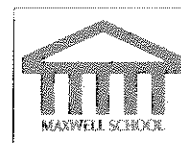


REVENUES

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Research & Policy Notes Concerning Public Finance in Developing Countries

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In this Issue

One of the goals of the Local Revenue Administration Project (LRAP), the several-year agreement between AID and the Metropolitan Studies Program, is to develop a center of expertise at Syracuse in local public finance, with close contact with other experts throughout the world, so as to promote greater knowledge and practice of decentralized local public finance. Evidence that such a goal is being met can be found in a recently published collection of articles on local public finance edited by Larry Schroeder, the director of the Metropolitan Studies Program and the Local Revenue Administration Project. The volume is a direct outcome of an Expert Group Meeting on Financing Local and Regional Development sponsored by the UN Centre for Regional Development (UNCRD) held in Nagoya, Japan, in March 1986.

Published in Japan by UNCRD in the August 1986 issue of its quarterly journal, *Regional Development Dialogue*, this collection of six articles and commentaries provides a

timely and important contribution to the study of local public finance in developing countries. The individual articles were not all direct results of LRAP funding, though the one by Schroeder and Dalton was prepared under LRAP institutional support. The overall task of coordinating the multi-authored publication was greatly facilitated by LRAP.

In order to help provide greater awareness of the publication, this issue of *Revenues* presents a summary of the articles. Interested readers should contact the United Nations Centre for Regional Development, Nagano 1-47-1, Nakamura-ku, Nagoya 450, Japan, for information on how to obtain a copy of the journal.

Approaches to Financing Regional and Local Development

There are several theoretical reasons to expect that decentralized decision making can lead to more effective spending of local governments and, thus, to more rapid economic growth. Localized decision making can more efficiently match spending decisions to the specific needs of a locality. Likewise, decision making at the local level can avoid many of the costs and delays of decision making which require approval from the capital city. Finally, since the decisions are their own, local residents will more actively participate in the development efforts of a locality.

At times central governments may also rely upon decentralization and local resource mobilization for somewhat self-serving reasons. In many developing countries urbanization is recognized as one of the most pressing domestic issues. As such, central governments may wish to stem the tide of migration into the cities. It is sometimes felt that such migration rates will be decreased by improving the relative quality of life in secondary cities and rural areas. Likewise, there is recognition that local governments may be in a better position than the central government to capture local revenue-raising capacity outside major cities and, thereby, reduce the revenue pressures on the national governments.

What resource-raising instruments are available and are used at the local government level? Basically, there are two classes of resource mobilization techniques available—local taxes and user fees. The former group includes a wide range of instruments from simple head or poll taxes levied on each individual or household in the locality to more complex taxes on the value of property, sales, or business transactions taking place locally. User fees are especially appropriate sources of revenue when attached to particular services provided by local governments, e.g., water supply, cattle dips, waste collections, or markets.

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Even with locally accessible resources being mobilized, it is unlikely that local governments in developing countries can be totally independent of external sources of funding. The two primary forms of external funding include loans to the local government and intergovernmental grants. While the first of these is not prominent in most third world countries, as development proceeds and local governments become more credit-worthy, there is good reason to turn to this source of funding to provide the resources for larger and longer term capital projects. Intergovernmental grants, too, can be designed to provide resources to localities while simultaneously providing some autonomy to local governments and encouraging them to carry out resource mobilization efforts on their own.

From a conceptual standpoint, there seems to be an adequate set of resource mobilization instruments available to local governments in developing nations. Yet, as the six papers in the volume document, reality may still be far from this conceptual ideal. User fees are not widely used, taxes assigned to local governments are not particularly suited to provide a growing source of revenues to meet increased demands for services, loan financing is limited by the macroeconomic circumstances faced by central governments, and intergovernmental grants are designed in such a way as to increase reliance upon the central government rather than to encourage local autonomy and fiscal responsibility.

The Six Papers

The papers in the volume include three that concentrate on different types of local government financing instruments and three that are country-specific in focus. In the first paper, Ved Prakash reviews the current status and potential of user fees as a way to finance urban services in developing countries. His paper discusses the underlying conceptual basis for user fees and why they can be deemed to be a desirable method of financing particular local government services to ensure that such services are, in fact, provided to local residents. He then provides detailed discussions of the applicability and techniques that might be used to impose user fees on such services as public housing, markets, and other commercial activities, transportation-related services, solid waste collection and disposal, water supply and sewerage facilities, as well as land and land development. Prakash concludes that, while user fees do not currently play a significant role in financing local government services, the potential for such fees is great if the political, administrative, and management problems that he raises could be surmounted.

Although local tax sources can and should be evaluated according to several criteria, Larry Schroeder and Elizabeth Dalton focus on the revenue growth or buoyancy characteristics of tax instruments most commonly used by local governments in developing countries. Their review of available studies suggests that the automatic growth potential of most revenues assigned to local governments is generally inadequate and that discretionary changes are necessary to achieve buoyant growth in revenues. Particularly important for property tax revenue growth is the assessment process. Finally, Schroeder and Dalton note that it might be a mistake to overemphasize revenue increases if such long-term growth is attainable only by giving up certainty or stability in revenues over time.

The third paper focuses on local government credit within a single country. Angel Q. Yoinco reviews the use of credit within the Philippines and emphasizes how policy recommendations made within one macroeconomic environment

should, perhaps, be reevaluated in the light of changing political and economic developments within the country. The paper documents the sources and uses of credit finance, including the repayment record of local governments which had previously obtained loans for a variety of activities. Yoinco notes how changing the current administrative structure that provides loan funds to local governments could and should be streamlined and stresses that, perhaps, loans designed to improve the tax administration capabilities of local governments might be particularly productive in the longer run.

The final three papers in this set turn to local finance issues in four different countries—Philippines, Republic of Korea, Sudan, and Thailand. The paper by Kraiyudht Dhiratayakinant focuses on the taxing powers of local governments in Thailand. In general this review finds that Thai local governments do not have extensive taxing power. At the same time, the analysis suggests that there is considerable scope for additional taxes to be levied locally. Dhiratayakinant stresses, however, that to do so will require a major change in central-local government relations in the country with the central government providing considerably more taxing autonomy to local bodies than currently is the case. It is likely that the same holds true in most developing nations.

Bashir Omer Mohamed Fadlalla's paper concentrates on intergovernmental transfers in Sudan. In 1980, the country embarked on a course to increase greatly the role of regional governments throughout the country by assigning them a wide range of responsibilities and functions. There was not, however, an equally sweeping increase in the revenue raising powers provided to these governments. As such, intergovernmental grants must continue to provide the bulk of the revenues necessary to finance these responsibilities. Unfortunately, the current grant system probably does not fulfill the goals of an effective grant system. Fadlalla, therefore, proposes a new grant system that, if deemed feasible by political leaders, would provide for a much more rational and effective flow of funds from the center to regional governments.

The final paper in this set is unique from the standpoint of the research method employed. Rather than relying upon financial or other records of local governments, Ed. B. Prantilla, Roman C. Bacani, and Choong Yong Ahn used the responses to a questionnaire mailed to responsible government officials in two countries—Philippines and Republic of Korea—to ascertain opinions of these leaders regarding the primary financial issues that they face. While the individual country findings are interesting, the cross-national comparison of the results is even more insightful. Local governments in the Republic of Korea are considerably more centralized than those in the Philippines (which the authors suggest gives rise to a broader question of whether the usual arguments favoring decentralization as a vehicle for growth are factually supported). It may not be particularly surprising that local government leaders in the Philippines were found to be more concerned with equity than their counterparts in the Republic of Korea, whose responses indicated that they are more growth-oriented. Another interesting difference between the two countries, which suggests future research is in order, is the finding that tax delinquency is viewed to be a major issue in Philippine local governments whereas it does not appear to be an important issue in the Republic of Korea.

Where Next?

As is commonly the case, the papers included in this set as well as the others presented to the Expert Group Meeting

answered some questions but also raised others. The participants in the meeting recognized that more work on policy and implementation remains to be done in the area of local and regional finance.

Since the social, economic and political circumstances of different developing countries vary so greatly, it is impossible to reach highly specific recommendations that might be implemented within all countries. At the same time, there was general agreement that the unitary and highly centralized nature of governmental systems in most developing countries gives rise to the neglect of subnational government finance. Likewise, it was felt that bilateral and multilateral assistance programs have generally ignored local government finance.

Participants in the meeting felt that there definitely is potential for greater resource mobilization at the local level. From the papers and other experiences of those in attendance there was the general feeling that simple, broad-based taxes, including shared taxes, should be emphasized in developing countries while abolishing the many "nuisance" taxes that characterize the revenue menu of many local governments. Likewise, there was the recognition that the role of user fees, including those for regulatory services, could be greatly expanded.

While the potential of greater resource mobilization efforts at the local level exists, a necessary condition for such improvement is an increase in the institutional and administrative capacities at these levels. Personnel issues, including pay structures, training, career opportunities, and retirement benefits, may be as important to successful resource mobilization efforts as tax structures.

Cross-national analysis of the relative advantages of autonomous versus centralized local government personnel services is an issue that deserves further research. Participants concluded that focused comparative resource could provide additional understanding of those resource mobilization techniques that are successful and unsuccessful. The key is "focused." Rather than considering the entire set of functions undertaken by local governments (which differ greatly among countries), such research would more likely lead to replicable results if functions were held constant and alternative financing methods were emphasized. Among the functions identified by the Expert Group Meeting participants were water supply, roads, public health, and primary education. Finally, empirically based research on the impact of alternative grant and credit systems was felt to offer strong potential for research payoffs.

In Rwanda

Steve Hagglade spent the month of August in Rwanda studying the textile industry for the Ministry of Finance and Economy and for USAID. He was particularly interested in the impact of large and growing used clothing imports on employment, income, and income distribution. Governments of neighboring countries have banned used clothing imports because of the potential displacement of domestic textile and garment manufacturers. Hagglade's study directly measured for the first time the net employment and income impact of imported used clothing in that country.

In Jamaica

Dan Holland of the Massachusetts Institute of Technology and James Wozny spent a week in Kingston, Jamaica, in

September. They presented their recommendations concerning reform of the company tax to the Revenue Board and the Tax Reform Committee.

In Latin America

David Robinson spent two weeks during July in Venezuela assisting in the organization, cataloging and staffing of the new historical archive of Bolivar State, Ciudad Bolivar. In August he traveled to Peru where, in Huaraz, he advised the Ancash regional office of the Peruvian National Statistics Institute concerning their proposed project on district delimitation and regional planning.

In China

Roy Bahl spent the month of September in Zeigang Province as part of a World Bank mission. His assignment was to prepare an analysis of the public finances of the province.

In India

Barbara Miller traveled to India in September under funding from the Wenner-Gren Foundation for Anthropological Research, Inc. Her purpose was to do preliminary planning of a research project on infant mortality in rural North India. The study will be used to help reduce infant mortality through improved health interventions.

Roy Bahl on Leave

In September Roy Bahl began a one-year leave from the Maxwell School. He will divide his time between working with the Water Supply and Urban Development Department of the World Bank and continuing his research on local public finance in developing countries. He continues to direct the Jamaica Tax Structure Examination Project.

Visitors to Metro

Sue Horton, economics professor at the University of Toronto, visited Metro in order to confer with Barbara Miller about the 1983-84 Low-Income Household Expenditure Survey which was conducted in Jamaica as part of the Jamaica Tax Structure Examination Project.

Nick Devas, a member of the Institute of Local Government at the University of Birmingham, England, visited the program in July. He gave a seminar on local government finance and administration in Indonesia.

JTSEP Staff Paper No. 31

Roy Bahl and Matthew Murray wrote on "Income Tax Evasion in Jamaica" in the 31st Staff Paper produced for the Jamaica Tax Structure Examination Project (November 1986, 167 pp, \$3.00). The report provides detailed estimations of the revenue cost of income tax evasion in Jamaica. The analysis is focused on the self-employed sector and employs data from a sample survey of Jamaicans working in nine "hard-to-tax" occupations. The results demonstrate a substantial revenue loss to evasion and indicate ways a

more active enforcement program might broaden the income tax base. The authors also address the impacts on evasion of the reformed, flat rate income tax.

Staff Publications

On Fiscal Decentralization

Roy Bahl and Shyam Nath published an article on "Public Expenditure Decentralization in Developing Countries" in *Environment and Planning*, 1986, Vol. 4, pp. 405-418. The authors identify the extent and determinants of public expenditure decentralization in developing countries. It is found that the public expenditure share of subnational governments is greater where the level of economic development is higher, in countries with larger populations, and in countries whose central government budgets carry less of a defense burden. The results also suggest that where central governments mobilize more resources through the revenue system, the subnational governments' share of expenditures tends to be lower because tax revenues are less likely to be passed as grants to local governments.

News and Notes

David Robinson gave two invited lectures during July for the Department of History, National University, Medellin, Colombia. The lectures were on "Spatial Aspects of Latin American Colonial History" and "The Historical Geography of Latin America: Recent Advances and Recurrent Problems." At a symposium on Population Movements in West-Central Mexico, sponsored by the French Embassy and El Colegio de Michoacan, he delivered a paper on "Patterns of Migration in Michoacan: Data and Methodologies."

Steve Haggblade participated as a panelist in the 25th Anniversary Celebration of the Peace Corps in September in Washington. As a panelist on the Botswana, Lesotho, Swaziland Country of Service update session, he gave a review of the recent economic developments in Botswana and an update on several Peace Corps projects.

David Greytak went to Washington, DC, in October to discuss the topic of local governments and education finance in Latin America with AID officials.

Barbara Miller gave a presentation in September on "Public Health Implications of Son Preference and Daughter Neglect in Rural India" at the United States Agency for International Development mission in New Delhi.

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