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LOCAL TAXATION IN DEVELOPING COUNTRIES:
SOME CRITICAL ISSUES

I. THE CONTEXT

In the last few years there has been a great resurgence of interest in the role of local government in Third World development. There is a new recognition that effective development cannot take place without competent and accountable agencies at the local level. In many countries of Africa, Asia and Latin America, attempts are being made to reinvigorate existing systems of local government and to equip them for a more effective role in local and regional development.

A crucial obstacle to a greater role for local government is the lack of financial resources. It is not surprising that local governments in poor countries are poor, but their situation is often worse than might be expected. Limited financial resources have tended to be concentrated at the national level, as central governments have sought to retain available revenue sources for themselves. During the 1960s and 1970s, local government was out of fashion in many countries, particularly those seeking to throw off the legacy of their colonial masters. As a result, local governments were given little encouragement to develop their own financial, technical or managerial resources, and they became increasingly dependent on often unpredictable handouts from central government. The task of reinvigorating local government in much of the developing world is, therefore, a substantial one.

Of course, the situation varies enormously from country to country. Any analysis which seeks to generalise about the situation on three continents is doomed to oversimplification. Developing countries vary massively in size, level of economic development, historical experience, culture and political systems. Yet there are some common themes, and it is surprising how often the

story repeats itself. I believe that it is worth taking the risk of making some broad generalisations and trying to identify some of the key issues.

II. SOME COMMON EXPERIENCES

There are a number of common experiences which should be noted before examining the issues related to particular local taxes. Firstly, as I have noted, the position of local government in most developing countries is weak when compared to the situation in Western developed countries (and perhaps even more so when compared to the socialist model of Eastern Europe where the local commune or soviet is supposed to be the very building block of the economic system). The data in the Annex to this paper shows how small local financial resources are compared to those at national level – for example, in Mexico, state and local government own revenues are only one seventh of those at national level, in Indonesia only one twentieth. As a result, local government is very much subservient to the central level (or to state level in some federal systems), where both political power and financial and technical resources are concentrated. In many cases, local government may be no more than the local agent of the central government. This may be justified on the grounds that there is no real system of democratic accountability at the local level – although such accountability may well be lacking at the national level as well.

Secondly, since central governments have generally taken for themselves the best tax sources, the sources left to local government are often very unsatisfactory: taxes which are inequitable, which have a distorting effect on the economy, which are costly to administer and which are unpopular. The scope which local governments have to develop new revenue sources are severely limited, either by statute or simply because there is little of significance left untaxed by higher levels. Even their ability to mobilise additional revenues from their existing taxes is often heavily constrained by central government regulations, such as statutory ceilings on tax rates which have long since been eroded by inflation.

Thirdly, those taxes which have traditionally been associated with local government – taxes on land and buildings, and licences fees – tend to lack buoyancy. As population grows and incomes and expectations increase, local governments need to have revenues which rise in proportion, so that services can be maintained and expanded. Because of outdated tax rolls, difficulties in carrying out revaluations, and ceilings on tariffs, the yield from taxes on land and buildings often fails to keep pace with real growth in population and incomes, while fixed fees for licences and permits are rapidly eroded by inflation. As a result, the financial position of local government tends to

worsen in relation to that of central government – benefitting as it does from elastic tax revenues such as progressive income taxes and ad valorem sales taxes.

Fourth, local authorities in poorer regions, especially in rural areas, face a particular problem: that there may simply be very little to tax. Apart from people, who are probably desparately poor, some subsistence agriculture and perhaps some livestock, there, may be little else to tax. Attempts to devise local taxes in such situations can easily turn into oppression. Such regions are likely to have to depend heavily on resources from central government until such time as they have developed a viable economic base.

Fifth, where local governments have been allowed some freedom to davise local taxes, the result has often been a selection of very unsatisfactory taxes with low yields and high administrative costs. Our research in Indonesia identified over 40 different local taxes (although not more than about 10 of these were normally collected in any one place). For several of these, the costs of administration exceeded the tax yield¹.

Sixth is the issue of inter-regional equity. Some regions are clearly much better endowed with potential resources than others, and the freedom to exploit their local revenue base is likely to reinforce inter-regional inequality. In particular, the scope for local revenue mobilisation in the major urban centres tends to be much greater than in the rural areas, and many of the obvious local taxes tend to be „urban-biased”. Of course, such differences can be offset to some extent throught the grant system, but the scale of inter-authority differences can be vast. In Brazil, for example, it is estimated that state capital municipalities in the Southeast have approximately twelve times the local revenues per capita of rhe interior municipalities in the Northeast². In Indonesia, the difference in local revenues per capita between the richest and the poorest second level local authorities (excluding the capital city) is about 40 to one³.

Seventh, there is the problem of corruption. In many developing countries, corruption is endemic, and taxation provides ample opportunities. Not only is evasion widespread, but collusion between tax-payer and official is widely accepted; tax officials have often paid good money to obtain a position which they can use to their own advantage. Such corruption cannot be eradicated

¹ The reason why these taxes continue to be collected is that no such comparison of costs and yield is made, especially since the bulk of the costs are staff costs, most of which are financed directly through a central government grant. Thus, from the point of view of the local authority, any revenue collected represents a net contribution to the local budget, despite the waste of national resources which that may imply.

² W. Dillinger, *Regional Aspects of State and Local Finance in Brazil* (unpublished paper for World Bank, 1979).

³ N. Devas, *Financing Local Government in Indonesia*, Ohio University Press, Ohio 1989.

overnight, but it does suggest that reforms to local tax systems should be concerned not solely with generating additional revenues but also with simplification and transparency, so that the scope for corruption, collusion and evasion can be minimised.

III. THE EXPERIENCE OF PARTICULAR LOCAL TAXES

1. Taxes on Incomes

In the developed world, taxes on income have become the dominant source of revenue at the national level and are assuming an increasing importance at the local level. The situation is very different in the developing world. With only a small proportion of the labour force employed in the formal, modern sector, and severe problems of assessing and collecting income tax outside that sector, the result is that income tax contributes only a relatively small share of taxation even at the national level. As far as local government is concerned, the scope is further reduced by the difficulty of assigning income tax revenues to the appropriate local authority, and the fact that any local income tax would really benefit only the largest urban centres, particularly the capital, where most of the formal sector employment tends to be concentrated. In the case of Indonesia, over 60% of all income tax is collected in the capital, Jakarta.

There are, nevertheless, a number of example of local income taxes. In some African countries, attempts have been made to convert colonial flat-rate poll taxes into graduated taxes (e. g. Uganda, Zambia, Botswana). These local graduated taxes were designed to dovetail in below national income tax. But the problem lies in the assessment of income. This is generally based on „imputed” or „presumed” values of income, mainly from agriculture in these cases. Inevitably such systems are crude, and such taxes often end up being regressive, especially if they are not well integrated into the national income tax system, or if they are not comprehensive in coverage.

2. Sales Taxes and Taxes on Commerce

In certain federal systems, such as India and Brazil, states may levy sales or value added taxes. But the scope for local governments in developing countries to levy sales taxes and other taxes on commerce is limited for the same reasons that apply to income tax: the relatively small formal sector, the difficulties and costs of levying taxes on the informal sector, and the problems of assigning revenues to the appropriate local authority. There are, however, examples of

attempts by local governments to tap the economic base of their regional through crude forms of taxation of the commercial sector, mainly through licences for particular forms of business activity. Examples of this are quite widespread in Francophone Africa, under the title of *patente* accounting for 75% of local revenues in Ougadougou, Burkina Faso, and 42% in Dakar, Senegal⁴. Other examples include the Business Tax in the Philippines, the Business and Professional tax in Nepal and Business Registration Tax in Indonesia. Such taxes are crudely assessed, usually on the basis of floor area of the premises occupied or the rent paid, installed power capacity, and classification of the type of activity. Because of the crude nature of the assessment, there are inequities, while their fixed fee nature means revenues tend to be inelastic. There are also problems of overlap with national taxes such as VAT, and with local property taxes. In addition, such taxes tend to benefit disproportionately the more prosperous regions: in Brazil, for example, the state-levied value added tax (ICM) generates five times as much per capita in the Southeast region as it does in the Northeast region⁵. Other examples of particular local taxes on commerce, such as those on entertainments, will be discussed later.

3. Property Tax

Although property taxation has declined in importance in much of the developed world, it remains a very important source of local revenue, at least for urban authorities, in many developing countries. Property tax has many positive features as a local tax: the tax object cannot be hidden or moved, and is clearly located within one particular jurisdiction; it is crudely equitable; and it causes no serious distortions of the economy, although it can act as a disincentive to development unless it is levied on land alone, or at a higher rate on land than on buildings. The main weakness lies in difficulties over valuation, and particularly in the technical and political problems in achieving regular revaluations. Failure to revalue means that yields are eroded by inflation. As a result, in most countries there has been a long-term decline in the real value of property tax revenues. In India, the effect of controlled rents – often fixed many years ago – has been to undermine totally the rental-value basis of this tax. In some countries, tax rates can be increased to counteract the declining real value of the assessed tax base, but this creates inequities as changes in relative property values over time are not reflected in assessments.

⁴ N. You, J. Mazurelle, *The Impoverishment of Large Francophone West African Cities Is Not An Inevitability* (unpublished paper for UNCHS/World Bank, May 1987).

⁵ Dillinger, *op cit*.

In some countries, the scope for increased tax rates has been exhausted as statutory ceilings have been reached. A particular problem in the rapidly growing cities of the Third World is that tax registers are not always kept up to date, especially where much of the the growth is in informal housing or squatter settlements which may not be recognised by government. The relatively high visibility of the property tax, together with the vested interests of influential property owners also limits the potential of this tax. Nevertheless, for many developing countries, the property tax remains the cornerstone of urban local authority finance.

4. Betterment Taxation

The rapid growth of cities presents huge problems for urban authorities in terms of the cost of the infrastructure required to service the growing population. At the same time, this growth produces huge windfall gains for private owners of land which is developed⁶. Only a few countries, though, have attempted to capture „windfall gains” from landowners in order to finance urban infrastructure costs. One case is Taiwan, with its Land Value Increment Tax. Some Latin American countries, such as Colombia Mexico and Ecuador, use a system of Valorization Charges – whereby the costs of new urban infrastructure are distributed between adjoining beneficiaries in proportion to the increase in the value of their property. Other countries, such as Korea and Thailand, have used the Japanese model of Land Readjustment, in which a group of land owners pool their holdings and surrender a part of their land to pay for infrastructure. Other models include Land Banking (public acquisition at agricultural use value of large tracts of land adjoining the urban area in advance of requirements, as used in Delhi) and Excess Condemnation (public acquisition and subsequent resale of land adjacent to new infrastructure), practiced widely by Improvement Trusts and Development Authorities in South Asia. In each case, the aim is to secure for the community some or all of the increases in land values as a way of financing urban infrastructure.

However, most of these techniques are complex, and equity effects are uncertain. In general, attempts to tax betterment epitomise the tax administration dilemma: to be equitable, the tax has to be sophisticated, but sophistication requires skilled, competent and honest administrators – just what is so often lacking. On the other hand, simple tax or cost recovery

⁶ It is often assumed that this problem can be solved by state ownership or control of land. However, experience from many countries (for example, Nigeria, Tanzania, Lesotho) suggests that state ownership or control on its own does not eliminate private gains from land so long as private individuals continue to have rights to occupy land or to transfer occupancy rights.

systems can be quite inequitable. Nevertheless, this is an area with potential for the future, since even a relatively simple system of „development charges” based on the size and location of land-holdings could cream off at least some of the unearned gains from landowners to finance a substantial share of new infrastructure costs.

5. Taxes on Rural Land

There are numerous forms of taxation on rural land: taxes on the capital value of land, such as in Latin America; taxes on land revenues or rent, such as in South and Southeast Asia and in some Islamic countries; mass personal taxes used in certain parts of Africa, such as Uganda (already mentioned under Taxes on Income); and taxes on marketed or exported produce, widely used in Africa. Apart from the last category, most of these taxes involve some system of classifying land and applying a tariff according to types of crop produced. Just as with the property tax, it is the problem of making – and remaking – accurate assessments of land, and often over vast areas, that is the main problem with this form of taxation. There are other problems too: the poverty of the rural population may severely limit the potential of such taxation; the costs of assessment and collection from a scattered population; the inequities which arise from outdated or inaccurate assessments, or from erratic harvest conditions; and the horizontal inequities between the agricultural community and those deriving incomes from other sources which may go untaxed. From an economic efficiency point of view, where the tax is based on capital values, on rent, or on presumed (rather than actual) income, there should be no disincentive to production – indeed there should be a positive incentive, since the tax has to be paid whatever the actual yield of the land.

Taxes on marketed produce, on the other hand, may discourage production or sale. They may also encourage smuggling and black markets, or may induce switching to other crops. There are celebrated cases – such as cocoa production in Ghana – where excessive taxation through export marketing boards in the 1970s virtually destroyed an industry. Such cases generally relate to central government taxation, but the increasing dependence of Kenyan local authorities on produce cesses is a cause of concern.

In some rural areas, notably in Africa, livestock is of great importance and may represent one of the few possible sources of local tax revenue. Taxation of livestock can be regarded as equitable, since animals are a store of wealth, and such a tax may have positive economic benefits in encouraging sale of livestock. However, the yield will never be large, and taxation of livestock may be politically sensitive. In addition, control may be difficult as livestock can easily be moved.

6. Taxes on Motor Vehicles and Motor Fuel

One of the fields with the greatest potential for local taxation is that of motor vehicles and fuel. In many developing countries, the number of vehicles is increasing rapidly, so that such revenues could be substantial and elastic, particularly if the taxes are value-based. Such taxes would, however, benefit mainly the large urban centres, especially the capital city, but that is true of a great many local taxes. From an equity point of view the predominant users of vehicles are the rich. Economic effects are fairly minimal, but are generally positive, especially for oil-importing countries. Such taxes are relatively easy to administer and to assign to the correct local authority. The main problem is that central governments are often unwilling to surrender such easy sources of revenue. Yet there are good reasons for giving local government access to such taxes, particularly where local government carries a major share of the responsibility for road maintenance.

7. Taxes on Non-Motorised Vehicles

Where central governments (or state/province governments) monopolise the taxation rights on motor vehicles, local governments may attempt to tax non-motorised vehicles – bicycles, rickshaws, carts, etc. The potential revenue from such taxes is very limited, and tends to be inelastic because of its fixed fee nature. There are also equity implications, since such vehicles are likely to be used by the relatively poor. Enforcement is also a problem. In Indonesia, we found that the costs of administering such a tax often absorbed more than half of the revenue.

8. Octroi

Octroi is a tax which is almost exclusive to the Indian subcontinent, but there it remains the dominant revenue source for many local authorities. It is a form of local customs duty on goods entering the local authority's jurisdiction. It has obvious negative consequences for the economy, by effectively establishing local trade barriers and hence creating unintended incentives and protections. Equity effects are uncertain, as the tax can generally be passed on to the consumer (although necessities are generally exempt). Octroi has continued to be an important source of local revenue because its ad valorem basis means that revenue have been highly elastic, while the fact that it can be passed on to the consumer tends to make it less visible. It

is also relatively easy to administer, although there is considerable scope for corruption. Whilst there is widespread agreement that octroi has a damaging effect of the national economy, no substitute with anything like the same potential seems to be available.

9. Entertainments Taxes

Many local authorities in the developing world levy taxes on cinemas, theatres and other places of entertainment, including in some cases taxes on hotels and restaurants. Such taxes have an obvious attraction of being relatively easy to administer, reasonably equitable, since the tax object is a luxury, and having no serious economic effects. The tax can be on an ad valorem basis, making the yield elastic. There are, however, problems of assessment, especially in relation to small, informal sector activities, and such taxes tend to benefit mainly the urban centres.

10. Taxes on the Production or Sale of Alcohol

The production and sale of alcohol often appear to be an attractive opportunity for a local tax, so long as it does not conflict with national taxation. Such taxes can have a positive effect in discouraging alcohol consumption, may be considered equitable, and are reasonably easy to administer, although there may be considerable scope for corruption. In Zimbabwe, local authorities in the Tribal Trust areas have traditionally obtained the bulk of their revenues from levies on traditional beer production, and such taxes have also been important in Botswana and Zambia.

11. Utility Surcharges

A growing field for local taxation in a number of countries has been surcharges on utilities: water, telephones, and most commonly, electricity. A small surcharge – usually between one and ten percent – is added to the bill sent to each consumer by the utility company. There are examples of such surcharges in Turkey, Colombia and Indonesia. The great advantage of such a tax is that it is extremely easy and cheap to administer – effectively an automatic mechanism, with automatic enforcement. So long as the tax is levied ad valorem, the revenue is elastic. It is reasonably equitable in a vertical sense, since the largest consumers of telephones and electricity are likely to be the rich (although this is less true if applied to water). However, such taxes can only

benefit those local authorities where electricity, telephones and piped water supplies are widely provided. Perhaps the main problem with such surcharges is the potentially distorting effects on public utility pricing; assuming that public utilities have adopted optimal pricing policies, a surcharge could upset the pattern and lead to underutilisation of capacity. However, it seems unlikely that the pricing structure is so finely balanced that a small surcharge – say 2 or 3 percent – would cause serious damage.

12. Poll Taxes

A survey such as this would not be complete without a mention of poll taxes. Flat-rate per capita taxes or hut taxes were widely used by colonial authorities in Africa as a means of financing local administration. For obvious reasons they were unpopular, and many countries abolished them after independence, although a number retained them, often under more fancy name, such as Development Levy or Community Tax. Other countries, such as Uganda and Zambia converted them into graduated taxes. A number of countries, such as Tanzania and Nigeria, faced with a shortage of resources for local government, are now reintroducing them (as, of course is the United Kingdom!).

13. Other Forms of Local Tax

Numerous other forms of local tax can be found in different countries: taxes on radios, on dogs, on advertisement billboards, on particular local products, etc. By and large such taxes generate little revenue, and much of what is collected may be used up in the costs of administration.

14. Charges for Services

Although this is a survey of local taxes, mention should be made of charges for local services. The use of charging varies widely between countries, and even between local authorities within countries. The types of service for which charges are commonly levied include water supply, markets, bus stations, clinics and hospitals, and refuse collection. It is difficult to draw conclusions about the extent of charging from comparative data on local authority finance because in some authorities the bulk of services for which charges can be levied are set up as separate trading undertakings or enterprises, so that only net surpluses or deficits are shown as local authority revenues. However, in many

Table 1

Local Taxation in Selected Countries

Country	ZIMBA-	KENYA	UGAN-	ZAMBIA	POLAND	UK	SWEDEN	USA		INDIA	INDONESIA		PHILIPPI-	THAIL-	BRAZIL		MEXICO		COLO-
	BWE		DA					State	Local	State	Prov.	Local	NES	AND	State	Local	State	Local	MBIA
Level	Local	Local	Local	Local	Local	Local	Local	1986	1986	1984	1984	1984	Local	Local	1985	1985	1984	1984	Local
Year	1984	1983	1983	1980	1986	1985	1986	1986	1986	1984	1984	1984	1985	1985	1985	1985	1984	1984	1983
Currency	M. \$	M. Shs	M. Shs	M. Kwacha	B. Zlotys	B. Pound	B. Kroner	B. \$	B. \$	B. Rupees	B. Rupiah	B. Rupiah	M. Pesos	B. Baht	M. Cruzeros	B. Pesos	B. Pesos	B. Pesos	
Total Local Govt. Revenue	684,9	1315	4,01	62,8	1955	43,7	237,5	396,6	341,9	258,0	1895	1737	8240	17,23	114,4	35,4	889,4	235,5	50,4
Total Local Own Revenue	480,7	1280	2,98	41,4	1199	22,4	185,5	315,1	210,1	208,1	461	285	4815	10,14	92,0	9,8	859,2	229,1	29,2
Total Local Tax Revenue	72,3	595	1,71	28,0	1000	13,2	138,1	219,3	134,5	119,1	292	40	2617	8,29	77,4	7,5	25,9	27,9	21,9
Taxes on Income/Profits	0,0	0	1,71	5,9	308	0	138,1	81,3	8,0	0,0	0	0	0	0,00	0,0	0,0	0,0	4,4	0,0
Taxes on Property	53,0	441	0,00	20,7	121	13,2	0	7,9	99,8	2,6	7	0	1471	1,66	1,3	2,1	5,4	14,2	10,5
Taxes on Goods/Services	16,5	149	0,00	1,4	147	0	0	126,1	26,7	106,7	251	40	1146	6,59	71,1	5,4	15,6	5,9	0,0
Other Taxes	2,8	5	0,00	0,0	24	0	0	4,0	0,0	9,8	34	0	0	0,04	5,0	0,0	4,9	3,4	11,4
Tax Sharing	0,0	0	0,00	0,0	0	0	0	0,0	0,0	57,8	57	109	0	0,00	0,0	0,0	689,4	155,3	0,0
Non-Tax Revenues	408,4	685	1,27	13,2	199	7,1	44,8	95,6	75,2	30,7	101	123	2198	1,85	14,6	2,3	143,9	45,9	7,0
Capital Receipts	0,0	0	0,00	0,2	0	2,1	2,6	0,2	0,4	0,5	11	13	0	0,00	0,0	0,0	0,0	0,0	0,3
Grants	204,2	35	1,03	21,4	756	21,3	52,0	81,5	131,8	49,9	1434	1452	3425	7,09	22,4	25,6	30,2	6,4	21,2
Central Govt: Total Revenue	2110,3	20090	53,68	790,7	5363	134,5	377,7	823,2	823,2	396,2	18182	18182	68961	166,39	367,7	367,7	7820,2	7820,2	407,1

Source: IMF Government Financial Statistics, 1987, except Indonesia data from Nick Devas: Financing Local Government in Indonesia (Ohio 1989).

Table 2

Local taxes as a proportion of total local government revenue (in %)

Country	INDIA	INDONESIA		PHILIP-	THAIL-	BRAZIL		MEXICO		COLOM-	ZIMBA-	KENYA	UGAN-	ZAM-	POLAND	UK	SWE-	USA	
	State	Prov.	Local	Local	Local	State	Local	State	Local	Local	Local	Local	Local	Local	Local	Local	Local	State	Local
Level	1984	1984		1985	1985	1985		1984		1983	1984	1983	1983	1980	1986	1985	1986	1986	
Total Local Govt. Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total Local Own Revenue	80.7	24.3	16.4	58.4	58.9	80.4	27.7	96.6	97.3	57.9	70.2	97.3	74.3	65.9	61.3	51.3	78.1	79.5	61.5
Total Local Tax Revenue	46.2	15.4	2.3	31.8	48.1	67.7	21.2	2.9	11.8	43.5	10.6	45.2	42.6	44.6	51.2	30.2	58.1	55.3	39.3
Taxes on Income/Profits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.9	0.0	0.0	0.0	42.6	9.4	15.8	0.0	58.1	20.5	2.3
Taxes on Property	1.0	0.4	0.0	17.9	9.6	1.1	5.9	0.6	6.0	20.8	7.7	33.5	0.0	33.0	6.2	30.2	0.0	2.0	29.2
Taxes on Goods/Services	41.4	13.2	2.3	13.9	38.2	62.2	15.3	1.8	2.5	0.0	2.4	11.3	0.0	2.2	7.5	0.0	0.0	31.8	7.8
Other Taxes	3.8	1.8	0.0	0.0	0.2	4.4	0.0	0.6	1.4	22.6	0.4	0.4	0.0	0.0	21.7	0.0	0.0	1.0	0.0
Tax Sharing	22.4	3.0	6.3	0.0	0.0	0.0	0.0	77.5	65.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Tax Revenues	11.9	5.3	7.1	26.7	10.7	12.8	6.5	16.2	19.5	13.9	59.6	52.1	31.7	21.0	10.2	16.2	18.9	24.1	22.0
Capital Receipts	0.2	0.6	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0	0.0	0.3	0.0	4.8	1.1	0.1	0.1
Grants	19.3	75.7	83.6	41.6	41.1	19.6	72.3	3.4	2.7	42.1	29.8	2.7	25.7	34.1	38.7	48.7	21.9	20.5	38.3

cases, there appears to be considerable scope for generating additional resources from charging. Charges are often set well below the costs of the service, and charge levels are rapidly eroded by inflation. Of course, there may be services for which full cost recovery is not appropriate, but there are others where failure to charge cost recovering prices implies a substantial subsidy to the consumers of a particular service – often the relatively rich – and a therefore suboptimal use of the local authority's resources. However, local authorities in developing countries often have little clear idea about how they should set charges. Or indeed about the real costs of the services they provide.

IV. DOES THE LACK OF LOCAL REVENUES MATTER?

Throughout this paper, it has been assumed that the lack of local revenue sources is a problem which should be addressed. Yet it may be argued that the level of local revenues does not matter, so long as there is an adequate system of grants from central government. After all, the local tax-payer is not really concerned whether the money he pays goes to central government or to local government so long as services are provided. However, I believe that improving local revenue sources is important, for a number of reasons.

Firstly, the range of services for which local governments are responsible is often substantial, services which are of crucial importance to national development – primary education, primary health care, agricultural extension, roads, basic urban services, etc. The costs of these services increase steadily as a result of population growth, rising expectations and inflation. Yet in a situation where government resources are in short supply, the claims of central government ministries on the national exchequer may be more immediate than those of local government „out there”. Thus, there is a tendency for local government to receive less than its „fair share” of resources – and often a declining share of national resources over time. Moreover, the way in which those resources are provided may increase the revenue problems for local government: specific and matching grants which require a substantial local contribution; capital projects which leave local government to meet the operating and maintenance costs of the new infrastructure; loans which require repayment. All of these leave local government needing more rather than less local resources.

Secondly, many local authorities in developing countries operate in a very precarious manner, balancing increasing service costs against declining revenues. Such a downward spiral does not permit the proper provision of basic services, let alone development of the region. In many situations, local authority officials are seen by the public merely to be collecting money in order to pay their own salaries – a sort of municipal „protection racket”. Only

a significant increase in resources will enable such authorities to begin to carry out their proper functions. Much of these additional resources will have to come from outside, but some must be generated locally, once the community can see that the authority is actually providing some services.

Thirdly, there are real risks in local government becoming too dependent on central government grants. One risk is the „beggingbowl mentality”, in which local government becomes a supine agent of central government, with little incentive to increase local resources or to operate in a cost-effective manner. Another risk arises from the arbitrariness of central government grants: in many third world countries there is no clear or consistent formula for resource transfers. The level of grants may vary widely from one year to the next without explanation. Grants may be paid late, or not at all. Local governments cannot rely wholly on such uncertain resources if they are to provide effective public services.

Fourthly, there is the matter of local discretion. One of the essential arguments for decentralised government is that the central government lacks the detailed knowledge and capacity to provide all services throughout the country. It follows that local governments must have some discretion in the provision of local services. It is normally assumed that such discretion implies the need for independent local revenue sources. While this is generally true, the existence of independent local revenue sources does not guarantee local autonomy: central governments have many other ways of bringing their will to bear on local authorities. In Kenya, for example, where local revenues finance the vast majority (over 95%) of local expenditures, central government still retains tight control over local government. Nor is it necessary for local revenues to finance all – or even most – of local expenditures in order to achieve a degree of local discretion. What matters is discretion at the margin. The bulk of local government expenditure is fixed – there is little effective choice about it. The choices arise at the margin – about spending a little more or a little less on particular services. It is here that local revenues are important – revenues over which local authorities have control, and have some choice over tax rates and hence of yield. There is no „magic figure” of what is and appropriate level for such local own revenues, but those countries where local revenues are particularly low – such as Indonesia – can be expected to encounter problems over local discretion.

V. LOCAL TAXATION: THE WAY FORWARD

In many countries of the developing world, there are now active programmes of local fiscal reform. These generally involve: the simplification of existing local revenue sources, through the abolition of many unsuitable and

low potential taxes; the strengthening of the more viable local tax sources; the introduction of more rigorous cost-recovery policies for local services; improvements in local revenue administration; and the assignment or sharing of certain national revenues with local government.

Property Tax: A prime candidate identified for strengthening has been urban property taxation. In many urban areas, the potential of this tax is considerable, although its relative inelasticity limits its long-term potential. Difficulties in property valuation remain a major obstacle, although modern technology, such as air photography and computers, can be assist and can provide information on land and property which has applications far beyond property taxation itself. For the rapidly growing cities of the developing world, it seems essential also to devise some mechanism to harness the increasing land values to finance essential infrastructure, even if this is only through some relatively crude system of development charges.

Other Urban Taxes: Motor vehicle and fuel taxation is a particularly promising area for local authorities, providing that central government can be persuaded to relinquish – or share – this tax field. Surcharging on utility accounts, particularly electricity, is another promising area, providing surcharge rates are kept low to avoid distorting utility prices. Entertainments taxes – broadly defined – are another worthwhile field, particularly for urban local authorities.

Rural Taxation: For rural authorities, the problem is generally much more difficult. Where agriculture is prosperous, there should be a proper system of taxation, whether on land or on income. Where there are established systems of rural land taxation, with a reasonable cadastral information base, these taxes can be developed. Where land is highly productive for certain types of crops, local cesses may be appropriate. But in many cases, the relative poverty of rural areas may mean a continuing high proportion of central government grants.

Charging: For many local authorities, especially in urban areas, there is scope for increased revenues from charging for services. There are sound economic reasons for ensuring that charges reflect the real costs of certain local services. However, this necessitates a more accurate measurement of service costs, and a willingness to adjust charges regularly in line with inflation.

Tax Sharing: Ideally, local governments need access to some of the buoyant revenue fields occupied by central government – notably income tax and sales tax/value added tax. Systems of surcharging on national income tax are increasingly common in Europe, and provide local authorities with both elastic revenues and local discretion. Surcharging is not a practical proposition in most developing countries, but tax sharing is. There are a number of important examples of tax-sharing in the developing world – India (at State level), Brazil (at local level), Nigeria, Philippines, Turkey. Through tax-sharing,

local governments obtain access to substantial and elastic revenue sources without the risks of arbitrariness involved in grant finance. However, revenue-sharing does not provide any scope for local discretion over tax rates, so that it cannot be a complete substitute for local taxation. In addition, the problems of assigning the tax shares to the correct authority, plus the huge differences which would arise between regions if the revenues were shared by origin, means that tax sharing schemes in the developing world are normally based on formula allocations. As a result tax-sharing may sometimes appear little different to a grant system. Yet there are important differences, in terms of the elastic nature of the revenue base and the greater predictability of resources.

Improvements in Revenue Administration: There is great scope for improvements in local revenue administration in most third world countries. Actual tax yield is often only a small proportion of the potential, and in many cases no estimate is ever made of the potential of local taxes – local authorities preferring to operate on targets based on previous years' performance. Improvements are needed at all stages of revenue administration: tax rolls need to be updated regularly; assessment procedures need to be simplified and made less open to collusion with the tax-payer; systems for payment need to be more accessible; and accounting and reporting systems need to be more secure and more responsive. In particular, greater attention needs to be given to enforcement. For many local taxes, arrears rates are phenomenal: in the case of property taxation, arrears amounting to the equivalent of two or three full years debit are not uncommon. Although penalties may exist on paper, they are often not implemented, especially where the main defaulters are well-connected citizens.

Improving revenue administration is easier said than done, but well-designed incentives – for the tax-payer, for the tax official and for the local authority as a whole – can achieve results. One example is Delhi Municipal Corporation, which managed to achieve a 96% increase in property tax revenues in one year (1986/7) without any increase in tax rates. This was achieved by such things as: rebates for prompt payment; incentive payments to staff for achievement above a target level; freezing the bank accounts of defaulters and refusing income tax deductions for property tax unless the tax had actually been paid; facilitating tax payment at a variety of collection centers and banks; and the introduction of a computerised management information system to monitor payments records on a weekly basis. At the same time, collection costs have even been reduced slightly as a proportion of revenue, mainly by exempting a large number of low value properties⁷.

⁷ N. You, T. Sudra, *Innovative Experience in Local Finance in South Asia*, „Quarterly Journal of the All-India Institute of Local Self-Government” Oct/Dec 1988.

Another approach is the contracting out of revenue collection to the private sector, as in the case of local road tolls in Bangladesh and parking fees in Jakarta, Indonesia. This can increase net revenues to the local authority considerably, especially if the collection rights are auctioned. However, there are risks that the contractor will abuse his position, so that adequate safeguards for the public are required, such as publicisation of tax and charge rates.

Self-Help: Finally, we should not forget the potential of local self-help. Poor communities with few taxable resources may still have resources of labour, and possibly of materials. Where projects are of clear benefit to the local community, such resources can often be mobilised to achieve considerable results at relatively low cost to the local authority. Examples include rural roads projects using labour in off-peak seasons, often subsidised by food-aid, and upgrading projects in slum and squatter housing areas. Such activities do require proper organisation if they are to achieve lasting results without wasting resources.

In conclusion, the task of improving the revenue base of local authorities in the developing world is a formidable one. Yet it is a key element in enhancing the development prospects of a large parts of the Third World.

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OPODATKOWANIE LOKALNE W KRAJACH ROZWIJAJĄCYCH SIĘ NAJWAŻNIEJSZE KWESTIE

W ciągu ostatnich lat odnotować można znaczny wzrost zainteresowania rolą władz lokalnych w rozwoju krajów Trzeciego Świata. Jako podstawową przeszkodę, uniemożliwiającą praktycznie zwiększenie owej roli wskazuje się najczęściej niedostateczny poziom dochodów lokalnych.

Autor opracowania, dzieląc wskazany pogląd, wskazuje następujące – występujące w praktyce powszechnie – przyczyny ograniczonego wpływu władz lokalnych na procesy polityczne i ekonomiczne w krajach Trzeciego Świata:

- słaba pozycja władz lokalnych w większości krajów rozwijających się;
- uznawanie przeważającej liczby wydajnych fiskalnie dochodów za dochody centrum;
- niestabilność finansowa dochodów tradycyjnie uznawanych za lokalne;
- różnice ekonomiczne pomiędzy poszczególnymi regionami (niewielka liczba potencjalnych podatników w regionach biedniejszych, głównie wiejskich);
- fakt, iż przyznanie władzom lokalnym szerszego zakresu swobody w zakresie opodatkowania lokalnego prowadzi najczęściej do wprowadzania podatków finansowo nieefektywnych, o wysokich kosztach poboru;
- powszechna w krajach Trzeciego Świata korupcja władz lokalnych.

W dalszej części opracowania Autor charakteryzuje najczęściej występujące w praktyce krajów rozwijających się rodzaje podatków i opłat lokalnych, wskazując m. in. na zwiększającą się w tym zakresie rolę podatków dochodowych i majątkowych.

W konkluzji Autor formułuje pogląd, iż – obok racjonalnej konstrukcji dotacji – ulepszenie systemu źródeł dochodów lokalnych stanowi zasadniczą przesłankę dla właściwego określenia pozycji władz terenowych. Jako szczególnie dogodne źródła podatkowe w tym zakresie Autor wskazuje przede wszystkim podatki majątkowe (od nieruchomości i niektórych innych składników majątku) oraz podatki rolne.