

Evaluation of Municipalities' Financing Patterns from Sustainability Perspective (Case Study: Tehran Municipality)

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Abstract

Nowadays considering the expansion of metropolitan regions, the demand for various kinds of urban goods and services has burgeoned and responding to these needs, requires having sufficient and sustainable financial sources; In a way that these incomes do not disturb the sustainable urban development trend, while being reliable and durable. In Iran, a significant portion of national municipalities' incomes depend on received tolls for land and building. Accordingly, finest changes and transformations in land and housing cost usually affect municipalities' income acutely. This way of financing is not only unsustainable, but also eventuates in adverse economic, social and skeletal consequences and aftereffects as time passes by. Therefore, in the present study effort has been put into investigating the instability trend of Tehran Municipality incomes in the period of 13 years (1380-1392), applying descriptive, analytical and comparative methods and conducting a comparison between different chapters' share of Tehran Municipality income. The results show that incomes derived from building and land which are among the most unsustainable items of income for cities contain the largest volume of Tehran Municipality incomes by a 60 percent share. This has resulted in municipality's income structure confronting continual fluctuations due to slightest changes in land and building cost. Thus it is apparent that making decisions and programming for the city face numerous ups and downs.

Keywords: sustainable income, Tehran Municipality, city financing, construction tolls

1. Introduction

High population concentration in urban localities has brought about many challenges ahead of urban policy-makers and planners. One of the most important challenges is how to finance sustainably and provide sufficient public services for citizens (Akbari, 1387: p. 156). In Iran, from the beginning of the formation of municipalities, the subject regarding financing sources of this public institution has never been defined and elucidated in national macroeconomic system framework. But from 1362, by the presentation of municipalities' self-sufficiency policy in the form of annual budget and also the emphasis of this matter in the first development program law of Islamic Republic of Iran, the instability trend of municipality's income source was accentuated and more consideration was drawn into unsustainable incomes such as selling density as urban management responses toward reduction in sources and funds. One of the

most important unsustainable income items for municipalities in national metropolises including Tehran are incomes earned from building and construction. Some of these incomes are not only unsustainable, but also considered as corrupt incomes (Akbarpour et al, 1389: p. 160). Existing statistics show that tax share on density construction permit which is known as the most unsustainable kinds of urban incomes, equals 0.05-1.25 percent in other countries and 34 percent in Iran (Organization of Municipalities and rural Municipalities Vice chancellor of programming and the development, 1391: p. 1). It should be mentioned that selling density as a factor of earning income in previous decades has been a consequence of ignorance towards creating new and sustainable incomes for municipalities. This ignorance has been due to taking "moneymaking" and "sustainable moneymaking" for the same. While sustainable moneymaking alludes to the fact

that urban income could not be derived from every source and it must have the following features: "Durability"; being consistent and not experiencing acute fluctuations at least in the short-run. "Favorability"; income from that source must eventuate in improving justice-oriented approach and not hamper the environmental, skeletal, social and economic structures of the city. "Flexibility"; the income base must increase in the passage of time and rise with expansion in expenditures collaterally, so to be away from financial deficiency (Hadi Zonnouz, 1386: pp. 2-3). According to the stated issues, the present study aims at "identifying and elucidating income instability trend in metropolitan areas of Iran (Tehran case)" and "analyzing Tehran Municipality's income items" and hence it is supposed that "Tehran Municipality's incomes structure pursues a totally unsustainable trend" and in order to examine this, first by conducting library studies, documents and reports related to the subject of this research, identification and a more precise description of the issues being studied are presented. Then by collecting the required statistics and information, the combination of Tehran Municipality's income share is extracted and its income items are analyzed.

2. Concepts, Views and Theoretical Background

Theoretically, urban management (municipalities) in many countries around the world conveys a sort of local government. In this kind of government, municipalities take hold of the tenure of all related zones to urban management. Such management relies on sustainable and independent local incomes (Tibajuka, 2009). The importance of how to finance this public institution is to the extent that investigating the theoretical background of local finance in pursuit of identifying scientific criteria for designing an optimal and favorable income pattern appears essential. Investigations reveal that four concepts including "financial decentralization (financial federalism)", "local tax economics", "municipality's services cost economics" and "central government aid to municipality economics" build the bases of public finance issue, which are explained in the following.

2.1. Financial Decentralization (Financial Federalism)

Financial decentralization which is also known as "financial federalism" is considered among the basic issues in the field of allocating income sources in different levels of the government. Samuelson, Arrow and Musgrave are among theorists that emphasize on government's role in correcting market failure¹ and creating an effective mechanism for better income distribution. They believe that when market fails due to existence of a variety of public goods, public sector policies must be utilized in order to compensate this failure. The reason why public goods which are in line with the implementation of public sector policies are supplied by the government, is that sometimes market mechanism does not supply a particular good sufficiently. For these goods the government can intervene and supply them by receiving their expenses (tax). In other words, the government can determine who are to make use of public goods production and by attaining the expenses of producing that good from these people, produce the sufficient amount and meanwhile, prevent people from "free riding". Also from Oates's point of view, governments are always pursuing maximization of social welfare level of citizens in their domain. One of these policies is "financial decentralization" which Oates has formulated as "Decentralization Theorem" (Oates, 1972). Meaning that by decentralizing and giving financial authority to local governments, they supply an optimal amount of public goods proportionate to their needs in the geographical district of their domain, so that advantages appear to citizens. Experts believe that at local levels of the government, they must rely mostly on taxes to have link to the profit gained from local public goods, among which tax on real estate and receiving the cost of urban services could be named (Gordon, 1983). Accordingly, Tiebout believes that taxes must be considered the same as costs paid by households for consuming local public goods (Hadi Zonnouz, 1388: p. 7). Generally, in financial federalism approach which is also known as "the traditional or first generation financial federalism", the central government must

¹. Market failure is a concept in economic theories in which allocation of goods and services by free market system leads to inefficiency. In such cases, the government intervenes as the corrector of market failure and the "efficiency" creator in the economy. the existence of market failure is usually asserted as a justification for government intervention in the market.

take responsibility for basic duties required for macroeconomic stability, supplying public goods at national level such as defense and income redistribution in the form of helping the indigent. On the other hand, local governments must have the necessary financial authorities in order to provide needs in their geographical district (at local level) (ibid, Oates).

2.2. Local Tax Economics

Local tax which is called municipality's tolls in Iran is used in financing subsidies that municipalities pay in these cases: "In cases where municipality's supply of services is accompanied with positive externalities", "In cases where services supplied by the municipality are merit goods, but citizens underestimate their actual value due to unawareness" and "In cases where services are in the form of public goods and demanding their cost from citizens is impossible". Local tax is a kind of tax that local authority determines its rate or base and preserves its earnings for special purposes (Kara, 1988)¹. Generally, local tax economics emphasizes on this issue that if people enjoy local government services, then they must pay for their production and preparation expenses. For services that are financed in group form, an optimal zone should be defined, in which geographical coverage of services overlap citizens' tax commitments.

2.3. Municipality's Services Cost Economics

Municipalities have always provided various services and received the required expenses from consumers. In economics language, in the condition that the cost of some goods or services (like public goods) could not be determined via market mechanisms, market failure occurs. Because determining the fiscal value of such goods is practically difficult. That is why local taxes and ex gratia aids of government are considered for financing municipality's expenses when the cost of urban services could not be received from people who enjoy them due to market failure (Baily, 1999). In fact, service suppliers are sensitive to consumers only when suppliers' income is directly dependent on the usage volume of services being

provided. This way of financing creates enough motivation for supplying services equal to demands and expected level of quality; thus services being supplied with unfavorable quality eventuate in a decrease in income from selling these services. Noting this matter presents a criterion for substituting reliable methods with fixed methods of financing. The municipality could rely are incomes that are related to services' application, instead of having a guaranteed income from taxes and government aids. These incomes are earned from receiving the cost of services from users, on the condition that it is consistent with goals of providing services and the concept of justice (Hadi Zonnouz, 1381: pp. 20-22). These theoretical considerations specify that in order to support municipalities for providing some public services, subsidies should be paid to this institution from the government. In order to pay subsidies to the public services supplied by municipalities, the monetary value of positive externalities and valuable goods of these services could not be solely considered as the base. Because as it was mentioned before, determining this monetary value is practically difficult. Therefore, different services shall be allocated different levels of subsidy commensurately.

2.4. Government Aid to Municipality

Government aid to the municipality is another way of paying for urban services' cost. This aid could be in the form of general aid (unconditional, non-elective) and/or particular aid (conditional or optional). This sort of aids is donated in pursuit of achieving horizontal and vertical justice through financial equalizing projects (Slack, 2009: p. 36). Horizontal justice is based on the idea that people with the same conditions must be treated the same. Vertical justice means that people in different income groups must be considered based on their payment power; so that after government aids' contribution the condition of the more indigent people improve better than that of the affluent. Ex gratia aids could be used for restricting local tax especially in the conditions that municipality relies on a unit, non-progressive tax which belongs to a small portion of citizens. Contribution of general aids allows the municipality to enjoy more freedom of action in allocating its sources between different consumptions. Generally, it is expected that ex gratia aids from government to municipality cause an increase in municipality's expenses on urban

¹. It should be mentioned that local governments do not have absolute freedom of action in determining the tax base and tax rate. Sometimes macroeconomic and political expediencies are also effective in the determination of this rate.

services or a decrease in local tax (Hadi Zonnouz, *ibid.*: p. 36).

2.5. Research Framework

Earning sustainable urban incomes is a basic section in economic growth and development of city and a strategic part in financing citizens' needs in growing cities. It should be noted that nowadays due to widespread duties and performance area of municipalities, relying merely on one of the mentioned financial bases (establishing financial federalism, collecting local tax, receiving municipality services' cost and government aids to the municipality) would not answer the needs of citizens and municipalities. Therefore it seems that a combination of these four bases could be the main source of municipality finance. It is possible that the source of one base in public sector finance become greater than the others. But certainly a combination of these bases is observed in the income system of municipalities around the world. Hence, the theoretical framework of the present study is also applying an optimal and favorable combination of the four theoretical bases of "financial federalism", "local tax", "municipality's service cost" and "government aid to municipality" as the theoretical ground of this research.

3. Investigation on National Municipalities' Income Structure (Tehran Municipality)

From experts' point of view, the income structure of Iran municipalities is evaluated as weak in small municipalities, and wrong and unsustainable in metropolises. Because these incomes are initially relied on corrupt and unsustainable income sources such as selling density and building infractions and secondly are linked to sources which are fluctuating, meaning that they increase or decrease with business cycles. On one hand, these conditions

have caused the budgeting system of municipalities face a frail, inappropriate and unsustainable income structure and on the other hand expenses are not considered to have balance. Now this question comes up that how could the factors related to municipality incomes challenges be identified and redressed so that sustainable incomes with acceptable security margins would realize? In order to answer this question, firstly the public area of municipalities' duties are discussed and then the income structure of Tehran Municipality during years 1380-1392 is evaluated and analyzed in detail.

3.1. Clarifying the Public Sector Finance Trend in Tehran Metropolis

Tehran is the largest city and capital of Iran and the centre of Tehran province. Its population equals 8,244,535 and is considered the 25th most populated city in the world (Iran Statistics Centre, 1394). According to the new renovations in urban management which regard "programming" as the main indicator of urban decision-makings, investigating the income structure and trend of municipalities is counted as essential in order to accomplish planning and decision-making. Therefore the 13-years period (1380-1392) has been considered for examining the income trend of Tehran Municipality. Based on 1394 budget, income components and sources of the municipality are classified as in the following table. The information presented in this table illustrates that municipality's sources and incomes are divided into 3 chapters. Chapter 1 is related to incomes, chapter 2 to sources from capital properties assignment and chapter 3 to financial properties assignment. In this table, components of each chapter are also specified and determined.

Table 1- Incomes and sources, main codes with their components

Chapter		Explanations	Income Components
1	Incomes	Incomes derived from public tolls (continual incomes)	Collected by other institutes
			Tolls on buildings and lands
			Tolls on communication and transportation
			Tolls on selling and services permits
		Incomes derived from special tolls	Collected by municipality and other institutes
			Share of collected concentrated toll
		Cost of services and Municipality's	Incomes from the cost of urban services

		profit institutes incomes	Incomes of municipality's installations
		Incomes derived from municipality's funds and properties	Incomes derived from municipality's funds
			Incomes derived from municipality's properties
		Contributed aids from government and governmental organizations	Contributed aids from government and governmental organizations
		Donations, contributions and properties	Donations and aids contributed by people and private organizations
			Aids and donations received from non-governmental public institutes
			Properties that belong to municipality accidentally or due to law
Tolls and incomes received in shielding privacies	Tolls and incomes received in shielding privacies		
	Other items		
2	Sources derived from capital properties assignment	Tolls on building permits	Tolls on building permits
		Selling municipality properties	Selling municipality properties
3	Sources derived from financial properties assignment	Received loans	Received loans from Ministry of the Interior
			Received loans from banks
			Received loans from other institutes
			Other items
		Other sources	Income surplus of previous periods
			Income surplus of previous periods
			Collecting endowed loans
			Collecting receivables Allocated sources of Islamic City Council
Other items			

Source: Tehran Municipality, 1394

Table 2 and 3 show the performance and share of municipality's income during years 1380-1392 separated by income chapters, respectively. It could be observed that the average share of first chapter

is 34.27 percent of total budget during the investigated period. Also, the average of chapters 2 and 3 during years 1380-1392 are equal to 59.34 and 6.39 percent, respectively.

Table 2- Performance of income chapters during years 1380 to 1392 (unit: Thousand Rials)

Income chapters	1380	1381	1382	1383	1384	1385	1386
Chapter 1	1,863,374,867	2,140,324,922	3,563,746,251	3,906,647,989	4,480,391,613	6,820,236,450	9,329,100,269

Chapter 2	3,124,067,453	3,527,176,821	5,942,074,075	7,077,325,218	7,179,149,636	11,671,604,072	19,181,735,796
Chapter 3	0	431,379,150	960,976,767	301,828,765	1,571,432,047	1,016,248,610	2,691,022,755
Total sum	4,987,442,320	6,098,880,893	10,466,797,093	11,285,801,972	13,230,973,295	19,508,089,132	31,201,858,821
Income chapters	1387	1388	1389	1390	1391	1392	
Chapter 1	14,055,094,485	15,995,812,457	22,341,129,129	22,573,823,788	37,073,020,383	56,465,034,835	
Chapter 2	32,369,695,362	39,192,504,091	50,260,821,791	52,894,198,431	76,699,107,402	82,357,248,603	
Chapter 3	6,356,711,606	6,127,931,436	9,939,845,084	8,775,494,122	14,299,000,000	17,467,906,950	
Total sum	52,781,501,453	61,316,247,983	82,541,796,004	84,243,516,341	128,071,127,785	156,290,190,388	

Source: Tehran Municipality

Table 3- Income chapters' share during years 1380 to 1392 (unit: percent)

Income chapters	1380	1381	1382	1383	1384	1385	1386
Chapter 1	37.40	35.10	34.00	34.60	33.90	35.00	29.90
Chapter 2	59.80	57.80	56.80	62.70	54.20	59.80	61.50
Chapter 3	5.20	7.10	9.20	2.70	11.90	5.20	8.60
Income chapters	1387	1388	1389	1390	1391	1392	Average
Chapter 1	26.60	26.10	27.10	26.80	28.90	36.10	34.27
Chapter 2	61.40	63.90	60.90	62.80	59.90	52.70	59.34
Chapter 3	12.00	10.00	12.00	10.40	11.20	11.20	6.39

Source: Author's calculations

Thus it could be observed that in the income structure of Tehran Municipality, the second chapter which contains sources from capital properties assignment has the top rank by almost 60 percent share and chapter 1 which includes incomes occupies the second position in ranking by 34.27 percent. Now in the following the aim is to identify the share of income items of chapter 1 and 2 that have the main share in municipality budget.

In order to do so, in table 4 a list of chapter 1 items in municipality budget is illustrated with their concomitant shares. It could be observed that from the 31 percent of chapter 1 income, a major part (43.72 percent) is gained from buildings and lands tolls. Moreover, from the 60 percent of chapter 2 income, more than 90 percent is earned from building construction permits (table 5).

Table 4- List of income items of chapter 1 from Tehran Municipality

Title	1380	1381	1382	1383	1384	1385	1386	1387	1388	1389	1390	1391	1392	Average
Incomes derived from public tolls- Collected by other institutes	2.6	3.5	4.3	4.8	7.6	5.0	3.8	2.5	0.9	34.0	43.3	40.0	33.8	14.32
Incomes derived from public tolls- Tolls on buildings and lands	67.2	52.0	50.8	39.6	42.2	50.1	50.2	58.2	44.9	34.8	34.4	26.9	17.1	43.72
Incomes derived from public tolls- Tolls on communication and transportation	1.6	1.9	1.5	1.8	2.2	1.9	1.8	1.4	1.5	1.7	1.7	1.2	1.1	1.64
Tolls on selling and services permits	2.6	3.6	2.5	3.5	3.2	2.2	1.8	14.3	22.3	3.2	2.0	1.9	1.2	4.95
Incomes derived from special tolls- Collected by municipality and other institutes	6.1	7.6	6.7	7.5	6.6	10.1	9.5	9.8	7.4	5.8	5.4	2.1	2.1	6.67
Incomes derived from special tolls- Share of collected concentrated toll	6.0	13.6	18.6	20.5	19.1	17.6	18.5	2.4	2.4	2.7	3.0	1.4	2.0	9.83
Incomes from the cost of urban services	3.8	6.1	4.2	4.5	4.6	2.5	3.4	4.2	5.0	4.5	3.7	2.7	2.3	3.96
Incomes of municipality's installations	0.1	0.1	0.4	0.3	0.2	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.11
Incomes derived from municipality's funds	0.2	0.1	3.4	1.9	0.9	0.7	2.0	2.1	7.2	3.1	1.0	1.0	11.9	2.73

Incomes derived from municipality's properties	0.7	0.8	0.7	0.6	0.7	0.7	0.8	0.7	2.2	0.7	2.7	18.5	24.8	4.20
Contributed aids from government and governmental organizations	0.0	0.6	1.9	7.2	5.1	2.5	0.0	0.0	2.3	1.8	0.0	0.4	0.0	1.68
Donations and aids contributed by people and private organizations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Aids and donations received from non-governmental public institutes	0.0	0.2	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.05
Properties that belong to municipality accidentally or due to law	7.2	7.3	5.0	7.1	7.5	6.5	8.1	4.5	3.8	7.1	2.7	3.7	3.5	5.69
Incomes derived from municipality's properties	1.8	2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.5	0.2	0.2	0.2	0.42

Source: Tehran Municipality and author's calculations

Table 5- Share of Tehran Municipality budget chapter 2 income items

Title	1380	1381	1382	1383	1384	1385	1386	1387	1388	1389	1390	1391	1392	Average
Tolls on building permits	98.1	95.2	95	90.8	95	94.2	93.1	90	85	87.1	97.9	94.9	93.8	93.08
Selling Municipality's properties	1.9	4.8	5	9.2	5	5.8	6.9	10	15	12.9	2.1	5.1	6.2	6.92

Source: Tehran Municipality and author's calculations

Thus, it could be claimed that a major part of Tehran Municipality incomes rely on buildings and lands tolls. Therefore, any changes in the cost of land could easily cause fluctuation in municipality incomes. So one of the main features of sustainable moneymaking which is certainty and predictability

of income is practically not present at Tehran Municipality and leads the income structure to instability.

Based on economic theories, sustainable incomes of municipalities must have the two features of "durability" and "purity". Durability means that

income items must be obtainable during the time and for achieving them, necessary plans could be conducted. Purity also means that earning these incomes does not eventuate in the devastation of urban space. So incomes that earning them lead to lowering the quality of city and threaten citizens' life conditions are not counted among sustainable income items.

Studies reveal that in developing countries including Iran, dominant trends in municipalities financing system are: instability, vulnerability from the overall condition of national economy especially in the field of land and housing, organizational, managerial and legal inefficiency, existence of inactive and inefficient income codes, durability and intensification of tendency for tax-evading and free riding (meaning that citizens enjoy the advantages of urban services but do not tend to pay for the expenses and neglect this responsibility in many ways). These conditions have resulted in urban financing system facing high reliance of incomes on building area volume and density construction, inflexibility in tax bases, relatively low levels of government aid, absence of transparency and dominance of expediency in ways of earning income and indeterminacy of municipalities' financing management position in laws and national public economic issues. Consequently, the basic pillars of sustainable urban development concept are also altered, affected by this inappropriate finance structure and are put into unsustainable conditions. While municipalities in developed countries resort to different financial sources such as tax and tolls, income from selling services, borrowing and also government aids in order to accomplish their duties, Iranian municipalities practically rely on incomes from construction tolls and building penalties, and income lines which are based on tax are considered as lower priorities. Therefore the existential philosophy of incomes that are earned in the form of penalties and are based on prohibition from exiting the comprehensive urban plans and lessening urban damages, are questioned. The experience of studies about urban incomes shows that national municipalities' attitude toward these penalties is not prohibition but moneymaking. This has resulted in maintenance of incomes from building infraction penalties, changing usage, omitting parking lots, etc, instead of their decrease and municipalities are not dissatisfied with their presence and even their increase. It is obvious that

such attitude extends greater reliance of national municipalities on unsustainable incomes and leads to a decrease in cities' life quality.

4. Summary and Conclusion

According to the theoretical views mentioned above, urban management finances by receiving permits for earning income from the central government which is known as financial federalism and also by collecting local tax, obtaining the cost of municipality's services and eventually by aids from central government to municipalities. Certainly no municipality has sufficed to only one of these ways and they try to use a combination of these four methods for earning income. But the important thing is how to combine these financing methods optimally and favorably, and also how to guarantee its execution. Investigations show that Tehran Municipality somehow uses these four ways of financing in order to compensate for its expenses. However, during the past 13 years (1380-1392) in this municipality, the share of unsustainable incomes which are derived from building and land tolls and selling density, has been significantly high (60 percent).

One of the main reasons for this matter stems from the inactivity of most income codes of Tehran Municipality. In a way that one income line is included in the list of Tehran Municipality incomes as sustainable income, but it does not have the required capacity for moneymaking. This not only causes acute income fluctuations for the municipality, but also results in urban managers' deviation in decision-making in the field of supplying services and investment method, and affects the efficiency of resource allocation and the level of economic activities in Tehran unfavorably. Therefore, it seems that in order to make municipality's incomes sustainable, investigating and evaluating all income codes, conducting pathology and assessing the capacity of inactive income codes, revising the definitions and bases of calculating income lines, combining the similar income codes and decreasing their number and eventually defining tolls and costs for new services in pursuit of exiting dependency to incomes derived from construction and doing away with deficiencies and shortcomings of Tehran Municipality financing methods, are among the necessary actions.

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