

# Big, or Too Big?

**Megacities create special issues of governance, funding, and provision of services**

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**C**ITIES are all about economies of scale. Successful cities are centers of entrepreneurship and innovation that attract talented and skilled workers and foster greater productivity and growth. The considerable combined spending power of a city's population encourages markets and choice, making cities exciting places in which to live.

But, as cities grow bigger and develop into megacities—those with more than 10 million people—they can also develop megaproblems. The concentration of population, which partly accounts for a metropolitan area's dynamism, also causes congestion, environmental degradation, housing shortages, and the formation of ghettos. And governance of a sprawling metropolitan area can become complex and difficult.

With the growth of megacities—whether from migration, growth of the existing population, or reclassification of populated rural areas as urban—difficulties related to overall infrastructure planning and the provision of adequate services become more pronounced. Overlapping and blurred spending responsibilities and inadequate revenues controlled directly by a city may limit the extent to which city administrations can be held accountable for their decisions. The absence of timely information on city finances compounds the accountability problem, often creating macroeconomic difficulties as well as potential political economy dilemmas. For example, in many cases, capital cities wield excessive political power, creating tensions with surrounding neighborhoods. Take the Bolivian capital of La Paz. Although La Paz is not a megacity, the tensions are evident

between it and the adjoining municipality of El Alto, which has had the power to paralyze the seat of government through strikes and protests.

Megacities tend to have not only greater spending needs but also greater potential revenue bases and human capital than other cities. Thus, it might make sense for them to have greater spending responsibilities and be assigned more rights to raise financing than other similar lower levels of government. This is known as asymmetric federalism (see Congleton, 2006).

This article examines some of the asymmetries in assignments and political power between megacities and other geographical areas of a country, the fiscal challenges that arise with the growth of large metropolitan areas, and possible modifications that might be needed in fiscal institutions and policies to address improvements in public services as well as urban poverty and inequality.

## **Power and the city**

The year 2008 represents a turning point in human development, according to a recent UN report. For the first time, the majority of the world's population will live in cities, as opposed to rural areas. By 2030, the pro-





Shanghai: a big engine of growth.

portion of the urban population will have increased to more than two-thirds of all the people in the world. Although the proportion of the population in megacities is still relatively small, it is growing. This huge shift toward megacities creates its own challenges of governability and fiscal responsibility.

With many megacities facing large environmental and social difficulties, the governability of these agglomerations represents one of the key challenges of the new millennium. It is unlikely that central governments will be able to effectively manage the planning and resources needed for such areas. Should these cities be granted greater spending and revenue-raising responsibilities than other municipalities?

Different countries have come up with different types of devolved powers for megacities. Megacities in Asia and Latin America have more political and economic powers than municipalities. In some cases, they are assigned the functions and responsibilities of states or provinces, in addition to their purely municipal functions, whereas in other cases, fewer powers are devolved, or responsibilities remain unclear.

**Strong devolution.** In China, megacities such as Beijing and Shanghai have dual status—with municipal functions and responsibilities in addition to those of provinces. This asymmetric treatment also recognizes the political power that Shanghai wields, for example, in relation to other provinces or states. Hong Kong SAR has even more autonomy over both spending and revenue raising, although this was largely part of the “one country, two systems” political settlement agreed to with the United Kingdom for the return of Hong Kong to Chinese rule in 1997.

Such asymmetric arrangements facilitate the implementation of distinct social policies and public investment that have led to rapid and impressive growth in these megacities. While Hong Kong SAR is a good model for other megacities in China—especially in terms of asymmetric responsibilities—the Chinese authorities need to ensure that overall borrowing by the megacities is coordinated with overall macroeconomic objectives. Thus, the focus should be to further clarify spending responsibilities and provide appropriate incentives and transparency needed for accountability in Chinese megacities.

**Partial devolution.** In Latin America, the Colombian capital of Bogotá presents an interesting experiment (see Fainboim, forthcoming), where a combination of measures have resulted in significantly improved public service delivery in the metropolis. This combination of measures includes the granting of additional powers to the capital (through a special organic statute approved in the 1990s); election of the city mayor—resulting in some dynamic leaders (such as Jaime Castro, 1992–94, and Antanas Mockus, 1995–97 and 2001–03); and the strengthening of the city’s finances, with increased efficiency in tax collections and transparency in spending. Adopting these measures has partially offset the perennial difficulty created by the overlapping of responsibilities of Colombian subnational governments.

**Little devolution.** In contrast to Bogotá, a more typical example of the implementation of asymmetric power is Mexico City—the world’s second largest city after Tokyo-Yokohama, with a population exceeding 19 million. It has achieved megacity status largely through inward migration (Graizbord and Santillán, 2005). However, spending functions remain unclear, and the ability to raise local revenues is as limited as those of other municipalities.

Although Mexico City generates more property tax revenues than any other metropolitan area in the country, collections are lower than they might be for other emerging market and advanced countries. And some of the key local functions, such as education and health care, continue to be directed by the federal government through special-purpose transfers. Similarly, the main social safety nets, such as “Progresas/Oportunidades” (see Levy and Rodríguez, 2004) and key edu-



cation and health spending programs, remain federal with direct provision, or are funded largely by the federal government. Thus, the asymmetric responsibilities and resources that might be possible for a more effective provision of public services in Mexico City have yet to be realized or even considered. Other Mexican states and cities, with limited own-source revenues, are even more dependent on transfers.

*Devolution, plus clear separation of functions.* The clarification and separation of functions—needed for greater accountability and good governance—remain high on the list of policy priorities in advanced and developing countries alike.

## “The degree of devolution of fiscal responsibility will vary from country to country and often reflects the existing political and institutional balance of power.”

A good example of the interplay of megacity administration and political power is London, with “megacity” functions separated from purely local-level activities. The Greater London Council (GLC) was established under a Labour government in 1965 and had significant powers over public service delivery. The Conservative government abolished the GLC in the mid-1980s; some functions were devolved to metropolitan boroughs, and others were taken back by the center. The government of Tony Blair reintroduced the GLC, but gave it more of a strategic and coordination role, including for transport, policing, emergency planning, and development functions. Thus, functions needing coordination at the metropolitan level were distinguished from the purely local functions of primary schooling and basic services, which remain at the borough level.

In other countries, capitals have been moved from major cities, such as Rio de Janeiro, Karachi, and Lagos, partly to insulate the central governments from vested interests of the metropolis. Other objectives included opening up the hinterland (Brasilia) and reinforcing security (Islamabad).

### Responsibility and accountability

It is clear that there is a direct interplay between the responsibilities of the megacities and the political power that they wield. Establishing their responsibilities together with accountability appears to be the most promising avenue for effective service delivery and poverty reduction. But how is this greater accountability to be achieved?

A key element in achieving greater accountability is to clarify which level of government is responsible for a given function. In many countries, particularly in Latin America, different levels of government operate with overlapping responsibilities, even for functions that might be considered appropriately local in other parts of the world.

One example is primary education. In several Andean countries, municipalities are responsible only for operations and maintenance expenditures for schools and, in one coun-

try, certification of hours worked. The hiring of teachers is often handled by the intermediate tier of administration, acting on behalf of the center, and payment of salaries is typically a central government function. In such cases, no level of administration could reasonably be held responsible for primary education outcomes. This is an example of incomplete decentralization and overlapping responsibilities.

The megacity must have access to significant own-source revenue at the margin. This allows it to raise additional moneys for its own priorities and not depend on the center to make financing available through transfers, which are often earmarked for particular central objectives. This access to own-source revenues is critical in ensuring a hard budget constraint at the megacity level and would also help to ensure that city borrowing and investment decisions do not create difficulties for the central government (see Ambrosiano and Bordignon, 2006).

### Spending and performance

Clarifying and simplifying the responsibilities of different levels of government, particularly on the spending side, is at the center of the policy dialogue in many parts of the world, including China, some countries in the Organization for Economic Cooperation and Development, and the Andean cases mentioned above. These efforts are increasingly being supplemented through the use of contracts for the delivery of certain outcomes (see Spahn, 2006). Making budget recipients responsible for policy outcomes has come to be known as “performance budgeting.”

Performance budgeting is useful because it clarifies the outcomes that city administrations or spending agencies can be held accountable for—with or without explicit contracts. However, accountability requires that such outcomes be first specified, costed, and then monitored. This also puts a premium on transparency in the generation and use of public funds—and most subnational governments may be at a disadvantage in this context because resources and capabilities are generally constrained. Even for central governments, the introduction of performance budgeting requires careful planning and takes time to implement.

But megacities may have built-in advantages. Capacity constraints are often not a problem because megacities have no dearth of workers and talent. In addition, with a flexible and accountable political framework, it might be easier to introduce changes in administration, management, and information systems at the megacity level than at the central or federal government level. This was the case in Bogotá, where the Mockus administration stressed efficient, responsible, and transparent management of public funds and the need for the administration to be held accountable. Since 2000, the city has been able to implement a results-based budget—something well beyond what the federal government is currently able to do (Fainboim, forthcoming).

Megacities could create an infrastructure for managing public finances that is capable of handling more significant functions than might be possible in smaller municipalities. For instance, the city of São Paulo has a more advanced government financial information management system than the government of Brazil.

To create such an infrastructure, information flows are critical. Full and standardized information about government functions and the economy, as well as programs and projects, is required to obtain full costing of outputs and, eventually, outcomes. The IMF's *Government Finance Statistics Manual 2001* provides the internationally accepted standards for the economic and functional budget classifications. This information should provide governments at all levels, as well as legislators and the public, with details on how much has been spent and for which purposes.

### Tapping revenues

In general, megacities tend to have significant revenue bases, some of which may be shared with central governments. They also have the potential to set up modern revenue administrations, given economies of scale, that could match or even exceed national standards.

On the taxation front, there is often some room for improvement in local property taxation to give the local authority adequate own-source revenue at the margin. For instance, the Mockus administration in Bogotá made significant advances in its collection of property tax revenues by using the modern principle of self-assessment, subject to greater reliance on market-based valuation techniques.

Property taxation may not be sufficient to provide significant own-source revenues if wider responsibilities are to be assumed. Mexico City, for example, collects 40 percent of the country's total property taxes but would need additional revenues if more functions were devolved. Mexico City has considerable potential for additional own-source revenues, such as surcharges on the value-added tax or income taxes, which have been proposed at various times. However, it has not felt the need to impose these taxes, given the weight and incentives in the system of transfers and its current responsibilities.

Megacities can also secure financing by borrowing. Together with the necessary revenue sources and public financial management infrastructure, megacities tend to have other conditions that might also permit an asymmetric approach to borrowing. They include the operation of credit agencies and information on government operations that would facilitate borrowing for likely infrastructure needs.

However, it is important that prudential limits be respected and that information on borrowing and risks from operations, including public-private partnerships, be properly recognized and recorded. Although market discipline is desirable and should be encouraged, there may be a need for a combination of instruments that include fiscal rules and administrative constraints, along with market discipline (Ter-Minassian and Craig, 1997). In most developing countries, the overall macroeconomic implications of significant subnational borrowing have to be kept in mind. For example, subnational debt crises in Argentina and Brazil in the late 1990s exacerbated the macroeconomic imbalances in both countries.

### Accountable devolution

The trend toward larger urban agglomerations and the creation of megacities poses particular challenges for public

policy and poverty reduction. Megacities increase pressures and risks, but these are counterbalanced by the dynamism and additional resources of the metropolis.

The need for strategic vision in megacities, particularly for overall infrastructural planning and its financing, suggests some need for accountable decision making in those cities. But decision-making authority can become remote from many citizens' local concerns, and the large spending needs of megacities create major fiscal challenges. At the same time, national goals—such as a demand for regional equity and maintenance of macroeconomic stability—might force metropolitan regions to contribute financially to the rest of the country or limit borrowing and investment plans to be consistent with a sustainable macroeconomic stance for the whole country.

Both national governments and megacities can secure potential benefits by exploring the devolution of clearly defined responsibilities that, together with the ability to generate additional own-source revenues, provide incentives for good governance. The degree of devolution of fiscal responsibility will vary from country to country and often reflects the existing political and institutional balance of power. However, standardized information flows and transparency remain critical for accountability, as well as for maintaining overall macroeconomic stability. A number of megacities have begun assuming asymmetric responsibilities, but there is clearly room to learn from the experiences of others and to develop appropriate measures and strategies—whether in Asia, Africa, or Latin America. ■

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