



FINANCING METROPOLITAN GOVERNMENTS *in* DEVELOPING COUNTRIES

Edited by

ROY W. BAHL, JOHANNES F. LINN, AND DEBORAH L. WETZEL



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THE DECENTRALIZATION OF GOVERNANCE IN METROPOLITAN AREAS

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ROY W. BAHL

The theory and practice of providing government services in metropolitan areas are subjects that have attracted a great deal of attention in the industrial countries but have been largely ignored in low- and middle-income countries.¹ With urbanization and the growth of megacities, time is running short for these countries to develop a workable approach to governance and finance in metropolitan areas with several million persons.

This chapter assesses whether the fiscal decentralization model that has been so instrumental in decisions about structuring governance on a nationwide basis can be applied successfully in metropolitan areas. The first section considers the theoretical underpinnings for choosing among the various possible metropolitan governance structures. Next is a review of some of the urban governance models used around the world and a discussion of their advantages and disadvantages. The chapter concludes with a discussion of the range of policy reform options that would appear to be feasible.

Unfortunately, there are no comparable data on metropolitan-area governance and public finances, so there is little empirical evidence on the impacts of various forms of decentralized governance on economic performance.² This chapter adopts the less ambitious goal of describing and analyzing the governance practices in a nonrandom sample of metropolitan areas in both industrial and developing countries. The choice of the sample is based on availability of information rather than any formal attempt at “representative” coverage. This chapter draws on the experience in industrial countries to demonstrate the kind of governance choices that are possible at higher levels of economic development.

¹ Mohanty et al. (2007, 139) conclude an intensive study of urban government finances in India by noting that local governments are yet to be put “on the public finance map of the country.”

² For discussion of the link between decentralization and economic performance, see Martinez-Vazquez and McNab (2001) and OECD (2006a).

THEORY AND METROPOLITAN GOVERNANCE

There is no single “best” way to structure governance in metropolitan areas; it depends on which objectives the government most wants to achieve and the costs it most wants to avoid. Most researchers on this subject start with economic efficiency criteria. The core argument is the now-familiar decentralization theorem, which holds to a basic rule of assigning each function to the lowest level of government consistent with its efficient performance (Bahl 2011; Bahl and Linn 1992; Bird and Slack 2004; Oates 1972). The apt phrase is that “people get what they want.” When this rule is followed, the overall public welfare is enhanced. The assignment that finally results involves a balancing act where expenditures characterized by economies of scale, or those generating external costs or benefits, are assigned to higher-level governments, and everything else stays local.

Can this same thinking be applied to assigning expenditure responsibilities within metropolitan areas? If so, such issues as the extent to which smaller local governments in a fragmented metropolitan governance system should drive expenditure decisions, whether a metropolitan government is necessary for managing and financing areawide services, what physical area the regional government should encompass, and how important state/federal vertical programs should be, can begin to be answered.³

Preferences and Home Rule

A major factor driving expenditure assignments in metropolitan areas is the demand for home rule. The smaller the population of a government, the greater the influence of an individual voter on budget choices. The larger the local government, the less likely it is that local voters will see their preferences matched by budget outcomes. Unless preferences are uniform, the welfare losses will rise as the population of the city government increases. Loss of local control and, even more so, loss of direct involvement of higher-level governments in urban service delivery are major criticisms of metropolitan-area-wide government. In places where budgetary decisions are in the hands of areawide governments or a higher-level government, lower-level units sometimes have been created either to give autonomy to neighborhood units or to get their advice for purposes of inputs to fiscal planning.⁴

Where this thinking leads is that, all else being equal, the stronger the push for direct local involvement in governance and fiscal decisions, the smaller the “optimally sized” local government. If sentiments about home rule are strong, a jurisdictionally fragmented system, or a two-tier metropolitan government structure with a strong bottom tier, is more likely than a dominant metropolitan government.

³A *vertical program* is one where the service is delivered in the metropolitan area by a provincial or central level government, and the funds do not pass through the budget of any local government budget.

⁴An example from industrial countries is the 21 districts within the city of Madrid that have been delegated administrative functions in such areas as urban parks, health, and licensing. In 2007, these districts managed about 12 percent of the city budget. The district councils include both appointed and elected members. A similar arrangement to encourage local participation is in place in The Netherlands, in the form of elected district councils that operate at a level below the elected municipal councils.

Economies of Scale and Externalities

A justification for assigning expenditure and financing responsibility to a higher tier of government is the welfare gains that come from economies of scale in the delivery of a service. To translate this guideline to practice, it is necessary to identify those public services that are characterized by economies of scale. Intuition and some empirical evidence tell us that some public services are characterized by economies of scale, for example, capital-intensive infrastructure such as public utilities, solid waste disposal, sewerage, and mass transit. Some social services may also qualify, and not much is known about the relationship between unit cost and government size for functions such as education, health, and welfare services. Unfortunately, much of the empirical research on this question has been undertaken in industrialized countries, and even there the findings are mixed (Fox and Gurley 2006). Most studies conclude that separating out all other variables (e.g., the quality of the service offered and the setting in which the question is asked) makes it difficult to come to a single, defensible answer about the optimally sized city.⁵

The presence of externalities will also push up the optimal size of government. For those public services assigned to them, lower-tier governments will underspend (or overspend) because they will account only for local benefits and costs in making their budgetary decisions. The problem is multiplied in a metropolitan area because there often are so many local governments operating in close proximity to one another. Almost every government's decisions affect someone else.

There are many examples of this. Suburban jurisdictions might underspend on hospitals and clinics, causing their residents to commute to the central city to take advantage of better health care services. Central city governments might underspend on the infrastructure necessary to control pollution, with the result that the environmental conditions in other jurisdictions in the area are harmed. Moreover, if services such as mass transit are not coordinated, the resulting congestion will harm all consumers, and the cost of providing any given level of services might be higher. In all of these cases, the provision of such services by a metropolitan-area-wide government would internalize these externalities.

As in the case of economies of scale, it is difficult to translate theory into practice. Spillover effects are known to cause economic losses, and often the public service areas that are most challenged can be identified (e.g., transportation and solid waste disposal). But in most cases, the welfare loss due to underspending or overspending by the local government can only be guessed. Nor is it usually known how large the service boundaries should be in order to internalize these external effects.

GOVERNMENT STRUCTURE IN METROPOLITAN AREAS

Policy leaders have used these considerations, and politics, to decide on a governance arrangement for service delivery in metropolitan areas. Some have created very fragmented structures with strong decentralization of responsibility and power,

⁵ An interesting review of the evidence for other Organisation for Economic Co-operation and Development (OECD) member countries comes to a similar conclusion (OECD 2006a).

whereas others have taken a more regional approach to service delivery. Almost all have tried to strike some balance between capturing the efficiencies of areawide government and maintaining local control. If there is a general conclusion that can be drawn about the choices actually made, it would seem to be that the sentiments for local control have largely held off the formation of metropolitan governments.

Bahl and Linn (1992) considered three basic approaches to metropolitan governance: jurisdictional fragmentation, which emphasizes home rule; functional fragmentation, which emphasizes technical efficiency; and metropolitan government, which emphasizes coordination and internalizing externalities. In practice, the advantages and disadvantages of various forms of metropolitan governance almost always play out in a compromise that attempts to capture the benefits of a favored approach while minimizing some of its costs. The result is mixed models of metropolitan governance.

Jurisdictional Fragmentation

Under a jurisdictional fragmentation approach, many general-purpose local governments operate in the same metropolitan area with some degree of independence in choosing their package of public services and their tax, user charge, and debt financing arrangements. In some cases, there also is an overlying metropolitan government, or regionwide special district, but the emphasis in service delivery is on the role of the lower-tier governments.

The advantage of the jurisdictional fragmentation model is that it keeps government close to the people. That is, the population of the fiscal decision-making unit is smaller than it would be if governance were areawide (as in the case of a metropolitan government). It also protects the position of the local government bureaucracy and local politicians by making them accountable to a relatively small constituency to whom they are known. However, the welfare gains from this home rule model will come at some cost: a failure to capture economies of scale, and operating within a set of boundaries that are arguably too small to internalize important external effects or to allow coordinated service delivery. Jurisdictional fragmentation also can lead to large fiscal disparities among local governments in the metropolitan area, since constituent local governments almost surely will have different expenditure needs and different financing and service delivery capacity.

INDUSTRIAL COUNTRIES

The jurisdictional fragmentation model best characterizes governance in most industrial countries. The traditions of home rule are particularly strong in the United States. Most urban services are delivered by municipalities, counties, and single-function special districts, that is, by the lower-level local governments. Regional planning is commonplace in the United States, but regional governance seems to have hit a dead end.

Strong traditions of home rule are also found in western Europe (Lotz 2006; OECD 2009a). The Copenhagen metropolitan region is an example of a jurisdictionally fragmented structure. Its 2.4 million population is governed by 45 municipalities, which are the dominant tier in terms of service delivery and taxation, and

the national capital region. The capital region is an elected areawide government that has health services as its primary responsibility, but it has no taxing powers.

The population of the city of Paris is about 2 million, but another 6 million people live in the inner suburbs. Local governance in this agglomeration is by eighty municipalities, three departments, and numerous companies that provide public services. The Stockholm metropolitan region includes sixty-five municipalities and five counties (OECD 2006b). The Randstad (Holland) metropolitan region contains 50 municipalities (OECD 2007b).

MIDDLE- AND LOW-INCOME COUNTRIES

The local government code in the Philippines, enacted in the 1990s, reassigned expenditures among the central, provincial, and local governments in a manner “consistent with the decentralization theorem” (Manasan 2009, 338). In metropolitan Manila, the eleven cities and six municipalities are responsible for those services whose benefits are thought to not spill over local boundaries.⁶ The Metropolitan Manila Development Authority, the overlapping areawide government, is responsible for planning and for delivering or coordinating services with a metro-wide impact, such as transportation, flood control, sewerage, urban renewal, zoning, health, sanitation, and public safety.

The Mexico City metropolitan area is perhaps the textbook example of jurisdictional fragmentation. The metropolitan area is overlapped by the Federal District and its 16 municipal-like subunits, the states of Mexico and Hidalgo with their 59 municipalities, and the federal government. The Federal District has most of the fiscal functions of states and an elected assembly. It has no constitution and is directly subordinate to the federal government. All of the lower-tier local units in the two states have elected governments, but the boroughs within the Federal District have no taxing powers. The service delivery emphasis is with the states and the Federal District. There is very little coordination of service delivery within the metropolitan area and virtually no planning (OECD 2004a).

The Kolkata metropolitan area is governed by three municipal corporations (including Kolkata), thirty-eight municipalities, and twenty-four rural local governments. The municipal governments are dominant in terms of service provision and revenue raising. The Kolkata Metropolitan Development Authority, an areawide government, has responsibility for planning and carrying out major infrastructure development in the metropolitan area. The authority is a state agency, though some elected local representatives are on its board. It is financed by grants from the federal and state governments.

The São Paulo metropolitan region, with a population of about 18 million, comprises 39 municipal governments with no overlapping metropolitan government. Coordination among the local units is attempted by agreement or compact among these municipalities, by a number of agencies and councils, and by the state government. The core city in the metropolitan area more or less drives the fiscal health

⁶The major departure from the textbook assignment is elementary and secondary education, which remains with the central government (though the responsibility for construction of school buildings was assigned to the local government units).

of the region. In the first half of the 2000s, the municipality of São Paulo faced a fiscal crisis that limited the ability of the larger metropolitan area to deal with overall problems (World Bank 2007). This reflects an important concern with jurisdictional fragmentation.

Functional Fragmentation

A second approach to metropolitan governance is functional fragmentation. Under this model, the delivery of a single function (or a related grouping of functions) is placed under the control of either a public company or a special district government. In fact, some degree of functional fragmentation exists in almost all metropolitan areas, but the structures vary widely, as does the degree of emphasis placed on the use of public companies.

A main advantage of functional fragmentation is that the autonomous agency is likely to be more technically efficient because it is specialized. Moreover, if the salary schedule is outside the normal civil service, the company may be able to attract and retain higher-quality workers. It also may be more efficient in its operations because it has a large enough area of coverage to capture economies of scale. Because it is usually the only entity in the urban area responsible for the function, the problems of coordination for that function are considerably less than under a jurisdictionally fragmented model. Finally, a public company or a special district government may have access to a dedicated revenue stream (e.g., an earmarked tax, a compulsory transfer from the city government, or user charges), and if well run, it has arguably a greater potential for debt finance than would a general-purpose local government.

The major drawback to this approach is that it is usually under less direct control of local voters than, for example, an elected municipal council. The extent of this disadvantage depends on how the board and the management of the autonomous agency are determined. Under one version of this approach, the city council(s) may have some membership on the board of the autonomous body, or even some ownership of the company. Under another model, the public service company might have an appointed independent board with no local government membership. A third approach would have the autonomous body function as an arm of the state or national government, with operational but not political autonomy. Neither of the latter two models protects accountability to a local constituency.

INDUSTRIAL COUNTRIES

Regional transportation is often provided by a separate agency that may or may not be linked to the municipal governments in the area. In the case of bus transit in Copenhagen, the coordinating body is a joint regional government/municipal government company. But in the New York metropolitan region the transportation authorities function more as state agencies than as local entities (Benjamin and Nathan 2001).

Another version of functional fragmentation assigns several areawide functions to a single government or agency. Sometimes these are related functions, such as transportation services and transportation planning, but sometimes they have only

their regional coverage in common. The Greater Vancouver Regional District consolidated all functions provided previously by special districts, most notably hospitals, water and sewer, capital expenditures, and solid waste management. Finances are primarily from user charges (Bird and Slack 2004). The governing board of the regional district is elected municipal government officials, but municipalities can opt out of many of the district functions.

The water boards in the Randstad region in The Netherlands, with responsibility for flood control, water quality, and wastewater treatment, are local, independent public authorities that are democratically elected (OECD 2007b). The 11 boards do not have administrative boundaries that are coterminous with municipalities but do have taxing powers, including a water board charge and a pollution levy.

Functional fragmentation opens a number of new doors in terms of financing metropolitan services. Since the services delivered are often amenable to pricing (e.g., public transportation and garbage collection), user charges provide a base level of revenues. In other cases, the services are partially financed by compulsory transfers from the city budget, or they might be profitable enough to subsidize the city budget. In Stockholm, a holding company was organized to manage several city-owned companies that provide services such as public housing, real estate management, port operations, and water utilities. These public companies are in a surplus position and have been paying dividends to the city budget. The same is true in the case of two energy companies in which the city of Oslo holds equity. The city of Lausanne has fully incorporated the electricity company into its budget, and the company maintained a surplus position during the late 2000s.

In other cases, the local government subsidizes the public company. The city of Paris participates (or is part owner) in several enterprises that provide services ranging from transportation to social services. These are financed by user charges and by compulsory transfers from the city budget. The city of Madrid makes compulsory transfers to the two public companies that provide transportation services. In several Italian metropolitan cities, transfers to the companies providing transportation, waste collection and disposal, and water treatment services account for about 25 percent of total metropolitan city government expenditures.

MIDDLE- AND LOW-INCOME COUNTRIES

Special-purpose agencies can be especially important in managing and financing public service delivery in countries that are not industrialized. Because the special district status helps to separate the service delivery function from politics at the local government level, it can make management easier and arguably more professional, and it can be a route to a dedicated revenue stream and debt finance. Moreover, separation from the general-purpose local governments enhances the possibility for full cost recovery in providing the service. Probably the most important reason is that it provides for more efficient delivery of the service than under a fragmented assignment of expenditure responsibilities. The institutional arrangements vary greatly, from public companies with some local control to central and state government enterprises that operate within the metropolitan area.

One area where public companies can play an especially important role is in the provision of metropolitan transportation services. In metropolitan Mexico

City and in Rio de Janeiro, mass transit is the responsibility of many providers, and there is relatively little coordination on routes or fares. In metropolitan Bogotá, however, a public company was created to implement a comprehensive transportation plan that included the regulation of private providers of bus services. The transit operations are fully financed from user charges and a surcharge on the gasoline tax.

In some cases, special-purpose agencies can become a dominant player in local government finance. Webster (2000) points out that more than 65 percent of urban infrastructure expenditures in metropolitan Bangkok are by state enterprises, compared with approximately 25 percent by the national government and less than 10 percent by the city government. India makes use of parastatals, which are public companies operated by various departments within the state government. The functions of these agencies range from planning to roads to housing and slum redevelopment. The 21 parastatals operating within Mumbai account for a large share of total infrastructure spending in the metropolitan area. A joint venture company owned by the city of Buenos Aires and the province of Buenos Aires is responsible for the disposal of solid waste.

Public companies also are important in delivering services in the metropolitan areas in transition countries. For example, the city of Riga provides services through 42 companies in which it holds ownership or has an equity stake. Most of these companies are self-supporting, but the transport enterprise claims about 10 percent of the operating budget of the city. In Zagreb, most capital spending (and some current spending) is the responsibility of a holding company that was created following the merger of 22 municipal companies. The city of Zagreb uses more than 15 percent of its budget for subsidy payments to the holding company. In other eastern European metropolitan cities, such as Sofia, Budapest, and Odessa, it is often more a matter of the city supporting the loss-making activity of a single company, notably transportation.

Metropolitan Government

Under the metropolitan government model, most general services are provided by an areawide metropolitan government.⁷ In theory, the metropolitan government would be elected and would have significant powers to regulate service delivery and financing. In practice, most areawide governments share fiscal powers with lower tiers of government or publicly owned companies.

The significant advantage of the pure metropolitan government approach is built-in coordination in the delivery of functions. This has the potential for better resource allocation compared with dividing responsibility for local services among multiple municipalities and special-purpose governments. The metropolitan government form also offers greater potential for equalization because the quality of local services is not tied to the wealth of each local jurisdiction, as it is with jurisdictional fragmentation. Finally, because factors are less mobile across than within metropolitan areas, there are more choices for efficient taxation (Bahl and Bird, 2008).

⁷ For discussions of metropolitan-area governance, see Bahl and Linn (1992), Bird and Slack (2004), Jouve and Lefevre (2002), OECD (2006a), and Slack (2007).

On the other hand, the metropolitan form of governance diminishes the power of local voters to influence the local budget. In effect, the election of the local council is replaced by election of local representatives to the more distant metropolitan council. A second drawback is that metropolitan governance often brings intergovernmental conflict. If lower-tier local governments exist under a metropolitan arrangement, they may resist the leadership (and especially the dominance) of the metropolitan government. When a function is shared between the metropolitan government and a higher-level state (province) or federal government, as is often the case, another set of conflicts may arise.

Another drawback is that the boundaries of the metropolitan government may not be large enough to fully capture the benefits of areawide governance. In this situation, one of the most significant advantages of metropolitan government may be substantially diminished. This problem might be resolved by annexations or consolidations or by appointing a commission to redraw jurisdictional boundaries, as was done in South Africa (Ahmad 2003; Cameron 2005).

INDUSTRIAL COUNTRIES

Toronto comes close to being a true metropolitan government. The former two-tier metropolitan government was replaced with a single-tier metropolitan city in 1998 (OECD 2009b; Slack 2000). All local government functions, including those previously invested in special districts and underlying municipalities, rest with the new metropolitan government. Following the amalgamation, the provincial government established the Greater Toronto Services Board to oversee regional transit. This board has no legislative authority.

There are other examples of areawide governments in Organisation for Economic Co-operation and Development (OECD) member countries. In Madrid, the dominant local government in the metropolitan area is the Community of Madrid, which is seen by some as being about the same size as the functional urban region of Madrid (OECD 2007a). Underneath the community are 179 municipalities, including the city of Madrid, which account for about half of the population of the metropolitan area. The functions of the community, however, are considerably broader than those of the municipalities.

The Tokyo metropolitan government has responsibility for service provision to a population of about 12 million persons (Togo 1995; Tokyo Metropolitan Government 2012). It has prefecture (state) status in Japan's intergovernmental fiscal system. Below the metropolitan government are twenty-three special wards in the core area, in addition to twenty-six cities, five towns, and one village. All have elected assemblies. The special wards carry out service delivery for designated functions on behalf of the metropolitan government, while the municipalities are general-purpose local governments.

The Greater London Authority was created in 1999 as a senior level of government in metropolitan London, with provision to elect a mayor and, separately, an assembly. The authority has responsibility for a number of functions, including transport, economic development, land use planning, environmental protection, and police. About 80 percent of expenditures are made for transport and police. It is financed by central government grants (63 percent), user charges (20 percent),

and property taxes (10 percent) (Bird and Slack 2004). In part because resources are so limited, it would be inaccurate to classify London as a strong metropolitan government. The underlying 23 boroughs are independent of the authority and provide basic urban services such as education, housing, social services, street cleaning, and roads. There is a clear separation of expenditure responsibilities between the higher and lower tiers of government in the metropolitan area.

MIDDLE- AND LOW-INCOME COUNTRIES

Before 1994, Cape Town comprised 61 local government entities. This number was reduced to six general-purpose governments and a metropolitan authority in 1996, and finally to a single local authority, the “unicity” of Cape Town, in 2000 (OECD 2008a). The gross inequity in services provided and the need for local input and coordination of areawide services were driving forces behind the consolidation. The present expenditure assignments mostly square with what theory would suggest: functions with large external effects and fixed costs are assigned to the center and the provinces; services with a smaller benefit zone are assigned to the local governments. When Cape Town became a metropolitan city with no lower-tier governments, it inherited all local government functions. In practice, most city expenditures are made for water, sewerage and drainage, and administration. Social services are a shared function with the province.

A different model was adopted in Manila, where the Metropolitan Manila Development Authority exists to manage areawide functions, while the local government units are responsible for local functions. The local government units (cities and municipalities) are governed by elected councils, while the chair of the authority is appointed by the president and its membership is prescribed by law. The formation of the authority (and its predecessor bodies) was a result of the concern for delivery of areawide services and the perception of government that the well-being of metropolitan Manila is a national priority. The history of metropolitan governance in Manila has been one of a struggle for power between the metropolitan government and the lower-level local governments.

Istanbul is a special case because the metropolitan area has both a provincial and a metropolitan city government. Beneath the metropolitan municipality are 73 local-level municipalities. The general pattern of assignment is much like that in other countries: higher-level governments plan and deliver services that are thought to have large external effects, while local (metropolitan) governments deliver services that are thought to have a smaller benefit zone. The result in Istanbul is a highly centralized system, with central ministries and their provincial arms accounting for about 90 percent of public spending in the metropolitan area (OECD 2008b).

Despite the checkered history of success with metropolitan governance, one might make the case that there are some prospects for its success in low- and middle-income countries. One reason is just inertia: in some cases, areawide governments were in place and their boundaries simply grew with their populations. Another reason is that, in many countries, democratically elected local government is relatively new, home rule traditions are much less entrenched, and the opposition to

metropolitan government is less unyielding. Finally, the weak level of infrastructure in place and the strains placed on city finances by migration may make areawide government an easier sell.

COSTS AND BENEFITS OF VARIOUS GOVERNMENT STRUCTURES

Most of the normative discussion about government structure in metropolitan areas centers on how various forms of governance and fiscal structures match up with the economic efficiency criteria. But there are other issues to consider, including equity, coordination, and, in some models, the cost of providing services under different structures. There also is more to be said about issues of local autonomy and about the political economy of choosing a metropolitan government structure.

The Cost of Service Delivery

Advocates of metropolitan government often try to make the case that some combination of scale economies and elimination of duplication will lead to a lower cost of government. This was a principal argument made in selling the metropolitan government in Toronto in the late 1990s. In fact, however, there is no convincing evidence that one form of government is more costly than another.

There are several reasons that one might expect a fragmented governance model to be a more costly way to deliver services. This governmental arrangement usually does not capture scale economies, and it leads to costly duplication of services and bureaucracy. For example, in the case of public management, each government must establish a general services staff, support an elected council, and provide facilities for the delivery of services. In theory, governance on an areawide basis could eliminate much of this duplication. Slack (2000) reports such results in the creation of the new metropolitan government in Toronto. The number of departments in the new city was reduced from fifty-two (in the seven former municipalities) to six; the number of divisions, from 206 to 37; the number of executive positions, from 381 to 154; and the number of management positions, from 1,837 to 1,204.

On the other hand, there also is good reason to think that an areawide approach to governance will be a higher-cost solution. Metropolitan government may lead to an equalization of service levels within the region but possibly at a level near the best that was provided prior to the consolidation. It is not clear that the reduction in duplicated efforts due to consolidation will offset the cost of “leveling up.” Toronto is a case of consolidation where the harmonization of wages and salaries, as well as the harmonization of service levels, resulted in a cost increase rather than a cost reduction (Slack 2007). This pattern also was observed in the aftermath of government consolidations in the United States in the 1960s and 1970s (Bahl and Campbell 1976). Public companies also may drive up costs if they are able to attract higher-quality (and more expensive) personnel, though this higher cost may lead to better-quality services. Finally, areawide governments are monopolists and miss out on the cost-cutting advantages that might come from competition in a fragmented government setting.

Interjurisdiction Equity

Fiscal disparities within a metropolitan area are likely to be most pronounced in a jurisdictionally fragmented system. A metropolitan government would seem more conducive to the goals of uniformity of service levels. As is discussed below, however, the path to removing fiscal disparities is much more complicated than this.

INDUSTRIAL COUNTRIES

The existence of a metropolitan government would eliminate jurisdiction boundaries. The result should be uniformity in service levels. But will this occur? The political process that often protects the politically powerful under a fragmented system may continue to work under a metropolitan government, and some neighborhoods will continue to be better serviced than others. If the form of metropolitan governance chosen is the weaker version, a jurisdictional fragmentation with an overlying metropolitan government, then equalization possibilities will be limited to those services provided on an areawide basis or through vertical programs.

Areawide government is not the only route to reducing fiscal disparities. In countries that have stayed with the jurisdictional fragmentation model, equalization has been pursued with intrametropolitan transfers from richer to poorer jurisdictions. For example, intermunicipal transfers of tax revenues are required in Copenhagen (OECD 2009a), Stockholm (OECD 2006b), and Madrid (OECD 2007a). In Tokyo, metropolitan government tax collections are allocated among the 23 special wards in the core city according to the difference between their revenue-raising potential and their estimated expenditure needs. The metropolitan city in Busan, Korea, allocates a portion of its tax revenues (on a judgmental basis) to subunits in order to reduce disparities in their fiscal base (OECD 2004b).

Another strategy for equalization of fiscal capacity is through national- or provincial-level fiscal equalization transfers. The U.S. states use this approach to equalization with differential transfers to rich and poor school districts. The Netherlands and Norway accomplish a similar equalization outcome by giving local governments little power to tax, thereby reducing the fiscal advantage of higher-income jurisdictions.

MIDDLE- AND LOW-INCOME COUNTRIES

Klink (2008) points out significant disparities between richer municipalities in the core and those on the outskirts of metropolitan Buenos Aires and São Paulo. He argues that these disparities will continue to grow because the poorer local governments lack sufficient voice to capture a greater share of funds for themselves. A striking example of extremes of fiscal disparities within metropolitan areas is the case of Abidjan, where the average per capita expenditure of the three wealthiest of the ten communes was 49 times the average for the three poorest communes (Stren 2007).

The metropolitan government approach to reducing disparities seems to have been effective in Cape Town. Before 1994, the Cape Town local government comprised 19 white local authorities, six white rural councils, 29 colored management

committees, and seven black local authorities. By 2000, this fragmented system, which had delivered a highly unequal level of services, was replaced by a single metropolitan government. The new unicity government produced a rationalization plan in order to create uniform standards of services across the new metropolitan region (OECD 2008a). At the same time, the metropolitan government invested capital to extend water distribution, electrification, and sanitation to disadvantaged areas. Still, equity has been only slowly gained, and significant fiscal- and service-level disparities still exist within the metropolitan region (Jaglin 2004).

Interjurisdictional fiscal disparities were not the primary reason for the creation of a metropolitan layer of government in Manila (Manasan and Mercado 1999). In fact, this may be one of the rare cases where metropolitan government exacerbated disparities. The Metropolitan Manila Development Authority established during the Marcos regime had broad powers to establish and administer programs and provide services. It was an appointed body, but it had legislative powers. It could levy taxes, it received a share of the national government transfer program to local governments (the Internal Revenue Allotment), and it received a 45 percent share of property tax collections by local governments within the metropolitan area. In addition, local governments were required to contribute 20 percent of their regular income to the metropolitan authority. In effect, the first version of metropolitan governance in metro Manila emasculated the local governments. Moreover, a fixed-percentage contribution from each local government, and a fixed-percentage claim on property taxes collected in each jurisdiction, almost guaranteed that the new system would increase fiscal disparities. Later reforms shifted the balance of power back toward the cities and municipalities, but the driving factor appears to be more politics than the desire for more equalization.

Lower-level governments in Istanbul must transfer 35 percent of their revenues to the Istanbul metropolitan municipality to finance services provided by the metropolitan government. Of the remainder, an additional 10 percent of local resources must be transferred to metropolitan Istanbul for transportation investments.

There are significant fiscal disparities between the Federal District of Mexico and the other local governments operating within the Mexico City metropolitan area (OECD 2004a). Per capita spending in the federal district is 75 percent higher than that in Hidalgo state and 42 percent higher than that in Mexico state. The reasons for this disparity are the higher level of economic development of the Federal District and the significantly greater taxing capacity that it has. Since there is no metropolitan government, fiscal equalization is left to the federal and state governments. The intergovernmental transfer system in Mexico, however, has no equalization transfers. A similar situation holds in Buenos Aires, where the capital district spends 40 percent more for education on a per student basis than do the surrounding suburban jurisdictions. The corresponding city-suburb disparity in per capita total expenditures in Mumbai is 60 percent.

Coordination

Public service delivery programs are not well coordinated in many metropolitan areas (Bahl 2011; OECD 2006a; Slack 2007). Even adjacent local jurisdictions

may have different ideas about the right level of services to be delivered (e.g., fire protection or policing); traffic and mass transit may not be synched, and ideas about good land use may vary greatly. One reason may be competition among local governments, which can lead to efficiency gains (Tiebout 1956) but also to higher costs, because some economies of size are forgone, as well as to uncompensated spillover costs and irritated consumers who must use these uncoordinated services. Vertical coordination between the higher-level metropolitan government and the lower-tier municipalities also can be very difficult. Sector ministries of higher-level governments deliver services within the urban area and often take little account of local government plans and practices.

The approaches taken to dealing with this issue include establishment of area-wide governments, assumption of expenditure responsibility by higher-level governments, voluntary or mandatory cooperation schemes, and simply ignoring the problem.

INDUSTRIAL COUNTRIES

In some U.S. cities, various voluntary schemes have been tried in an attempt to improve service coordination. These include informal arrangements such as joint planning committees and interlocal agreements to cover such functions as police patrols and fire protection services (Chen and Thurmaier 2009). Where areawide government has been tried in the United States, it is usually in the form of single-function special districts.

Some Canadian metropolitan areas have maintained an emphasis on home rule by local jurisdictions but have introduced a mechanism for coordination of service delivery. Metropolitan Vancouver includes 21 municipalities and a population of about 2 million and has a strong tradition of local government autonomy. In 1967 the Greater Vancouver Regional District was created by local initiative to coordinate the delivery of services with regionwide benefits, including water and sewer, capital spending, and solid waste management. It is governed by its member municipalities, which can freely reject its recommendations and even decline to be involved in district functions. Some have argued that it is not likely to succeed in coordinating services in the long run (Smith 2009).

Stockholm authorizes several instruments for interlocal cooperation, ranging from contracting for services to forming a “federation” for joint provision of services and a regional development council for coordination of regional development work and infrastructure planning (OECD 2006b). Denmark replaced a voluntary scheme for coordinating metropolitan services among municipalities in Copenhagen with a directly elected regional government that has the mandate to do comprehensive planning. The regional government has no taxing powers and limited service delivery responsibilities, and it covers an area that is less than the functional metropolitan area. Nevertheless, OECD (2009a) sees the capital region as becoming the vehicle for coordination in metropolitan Copenhagen.

The metropolitan government arrangement in Toronto offers the greatest potential for coordination of services provided in the metropolitan area because a bottom tier of local government is no longer in place. Still, the problem of coordinating service delivery with the provincial government remains. Moreover, the

metropolitan government does not cover all local governments in the functional metropolitan area, and as Sanction (2009, 236) puts it, “In short, all the difficult issues associated with metropolitan growth were taking place outside the new city’s borders.”

MIDDLE- AND LOW-INCOME COUNTRIES

In general, the governance in most developing and transition countries is more centralized than that in industrialized countries. Thus, it is not surprising that the most problematic coordination issue is conflict between governments in the metropolitan area, which take a local view, and sector ministries, which are more bound by national objectives. In the case of Manila, for example, some have argued that the ministries in charge are more concerned with their sectoral priorities than with serving the needs of the metropolis *per se* (Manasan and Mercado 1999).

The general approach to resolving conflicts between levels of government is some sort of intergovernmental arrangement where the various levels negotiate to resolve the issues. For example, in Cape Town, the law provides a framework for dispute resolution. Still, important unresolved conflicts remain regarding responsibilities for certain functions of government, particularly transportation, infrastructure, housing, land use planning, and policy implementation (OECD 2008a).

In Mexico City, the coordination problem is complicated by the number of layers of government involved, the number of local governments, and the presence of two states and a national capital district. It is further complicated by disagreements among the subnational governments about the uncompensated costs they impose on one another and by the strong presence of political parties with different views (Bird and Slack 2004). The response has been the creation of a number of coordinating and planning bodies, regional trusts, and federal programs. OECD (2004a) argues that the results so far have not led to much coordination.

The metropolitan municipality of Istanbul does have lower-tier membership on its council, but there are 73 participating lower-tier governments. In this situation, dialogue with any single local government and reaching a general consensus become very difficult.

Arguably, the most important vehicle for coordination among governments on matters of service delivery is a metropolitan government. But even this can be a problematic solution. The metropolitan government in Cape Town carries out a five-year management plan that links the municipal budget to the sector plans for transportation and other infrastructure. However, the metropolitan government has no jurisdiction over parastatals or sectoral programs of higher-level government ministries.

Home Rule

Local voter influence is strongest under a jurisdictionally fragmented system. The problem becomes how to maintain some degree of local (even neighborhood) involvement in fiscal decision making while expanding jurisdiction boundaries to capture economies of scale and deal with externalities.

INDUSTRIAL COUNTRIES

Amalgamation to an areawide government will lessen the influence of local voters over local budgets. It also may result in some voters being alienated from government. In the case of Toronto's metropolitan government, the heretofore lower-tier municipality budgets simply disappeared, and voters from smaller municipalities were right in feeling that they had less voice. Slack (2000) reports that for one municipality in what is now metropolitan Toronto, the elected representation changed from 7,300 people per councilor before the reform to 54,214 afterward. The corresponding numbers for the city of Toronto were from 41,850 to 54,214.

This said, various fixes for decentralization in metropolitan governance can be used to claw back some home rule features. The Vancouver arrangement of lower-tier control of the regional government is one example. A two-tier structure of governance as in Montreal is another approach. The election of decentralized districts within the larger urban government, as in Madrid, Amsterdam, and Tokyo, is another.

MIDDLE- AND LOW-INCOME COUNTRIES

In some poor countries, home rule is a luxury that might not be affordable. Government structure in the large cities is driven more by technical efficiency and possibilities for cost recovery and more effective maintenance of the asset stock. These objectives point toward metropolitan governance, special districts or public companies, or central government responsibility as the best arrangements for delivering services.

To make some provision for local voice, arrangements have been institutionalized for community inputs on budget decisions. In Cape Town, there are no political jurisdictions below the metropolitan government level, but 23 subcouncils have been established and empowered to present development plans. This deconcentration approach allows the metropolitan city to demonstrate that it recognizes the need for decentralized decision making without giving up much power.

In the Philippines, elected local government units remain as a lower layer in the metropolitan structure. Beneath the local government level there is a provision for a *barangay* government with some fiscal powers, thereby providing another layer of decentralization.

Political Economy Considerations

Important political agendas and bureaucratic politics must be addressed in designing the structure of service delivery and finance in metropolitan areas. Political economy considerations are often the determining factor on metropolitan government structure. The stronger the local government units in urban areas and the more wedded they are to home rule, the more difficult it will be to create and sustain a strong metropolitan government. And, the more dominant the central and state governments, the weaker will be both the local and the metropolitan-area governments.

INDUSTRIAL COUNTRIES

In the case of Toronto, the metropolitan government was put in place by a provincial act. It was hotly opposed by some citizen groups, mostly on grounds of losses

in home rule (Slack 2000). To gain some favor with voters, there also was a promise that the amalgamation proposed would save money by eliminating many “duplicate” local government jobs. Elsewhere in Canada, however, the strength of sentiment for home rule was not overcome, even with provincial involvement in enacting the legislation. In fact, the provincial government in British Columbia went to some lengths to make the point that restructuring Vancouver was not about creating a new level of government (Sanction 2009). The concept of the Greater Vancouver Regional District was sold as a vehicle for better coordination of services. The Quebec legislature established metropolitan communities for Montreal and Quebec City. The Montreal community is made up of the councils of Montreal and Longueuil and 61 other municipalities.

Politics also has led to the dismantling of metropolitan governments. Grimaldos and Ferrer (1999) cite the conflict between the socialist majority in the metropolitan government and the autonomous government of Catalonia as leading to the abolition of the Barcelona metropolitan government. Politics have deadlocked the discussion in Italy to a point where even agencies for intermunicipal cooperation have failed.

The United States represents perhaps the extreme case of opposition to metropolitan government. Hundreds of proposals for governmental consolidation have reached the referendum stage over the past 20 years, but only 34 had succeeded as of 2008 (Hall 2009; Leland and Thurmaier 2005). Boundary changes and changes in the distribution of political power are a tough sell in the United States.

MIDDLE- AND LOW-INCOME COUNTRIES

Governance and finance in low- and middle-income countries are more centralized in general, but this pattern has been challenged by democratization and the growing voice of elected metropolitan-area political leaders. Another consideration is that the post of mayor or governor of a large metropolitan area is high profile and can be a good platform for some who aspire to national office. Especially when the local leader is from an opposition political party, the turmoil can spill over into counterproductive intergovernmental conflicts.

In Mexico City, a political tug-of-war is played out between the federal government and the state governors within the metropolitan area. Matters have become more complicated with the end of one-party rule.

The history in Manila has been a clash between the municipal government units and the appointed metropolitan government. During the Marcos period, the metropolitan government was stronger in terms of its regulatory powers and even held a claim on a significant part of the revenues of the local government units. In the post-Marcos period, the balance of power has swung back toward the local governments in terms of both service delivery autonomy and the claim on revenues (Laquian 2002).

CONCLUSIONS: HOW TO MOVE FORWARD?

Removing the constraints to providing an adequate level of public services in metropolitan areas is a subject that will continue to demand more attention from policy

makers, particularly those in middle- and low-income countries. The population growth of urban areas, their importance in the national economy, and the large unmet demand for public services will force this. But reform in this area will not be for the politically faint-hearted. Addressing these issues will require considering whether metropolitan-area governance and finance should be structured differently from the rest of the country.

The Problem

Part of the problem with metropolitan governance is the limited resources available to invest in expanding and maintaining the infrastructure and to support basic social services. This might lead to increased revenue mobilization by local governments, which might be better done under an areawide governance arrangement. But the problem can also be helped by reducing some of the costs of service delivery. This would lead to reforms that address the economies of scale that go uncaptured in many fragmented metropolitan areas and to reforms that can reduce burdensome spillover costs, such as traffic congestion and pollution.

The solution to this problem, or at least part of it, might be to organize metropolitan governance in a more efficient way, that is, to move toward an areawide governance model. But this model would move governance another step away from local control and would impose an efficiency cost on the local population. The dilemma facing those who would change government structures is the trade-off between benefits inherent in metropolitan governance and the loss in home rule this would bring.

The underlying problem in metropolitan governance and finance is the unrealistic goal of marrying two very different spatial units. The functional economic region has boundaries that are informal and always changing, as one would expect of a labor market area. The “champion” of making the region a government entity is the planner who sees great efficiency and equity gains from some form of regional service delivery. The other spatial unit, the local government, has fixed boundaries. The champions of local government are elected officials and voters, both of whom want to maintain control over services provided in the local area. It seems unlikely that these two very different actors will come together easily in support of a general-purpose regionwide government. The issue is even more complicated by the technocratic goals of special districts or public companies whose service boundaries may not be coterminous with either the metropolitan area (labor market area) or the general-purpose local governments. It will take participation by a higher-level government to get around these special interests, though higher-level governments will themselves have vested interests.

The public policy solution lies in finding a way to deliver some services with a degree of local control and financing, while delivering others on a regionwide basis and with a broader finance base. All governments will likely identify with a model that produces better prospects for long-run economic growth and better infrastructure services. Local governments can be moved by strategies that give them some voice and a promise to hold down taxes. But none of these arguments seems

to be convincing when it comes to moving basic services away from the local government level or, more drastic yet, abolishing local units of government. The practice shows that governance and finance in some metropolitan areas have moved toward this solution, but almost no one would declare that the delivery of regional services is properly coordinated.

How to Design a Reform

The reform of metropolitan governance and finance in low- and middle-income countries is a relatively new frontier in policy analysis. Economics, politics, history, and culture all play an important role in deciding on the best arrangement for metropolitan governance and finance, so it is not surprising that many different versions are in practice. Theory would have us think of governments and perhaps voters sitting down to decide who should do what, as if the game had just begun. In fact, the game began long ago, and many subnational governments are locked into expenditure assignment and financing “entitlements.” These entitlements are not easily discarded just because an urban area has grown rapidly, because two urban areas have grown together to become a single labor market area, or because the current structure of government has become unwieldy. However, the time for wholesale rethinking may be close at hand in many low-income countries.

The place to begin the reform process is with a comprehensive fiscal review for the metropolitan area. This will be new ground for many metropolitan regions, where the status quo on governance is accepted and where there is often a willingness to stray only so far, such as appointing regional advisory commissions. Mostly, there is a willingness to live within the fiscal regime set by the central or state government.

This comprehensive review might include the following:

- A rethinking of the structure of government that will deliver services. While this seems a daunting undertaking, one might point to the experiences in Toronto and Cape Town, where exactly this was done.
- An analysis of options for the division of expenditure assignments among the tiers of government.
- A review of revenue-raising choices, including local and areawide taxes and user charges and intergovernmental transfers.
- Consideration of borrowing powers of metropolitan local governments, and perhaps a separate regulatory framework for these governments.
- Integration of alternative fiscal structures for the comprehensive development plan and land use plan for the metropolitan area.

The committee that develops this plan must include the important stakeholders in the metropolitan area. Without the local government’s inputs and eventually approval at some level, fiscal reform cannot move forward. However, most low- and middle-income countries are centralized, so the fiscal review and action plan would have to be led by the central government (or perhaps state government in the case

of some federations). It is quite possible that the recommendation will be to enact a completely different fiscal regime than exists for other local governments in the country.

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