

# **Fiscal decentralisation in developing countries: challenges and prospects**

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# TALKING POINTS

- I. WHAT DO WE MEAN BY FISCAL DECENTRALISATION?
- II. FISCAL DECENTRALISATION: PROs AND CONs  
*à GAP BETWEEN PRINCIPLES AND REALITIES*
- III. SUB-NATIONAL REVENUE SOURCES
- IV. LESSONS FOR REFORMERS
- V. FISCAL DECENTRALISATION IN BANGLADESH: ISSUES FOR CONSIDERATION

# I. WHAT DO WE MEAN BY FISCAL DECENTRALISATION?

- Ø Fiscal decentralisation (FD) → the transfer of taxing and spending powers to lower levels of government
- Ø FD reforms vary in the degree to which tax and spending powers is shifted from the central to a sub-national government
  - Depth of decentralisation
- Ø What is the best arrangement of fiscal powers and responsibilities between the different levels of government?

# (Fiscal) decentralisation reforms generally framed around three pillars:

- 1) The need for clarity of roles and responsibilities between different levels of government
  - Who taxes what?
  - Who provides what services?
  - Who is accountable to whom?
- 2) A minimum degree of autonomy for sub-national governments on the expenditure and revenue side, staffing etc
- 3) Institution building:
  - Sub-national governments must possess the required administrative and technical capacity to effectively carry out their assignment responsibilities

## II. FISCAL DECENTRALISATION: PROs and CONs (theoretical perspectives)

### Ø *Advantages:*

- Preference-matching (demand & supply of services)
- Efficiency in service provision through competition
- Enhance revenue mobilisation
- Strengthen citizen participation
- Increased accountability

### Ø *Disadvantages:*

- May cause an unstable macro economy
- May lead to inefficient decisions and use of resources
- May increase national inequity (e.g. rural vs urban)
- May transfer tasks to local level which it is incapable to address
- Elite capture

# Does it work? Gap between principles and reality

## Common challenges

- 1) Decentralisation often a remedy for certain specific political or social problems rather than just a fiscal strategy
  - Often response to crisis or shifts in political dynamics (Sudan)
  - Rarely adopted primarily for the reasons argued by democratisation and fiscal federalism theories (East Africa)
- 2) Lack of strategic orientation in decentralisation and fiscal reform programmes
  - Main motives for reform usually complex (South Africa)
- 3) Perception that there is insufficient “political will” for decentralisation
  - Many vested interests (national, sub-national, donors...)
  - Important to recognise key political and institutional constraints

## Common challenges (cont.)

4) Poor intergovernmental coordination à policy inconsistencies and resistance (Uganda)

5) Local political realities can severely constrain implementation of even a well-designed intergovernmental fiscal system endorsed by national legislators and administrators (Kenya, South Africa)

6) Capacity issues are critical at both central & subnational levels (Sudan)

7) Lack of appropriate & reliable info for good policy design and adm.

à Growing recognition that implementation strategies have received too limited attention: *Too much about what should be done; less about what can be done given the political, institutional, economic & financial constraints*

### III. A 'sound' revenue system for sub-national governments is an essential pre-condition for sustainable fiscal decentralisation

#### Ø Main components of local revenue systems:

##### ✓ **'Own revenues'**

- Revenue assignment between national & sub-national levels
- Taxes, user fees, and various (business) licences

##### ✓ **Transfers from the central gov:** Major revenue sources

- Revenue sharing
- Grants: unconditional; conditional; equalisation

##### ✓ **Borrowing:** Moral hazard & expectations of bailing out?

##### ✓ **Donor funding:** Matching funds?

##### ✓ **Community Development Funds:** Bypassing local gov. budgets

##### ✓ **Social Action Funds and Community Self-Help:** Why pay tax?



# Tanzania (1990s) & Sudan (2013): A jungle of local government taxes and non-tax sources

## TAXES

1. Development levy
2. Crop cess
3. Livestock cess
4. Industrial cess
5. **Property taxes**
6. City service levy
7. Hotel levy
8. Guest house levy
9. Entertainment levy
10. Bicycle tax

## Licences

1. Business licence
2. Street vending and hawking licence
3. Intoxicating liquor licence
4. Foreign liquor licence
5. Local liquor licence
6. Livestock licence
7. Dog keeping licence
8. Fisheries licence
9. Hunting licence
10. Gun holding licence
11. Blood drying activity licence
12. Forestry product
13. Road licence
14. Taxi, pick-up and lorry licence
15. Bus stand licence
16. Scaffolding licence
17. Plying licence
18. Human resource licence

## NON TAX SOURCES

## Fees and Charges

1. Market fees
2. Tax registration fees
3. Street vending fee
4. Sand fee
5. Entertainment fees
6. Advertising board fee (billboards)
7. Cattle market charge
8. Abattoir (slaughter) fee
9. Bicycle registration fee
10. Business licence application fee
11. Licence transfer fee (for business people changing area or type of business)
12. Tender application fee
13. Refuse collection charge
14. By-law permit charge
15. Burial charge
16. Business premises inspection charge
17. Playing ground charge
18. Cesspit emptying fee
19. Planning scrutiny fee
20. School fee
21. UPE contributions fee
22. Weights and measures fee
23. Motor vehicle parking fee
24. Water pipe installation fee
25. Storm water drainage fee
26. Inoculation/vaccination fee/clinic fee
27. Medical examination fee
28. Fire service fee
29. Market stall renting fee
30. Hire of plant fee
31. Valuation fee
32. Cultural games/recreation fee
33. Ambulance hire fee
34. Public convenience fee
35. Recovering charge of lost dev. levy receipt
36. Contract approval fee
37. Skin treating fee
38. Push cart fee
39. Cattle trekking fee
40. Pupil transfer fee (paid by parents)

## Other Revenue

1. Road toll
2. Land rent and service charge
3. Rent from council's houses/buildings
4. By-law fines
5. Stray animals fine
6. Permit to move animals in urban areas
7. Tourist hunting fee
8. Sale of fish commission
9. Bank interest
10. Sale of assets
11. Hire of plants and vehicles
12. Sale of plants and seeds
13. Sale of identity cards
14. Investment dividends
15. Other transfers
16. Other income

# Features of many local government tax systems

## Ø Complicated and non-transparent

- Costly to adm; corruption; obstacles for SMEs; inconsistencies
- Major reforms in some East African countries

## Ø Large variations among LGs:

- Different taxes and rates on same sources
- Smuggling of goods between sub-national entities

## Ø Revenues per capita vary significantly between LGs

- Urban – rural

## Ø How did such a LG-revenue system emerge?

- a) Legislation allows LGs to introduce new taxes, fees and charges
- b) Lack of clear criteria for tax design
- c) Poor co-ordination between the various levels of government
- d) Poor data

**à Need for a 'Financial and Fiscal Commission' to coordinate, compile data, analyse and advice? (South Africa)**

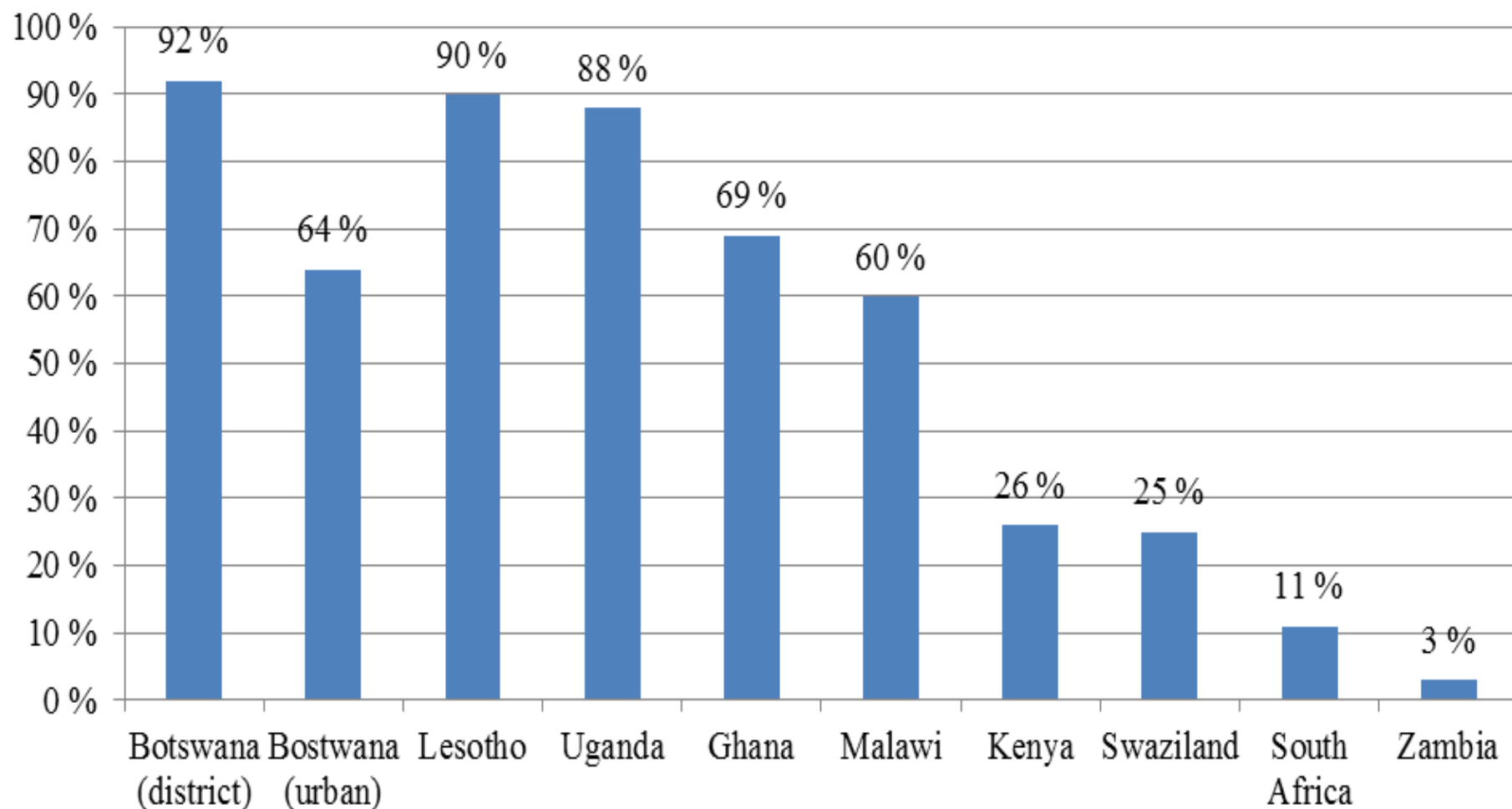
## A local tax collector and his tool



**Not only a question about how much tax is collected but how it is collected**

**à Outsourcing?**

**Figure 2: Intergovernmental transfers in percent of total local revenues  
in selected African countries (2007)**



*Huge differences between and within countries with respect to sub-national fiscal dependence on the centre*

## IV. LESSONS FOR REFORMERS

### Ø Context matters

- One size does not fit all
- Politics of rolling out reform: 'grandialism vs gradualism'

### Ø Different systems for rural and urban units

- How to address regional inequalities?
- (Equalisation) grants & incentives

### Ø Explicit rules are important

- Kenya's cities have special fiscal powers to borrow, but national regulation restrict the amount of loan to a certain threshold

## LESSONS (cont...)

Ø Central Gov relations with Sub-national Gov should be:

- Supportive, consistent, predictable, and transparent

Ø If not, this is likely to imply:

- Imbalance of revenue and expenditure assignments
- Underfunding of transfers to LGs
- Unpredictable financial situation for LGs
- Inconsistencies between national and sub-national taxes
- Growing regional inequality

## LESSONS (cont...)

Ø CG must be able to monitor and evaluate

- Requirements (often lacking):
  - Fiscal analysis unit to monitor LG finances?

à ***'Financial and Fiscal Commission'***

- Fiscal data vital to strengthen revenue forecasting and economic and social impact analysis to enhance the quality of policy making at both national and sub-national levels

à ***'Formative process research' on the implementation and effects of decentralisation reform?***

# MORE LESSONS FOR REFORMERS ...

- Ø Strengthen financial management
  - Budgeting & accounting capacity (...*IT not a magic bullet...*)
  - Accountability:
    - Hard budget constraints problematic when LGs not in control of their resources
    - Citizen access to (accessible) info, monitoring and participation
- Ø Redesign the current local revenue structure
  - Simplification
  - Harmonisation of local and central revenue systems
- Ø Enhance citizens' compliance by improving service delivery and the accountability of local officials
- Ø **Local own revenues a necessary, but generally not a sufficient condition for fiscal decentralisation**



## V. FISCAL DECENTRALISATION IN BANGLADESH: ISSUES FOR CONSIDERATION

Ø Will greater devolution of government offer substantial advantages by enhancing the quality of local public service delivery, encouraging local revenue mobilisation, allowing for greater local voice in public service decisions, and increase citizen satisfaction with government?

Ø Fox & Menon (2008)

# Issues for consideration

Ø What decision making authority do sub-national governments have?

- Differences between various levels
- Coordination? Exchange of information

Ø Whom do sub-national staff report to?

- Hiring & firing and accountability

Ø Budgeting and accounting processes?

- Constraints: staffing, procedures...
- Role of and relations between staff and politicians
- Transparency & accountability
- Revenue & expenditure tracking
- Citizen participation and access to (accessible) information

# Issues for consideration (cont.)

Ø What expenditures are assigned to sub-national gov's?

- Responsibilities
- Matching expenditures and finances

Ø What revenue sources are assigned to sub-national governments?

- Revenues generated by each source
- Administrative & compliance costs

Ø Intergovernmental transfers and revenue sharing?

- Composition of transfers

Ø How is the administrative framework for revenue collection organised?

- Intra-governmental exchange of information

THANK YOU FOR YOUR ATTENTION!