The Chicago Proposal for Financing Sustainable Cities

Policy alignment across levels of government

1. **National policies are key.** The greener the national framework, the easier it will be to address city-specific challenges and to ensure coherence and consistency between national and local policies. The national framework is particularly important with respect to pricing signals for non-localised environmental externalities, such as GHG emissions. In many countries, moreover, reform of urban revenue sources requires central government action.

2. **Remove barriers to local government action.** While national governments may face challenges to immediately implementing holistic reforms, they can start by eliminating current regulations that impair the potential for local governments to act.

3. **A holistic approach is necessary.** Efforts to green urban revenue sources may have undesirable distributional consequences. These concerns should be addressed in the context of the entire tax and benefit system, rather than trying to ensure that each individual policy measure serves both environmental and equity objectives.

4. **Keep the policy package simple.** While the design of specific instruments will in many cases need to be quite sophisticated, it is important to keep the overall policy package as simple as possible. An overly complex system of environmental taxes, charges and fees makes impact assessment harder and raises the risk of unintended interaction effects or perverse incentives.

Making existing revenue sources greener

5. **The overriding aim is to internalise externalities.** To the extent possible, taxes, charges and fees should be designed to confront agents with the full marginal social cost of actions affecting the environment. At a minimum, this means eliminating the anti-green bias of some existing local tax provisions and the perverse incentives created by many environmentally harmful subsidies.

6. **Road-pricing policies can help reduce traffic and pollution.** Road-pricing policies like congestion charges are likely to be most effective at reducing traffic and emissions when differentiated according to the level of congestion, peak hours or both.
Linking pricing structures to vehicle type as well may strengthen incentives to switch to greener forms of transport.

7. *Transport-related revenue sources require coherent planning.* The use of congestion charges to achieve green objectives will be more effective and less costly to users when alternative mobility solutions are available; governments might consider earmarking such revenues to finance public transportation.

8. *Fees for water and waste services should be more responsive to actual resource use.* Fees and prices should be used to signal the scarcity of the resources being consumed, as well as covering the costs of infrastructure investment and service provision.

9. *Where appropriate, intergovernmental grants should take into account environmental objectives.* This will help compensate cities for the opportunity costs of green behaviour (e.g., the loss of development charges if an area is designated as a public park). Specific or matching grants can compensate local governments for the spillovers generated by green policies that incur localised costs but generate broad benefits.

**Tapping new sources of finance**

10. *Carbon finance should be more accessible to cities.* Cities and central governments can work together to make better use of carbon-offsetting programmes (e.g., the Clean Development Mechanism and Joint Implementation) and to ensure that these (and other) resources may come directly to cities. One of the conditions of carbon finance should be use of a harmonised emission inventory for cities.

11. *Infrastructure needs related to new development should be internalised in the financing of development projects.* The costs of sprawl, for example, may be recovered from developers through development charges or other financial contributions. In a similar fashion, new developments should also, where appropriate, incorporate the cost of investment in alternative water sources.

12. *National-local co-operation is essential to developing access to new forms of green finance.* There are a number of potential instruments for tapping private finance in support of urban greening and aligning private investment with policy priorities. These include private-public partnerships, green bonds and green infrastructure banks. However, they each raise potential problems of insufficient size, moral hazard and opportunism. Cities thus need to co-operate with one another and with central governments to build capacity and ensure that they possess the requisite financial, technical and legal expertise, as well as sufficient bargaining power, when negotiating private-sector financing.