgeted yields, while Chiapas, systematically collected more OSR than what they can initially budgeted. The reasons underlying these different patterns will need to be explored in further research.

**Graph 2: Trends in per capita OSR yield (budgeted and actual) pre-COVID**

In terms of the levels of per capita OSR yields during the two to three fiscal years prior to the COVID-19 pandemic, a considerable variation between the SNGs can be observed. Kumasi collected only around 3 to 4 USD, which appears particularly low in light of the fact that about half of the funds in Kumasi’s budget come from OSR (see graph 1 above). The same is true for Chandpur, but here, per capita OSR was between 15 and 18 USD. Furthermore, per capita OSR
ranged from 10 to 12 USD in Gulu, and from 18 to 26 USD in Telita, however, in both these SNGs, OSR only played a minor role in the local overall revenue mix. Chiapas collected between 50 and 80 USD in annual per capita OSR in the three fiscal years preceding COVID-19, although, here it needs to be kept in mind of course that Chiapas is a federal state, not a municipality. The reasons underlying these variations in per capita OSR between SNGs can be manifold and require further investigation before drawing any conclusions regarding the appropriateness of the OSR levels in the respective SNGs.

At closer inspection of the local own revenue sources that the SNGs in the sample have at their disposal, all SNGs draw on a broad range of different sources. Most of these are very typical local revenue sources, such as taxes and fees on land, immovable property and local business activity, charges on local government services, rental income and fines. The SNGs indicated tapping between five and 40 different sources, but many of them alone yielding only fairly small amounts. The second column in table 3 below provides a list of the main local own revenue sources for each of the five SNGs. Graph 3 displays the most important local own revenue sources for each SNG as percentage shares of total local OSR to give a better idea of the relative importance of different own sources. Almost none of the SNGs indicate capturing revenue from taxing online business or what is widely referred to as the ‘new gig economy’ (Uber, Air BnB, TaskRabbit etc.). Here the only exception is Gulu, which indicates capturing revenue from this type of business activity at least to a small extent.

**Graph 3: Most important local own revenue sources for each SNG as shares of total local OSR**

![Graph showing local own revenue sources for each SNG as shares of total OSR](image_url)
In terms of compliance and enforcement, there appears to be quite some variation between the different SNGs. Here, a common measure is the collection ratio, i.e. the amount of tax and fee collection as a share of the total amount billed. The average collection ratio over the past three pre-COVID fiscal years ranged from 46% in Gulu to 99 and 97% in Chandpur and Kumasi respectively (two of the SNGs were unable to provide this particular metric). Furthermore, most SNG report still having considerable untapped revenue potential due to a large informal sector or potential taxpayers otherwise escaping the tax net. Chandpur estimates having been able to capture just under half (48%) of its revenue potential pre-COVID, while Gulu and Kumasi estimate tapping around 65 and 70% respectively (two of the SNGs were unable to provide this particular metric). This suggests that strengthening the revenue collection systems of these SNGs might allow them to substantively increase their revenue yields. The SNGs reported their local revenue collection systems to suffer from a number of challenges and weaknesses that impair their ability to exploit their revenue potential to a fuller extent. These were:

- Incomplete and out-dated taxpayer information and poor record keeping;
- Revenue administration systems being not, or only partially automated;
- Continued manual collection of at least some of the revenue payments;
- Persistent revenue leakages; and
- Poor taxpayer awareness.

While some SNGs appear to have more effective systems in place than others, all of them struggle with at least some of the issues mentioned above. Addressing these issues with a clear aim to improve the efficiency and effectiveness of the local revenue collection systems and widen the tax net might thus be an effective way to increase local own source revenue yields, by effectively spreading the tax burden among a larger number of taxpayers.
Table 3: Overview of OSR system

<table>
<thead>
<tr>
<th>SNG</th>
<th>List of main OSR sources</th>
<th>Revenue captured from online or ‘new gig’ economy?</th>
<th>Average collection ratio over past 3 FYs N-1, N-2, N-3</th>
<th>Share (in %) of revenue potential captured</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD (FY July-June)</td>
<td>Taxes (8 types) e.g. holding or business tax; rates (3) e.g. lighting rate; fees (6) e.g. slaughterhouse; leases and others (12) e.g. marketplace lease</td>
<td>Not at all</td>
<td>FY 17/18-18/19: 99%</td>
<td>48%</td>
</tr>
<tr>
<td>Chiapas, MX (FY Jan-Dec)</td>
<td>Taxes (7); dues and ss contributions; improvement contributions; fees (16); commodities (2); fees for public services (10); sales revenue</td>
<td>Not at all</td>
<td>FY 2017-2019: NA</td>
<td>NA</td>
</tr>
<tr>
<td>Gulu, UG (FY July-June)</td>
<td>Taxes (2) e.g. local service tax; fees (9+) e.g. land or parking fee; licenses (4) e.g. business license; levies (2); rents and others (3+) e.g. ground rent</td>
<td>To a small extent</td>
<td>FY 17/18-18/19: 46%</td>
<td>65%</td>
</tr>
<tr>
<td>Kumasi, GH (FY Jan-Dec)</td>
<td>Property rates, land development permits, business operating license, fees e.g. market or parking, rental payments, fines</td>
<td>Not at all</td>
<td>FY 2017-2019: 97%</td>
<td>70% (50% for property rates)</td>
</tr>
<tr>
<td>Telića, MD (FY Jan-Dec)</td>
<td>Property taxes, income taxes, business licences, market fees, salubrity fees</td>
<td>Not at all</td>
<td>FY 2017-2019: NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

2.3 Challenges due to COVID-19

COVID-19 unfolded globally in March 2020 taking effect on local societies, economies and budgets in the weeks and months to follow. As a result of the pandemic, all SNGs in the sample reported experiencing a drop in their local OSR yields – some of them describe the drop as dramatic (see table Y below). When comparing OSR yields collected in the period from March to September 2020, the months during which the pandemic has made its initial impact on public life, with yields from the same period (March to September) of previous years, the impact of COVID-19 becomes apparent. Graph 4 below visualizes this impact. It compares the OSR yields collected from March to September in the years 2017, 2018, 2019, and 2020, where the year with the highest yield (peak year) represents 100. OSR yields during COVID-19 (represented by the yellow bar) are lowest for four of the five SNGs, and for some like Gulu severely so. This
means that almost all SNGs experienced a considerable drop in OSR due to COVID-19 resulting in
the lowest yields in 3 to 4 years. The only exception here is Telita, where our analysis shows that
OSR collected from April to September 2020 was highest in comparison to the previous three years. This is not only an unexpected finding, it also contradicts the response by Telita officials to the question inquiring into the impact of COVID-19 on OSR yields, where they indicated that it resulted in OSR having “dropped a little” (see table 4, column 2). The origin of this discrepancy will need to be explored in the following phase of the initiative.

Graph 4: Impact of COVID-19 on OSR yields in comparison to previous trend

![Graph showing the impact of COVID-19 on OSR yields in comparison to previous trend]

Comparing the OSR yield collected during COVID-19 (March to September 2020) to the average yield from the same period across the three previous years, shows a 23% decrease in OSR during the pandemic for Chandpur (for Chandpur, data was available only for 2018, 2019, and 2020), a 41% decrease for Chiapas, a 87% decrease for Gulu, and a 25% decrease for Kumasi.

When exploring the effect of COVID-19 on the various local own revenue sources, it became clear that almost no OSR source remained untouched but that certain groups of revenue sources have been particularly hard hit (see table 4, column 3 for details on each SNG). Unsurprisingly, the ones most affected by the pandemic have been the ones relating to local business activities, such as business licenses, market fees, hotel taxes and others. These activities were often substantially restricted or even temporarily suspended, following central government instructions, in an attempt to slow down the spread of the virus. As a result, the amount of taxes, fees or other payments owed to the SNGs reduced considerably resulting in revenue losses that the SNGs will not be able to recover. However, other local own revenue sources like property taxes or water tariffs were reportedly also affected, as taxpayers suffered shocks to their income, e.g. due to job

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2 For Telita, the comparative period is April to September, since the required data is only available quarterly.
loss, making it harder for them to settle their tax bills. In these cases, liabilities remain on the books and are recoverable, at least in principle, by the SNGs going forward.

Inquiring into the timeframe for the recovery of local OSR yields, Chandpur, Gulu and Telita stated expecting their local OSR to take between 2 to 3 years to fully recover from the effects of the pandemic. Kumasi expects a slightly swifter recovery within the coming 12 months and Chiapas reported that their OSR yields were already in the process of recovering. This suggests that the majority of the SNGs will likely continue to struggle with the aftermath of the pandemic and the fiscal gap created by it for quite some time.

The COVID-19 pandemic has also impacted the routine collection practices of local OSR in the SNGs, although to a varying extent. In-person visits of taxpayers were drastically reduced, which meant that in some SNGs, tax bills were not delivered, and payments were not followed up or collected. In other SNGs, taxpayers were encouraged to make their payments online or at the bank, and special purpose tellers were established to reduce wait times for taxpayers (see table 4, column 5 for details on each SNG). While some of these changes weakened collection practices and resulted in lower revenue yields, thus (presumably) remaining temporary, others contributed to modernizing the collection system (i.e. bank and online payments) and can be expected to be maintained in the future. Further measures undertaken by the SNGs to address the impact of the COVID-19 pandemic will be discussed in the subsequent section.

Table 4: Impact of COVID-19 on OSR

<table>
<thead>
<tr>
<th>SNG</th>
<th>Impact of COVID-19 on OSR</th>
<th>OSR sources most affected</th>
<th>OSR expected to recover</th>
<th>Effect of OSR collection practices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>OSR has dropped dramatically</td>
<td>Holding tax, water bill, trading license, immovable property tax, lease money from local hat bazar</td>
<td>In 2 to 3 years</td>
<td>Yes – no enforcement visits; interruption of internal monitoring procedures</td>
</tr>
<tr>
<td>(FY July-June)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>OSR has dropped a little</td>
<td>Lodging tax, fees for state government services, fines for late payment of tax</td>
<td>In the process of recovering</td>
<td>Yes – reduced hours of tax office; taxpayers are encouraged to pay online</td>
</tr>
<tr>
<td>(FY Jan-Dec)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>OSR has dropped dramatically</td>
<td>Business licenses, property taxes, local hotel taxes, market fees, rents</td>
<td>In 2 to 3 years</td>
<td>Yes – tax bills are not distributed; no enforcement visits</td>
</tr>
<tr>
<td>(FY July-June)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>OSR has dropped considerably</td>
<td>Market and parking fees, property rates, business operating licences</td>
<td>In next 12 months</td>
<td>Yes – taxpayers were encouraged to pay at the bank</td>
</tr>
<tr>
<td>(FY Jan-Dec)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2.4 Responses to Challenges

Given the challenges to the local fiscal and economic situation caused by the COVID-pandemic, the questionnaire also inquired into the SNG responses to the challenges, in particular what measures with regard to revenue collection were put in place. Here it was found that the SNGs were employing a range of different measures aimed at providing relief to struggling taxpayers. The most common measures were pushing back due dates for tax payments, agreeing with taxpayers on deferred payment schedules on a case-by-case basis, and relaxing enforcement in general (see table 5 for details on each SNG). All these measures, while accommodating taxpayers’ temporary inability to fully meet their tax obligations, entailed a relaxation of tax efforts, which resulted in lower OSR yields.

Table 5: Tax Measures to provide relief

| Measures to relax tax efforts with the aim of providing relief to struggling taxpayers |
|----------------------------------------|----------------------------------|-------------------------|-------------------|-----------------------------|-------------------------------|-----------------------------|
| SNG | Lowered tax and fee rates | Pushed back due dates for payment | Provided tax holiday | Relaxed enforcement | Waived penalty fees for late payment | Agreed on deferred payment schedule on case-by-case basis | Granted tax abatements on case-by-case basis | Other |
| Chandpur, BD | X | | X | | X | | X |
| Chiapas, MX | X | X | | | | | |
| Gulu, UG | X | | X | | | | X |
| Kumasi, GH | X | X | | X | | | |
| Telița, MD | | | | | | | |

At the same time, the questionnaire found that the SNGs were employing very few measures aimed at intensifying revenue collection efforts in an attempt to make up for experienced or
anticipated revenue shortfalls. The only measures reported by just two SNGs consisted of running media campaigns to strengthen taxpayer compliance, enlisting volunteers to support collection, and doubling down on enforcement in general. Chandpur granted rebates for taxpayers paying on time as an incentive (see table 6 for details on each SNG).

**Table 6: Tax measures to increase efforts**

<table>
<thead>
<tr>
<th>SNG</th>
<th>Increased tax and fee rates</th>
<th>Doubled down on enforcement</th>
<th>Requested overtime from existing revenue officers</th>
<th>Hired additional staff to support revenue officers</th>
<th>Enlisted volunteers to support collection</th>
<th>Conducted media campaign to enhance compliance</th>
<th>Imposed new taxes/fees</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rebate for timely payment</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gulu, UG</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Telita, MD</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The revenue collection measures adopted by the SNGs in response to the COVID-pandemic thus focus on providing relief to struggling taxpayers at the expense of local revenue yields. This can be interpreted as a SNG version of a countercyclical fiscal policy approach, which seeks to stimulate (or at least not further damage) the local economy by leaving more money in the hands of local economic actors. This does, however, at least in the short term, come at the price of considerably reduced local OSR yields and a contracted local fiscal space, especially during a time where new activities (e.g. within health protection) generated additional costs.

One way for the SNGs to gain a little breathing room within their contracted local fiscal space might be to divest municipal assets or take on debt to cover any revenue shortfalls or additional expenditures as a result of the pandemic. When asked about potential divestments to compensate for any expected or experienced revenue shortfalls due to COVID-19, the research revealed that none of the SNGs had sold or were planning on selling any of their municipal assets. The reasons for this ranged from some SNGs not owning any assets that might be appropriate to sell, to not being legally permitted to divest assets, to not needing any additional revenue (see table 7, column 3 and 4 for details on each SNG).
A similar pattern emerged with regard to taking on municipal debt. With the exception of one, none of the SNGs had taken or were considering taking on any type of loan to make up for the revenue shortfall caused by the pandemic. Here the reasons included the SNGs not considering this a feasible option, not being legally permitted to take loans for recurrent expenditures, or not needing the addition revenue. (see table 7, column 5 and 6 for details on each SNG). Only Kumasi reported considering taking on a loan from the domestic financial market in the near future to improve its financial situation in the short term.

This underlines again that the SNGs in this sample heavily rely on a combination of local own source revenue and intergovernmental fiscal transfers as their two main sources of local revenue, even in times of fiscal distress as currently experienced due to the COVID-19 pandemic. Divestures of municipal assets or municipal loans do not appear to provide feasible alternative revenue streams to these SNGs, even during emergency situations.

On the upside, all but one SNG also observed potentially taxable, new economic activities during the pandemic (see table 7, column 2 for details on each SNG). Chandpur, Chiapas and Kumasi for example observed an increase in online business and services. The SNGs will thus need to explore whether taxing those new economic activities will be feasible and productive for them and if so, find a way to bring them into the local tax net.

Table 7: Measures to generate other revenues

<table>
<thead>
<tr>
<th>SNG</th>
<th>Potentially taxable new economic activity observed?</th>
<th>Any sale of municipal assets in the past 12 months?</th>
<th>Any plans for future sales of municipal assets?</th>
<th>Any loans requested in the past 12 months?</th>
<th>Any plans for requesting future loans?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Yes – pharmacies; grocery shops; online business; IT/ internet/ mobile services</td>
<td>No – legally not permitted</td>
<td>No – legally not permitted</td>
<td>No – legally not permitted for recurrent expenditures</td>
<td>No – legally not permitted for recurrent expenditures</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Yes – construction of public works, online ordering of food delivery</td>
<td>No – additional revenue not needed</td>
<td>No – additional revenue not needed</td>
<td>No – additional revenue not needed</td>
<td>No – additional revenue not needed</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Yes – local production of liquid soap, sanitizers, hand washing equipment and masks</td>
<td>No – assets intended for different purpose</td>
<td>No – assets intended for different purpose</td>
<td>No – not a feasible option</td>
<td>No – not a feasible option</td>
</tr>
</tbody>
</table>
2.5 Takeaways, Tentative Recommendations and Possible Follow-Up

The present questionnaire exploring the impact of the COVID-19 pandemic on the fiscal and economic health of the SNGs in the sample has brought to light a number of interesting and useful insights that will help UNCDF and its partners provide adequate support to the SNGs in rebuilding their local fiscal space following the COVID-19 pandemic. With regard to local OSR, the core findings of the questionnaire are as follows:

Core findings

OSR as a revenue source is of varying importance to the SNGs. While for some of the SNGs in the sample, OSR constitutes half or more of their total revenue intake, for others, OSR plays only a minor role compared to large intergovernmental transfers from central government. This is important to keep in mind when thinking about prioritization and incentive setting of support activities.

The local own revenue sources tapped by the SNGs are fairly traditional local government revenue sources such as land and immovable property, local business activity, subnational government services, and others. So far, none of the SNGs levy taxes or fees on more modern sources, such as online business or new gig economy, although some think that there could be potential in this area.

The SNGs report having considerable untapped local revenue potential. This suggests that SNGs have the opportunity to increase their OSR yields by exploiting this untapped potential through the strengthening of their local revenue collection practices and the widening of their tax net. The SNGs have pointed to a number of weaknesses and challenges in their tax collection systems that should be addressed in order to allow them to exploit their revenue potential to a fuller extent.
The effect that the COVID-19 pandemic, or rather the measures taken to limit its spread have had on SNGs’ OSR yields is quite considerable. All SNGs reported a drop in their OSR yields, some of them describing this drop as dramatic. In the period from March to September 2020, they experienced a reduction between 23% and 87% compared to the average OSR yields collected in the same periods over the previous three years.

In their initial response to the pandemic, SNGs have focused on measures that relieve struggling local taxpayers as opposed to measures that reinforce revenue collection. This has restricted their ability to collect OSR further reducing their yields. This also affects their ability to strengthen service delivery in required areas, especially measures taken in response to the pandemic.

Even during times of fiscal distress, SNG rely heavily on local own source revenue and intergovernmental fiscal transfers (which will be discussed in the next section), as divesture of municipal assets or debt financing does not appear to be a feasible option for most of them.

*Tentative recommendations for future interventions and support*\(^3\)

Based on the results from the preliminary data collection, the following tentative recommendations for future interventions and support can be made to be further explored during phase II of the “Rebuilding Local Fiscal Space Initiative”.

**First**, it will be useful to further explore and quantify where possible the untapped local revenue potential of the SNGs, with a focus on those local own sources that have the greatest potential and/or whose potential can be most easily tapped. This will allow the SNGs to develop measures to help them exploit the most promising local own revenue sources to a fuller extent. This will also encompass a collection and sharing of good practices across the SNGs in each country.

**Second**, many of the SNGs report having observed economic activities, in particular in the area of online business and/or the new gig economy that are currently not being taxed but potentially could contribute to local own revenue. It might be useful for the SNGs to work out a strategy and approach on how to extract revenue yields from these new business activities, in particular where these new business activities make use of SNG services and infrastructure without contributing to their financing and maintenance. This will require are review of the activities, legal framework, possible intervention procedures, capacity and staffing requirements etc.

**Third**, as all SNGs report some weaknesses and challenges in their revenue collection practices prior to the start of the COVID-19 pandemic, and as with the onset of the pandemic, some of these practices further deteriorated, it might be useful to develop a strategy that will help the SNGs improve their revenue collection practices and systems so as to strengthen their OSR yields. This can range from updating and expanding taxpayer data bases, to further automating local revenue administration systems, to further encouraging bank or online payments and limiting other opportunities for revenue leakages.

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\(^3\) These will be further detailed in the Phase II of the Fiscal Space Intervention.
Fourth, it might be useful to strengthen taxpayer communication, education, and awareness raising with the aim to improve compliance and reach taxpayer segments currently not in the tax net. Here, the focus should be on local revenue sources with large untapped potential.

Fifth, in conjunction with recommendations presented in the section on LED, further review measures to stimulate LED to provide an enhanced tax base for further revenue tapping.
3. Factor 2: Loss of Intergovernmental Fiscal Transfers (IGFTs)\(^4\)

3.1 Introduction to the Factor

Intergovernmental fiscal transfers (IGFTs) constitute a fundamental part of subnational government (SNG) revenue. All countries have IGFTs to SNGs and hardly any SNGs around the world can function without some fiscal support from the central level/upper tier of government. This also goes for urban local governments (ULGs) or cities with better access to own source revenues than in the rural areas.

IGFTs are generally the most important source of revenue\(^5\) for SNGs and constitute on average more than 50 % of total SNG revenues in a review of 106 countries, and 46% in a review of high-income countries\(^6\). This covers a great variation from less than 5% in a few countries with relatively low levels, e.g. Jordan (1%), to the highest level in e.g. China with 85% and Indonesia with 78% as examples from Asia, and Kenya (89%), Rwanda (89%) and Tanzania (90%) from Africa\(^7\) with high level of transfers from central government. In several countries such as Indonesia, Philippines, Bhutan, Nepal, Cambodia, East Timor, Uganda, Kenya, Tanzania, Rwanda, and many others, the transfers to SNGs constitute more than 80% of the total SNG revenues, and the features of the systems are regularly discussed and reformed.

A recent OECD study of 106 countries (2019) also showed the importance of IGFTs, and that the share of grants and subsides in subnational revenue is below 25% of total SNG revenues in only 17 countries (including Iceland, Zimbabwe, Argentina and Jordan for the lowest) and above 80% in 14 countries (including Uganda, Peru, Malta, Mexico, Rwanda and Tanzania for the highest), see below.

However, as SNGs’ share of total public expenditures and of the GDP are low, the size of the grants are relatively small in most developing and middle income countries, which has resulted in numerous service delivery challenges as SNGs are typically responsible for most of core local services.

\(^4\) In some countries, this will be named “grants” or “subsidies” to subnational governments or just “transfers”. When not mentioned actual figures (outturns) are applied, not budgeted figures, which often varies greatly.


\(^7\) Data from Indonesia Public Expenditure Review, 2020, “Spending for Better Results”, 2020.
Graph 5: Grants & subsidies as a share of SNG revenue by income groups and geographical areas

This important finding has been confirmed by data from the five SNGs reviewed under the Fiscal Space Stock-take, where the IGFTs are amongst the most important sources of SNG revenues, see below. As a share of the total revenues in the pre-COVID-19 period, IGFTs constituted between 44% in Kumasi to 89% in Gulu Municipality, 90 % in Telita and 96 % in Chiapas State (transfers from the federal to the state level). These are all (except the state of Chiapas) urban governments, where own source revenues can be expected to be higher than in more rural areas.

Graph 6: Importance of IGFTs in the funding of SNGs (IGFT share of total SNG revenues)

IGFTs can be a potentially effective vehicle for governments to implement their COVID-19 response strategy. Yet during the crisis the fear from SNG’s may be that central governments...
would hold back these payments due to fiscal stress and, that there might be a risk that payments
would be further reduced in 2021 and/or that the intergovernmental fiscal transfer system might
not be non-conducive in terms of design or implementation arrangements to effectively respond
to the current challenges.

The survey reviewed the transfer systems before and after the start of COVID-19 in terms of their
core features such as size of transfers and various allocation features (predictability, timeliness
and formulas for allocations). It further explored whether countries have introduced new grants
to address the COVID-19 challenges and whether new SNG functions had been established to
mitigate these challenges. Finally, it reviewed possible interventions from the central as well as
the SNG level to improve the situation, and how the coordination across the tiers of government
has evolved.

3.2 Pre-COVID-19 IGFT System

The survey reviewed the size and the trends in transfers from the national/central level of
government to the SNG level, as well as a number of core features of the system. The graph below
shows the trends in relative importance of the IGFT in total SNG revenues.

Graph 7: Trends in Importance of the IGFT

The trends show that IGFT is having a stable or increasing trends in 4 out of the 5 SNG while in
Kumasi the share of OSR has been increasing over the past 3 years.
The per capita allocations varied greatly from only US$ 3 in Kumasi to US$ 949 in Chiapas (the only state in the survey)\(^8\), but also across the municipalities with Telita having the highest level at US$ 175 per capita.

In terms of nominal figures three of the five SNGs experienced an increase in transfers in the 3 years prior to COVID-19, whereas Kumasi observed a decline. The decline in transfers to Gulu Municipality (now established as City from July 1, 2020) was due to the late disbursement of the largest grant, the DDEG, which came in only during the FY 2020/21\(^9\), just after the period reviewed below.

Graph 8: Trends in per capita IGFTs (budgeted and actual) pre-COVID 19 (US$)

All the SNGs (except the state: Chiapas) reported that the IGFT system was not predictable, constituting a challenge for local planning and project execution. This was also confirmed by data submissions from all SNGs, where there are great differences between budgeted and actual allocations of transfers (often more than 30%) even prior to the start of the COVID-19 pandemic, see the graphs above. On the other hand, only one municipality (Telita) raised the issue of a lack of transparent criteria for the horizontal allocation across cities.

All the SNGs had a complex system of transfers with multiple streams such as non-sectoral block grants, recurrent grants and grants targeting cross-sectoral development, e.g. the Discretionary

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\(^8\) Most recent actual figures from financial statements.

\(^9\) Contrary to other grants the DDEG for municipalities can be severely delayed as it is performance-based and there have been delays in the annual performance assessments.
Equalization Development Grant (DDEG) for Gulu Municipality (now City), and the Annual Development Grant (ADP) in Chandpur Municipality, and some of the cities raised the issue that enhancement of SNG autonomy regarding grant utilization would improve efficiency.

The transfer systems in most of the SNGs are perceived to lack sufficient flexibility with a high level of funding being earmarked (non-discretionary) for particular sector services/activities leaving limited flexibility for SNGs to adjust these resources to the needs of local emergency response. Moreover, non-capital recurrent grants are usually only sufficient to cover payroll expenses, whereas operations and maintenance costs are often neglected, and with the strong focus on salary components in the funding system (see Section Expenditures).

The composition of grants varies greatly across the SNGs, from Gulu Municipality, Telita and Kumasi where significant components of the grants are for recurrent expenditures, to Chandpur where most of the allocations are targeted development projects, to Chiapas, where transfers are based on revenue sharing and funds are more flexible in terms of utilization (as a state). Gulu and Kumasi both are faced with very elaborate and complex transfer systems where each grant is clearly defined, with eligible expenditures, recurrent and development grants multisectoral as well as sector development grants, and with an earmarking of 10 – 15 grants (or windows) with defined eligible expenditures. Telita Municipality reported that it had 8 different transfer schemes, most of these linked to various sectors funds, energy, roads, social funds, etc. SNGs reported that increased flexibility in the use of funds would enable them to better respond to emerging challenges.

3.3 Challenges due to COVID-19

Contrary to expectations prior to the survey, only two out of the five SNGs reported a significant drop in transfers when comparing March 2020-September 2020 with the similar period March 2019-September 2019 prior to the COVID-19 impact, i.e. Chandpur (with a drop in one of the grants, the ADP, and some project specific grants), and Telita Municipality, which reported a general reduction in transfers during the pandemic, but where the exact figures were hard to establish due to the general lack of predictability and delays in allocations. Uganda experienced delays in the transfers of one grant, the road maintenance grant, due to COVID-19, but reported an overall increase. This overall increase was due to the late arrival of the development grant DDEG, which was transferred during the COVID-19 period (in September), and which more than off-set the decline in the road maintenance grant. Other SNGs were not impacted and continued to receive the same level of transfers with smaller modifications, see below.

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10 This is also supported by the UNCDF surveys leading to the COVID-19 Guidance Note, May 2020 Version, UNCDF 2020.
11 In the FY N-1.
12 Since the start of the IGFTS reform in Uganda in 2015, the grants have been significantly reduced from more than 30 different grants to current maximum 3 per sector, but still the system is comparably complex.
13 As this is a performance-based grants, and Gulu Municipality performed well, it received a larger allocation of the DDEG, and this was transferred in the FY after the start of COVID-19 (i.e. September 2020).
Table 8: Impact from COVID-19

<table>
<thead>
<tr>
<th>SNG</th>
<th>Increased costs of new functions*</th>
<th>Impact on size of the grants</th>
<th>Other impacts (e.g. allocation formulas, delays, etc.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>High</td>
<td>Yes - reduced significantly</td>
<td>No</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>High</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>High</td>
<td>No (mixed across grants)</td>
<td>One grant (the road maintenance grant) reduced (delayed), but another (the DDEG) was delayed from the previous FY and arrived during the COVID-19 impact period. Most of the new grants for COVID-19 only went to districts, not to urban LGs.</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>High</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Telita, MD</td>
<td>High</td>
<td>Yes – reduced but as grants are non-predictable, the figures are hard to establish.</td>
<td>Delays increased significantly for all transfers during COVID-19.</td>
</tr>
</tbody>
</table>

Source: Submissions from the five SNGs in October 2020. * Please cross refer to the Expenditure Section.

As it appears under Section 4 below, all SNGs have had significant additional costs due to the COVID-19 pandemic, but only a few have received support to address these from the central government. One municipality, Telita, has even experienced significant additional general delays in fund allocations and increasing challenges with the entire IGFT system, and similarly for Gulu with delays in the road fund allocations, whereas other SNGs already experienced these problems prior to the COVID-19 Pandemic.

3.4 Responses to Challenges

The responses to the COVID-19 pandemic have been both financial and non-financial. In terms of funding, although the mandate and costs for SNGs have expanded significantly, additional support has been limited. Four out of the five SNGs experienced new support from the central level. However, this was very limited compared to the overall operational grant system, see table 9 below.

New grants to cover additional costs were very small in all cases, typically around 0.2-0.4 % of total grants in the reviewed period, and not above 1.6 % of total grants from March-September 2020 in any of the five SNGs, see below. These new grants were typically earmarked for specific health activities such as protection equipment, e.g. face masks, and awareness raising, i.e. not for a general support across sectors.
Table 9: Overview of new transfers to address COVID-19

<table>
<thead>
<tr>
<th>SNG</th>
<th>New Grants</th>
<th>Size US$</th>
<th>Size of new grants compared to total transfers*</th>
<th>Expected areas for use of the grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Yes</td>
<td>14,000</td>
<td>1.6 %</td>
<td>Specific recurrent costs: Distribution of health, hygiene and safety material and equipment, awareness raising</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Yes</td>
<td>9,961,548</td>
<td>0.4 %</td>
<td>Assistance within health care, but limited compared to the total grants</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Yes</td>
<td>15,000</td>
<td>0.2 %</td>
<td>Very small for the recurrent additional costs of reopening primary and secondary schools</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>Yes</td>
<td>3,400</td>
<td>0.3%</td>
<td>Recurrent health related items directly related to the COVID-19 pandemic (protection, awareness raising etc.)</td>
</tr>
<tr>
<td>Telita, MD</td>
<td>No</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: Submissions from the 5 SNGs in October 2020.

*New grants for COVID-19 are compared to the total transfers in the same period, i.e. from March - September 2020.

Generally, most of the SNGs have been consulted during the COVID-19 pandemic on the challenges and ways to react. However, the SNGs reported that this consultation should have been more comprehensive, with SNGs having more influence over the policies and strategic responses by the upper tier of government, see below.

Table 10: Reactions to COVID-19

<table>
<thead>
<tr>
<th>SNG</th>
<th>Involvement of SNGs in dialogue with CG?</th>
<th>SNG changes and reactions in transfer system due to COVID-19?</th>
<th>SNG recommendations to central government</th>
<th>Recommended future SNG actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Yes - some hearings between CG and SNGs</td>
<td>Yes - Some reprioritization of expenditures.</td>
<td>Increase size of IGFTs to address COVID-19 &amp; provide more autonomy on grants.</td>
<td>Timely reporting on expenditures of transfers; proper adherence with procurement rules; continue reporting through use of new accounting tool to the Ministry of Finance; advocacy &amp; piloting of new OSR sources to attract grants for capital investment</td>
</tr>
<tr>
<td></td>
<td>The Mayor of Chandpur Municipality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>communicated several times with the national government ministry/departments through virtual meetings. Chandpur has issued an official letter regarding financial support.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SNG</td>
<td>Involvement of SNGs in dialogue with CG?</td>
<td>SNG changes and reactions in transfer system due to COVID-19?</td>
<td>SNG recommendations to central government</td>
<td>Recommended future SNG actions</td>
</tr>
<tr>
<td>----------------</td>
<td>----------------------------------------</td>
<td>---------------------------------------------------------------</td>
<td>------------------------------------------</td>
<td>---------------------------------------------------------------------</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Yes - Strong coordination with the Institute of Public Health through State Committee</td>
<td>Yes - Reprioritization of expenditures</td>
<td>Reallocation of resources to new priorities for COVID-19</td>
<td>Increase the collection of revenues that serve as variables in the distribution formulas for shares and contributions</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>No - This has been a great challenge. Districts have been involved, but urban LGs have not been sufficiently consulted.</td>
<td>Yes - To some extent through reduction in costs and reprioritization.</td>
<td>Increase size of health grants and improve coordination. Involve SNGs in dialogue.</td>
<td>Provide intervention and prepare for handling of eventualities and disasters</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>Yes - Assembly has engaged some sector ministries for support</td>
<td>Yes - shift from capital to recurrent funding and reprioritization.</td>
<td>Increase size of transfers and improve predictability</td>
<td>Continue with stronger prioritization of expenditures</td>
</tr>
<tr>
<td>Teliţa, MD</td>
<td>Some - Despite requests from SNG, no additional funding or genuine dialogue</td>
<td>Yes - Priority investments in health and anti-COVID-19 measures, and priorities.</td>
<td>Involve SNGs in coordination and improve the size of grants and functioning of the IGFT system</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: Submissions from the five SNGs in October 2020.

3.5 Takeaways, Tentative Recommendations and Possible Follow-Up

As a recent OECD survey observed, there are typically three phases of importance for reviews and understanding of the COVID 19 situation, its impact and the way forward: 1) Actions related to preparedness, 2) actions for the emergency phase, 3) actions in support of economic recovery & rebuilding fiscal space. The responses from the five SNGs shows that the five SNGs and the national/federal governments are in the middle of the emergency phase, which shape their policy responses and recommendations addressing the immediate concerns to improve response effectively when it comes to the IGFT.

The review of the challenges, the impact of COVID-19, and reactions from SNGs and Central government level offered a number of lessons learned and recommendations for the future IGFT systems.

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Core findings

Some of the core findings from the review of the IGFTs before and during COVID-19 are that the challenges within the current IGFTs were further exacerbated during the crisis. However, the responses to the new challenges have been insufficient to ensure a robust impact. SNG efforts on savings and reprioritization, although contributing to some short term fiscal “breathing” space, will not be sufficient in the future, nor is it (as standing alone) a sustainable approach in the future.

Generally, the survey shows that has been:

- Limited extra support to tackle the significantly increased SNG costs of COVID-19;
- Lack of coordination across tiers of government;
- Significant earmarking of funding and lack of flexibility, which also impacts on the SNG options to react effectively;
- Non-predictable transfers e.g. delays in funding flows, and great variation between budgeted and actual transfers in most SNGs.

Tentative recommendations for future inventions and support\textsuperscript{15}

**First**, there is a need to review, plan and predict the additional costs of SNG interventions needed in response to the COVID-19 pandemic and prepare for future similar challenges/disasters/pandemics. As seen from the review of additional costs (See Section XX) these are significant, but not properly measured and defined, nor fully financed, and the new mandates have been handled haphazardly.

**Second**, there is a need to address the extra costs with a flexible and well-developed system for transferring additional resources to address the new interventions and emergency situations. As mentioned, the IGFTs reviewed by the survey did not respond sufficiently to the new challenges; new grants were small with a lack of systems and procedures to manage them. This situation is in obvious contradiction with an effective epidemic response which, according to recent UNCDF reviews from March – May 2020\textsuperscript{16}, requires: (i) a sector-wide approach, which implies reallocation of funding between various sectors; and (ii) increased non-capital expenditures for community awareness and mobilization, enforcement of public order and restructuring of public service delivery to ensure its continuity and health responses. In many countries, the legal framework provides for local disaster risk management. However, these frameworks have often not been given adequate fiscal attention – and where this is the case, the funds require complex procedures to unlock every time, rather than allowing for an immediate liquidity response with predetermined procedures.

\textsuperscript{15} These will be further detailed in the Phase II of the Fiscal Space Intervention.

\textsuperscript{16} UNCDF, COVID-19 guidance note, May 2020. Part of these is drawn from the guidance note, which findings are supported by our Survey.
There is a need to improve the size of the IGFTs and make necessary adjustments for situations like the pandemic, but also a need to improve the predictability and timeliness of transfers, to develop clear formulas for allocation with sufficient levels of flexibility/autonomy. The development of additional, targeted grants to address new mandates is urgently required to improve fiscal space and room for an effective SNG response. These new schemes should be flexible, non-sectoral and focusing on recurrent cost implications, especially in the emergency phase.

The suggestions in a recent UNCDF COVID-19 guidance note on how to improve the funding system in general, are supported by the findings in the Fiscal Space Survey in the five SNGs. According to this note, as an immediate response to COVID-19 it is recommended – if not already in place - to establish a kind of “Operational Expenditure Block Grants (OEBGs) and a SME economic recovery support mechanism”, customized to local circumstances and which can be calibrated in an effective way for SNGs to accelerate the COVID-19 response in a timely manner and in accordance with the stage of the epidemic in the locality. This “OEBG” is a specific type of intergovernmental fiscal transfer that can be a useful and effective vehicle for governments to implement their COVID-19 response strategies. The advantage of an OEBG is that it combines the most effective elements of the discretionary capital grant and the discretionary recurrent grant. The resources are not drawn from the recurrent budget for human resources and basic operating expenditures; instead, they are drawn from other funds and use the modality of the development budget (or capital budget or local development fund approach) as appropriate, focusing on the immediate new responsibilities to address the COVID-19 pandemic and similar crises. It uses several of the typical features from typical local development funds but targets the immediate recurrent cost implications.

In most countries, also seen from the Fiscal Space Survey in the five countries, there are at least one of the four existing channels that can be activated:

1. Discretionary recurrent expenditure grants and transfers to local governments usually applied to salaries, travel costs, goods and services.

The advantage of this channel is that it is available across all local government departments at the discretion of local leadership. These grants can be increased and re-purposed as COVID-19 operational response grants to implement local protocols. Reporting can be through existing channels, with supervision provided by the relevant health authority. Procurement of goods and services is accomplished through existing mechanisms, with increased delegation of authority or ceilings for local procurement where appropriate. Increased value to these transfers will enable co-financing with the next category below for additional effectiveness. E.g. in Uganda this would

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17 UNCDF guidance note, COVID-19 guidance edition 4, UNCDF, May 2020. OEBG was first piloted for general recurrent costs in Lao PDR, but has been increasingly used for COVID-19 challenges in a number of countries, e.g. in some SNGs in Uganda, but still needs to be institutionalized as a country wide system for combating issues such as COVID-19.
be through a top up of the unconditional grants, the non-wage component, and in e.g. Ghana through a top-up op of the DACF/RFG.

II. Conditional grants to local education and health departments by central ministries.
This should be a key vehicle for the response – not only for national fiscal resources but also for additional resources received as part of international relief efforts. In e.g. Uganda, this would be through augmenting in the short to medium term the recurrent health grants to respond to the COVID-19 challenges, and in other countries it would be through a top up of specific sector funding (e.g. Chiapas and Telita).

III. Discretionary capital grants to local governments.
These funds provide less scope for an immediate response in the next few months, as they depend on construction and procurement cycles. Nevertheless, this emergency provides a case for them to be reapplied to the purchase of medical equipment, vehicles and other capital expenditure items eligible ‘within the chart of accounts and public expenditure classifications for capital expenditure. Procurement could be expedited. It would be important for local governments to be reimbursed later for this immediate response, to avoid interrupting ongoing capital projects. One advantage of this approach is that many capital projects will have halted due to social distancing and other measures; therefore, some liquidity may exist. In e.g. Bangladesh (Chandpur), this could happen through a top-up of the current ADP grants, in Ghana through the top-up of the DACF/RGF grants and in Uganda through a top-up of the Discretionary Development Equalization grant (DDEG). This may also help supporting employment generating initiatives. In the later phases of the response, this will be important to boost the general economic development and create employment.

IV. Re-purposing the disaster risk management fund to support the COVID-19 response.
Several countries have provisions for a disaster risk response fund18. However, in many countries, these have never been operationalized or are fully administered from the central governments. These funds could be quickly recapitalized and transferred to SNGs to support their response plans. In the SNG review, this was not seen as an operational instrument but could be initiated to respond to future pandemics. Or if not already established, work could be initiated to build up the capacity.

Third, there is a need to involve SNG more in intergovernmental fiscal coordination and the design and critical features of implementation, and in developing fiscal tools to combat the funding challenges imposed by COVID-19. SNGs cannot fix the magnitude of the challenge on their own and the central government need to insights and knowledge from SNG in their response plans. Recovery from the crisis should be a shared responsibility across all levels of government.

Fourth, the general challenges within the IGFTs observed in most of the SNGs in the survey need to be addressed, to strengthen the flow of funds and their timeliness and predictability, improve

18 E.g. Bhutan, Solomon Islands and Jamaica.
SNG autonomy, reduce transaction costs, as well as to improve allocation formulas (targeting the particular needs of vulnerable groups) and incentives through performance-based allocations\textsuperscript{19}. The importance of these core conducive features has been further emphasized in time of a crises.

\textbf{Fifth,} within use of these tools, it is important that where ever possible, development partners should coordinate with the country agencies, build on their local knowledge and operational capacity, to the extent possible use existing flow of fund mechanism, and support improvement of these, while avoiding setting up of parallel and non-sustainable systems.

The above recommendations as well as the longer-term efforts, will be further reviewed during Phase II of the initiative.

\textsuperscript{19} Examples of these are the performance-based DDEG in Uganda and the performance-based window in the DACF, the RFG in Ghana.
4. Factor 3: Loss of Local Economic Activity

4.1 Introduction to the Factor

Local fiscal space is not just about taxes, fees and transfers. It is also about local economic development and jobs, about creating a conducive environment for local business activity, and about fostering the kind of economic growth that adds value to a local economy and development. The pandemic has both highlighted the risks of growth without local economic development and accelerated the challenges of SNGs in interacting with new business activities such as online platforms and the “new gig economy”. The results of this preliminary study help determine how far this has gone and what can be done to mitigate these risks and address future challenges to SNGs.

4.2 Current LED system with focus on features before COVID-19

Before the COVID-19 pandemic, all the SNGs in the sample had a fairly diverse economy with business activities taking place across the sectors of agriculture, light manufacturing, and traditional service industry. Details on the main local economic activities in each SNG can be found in Table 11, column 2. Only Gulu indicated having some economic activities in the modern service industry sector, such as online business or the ‘new gig economy’. The local economies of the SNGs also appear to be fairly integrated with areas outside of their jurisdictions. All of them were reported to serve local and regional markets, while Chiapas, Gulu and Kumasi indicated serving also national and even global markets.

In terms of generating employment, the agriculture sector, by some SNGs referred to as the primary sector, varied greatly in importance across SNGs. While for some SNGs such as Chandpur and Gulu, around 50% of the workforce was employed in the agricultural sector, in Kumasi, this share was as low as 3%. Light manufacturing was reported to employ at least between 10% and 32% of the workforce, while the service sector appeared to feature quite prominently in terms of employment across all SNGs ranging from at least 15% in Gulu to 50% or more in Chiapas and Kumasi (see table 11, column 5 for more details on each SNG).

Table 11: Main local economic activities

<table>
<thead>
<tr>
<th>SNG</th>
<th>Main local economic activities</th>
<th>Main local economic sectors</th>
<th>Markets served by sectors</th>
<th>Share of local workforce employed by economic sector/activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Agriculture, fisheries, poultry production, rice milling, jute milling, brick manufacturing, service sector</td>
<td>Agriculture Light manufacturing (conventional) Service industry (traditional)</td>
<td>Local Regional</td>
<td>Agriculture: 46% Light manufacturing: 32% Service industry: 22%</td>
</tr>
</tbody>
</table>
### Table 1: Main Local Economic Activities and Sectors

<table>
<thead>
<tr>
<th>SNG</th>
<th>Main local economic activities</th>
<th>Main local economic sectors</th>
<th>Markets served by sectors</th>
<th>Share of local workforce employed by economic sector/activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chiapas, MX</td>
<td>Agriculture, livestock and fishing, manufacturing, construction, mining, trade, services</td>
<td>Agriculture Light manufacturing (conventional) Service industry (traditional)</td>
<td>Local Regional National Global</td>
<td>Primary sector: 31% Secondary sector: 19% Tertiary sector: 50%</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Agriculture, grain milling, food oil and food processing, bakeries and catering services, telecommunication, education (private), health (private), hospitality services, banking, carpentry, welding, construction</td>
<td>Agriculture Light manufacturing (conventional) Service industry (traditional)</td>
<td>Local Regional National Global</td>
<td>Agriculture: 50+% Light industry: 5% Light manufacturing: 10% Service industry: 15%</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>Agriculture, forestry &amp; fishing, manufacturing &amp; repairs, transportation &amp; storage, wholesale &amp; retailing, hospitality &amp; service industry</td>
<td>Agriculture Light manufacturing (conventional) Service industry (traditional)</td>
<td>Local Regional National Global</td>
<td>Agriculture: 3% Manufacturing: 14% Wholesale: 38% Transportation: 5% hospitality: 8%</td>
</tr>
<tr>
<td>Teliţa, MD</td>
<td>Agriculture, trade services, transport service, IT services, extractive industry (quarries)</td>
<td>Agriculture Light manufacturing (conventional) Service industry (traditional)</td>
<td>Local Regional</td>
<td>No information available</td>
</tr>
</tbody>
</table>

In terms of the role in local economic development that the SNGs played before the onset of the COVID pandemic, the present study revealed an interesting dichotomy in the SNGs’ understanding of their role. Two of SNGs, i.e. Chandpur and Gulu, appeared to understand their role predominantly as providing business-friendly local infrastructure, such as roads, water, street lighting, waste management, providing the necessary physical framework conditions for local businesses to function effectively. The other three SNGs, in particular Chiapas and Telita seem to have taken a much more interventionist approach in shaping the local economy in their municipality (or state) though local investment plans, strategic support to LED projects, incentive schemes to attract investors etc. Some of the LED activities targeting specific sectors or sub-groups within the local business community range from developing strategies to promote tourism, to organizing training programmes for small and medium enterprises (see table 12 for more detail on each SNG).
Table 12: SNG role in LED

<table>
<thead>
<tr>
<th>SNG</th>
<th>SNG role in LED</th>
<th>Activities targeting specific sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Development of roads &amp; communication, business infrastructure and drainage infra-structure; street lighting; waste management</td>
<td>None</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Support of strategic investment projects; attracting investors; facilitate access to finance; develop promotion strategy for local businesses; strengthen employability of workforce</td>
<td>Numerous projects promoting LED</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Infrastructure provision, e.g. streetlights; engagement with business community; business taxpayer convenience, e.g. bank teller for tax payment</td>
<td>Media campaigns to sensitize business on one-stop center</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>Partner with private sector to fully harness economic potential of the city</td>
<td>Training programmes for SMEs</td>
</tr>
<tr>
<td>Teliţa, MD</td>
<td>Prioritization of local development sectors, elaboration of local investment plan and programs, attracting investors</td>
<td>Construction of industrial park; tourism strategy</td>
</tr>
</tbody>
</table>

4.3 Challenges due to COVID-19

In terms of the challenges to the local economy caused by COVID-19, the SNGs reported that the pandemic, through the measures taken to limit its spread, had considerably impacted local business activities, by way of business closures and limiting operations to ensure social distancing, resulting in job loss for business owners and employees, and interruptions in the transport system. The sectors that were hit the hardest by the pandemic were retail and other trading, food production and catering, hospitality and tourism, and transportation (see table 13, column 2 for more detail on each SNG). Some but not all SNGs, i.e. Chandpur, Gulu, and Telita also reported supply shortages, for example of fresh food products from producers to markets due to a lack of transportation into the cities, affecting the provision of foodstuffs to the wider local population.

All SNGs however reported that despite a dramatic impact on business operations in the early days of the pandemic, by the time of the research in October 2020, local economic activities had resumed. However, it should be noted that the SNGs’ expectations regarding the recovery of OSR collection (as presented in section 2 on OSR) suggest that local business activities are currently nowhere near pre-COVID-19 levels and will take some time to fully recover. Also, subsequent waves of the pandemic could reverse the initial steps towards recovery. On the upside, the fact that only two of the SNGs reported that some few economic activities had to be abandoned permanently due to COVID-19, while the majority of the SNGs report this not being the case (see
Table 13: COVID-19 impact on local economy

<table>
<thead>
<tr>
<th>SNG</th>
<th>COVID-19 impact on local economy and most affected sectors</th>
<th>Supply shortages</th>
<th>Local economic activities expected to resume</th>
<th>Any activities permanently abandoned</th>
<th>Growth of online business/new gig economy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Yes – Agriculture; food &amp; garment production; transportation; hospitality &amp; tourism; salons</td>
<td>Yes – supply shortages for certain economic activities</td>
<td>Have already resumed</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Yes – Catering; manufacturing; housing &amp; real estate; equipment rental services</td>
<td>No</td>
<td>Have already resumed</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Yes – Hotel and hospitality sector; transport sector; health sector other than COVID related</td>
<td>Yes – transport of agricultural products was interrupted resulting in food shortages</td>
<td>Have already resumed</td>
<td>Bars, gyms</td>
<td>Yes, but extent unknown</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>Yes – Hospitality &amp; service; wholesale &amp; retailing; transportation &amp; storage</td>
<td>No</td>
<td>Have already resumed</td>
<td>No</td>
<td>Yes, but extent unknown</td>
</tr>
<tr>
<td>Teliţa, MD</td>
<td>Yes – Trade, transport, manufacturing industry</td>
<td>Yes – supply shortages of food and other goods in the markets due to suspension of transport systems.</td>
<td>Have already resumed</td>
<td>Hospitality services</td>
<td>No</td>
</tr>
</tbody>
</table>

Regarding the impact of COVID-19 on the local employment situation, all SNGs reported observing substantial layoffs within their jurisdiction. The economic activities most affected by job loss were diverse, including retail, hospitality and tourism, services and transportation. Chiapas also reported layoffs in the farming and livestock sectors, and Gulu reported a high number of jobs being lost in private education services (see table 14, column 2 for more detail).
on each SNG). According to the SNGs, many of workers who lost their jobs due to the pandemic were pushed into the informal sector resulting in substantive growth of the sector over the course of the pandemic. In Gulu for example, around 40% of workers formerly employed as private teachers sought to make a living by becoming street and market vendors. In Telita, a considerable share of the recently unemployed were absorbed by the agricultural sector on seasonal contracts (see table 14, column 3 for more detail on each SNG). This shows that while at least part of the laid off workforce might have been able to find alternative employment elsewhere even while the pandemic was still going on, the new jobs were on average considerably more precarious, increasing vulnerability within the workforce.

The extent to which laid-off workers moved out of the jurisdiction of the SNGs to find employment elsewhere appears not to be well understood until now. Chiapas reported having some evidence of workers from within the state migrating to the United States during the pandemic. Telita assumed that about 10 to 15% of the laid-off workforce has sought employment outside the municipality. The other SNGs have no information on whether employment-related outmigration is happening or to what extent.

Table 14: COVID 19 impact on local jobs

<table>
<thead>
<tr>
<th>SNG</th>
<th>Economic activities most affected by job loss</th>
<th>Laid-off workers absorbed by other sectors</th>
<th>Laid-off workers moved to find employment outside the SNG’s jurisdiction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Clothing shops; hair and beauty salons; hospitality &amp; tourism; services; transportation</td>
<td>No information available</td>
<td>No information available</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Farming &amp; livestock; trade; businesses; home services; Processing industry</td>
<td>Absorbed by the informal sector which has grown exponentially</td>
<td>Some evidence of workers migrating to the US</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Private education sector; bars</td>
<td>40% of private teachers absorbed by informal sector</td>
<td>Some, but extent unknown</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>Hospitality &amp; service; wholesale &amp; retailing; transportation &amp; storage</td>
<td>No information available</td>
<td>No information available</td>
</tr>
<tr>
<td>Telita, MD</td>
<td>Tourism</td>
<td>Absorbed by agriculture sector on seasonal contracts</td>
<td>10-15%</td>
</tr>
</tbody>
</table>
4.4 Responses to Challenges

In terms of responses of SNGs to the impact of COVID-19 on the local economy, the research found that some but not all SNGs were undertaking initiatives to mitigate the impact of the pandemic on the local business community and the local workforce. These initiatives consisted primarily of ensuring that local businesses could continue to operate despite the pandemic by distributing safety equipment and installing hand-washing facilities, expanding market areas so as to allow for social distancing, and providing or facilitating access to financial support for local businesses or people in need (see table 15, column 2 for more detail on each SNG).

Some SNGs also undertook initiatives to prevent the layoff of workers or, to get laid-off workers back into employment. These initiatives ranged from encouraging the business community to refrain from laying off workers or to rehire them at the earliest possible moment such as in Chandpur, to providing financial and legal support to laid-off workers and to additional online services to job seekers as in Chiapas (see table 15, column 3 and 4 for more detail on each SNG).

Some SNGs also supported initiatives to help laid-off workers in other ways, such as assisting in the distribution of cash and in-kind transfers provided by the central government, to organizing trainings for skills development to creating opportunities for short-term income generation as a way to tide over periods of unemployment (see table 15, column 5 for more detail on each SNG).

Table 15: Initiatives to improve local employment

<table>
<thead>
<tr>
<th>SNG</th>
<th>Initiatives to mitigate COVID-19 impact on LED</th>
<th>Initiatives to prevent layoff of workers</th>
<th>Initiatives to get laid-off workers back into jobs</th>
<th>Initiatives to help laid-off workers in any other way</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Safety equipment distribution; Support cash &amp; in-kind transfers to the poor</td>
<td>Encourage business owners not to lay-off workers</td>
<td>Reaching out to businesses to (re)hire laid-off workers</td>
<td>Support cash &amp; in-kind transfers</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Facilitate access to finance for SMEs; financial support and training for businesses</td>
<td>Financial support; legal support to laid-off workers</td>
<td>Additional online services for job seekers</td>
<td>Training for skills development</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Expansion of market areas to facilitate social distancing; hand washing; promotion of sanitation rules</td>
<td>No information available</td>
<td>Expansion of market areas</td>
<td>None</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>None</td>
<td>None</td>
<td>Trainings for SMEs</td>
<td>None</td>
</tr>
<tr>
<td>Telița, MD</td>
<td>None</td>
<td>Maintained full employment by commune</td>
<td>None</td>
<td>Income generation opportunities from sale of donated rummage</td>
</tr>
</tbody>
</table>
With regards to promoting COVID-19 compatible economic activities, only Chiapas implemented an initiative to this end. This initiative consisted of connecting local producers with online sales platforms such as Amazon and others, to help them market and sell their products online to a global customer base. However, all but one SNG reported undertaking a number of investments to build productive infrastructure for fostering local economic development and generating new OSR. Many of the investments revolve around building or expanding marketplaces to allow for more space to open businesses. Other infrastructure investments aim at facilitating transportation of goods and customers into and out of the locality (see table 16, column 2 and 3 for more detail on each SNG). It should be noted, however, that the decline in OSR has limited the ability of SNGs to make investments and support LED more generally, which might provide an explanation as to why SNGs have not engaged in more countercyclical spending to this point.

Finally, in terms of strengthening the role of SNG in fostering LED post-pandemic, some of the SNGs seem open to exploring innovative approaches in terms of creating new partnerships e.g. with the private sector or neighboring jurisdictions, and in terms of adopting a stronger service orientation vis-à-vis the business community, e.g. by setting up one-stop centers for business services (see table 16, column 4 for more detail on each SNG).

### Table 16: Initiatives to foster LED

<table>
<thead>
<tr>
<th>SNG</th>
<th>Initiatives to promote COVID-compatible economic activities</th>
<th>Investments to foster LED and generate OSR</th>
<th>Strengthening role of SNGs in LED in the future</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>None</td>
<td>Market complex and housing project; Waste-to-energy infrastructure development project</td>
<td>Provide business-friendly infrastructure; business facilitation services</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Connecting local producers with digital sale platforms, e.g. Amazon, etc.</td>
<td>Numerous investments projects, e.g. new port terminal</td>
<td>Partner with other states to promote regional economic development</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>None</td>
<td>Permanent expansion of markets accommodating more vendors</td>
<td>Attract funding to set up LED programmes</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>None</td>
<td>Construction of new markets and multi-purpose car park</td>
<td>Strengthen collaboration with private sector; Provide infrastructure</td>
</tr>
<tr>
<td>Telița, MD</td>
<td>None</td>
<td>No information available</td>
<td>Reducing bureaucracy (one-stop shop services); support creation of online business</td>
</tr>
</tbody>
</table>
4.5 Tentative Recommendations and Possible Follow-Up

The present research has brought to light a number of interesting and useful insights on the impact of COVID-19 on the local economy of the SNGs in the sample, as well as on the measures taken by the SNGs to mitigate this impact. The main findings and insights can be summarized as follows:

Core findings

Before the onset of the pandemic, all SNGs in the sample had fairly diverse, well integrated economies with business activities in a wide range of sectors serving markets locally, regionally, nationally and globally. In support of the local economy and local economic development, SNGs are found to have adopted two types of approaches: one approach focusing primarily on creating a business-friendly environment; the other somewhat more interventionist approach seeking to influence private investment and actively promoting selected business sectors.

The COVID-19 pandemic has had a significant impact on the local economies of all SNGs in the sample through the various measures and restrictions put in place to limit the spread of the virus. In all SNGs, a wide range of different business sectors were affected, and supply chains were interrupted resulting in supply shortages of certain goods and services. During the pandemic, many workers lost their employment and were pushed into taking up jobs in the informal sector, increasing their vulnerability. At the time of writing, many of the local business activities have resumed, and local economic recovery is under way, but will take some time to return to pre-pandemic levels, and the fiscal space will be impacted by these trends in the years to come.

As an immediate response to the effects of the pandemic on the local economy, the SNGs implemented numerous initiatives to mitigate the impact of COVID-19 on local business activities and to provide relief and support to laid-off workers. Taking a more strategic perspective, the SNGs also engaged in quite a number of infrastructure investments and explored innovative approaches to rebuild and strengthen local economic development and secure sources of OSR in the long-term.

Tentative recommendations for future interventions and support

Based on the findings outlined above, the following tentative recommendations for future interventions and support can be made to be further explored during phase II of the Rebuilding Local Fiscal Space Project.

First, SNGs should continue to work towards providing a general enabling environment for local businesses, both in terms of the physical environment, as well as in terms of improving the ease of doing business, e.g. by speeding up licensing procedures, and providing business training to SMEs.

20 These will be further detailed in the Phase II of the Fiscal Space Intervention.
Second, it will be useful for SNGs to strengthen continuous communication and collaboration with the local business community. Here it will be important not to treat the local business community as a black box, but rather to identify the different sub-groups (e.g. by size, or business sector) and tailor the engagement with them to their specific characteristics and needs. This will ensure that not only the most influential local business elites are being heard and that each sub-group is being supported in the most appropriate way.

Third, for some of the SNGs, it might be useful to consider taking more interventionist and/or innovative approaches to promote developing certain, strategically important business sectors in their locality including focusing on a more strategic physical planning, land management, strategic investments, etc. Here, they could learn from other SNGs with some experience in this regard. These approaches could be developed in collaboration with relevant actors from the local business community and be articulated in a LED strategy that could be used to communicate the approaches to potential partners and attract funding.

Fourth, it could be useful to strengthen the understanding of SNGs of the structure of their local workforce and fill some of the information gaps regarding their movements due to the pandemic. This would allow the SNGs to develop a strategy to help laid-off workers get back into stable employment and reduce their vulnerability. Here it will be important to collaborate with central government institutions, business associations and training centers to ensure existing mandates are respected and appropriate support is provided by the stakeholder most suitable do to so.

Fifth, it will be important to distill and document lessons learnt together with the local business community on what measures and initiatives did and did not work in response to the COVID-19 pandemic. These lessons learnt should feed into the preparation (or update) of a local crisis response plan to allow the SNG to react swiftly and appropriately to any future pandemics or similar crises.
5. Factor 4: Changes in SNG Expenditure Levels and Composition

5.1 Introduction to the Factor

As SNGs play an important role in the COVID-19 response at the local level, the prior expectation was that the pandemic would have an impact on the level and composition of SNG expenditures, and that the pandemic would contribute to the shrinking of the fiscal space because the response to it generated additional expenditures related to the health care system, new costs of prevention, protection, logistical challenges due to the restriction of movements, awareness raising, etc.

As mentioned in the COVID-19 guidance notes by UNCDF (May 2020), SNGs are uniquely positioned to shape, adapt and deliver a holistic response to epidemics. Since an epidemic produces multifaceted socioeconomic effects that threaten the very social, governance and economic fabric, it requires a cohesive response across sector boundaries to ensure alignment and synergies between different sector interventions in a particular locality. As COVID-19 is spreading through cities around the world, with devastating impacts on local communities and the wellbeing of residents, many SNGs are at the frontline of combating the outbreak. While most national governments were taking the lead to minimize the spread of the virus, cities in many countries play an important role to complement responses to COVID-19 policy challenges on the ground. In many countries, studies\(^{21}\) show that the role of SNGs has been two-fold:

- On the one hand, SNGs have acted as **implementation vehicles of nation-wide measures** such as the local support to and enforcement of the confinement measures, thanks to their resources and capacity (i.e. municipal police) or their local prerogatives (i.e. closure of public parks and gardens).
- On the other hand, SNGs have been **spearheading more bottom-up, innovative responses** while resorting to technology or other resources and building on their unique proximity to citizens.

As the preset Fiscal Space Survey was conducted at the early stage of the COVID-19 response, it was expected that the new mandates and activities related with COVID-19 interventions, combined with austerity measures and savings in other areas, would be among the responses. SNGs in many countries have taken stock of available resources and revised the cash budget for the subsequent quarters. The most common approach, according to the recent UNCDF guidance note from May 2020, has been to move resources earmarked for capital expenditure to operational expenditure; this does not add resources but redeploy what is available. It is an action within the control of local governments that only requires policy direction from central government about the kinds of already budgeted resources that can be redeployed. Such guidance is necessary because some local governments may be overly cautious and might wait

for transfers, while others may over-react and deploy resources earmarked for critical payments such as salaries to buy sanitizing equipment. (UNCDF, May 2020).

Similarly, a recent OECD survey of a larger number of SNGs in OECD countries showed that city policy responses in the early stages of the lockdown focused on the interventions outlined in the figure below:

**Figure 1: SNGs responses to COVID-19 in OECD countries**

![Figure 1: SNGs responses to COVID-19 in OECD countries](source)


The current “Rebuilding Local Fiscal Space Initiative Fiscal Space” exercise reviewed the impact of COVID 19 on the SNG expenditures in the five SNGs, and the response of these SNGs as well as their interactions with the central government level.

### 5.2 Current System of SNG Expenditures with Focus on Features Before COVID-19

The table below shows the overall SNG expenditure patterns prior to the COVID-19 impact with focus on the areas relevant for the response to the pandemic.
Table 17: Overview of the SNG expenditures and trends prior to the COVID-19 pandemic

<table>
<thead>
<tr>
<th>SNG</th>
<th>Expenditure per capita (US$) (Fiscal Year N-1)</th>
<th>Expenditure composition (recurrent/development) in % (Fiscal Year N-1)</th>
<th>Total trends in Expenditures over 3 FYs (%)</th>
<th>Expenditure assignments related to COVID-19?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>35</td>
<td>49% / 51%</td>
<td>Increase (but great variations in composition over time)</td>
<td>Yes - multiple, e.g. health, preparedness, safety measures, and coordination</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>965</td>
<td>76% / 24%</td>
<td>Small decrease in the most recent year</td>
<td>Yes - health, public safety, LED, education</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>23</td>
<td>73% / 27%</td>
<td>Decrease (due to DDEG delays)</td>
<td>Yes – multiple e.g. hospitals, civic education, regulation of economic activities</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>7</td>
<td>76% / 24%</td>
<td>Decrease</td>
<td>Yes – multiple, e.g. health, awareness raising, water &amp; sanitation, LED</td>
</tr>
<tr>
<td>Telița, MD</td>
<td>139</td>
<td>42% / 58%</td>
<td>Increase</td>
<td>Yes - multiple e.g. construction of CHPS compounds, clinics, wards, sanitary skip pads, awareness raising, LED, prophylaxis measures, disinfection measures, expenses for medical equipment - disinfectant, masks, gloves, dispensers</td>
</tr>
</tbody>
</table>

Source: Data submitted from the five SNGs involved in the review in October 2020.

The survey, as expected, shows great variation in expenditure per capita across the SNGs, and in terms of the share of expenditure applied to capital expenses in the pre-COVID 19 situation as well as in the trends over time. However, all SNGs had expenditure assignments highly relevant for the COVID 19 interventions, especially in public health, public relations, prevention and protection including awareness raising.
In some cases, e.g. in Uganda (represented by Gulu Municipality), the SNGs are seen as the most important unit for most health care interventions. In Chandpur however, the role is very much focusing on coordination, prevention, and protection, including areas such as:

- Communicate update on country-wide and global situation;
- Coordination with national health departments;
- Coordination with public health engineering department;
- Coordination with local deconcentrated administrative units for preparedness;
- Dissemination of safety measures and preventive directives received from health department; and
- Ensuring that lower levels are informed and well-coordinated, including ward-level meetings, municipality-level meeting, etc.

5.3 Challenges due to COVID-19

The table below shows the impact of and new challenges caused by the COVID-19 pandemic on SNG expenditure levels and composition.

**Table 18: Overview of the impact of COVID-19 on SNG expenditures**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Yes significant</td>
<td>Health, public relations</td>
<td>Awareness raising, support to prevention, distribution of safety equipment and materials</td>
<td>High, but no estimate provided</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Yes significant</td>
<td>Health, LED, social well-being, education</td>
<td>Hygiene and health awareness campaigns, campaigns to detect cases house-by-house, acquisition of medical supplies (covers, gel, sanitizer, masks), medicines and equipment for the cleaning and sanitization of buildings and access to public spaces, control of access to buildings, agreement with companies on protection equipment.</td>
<td>1-20% across sectors</td>
</tr>
</tbody>
</table>
In all SNGs, the response to COVID-19 had significant additional cost implications in the period from March 2020 to end of September 2020 (the period under review), especially in areas such as health, public awareness raising, prevention, coordination of central government health initiatives at the local level, distribution of protective equipment, and various new environmental and sanitary tasks. However, there was limited mentioning of support to poor people, food security, work engagement etc., with the exception of the Federal State of Chiapas. This was typically due to a lack of fiscal space, preparedness and lack of capacity to do so.

An example of newly assumed functions and their cost implications from Telita Municipality is shown below:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gulu, UG</td>
<td>Yes significant</td>
<td>Health, public relations</td>
<td>Prevention, washing facilities, protection, radio talk shows, procurement of sanitizer and health related materials like face masks</td>
<td>Examples: Health 25% and education 15%</td>
</tr>
<tr>
<td>Kumasi, GH</td>
<td>Yes significant</td>
<td>Health (hospitals, clinics etc.), environment, public relations</td>
<td>Health care, procurement and distribution of PPEs &amp; Veronica buckets, radio campaigns on importance of paying levies and on environmental sanitation</td>
<td>300% (in health and education)</td>
</tr>
<tr>
<td>Teliţa, MD</td>
<td>Yes significant</td>
<td>Health, public relations (awareness raising campaigns etc.)</td>
<td>Measures to prevent the spread of the pandemic, migration control mechanisms, reporting and coordination measures, procurement of disinfectant and protective equipment, e.g. mask, gloves, visors, etc., preparation of intervention teams.</td>
<td>Health &amp; Education: both estimated at 100%, and 70% in the social area and activities to promote/keep tourism</td>
</tr>
</tbody>
</table>

Source: Data submitted from the five SNGs in October 2020.
In addition to the actual additional costs due to COVID-19 listed by the SNGs, the SNGs were asked to provide an estimate of their full additional costs of COVID-19 interventions, had their needs been fully covered. These figures show significant unfunded demands in the range from 15 % to more than 100 % across the SNGs. E.g. in Gulu Municipality the estimated additional needs would be in the ballpark of 15-35% across the core 12 specified sectors (health, education, production, water & sanitation, etc.), and Kumasi an increase in expenditure needs for core sectors such as education and health was estimated at a three-fold increase in expenditures in order to cover the additional required efforts with COVID-19 interventions to a full scale.

### Table 19 Additional cost implications of COVID-19: - Example from Telita Municipality

<table>
<thead>
<tr>
<th>Sector</th>
<th>Impact on actual expenditure due to COVID-19?</th>
<th>Costs of SNG initiatives to address COVID-19, i.e. costs of implemented new activities</th>
<th>How has this increase in spending been financed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td>Yes</td>
<td>7,823 $ financing anti-COVID measures</td>
<td>Reallocation of funds from the local budget</td>
</tr>
<tr>
<td>Education</td>
<td>Yes</td>
<td>2,470 $ financing anti-COVID measures</td>
<td>Reallocation of funds from the local budget</td>
</tr>
<tr>
<td>Social</td>
<td>Yes</td>
<td>4,100 $ financing anti-COVID measures</td>
<td>Savings and reallocation of funds from the local budget</td>
</tr>
<tr>
<td>Investments in spatial restructuring of public institutions</td>
<td>Yes</td>
<td>21,000 $ financing anti-COVID measures</td>
<td>Savings and reallocation of funds from the local budget</td>
</tr>
<tr>
<td>Local government process, e-government</td>
<td>Yes</td>
<td>1,900 $ financing anti-COVID measures</td>
<td>Reallocation of funds from the local budget</td>
</tr>
<tr>
<td>Reconstruction and arrangement of the agricultural market</td>
<td>Yes</td>
<td>17,058 $ financing anti-COVID measures</td>
<td>Reallocation of funds from the local budget</td>
</tr>
<tr>
<td>Cultural</td>
<td>Yes</td>
<td>2,882$ financing anti-COVID measures</td>
<td>Reallocation from the capital investment chapter</td>
</tr>
<tr>
<td>Tourism</td>
<td>Yes</td>
<td>1,100 $ financing anti-COVID measures</td>
<td>Reallocation from the capital investment chapter of the budget</td>
</tr>
</tbody>
</table>

Source: Data submitted from Telita Municipality in October 2020.
However, Kumasi was only able to mobilize very limited additional funding from savings and additional insignificant grants from central government (less than 2% of the total transfers - see section on IGFTs above).

Hence, the fiscal stress that most SNGs were experiencing prior to the pandemic was significantly reinforced during the COVID-19 impact period, and SNGs were not able to respond effectively to the enormous additional assignments and new cost implications, as outlined below.

5.4 Responses to Challenges

How did SNGs and central governments react to the increased pressure on expenditure assignments and resulting raising costs due to COVID-19?

Table 20: SNG and CG responses to the cost increases due to COVID-19

<table>
<thead>
<tr>
<th>SNG</th>
<th>CG reactions</th>
<th>SNG savings</th>
<th>Reprioritization</th>
<th>Revenue mobilization?</th>
<th>Can SNGs do more?*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>Limited extra support</td>
<td>Yes – utility bill, costs for office operations, citizen/hospitality costs</td>
<td>Yes – reduction of costs for office operations, cost effective expenditure reduction of staff travel allowances/DA costs by attending virtual meetings &amp; efficient use of available resources</td>
<td>Yes – although limited</td>
<td>Yes – maintain cost effectiveness in all kinds of expenditure, reduce utility expenses, office operations expenses, strengthen OSR generation</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>Limited extra support</td>
<td>Yes – reduction of non-essential recurrent costs</td>
<td>Yes – reductions of 40% of operating expenses for non-essential activities, focus on basic services such as water, electricity, telephony, and essential operations</td>
<td>No</td>
<td>Yes – continue with the austerity measures</td>
</tr>
<tr>
<td>Gulu, UG</td>
<td>Limited, and lack of coordination</td>
<td>Yes – on recurrent cost items</td>
<td>Yes – suspension of many cost items e.g. in administration, workshops, etc.</td>
<td>Yes – attempts made, no impact yet</td>
<td>Yes – improve strategic planning for disasters and other</td>
</tr>
</tbody>
</table>
As mentioned in previous sections, in addition to the pressure derived from the reduction in SNG own source revenues, all five SNGs reported that they had only limited or no support from central government during the COVID-19 pandemic. As expenditures were driven up with new unfunded mandates in areas such as health, control & protection, and awareness raising, all five SNGs had to make significant savings and reprioritizations, such as:

- Re-allocation of funds from capital to recurrent expenditures and delays in major investments;
- Reduction of costs for workshops, trainings, DSA, office expenses etc. and reduction in expenses in all non-essential areas,

<table>
<thead>
<tr>
<th>SNG</th>
<th>CG reactions</th>
<th>SNG savings</th>
<th>Reprioritization</th>
<th>Revenue mobilization?</th>
<th>Can SNGs do more?*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kumasi, GH</td>
<td>Limited extra support</td>
<td>Yes</td>
<td>Yes – reduced investments</td>
<td>Yes – received some limited off budget DP funds</td>
<td>Yes – re-prioritize, and mobilize funding from both internal and external sources, introducing ICT in revenue collection reducing leakages</td>
</tr>
<tr>
<td>Telița, MD</td>
<td>No support</td>
<td>Yes</td>
<td>Yes – Reduced investment in the repair of public buildings and road infrastructure to create savings (note: over 50% of local revenue was directed to anti-COVID measures)</td>
<td>No – not possible so far</td>
<td>Yes – support e-gov. &amp; online services, support the poor to procure IT, train local businesses to sell on online platforms, support agriculture, mobilize NGOs</td>
</tr>
</tbody>
</table>

Source: Data submitted from the 5 SNGs in October 2020. *Based on SNG recommendations.
• Across the board reductions in expenditure ceilings (e.g. Chiapas)

Most of the SNGs reported that they would continue with these austerity measures in the short to medium term but also noted that additional support from particularly two sources would be required going forward:

1. Improvement of OSR (e.g. Kumasi, Chandpur and Telita). However, it is expected that this will take some time due to the contraction of the local economies, see the sections on OSR and LED; and
2. Improvement of the intergovernmental transfer system (all SNGs).

In addition to this, several SNGs, e.g. Gulu, stressed the importance for SNG to prepare better for future disasters, arguing for the establishment of a disaster fund. Furthermore, in some of the SNGs, the focus is currently on improved PFM procedures to enhance efficiency and reduce losses. Chandpur for example currently plans to reduce office operations costs, ensure cost effective expenditure, reduce staff travel allowances/DA cost by organizing virtual meeting, and promote efficient use of official recourses and utilities (maintain office time, minimum use of office utilities and electric equipment). Other municipalities have cut down on costs for workshops, DSA, office operations and administration as well.

5.5 Tentative Recommendations and Possible Follow-Up

The findings from the current stock take are generally in line with other recent studies such as e.g. the OECD, 2020 Report, Tackling Coronavirus (COVID 19) Contributing to a Global Effort, June 23, OECD, 2020. The OECD report calls for a stronger focus on resilience; preparedness for future shocks requires managing who does what at which scale and how? To close the fiscal gap and address structural inequality in the recovery period, cities around the world have taken many inclusive measures, especially for local business support and employment, affordable housing construction and renovation, and support to vulnerable households. Key lessons from urban resilience show that three steps are required to institute effective risk management: i) preparation, ii) prevention and iii) response.

While this current stock-take of the 5 SNGs focused mostly on the “responses”, preparation and prevention should also guide future actions. Resilience in cities can be achieved not only by responding to a crisis, but by preparing for future crises and preventing them. Preparation provides a foundation to manage and limit damage, while considering the cost and time required for recovering from crisis. Prevention is a proactive way to reduce exposure to social, economic and environmental crisis in the long-term through regulation, fiscal instruments as well as investment in resilient urban infrastructure (OECD, 2020).

Some of the general recommendations for future inventions and support derived from the findings in the current stock-take are listed below:
**First**, SNGs need to continue reprioritization and review of the composition of expenditures to ensure the optimal balance between strategic and targeted spending, and to create room for non-salary recurrent cost items.

**Second**, when the current phase of the pandemic will move from “emergency” to “recovery”, more focus will be needed on tools and measures to improve local economic development and public investments to ensure an expansion of economic activities and employment, and for medium to longer term strategic planning to ensure a sustainable resilience of SNG fiscal space and better preparedness for various forms of shocks. In the next phase, the recovery phase, there should be a strengthened focus on expenditures, which will have a multiplier effect on the local economy; and Improved focus on initiatives for LED, see the section on this.

**Third**, SNGs need to strengthen the planning and financing of preparedness for future disasters and pandemics.

**Fourth**, SNGs need to develop COVID-19 emergency and recovery plans, that are costed and include strategies for improved revenue mobilization.

**Fifth**, SNGs should explore ways to provide services more effectively, including the use of e-governance, IT systems, efficiency in processes and procedures; to allow for a seamless suspension of physical contact in times of health crises.

**Sixth**, SNGs and central governments should work together to further clarify functional assignments to avoid ambiguity, and improve intergovernmental coordination and consultations as suggested by all SNGs involved in the survey.

**Seventh**, central governments should strengthen their support to SNGs (see the section on IGFTs), to ensure better revenue sharing models, but also to improve the flexibility of allocation across sectors, rather than reinforcing silo-based funding mechanisms.

**Eighth**, SNGs should be allowed to have more autonomy with regard to the composition of expenditures, combined with more performance-based allocations and strengthened tools for accountability.
6. Summary and the Way Forward

The present report summarizes the key findings from a survey conducted to explore the impact of COVID-19 on the fiscal and economic health of five subnational governments and makes some preliminary recommendations on how these SNGs can rebuild their fiscal space in the aftermath of the pandemic. These findings and recommendations constitute the basis for subsequent work that will support the SNGs in developing, piloting and implementing interventions that will help them rebuild their local fiscal space.

The key findings of the Local Fiscal Space Survey can be outlined as follows: the SNGs included in this assessment have significant mandates to respond to the COVID-19 pandemic. The radical measures taken to prevent the spread of the virus have resulted in a considerable contraction of their local economies and have put their finances under increased pressure. In particular OSR has shown some considerable reduction ranging from 23% to 87%. To some extent, this is due to SNGs relaxing their tax efforts during the pandemic to alleviate the burden for struggling taxpayers. The impact of COVID-19 on IGFTs was not quite as marked during the first months of the pandemic, although some SNGs reported experiencing recent decreases in transfer payments. Furthermore, SNGs generally raised a number of concerns with the existing intergovernmental fiscal transfer system in terms of predictability, timeliness and level of flexibility, and only received very limited additional support from CG (max 2% of total IGFTs) to fund COVID-related assignments and expenditures. As a result, SNGs were forced to focus on making savings where possible and reprioritizing expenditures. The survey thus concluded that SNGs have only limited opportunities to mobilize additional funding in the short term but identified some initiatives under way to improve revenues in the medium term.

6.1 Summary of Recommendations

The following section reiterates the recommendations articulated in this report for each of the four factors affecting local fiscal space.

**Recommendations on factor 1: OSR**

**First**, it will be useful to further explore and quantify where possible the untapped local revenue potential of the SNGs, with a focus on those local own sources that have the greatest potential and/or whose potential can be most easily tapped. This will allow the SNGs to develop measures to help them exploit the most promising local own revenue sources to a fuller extent. This will also encompass a collection and sharing of good practices across the SNGs in each country.

**Second**, many of the SNGs report having observed economic activities, in particular in the area of online business and/or the new gig economy that are currently not being taxed but potentially could contribute to local own revenue. It might be useful for the SNGs to work out a strategy and approach on how to extract revenue yields from these new business activities, in particular where these new business activities make use of SNG services and infrastructure without contributing
to their financing and maintenance. This will require a review of the activities, legal framework, possible intervention procedures, capacity and staffing requirements etc.

Third, as all SNGs report some weaknesses and challenges in their revenue collection practices prior to the start of the COVID-19 pandemic, and as with the onset of the pandemic, some of these practices further deteriorated, it might be useful to develop a strategy that will help the SNGs improve their revenue collection practices and systems so as to strengthen their OSR yields. This can range from updating and expanding taxpayer data bases, to further automating local revenue administration systems, to further encouraging bank or online payments and limiting other opportunities for revenue leakages.

Fourth, it might be useful to strengthen taxpayer communication, education, and awareness raising with the aim to improve compliance and reach taxpayer segments currently not in the tax net. Here, the focus should be on local revenue sources with large untapped potential.

Fifth, in conjunction with recommendations presented in the section on LED, further review measures to stimulate LED to provide an enhanced tax base for further revenue tapping.

Recommendations on factor 2: IGFTs

First, there is a need to review, plan and predict the additional costs of SNG interventions needed in response to the COVID-19 pandemic and prepare for future similar challenges/disasters/pandemics. As seen from the review of additional costs (See Section 5) these are significant, but not properly measured and defined, nor fully financed, and the new mandates have been handled haphazardly.

Second, there is a need to address the extra costs with a flexible and well-developed system for transferring additional resources to address the new interventions and emergency situations. As mentioned, the IGFTs reviewed by the survey did not respond sufficiently to the new challenges; new grants were small with a lack of systems and procedures to manage them. This situation is in obvious contradiction with an effective epidemic response which, according to recent UNCDF reviews from March – May 2020, requires: (i) a sector-wide approach, which implies reallocation of funding between various sectors; and (ii) increased non-capital expenditures for community awareness and mobilization, enforcement of public order and restructuring of public service delivery to ensure its continuity and health responses. In many countries, the legal framework provides for local disaster risk management. However, these frameworks have often not been given adequate fiscal attention – and where this is the case, the funds require complex procedures to unlock every time, rather than allowing for an immediate liquidity response with predetermined procedures.

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22 UNCDF, COVID-19 guidance note, May 2020. Part of these is drawn from the guidance note, which findings are supported by our Survey.
There is a need to improve the size of the IGFTs and make necessary adjustments for situations like the pandemic, but also a need to improve the predictability and timeliness of transfers, to develop clear formulas for allocation with appropriate and sufficient levels of flexibility/autonomy. The development of additional, targeted grants to address new mandates is urgently required to improve fiscal space and room for an effective SNG response. These new schemes should be flexible, non-sectoral and focusing on recurrent cost implications, especially during the emergency phase.

The suggestions in a recent UNCDF COVID-19 guidance note on how to improve the funding system in general, are supported by the findings in the Fiscal Space Survey in the five SNGs. According to this note, as an immediate responses to COVID-19 it is recommended – if not already in place - to establish a kind of “Operational Expenditure Block Grants (OEBGs)”, customized to local circumstances and which can be a calibrated in an effective way for SNGs to accelerate the COVID-19 response in a timely manner and in accordance with the stage of the epidemic in the locality. This “OEBG” is a specific type of intergovernmental fiscal transfer that can be a useful and effective vehicle for governments to implement their COVID-19 response strategies. The advantage of an OEBG is that it combines the most effective elements of the discretionary capital grant and the discretionary recurrent grant. The resources are not drawn from the recurrent budget for human resources and basic operating expenditures; instead, they are drawn from other funds and use the modality of the development budget (or capital budget or local development fund approach) as appropriate, focusing on the immediate new responsibilities to address the COVID-19 pandemic and similar crises. It uses several of the typical features from typical local development funds but targets the immediate recurrent cost implications.

In most countries, also seen from the Fiscal Space Survey in the five countries, there are at least one of the four existing channels that can be activated:

1. Discretionary recurrent expenditure grants and transfers to local governments usually applied to salaries, travel costs, goods and services.

The advantage of this channel is that it is available across all local government departments at the discretion of local leadership. These grants can be increased and re-purposed as COVID-19 operational response grants to implement local protocols. Reporting can be through existing channels, with supervision provided by the relevant health authority. Procurement of goods and services is accomplished through existing mechanisms, with increased delegation of authority or ceilings for local procurement where appropriate. Increased value to these transfers will enable co-financing with the next category below for additional effectiveness. E.g. in Uganda this would be through a top up of the unconditional grants, the non-wage component, and in e.g. Ghana through a top-up op of the DACF/RFG.

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23 UNCDF guidance note, COVID-19 guidance edition 4, UNCDF, May 2020. OEBG was first piloted for general recurrent costs in Lao PDR, but has been increasingly used for COVID-19 challenges in a number of countries, e.g. in some SNGs in Uganda, but still needs to be institutionalized as a country wide system for combating issues such as COVID-19.
II. Conditional grants to local education and health departments by central ministries.
This should be a key vehicle for the response – not only for national fiscal resources but also for additional resources received as part of international relief efforts. In e.g. Uganda, this would be through augmenting in the short to medium term the recurrent health grants to respond to the COVID-19 challenges, and in other countries it would be through a top up of specific sector funding (e.g. Chiapas and Telita).

III. Discretionary capital grants to local governments.
These funds provide less scope for an immediate response in the next few months, as they depend on construction and procurement cycles. Nevertheless, this emergency provides a case for them to be reapplied to the purchase of medical equipment, vehicles and other capital expenditure items eligible ‘within the chart of accounts and public expenditure classifications for capital expenditure. Procurement could be expedited. It would be important for local governments to be reimbursed later for this immediate response, to avoid interrupting ongoing capital projects. One advantage of this approach is that many capital projects will have halted due to social distancing and other measures; therefore, some liquidity may exist. In e.g. Bangladesh (Chandpur), this could happen through a top-up of the current ADP grants, in Ghana through the top-up of the DACF/RGF grants and in Uganda through a top-up of the Discretionary Development Equalization grant (DDEG). This may also help supporting employment generating initiatives. In the later phases of the response, this will be important to boost the general economic development and create employment.

IV. Re-purposing the disaster risk management fund to support the COVID-19 response.
Several countries have provisions for a disaster risk response fund. However, in many countries, these have never been operationalized or are fully administered from the central governments. These funds could be quickly recapitalized and transferred to SNGs to support their response plans. In the SNG review, this was not seen as an operational instrument but could be initiated to respond to future pandemics. Or if not already established, work could be initiated to build up the capacity.

Third, there is a need to involve SNG more in intergovernmental fiscal coordination and the design and critical features of implementation, and in developing fiscal tools to combat the funding challenges imposed by COVID-19. SNGs cannot fix the magnitude of the challenge on their own and the central government need to insights and knowledge from SNG in their response plans. Recovery from the crisis should be a shared responsibility across all levels of government.

Fourth, the general challenges within the IGFTs observed in most of the SNGs in the survey need to be addressed, to strengthen the flow of funds and their timeliness and predictability, improve SNG autonomy, reduce transaction costs, as well as to improve allocation formulas (targeting the

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24 E.g. Bhutan, Solomon Islands and Jamaica.
particular needs of vulnerable groups) and incentives through performance-based allocations\(^{25}\). The importance of these core conducive features has been further emphasized in time of crises.

**Fifth**, within use of these tools, it is important that where ever possible, development partners should coordinate with the country agencies, build on their local knowledge and operational capacity, to the extent possible use existing flow of fund mechanism, and support improvement of these, while avoiding setting up of parallel and non-sustainable systems.

**Recommendations on factor 3: LED**

**First**, SNGs should continue to work towards providing a general enabling environment for local businesses, both in terms of the physical environment, as well as in terms of improving the ease of doing business, e.g. by speeding up licensing procedures, and providing business training to SMEs.

**Second**, it will be useful for SNGs to strengthen continuous communication and collaboration with the local business community. Here it will be important not to treat the local business community as a black box, but rather to identify the different sub-groups (e.g. by size, or business sector) and tailor the engagement with them to their specific characteristics and needs. This will ensure that not only the most influential local business elites are being heard and that each sub-group is being supported in the most appropriate way.

**Third**, for some of the SNGs, it might be useful to consider taking more interventionist and/or innovative approaches to promote developing certain, strategically important business sectors in their locality including focusing on a more strategic physical planning, land management, strategic investments, etc. Here, they could learn from other SNGs with some experience in this regard. These approaches could be developed in collaboration with relevant actors from the local business community and be articulated in a LED strategy that could be used to communicate the approaches to potential partners and attract funding.

**Fourth**, it could be useful to strengthen the understanding of SNGs of the structure of their local workforce and fill some of the information gaps regarding their movements due to the pandemic. This would allow the SNGs to develop a strategy to help laid-off workers get back into stable employment and reduce their vulnerability. Here it will be important to collaborate with central government institutions, business associations and training centers to ensure existing mandates are respected and appropriate support is provided by the stakeholder most suitable to do so.

**Fifth**, it will be important to distill and document lessons learnt together with the local business community on what measures and initiatives did and did not work in response to the COVID-19 pandemic. These lessons learnt should feed into the preparation (or update) of a local crisis

\(^{25}\) Examples of these are the performance-based DDEG in Uganda and the performance-based window in the DACF, the RFG in Ghana.
response plan to allow the SNG to react swiftly and appropriately to any future pandemics or similar crises.

**Recommendations on factor 4: Expenditures**

**First,** SNGs need to continue reprioritization and review of the composition of expenditures to ensure the optimal balance between strategic and targeted spending, and to create room for new urgent non-salary recurrent cost items.

**Second,** when the current phase of the pandemic will move from “emergency” to “recovery”, more focus will be needed on tools and measures to improve local economic development and public investments to ensure an expansion of economic activities and employment, and for medium to longer term strategic planning to ensure a sustainable resilience of SNG fiscal space and better preparedness for various forms of shocks. In the next phase, the recovery phase, there should be a strengthened focus on expenditures, which will have a multiplier effect on the local economy; and Improved focus on initiatives for LED, see the section on this.

**Third,** SNGs need to strengthen the planning and financing of preparedness for future disasters and pandemics.

**Fourth,** SNGs need to develop COVID-19 emergency and recovery plans, that are costed and include strategies for improved revenue mobilization.

**Fifth,** SNGs should explore ways to provide services more effectively, including the use of e-governance, IT systems, efficiency in processes and procedures; to allow for a seamless suspension of physical contact in times of health crises.

**Sixth,** SNGs and central governments should work together to further clarify functional assignments to avoid ambiguity, and improve intergovernmental coordination and consultations as suggested by all SNGs involved in the survey.

**Seventh,** central governments should strengthen their support to SNGs (see the section on IGFTs), to ensure better revenue sharing models, but also to improve the flexibility of allocation across sectors, rather than reinforcing silo-based funding mechanisms.

**Eighth,** SNGs should be allowed to have more autonomy with regard to the composition of expenditures, combined with more performance-based allocations and strengthened tools for accountability.
6.2 Proposed Areas of Potential Support During Phase II

Table 21 below outlines the proposed areas of potential support tailored to the extent possible (given the current level of understanding) to each of the SNGs. They can serve as a basis for further discussions about priority areas of intervention with the SNGs. Prioritization will be important as it might not be feasible to support all proposed areas in all SNGs as part of this initiative.

Table 21: Proposed areas of potential support during phase II

<table>
<thead>
<tr>
<th>SNGs</th>
<th>OSR</th>
<th>IGFT(^{26})</th>
<th>LED</th>
<th>Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chandpur, BD</td>
<td>• Explore and identify existing and new revenue sources with greatest, easily accessible potential&lt;br&gt;• Support development of strategy for reinforcing revenue collection focusing on high potential sources&lt;br&gt;• Support development of taxpayer communication strategy&lt;br&gt;• Support implementation of selected elements of the above strategies</td>
<td>• Work on continuation of the support to the general grant system (ADP), and strengthen the performance-based allocation features;&lt;br&gt;• Review options for establishment of a multisectoral discretionary grant to target issues such as disasters, pandemics, impact from climate change, etc.</td>
<td>• Support in developing a systematic framework for engaging with key sub-groups within the local business community&lt;br&gt;• Support managing a process of identifying priority public/PP LED investments and other interventions in collaboration with the local business community&lt;br&gt;• Compile lessons learnt from local COVID response in collaboration with local business community</td>
<td>• Initiatives to maintain and enhance cost effectiveness in all types of expenditure, including strategy and measures to reduce utility expenses, office operational costs, etc.</td>
</tr>
<tr>
<td>Chiapas, MX</td>
<td>• Support the development and implementation of a feasible approach to taxing online business</td>
<td>• According to the SNG (State of Chiapas), the general system of IGFT is generally working appropriately.</td>
<td>• Support the development of a strategy to help grow online business (i.e. connecting local producers and manufacturers with online sellers and marketing platforms)&lt;br&gt;• Compile lessons learnt from local COVID response in</td>
<td></td>
</tr>
</tbody>
</table>

\(^{26}\) Most of these will require central government initiatives in collaborations and with inputs from SNGs, hence substantive dialogue across the levels of government.
| Gulu, UG | Explore and identify existing and new revenue sources with greatest, easily accessible potential, in particular in property related areas, in light of Gulu’s new city status | Ensure timeliness of the DDEG, and improve timing of the annual performance assessments, which are decisive for the predictability of fund flows (covers more than 50% of the grants). | Support in developing a systematic framework for engaging with key sub-groups within the local business community |
| | Support development of strategy for reinforcing revenue collection focusing on high potential sources | Enhance flexibility in the IGFTS across the budget lines and work on establishment of a top-up mechanism for the unconditional grants in cases with disasters, pandemics, etc. as well as generally improvement in the size of the discretionary grants | Support managing a process of identifying priority public/PP LED investments and other interventions in collaboration with the local business community |
| | Support development of taxpayer communication strategy | Review of the IGFTS for “cities” in the light of their new status moving from a Municipality to “City” (Gulu as per July 1, 2020) | Support the re-building of the private education sector |
| | Support implementation of selected elements of the above strategies | | Compile lessons learnt from local COVID response in collaboration with local business community |
| | | | Review of costing of new activities, and strategic planning and budgeting to ensure that future emergency responses are factored in, |
| Kumasi, GH | Explore and identify existing and new revenue sources with greatest, easily accessible potential (focus on property taxes) | Work between CG and SNGs to ensure stronger predictability and timeliness in transfers, and ways and means to increase the size of these (are comparatively very low), | Support in developing a systematic framework for engaging with key sub-groups within the local business community |
| | | | Support to reprioritizing of expenditures |
| | | | Mobilizing funding support from both internal and external sources and ways and means to ensure that off- |
| **Telița, MD** | **Support development of strategy for modernizing OSR collection (e.g. property taxes)**  
- Support implementation of selected elements of the above strategy  
- With central government: Explore possibility to devolve more revenue sources / give SNGs more control over shared taxes  
- Support the development and implementation of a feasible approach to taxing online business | **Need for a general overhaul and reform of the IGFT, including work on a more predictable, objective and formula-based system as the current system is causing severe challenges for the cities;**  
- Work on establishment of a dedicated funding stream for situations like COVID 19. | **Support in developing a systematic framework for engaging with key sub-groups within the local business community**  
- Support developing a strategy to attract investment/business for the industrial park currently under development  
- Support the finalization/review of the tourism sector development strategy  
- Support the implementation of selected elements from the tourism sector development strategy  
- Support the development of a strategy to help grow online business (i.e. connecting local producers and manufacturers with online sellers and marketing platforms) | **Continue support to strengthen efficiency in spending**  
- Support to implementation of e-government principles & transition to online public services and enhanced use of IT in service provision, including training and strengthened linked with private sector (steps could be compilation of lessons learned on how this has been done in other places). |
6.3 Suggested Process Steps for Phase II of the Initiative

Based on the experiences, findings and recommendations from phase I, it is proposed that phase II, which will last about a year, should follow the steps outlined below:

- Review of findings and recommendations from the stock take exercise by the SNGs involved;
- Expression of interest by the SNGs for participating in phase II;
- Elaboration of a Memorandum of Understanding (MoU) between the SNG and UNCDF on support for phase II with clear definition of objectives, roles and responsibilities, timing, etc. between the SNGs, UNCDF and the technical support team;
- Articulation by SNGs of a few priority strategic interventions to be further elaborated in interactions with the technical support team, including objectives, target areas, form of involvement of support, tools and means to achieve the objectives (the technical support team will provide a format for this);
- Further identification of scope of work and expertise required for each intervention;
- Identification of locally based consultant(s) to support the work on the ground.
- Field missions to the SNGs (scope of work to be defined based on the above strategic inventions) by the technical support team (2-3 experts for each mission) over a 6-8 months period, first to review, then to support the design of the reform interventions;
- Preliminary testing of 1-3 core activities, e.g. review of tax base, public financial management reforms such as further review of measures to enhance efficiency in spending or strategic budgeting, LED strategy development etc.;
- Progress reviews, stock-take events through joint video conferences, to share experiences and lessons learnt (throughout the exercise);
- Review of options for deepening of the interventions and for wider application and roll-out to other SNGs, and design of overall framework for Phase III.

Note: If the COVID 19 situation permits, otherwise, this will be substituted with close VC interactions and adjustment of timing if need be.
7. References