Proceedings of the 2007 Land Policies Conference

FISCAL DECENTRALIZATION AND LAND POLICIES

Edited by Gregory K. Ingram and Yu-Hung Hong

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LINCOLN INSTITUTE OF LAND POLICY
CAMBRIDGE, MASSACHUSETTS

Library of Congress Cataloging-in-Publication Data

Fiscal decentralization and land policies /
edited by Gregory K. Ingram and Yu-Hung Hong.
p. cm.
Includes index.
ISBN 978-1-55844-178-1
1. Intergovernmental fiscal relations. 2. Land use—Government policy.
I. Ingram, Gregory K. II. Hong, Yu-Hung. III. Lincoln Institute of Land Policy.
HJ197.F57155 2008
333.77—dc22 2008008703

Designed by Vern Associates

Composed in Sabon by Achorn International in Bolton, Massachusetts.
Printed and bound by Puritan Press, Inc., in Hollis, New Hampshire.
The paper is Roland Opaque 30, an acid-free, recycled sheet.

MANUFACTURED IN THE UNITED STATES OF AMERICA

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Local Revenues Under Fiscal Decentralization in Developing Countries: Linking Policy Reform, Governance, and Capacity

Paul Smoke

As many developing countries have pursued fiscal decentralization reforms in recent years, local government revenue enhancement has received considerable attention. Public finance specialists have elaborated well-defined and broadly used principles for selecting and designing own-source revenues. It is clear from the empirical literature, however, that even where such advice has been followed, local revenue generation has rarely met expectations. Indeed, much of the literature documents frustrating underperformance (Ahmad and Tanzi 2002; Bahl and Linn 1992; Bardhan and Mookherjee 2006; Bird and Vaillancourt 1998; Ebel and Taliercio 2005; Ebel and Yilmaz 2003; Litvack, Ahmad, and Bird 1998; Prud'homme 1995; Shah 1994, 2004; Smoke 2001; Tanzi 2001; Ter-Minassian 1997; World Bank 2001, 2005).

This chapter argues that the often limited success with local revenue generation in developing countries results, at least in part, from the mainstream analytical framework that dominates how reform is approached. Public finance experts continue to focus on overly narrow and technical fiscal factors, paying insufficient attention to the broader political and institutional context in which reform must take place. A brief review of key elements of the mainstream fiscal decentralization approach is followed by a consideration of how moving beyond it could promote and sustain improved local revenue performance.

Given great variations in structures, functions, and performance across and within regions and countries, it is misleading to speak authoritatively about "local governments in developing countries" as a single group.[1] Reforms appropriate for established, capacitated, economically dynamic urban governments in a more advanced developing country may be irrelevant for weak, poor rural councils recently created in a least developed country. Although illustrative examples are provided throughout this chapter, it is impossible to cover the diversity of experience or to generalize beyond some basic points.

Conventional Fiscal Federalism Wisdom and Experience: A Condensed, Selective Review

The typical starting point for considering local revenues is to determine the specific sources permitted by constitutional, legal, or administrative provisions in a particular country (Litvack, Ahmad, and Bird 1998; Bahl 2000a; Bahl and Martinez-Vazquez 2006; Ebel and Taliercio 2005; Rodden, Eskeland, and Litvack 2003; Shah 1994, 2004; Smoke 2006a). Local revenue generation ultimately depends on establishing a broader enabling environment for decentralization, including the legal status of local governments, their specific rights and functions, and their degree of autonomy. Certain elements of the national legal framework not specific to decentralization may also affect revenue generation. Property rights, for example, set parameters for property tax policy and administration. Legal provisions for local political mechanisms are also important. Although they do not directly determine revenue design, they do influence the extent to which local governments are accountable to their constituents in how they raise and spend public resources.

Fiscal federalism principles for assigning revenues to local governments are fairly well defined.[2] Developing countries often broadly follow these principles. Thus, central governments typically attempt to assign to local governments revenue bases that are, for example, relatively immobile and do not compete seriously with central tax bases. There are, however, examples of local taxes that violate key principles, such as the infamous South Asian *octroi*. This productive,

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1. This diversity is a theme throughout the fiscal decentralization literature. A number of volumes focus on individual countries, including Alm, Martinez-Vazquez, and Indrawati (2004) and Bahl and Smoke (2003). Some are regional specific and somewhat interdisciplinary, including Bird and Vaillancourt (1998), Burki, Perry, and Dillinger (1999), Smoke (2003a), Wunsch and Olowu (2003), and World Bank (2001, 2005). Others are cross regional, including Ahmad and Tanzi (2002), Bardhan and Mookherjee (2006), and Smoke, Gomez, and Peterson (2006).

2. Fiscal federalism is introduced in Oates (1972) and revisited in Oates (1999). Other work, some revenue specific, includes Bahl (2000a), Bird (1999), Ebel and Taliercio (2005), Litvack, Ahmad, and Bird (1998), McClure and Martinez-Vazquez (2000), Shah (1994), and Ter-Minassian (1997). Critiques include Prud'homme (1995), Smoke (2001), and Tanzi (1996, 2001). Recent literature on "second-generation" fiscal federalism includes Oates (2005) and Weingast (2006).

but inefficient, tax on interjurisdictional commerce is also used in various forms in other parts of the world.

LOCAL REVENUE SYSTEM DESIGN: PRINCIPLES AND REALITY

Although local revenue design principles may seem to be straightforward, challenges arise when they are applied in the real world (Bahl 2000a; Bahl and Linn 1992; Bird 1999, 2001; Ebel and Taliercio 2005; Ebel and Weist 2006; Shah 1994; Taliercio 2005). Key principles and illustrations of practice are only outlined here, but references to more complete discussions are provided.

Own-source revenues, over which local governments exercise an element of control, should cover budgetary needs to a reasonable degree of adequacy as per the well-known "finance follows function" principle. In reality, revenue adequacy is difficult to determine given common problems with insufficient clarity, inconsistency, and incomplete adoption of functional assignments. In addition, the well-accepted inherent advantage of central governments in revenue generation often promotes central claims on the most productive sources; a greater role than some analysts might like for intergovernmental transfers; and a tendency for local governments to use numerous unproductive, and even unofficial, sources (Lewis 2003b, 2005; Prud'homme 2003; Taliercio 2004, 2005).

Local revenues are also expected to be elastic, growing at least in proportion to the local economy and expenditure needs. Adequate elasticity, however, is elusive, due both to the types of revenues that are typically decentralized and to the failure of local governments to take actions needed to ensure base growth, such as revaluing and indexing property assessments.

Local revenues are expected to be efficient and equitable. Efficiency comprises both minimizing distortions of economic decisions made by individuals and firms (that result, for example, from selectively differentiated property assessment ratios and rates) and ensuring correspondence between payments and benefits (by, for example, limiting tax exporting). In fact, local revenue systems often compromise efficiency through choice of potentially problematic instruments, such as turnover taxes; differential treatment for specific policy objectives, such as favorable property tax rates to spur development in target areas; poorly developed or enforced rules, which may facilitate political manipulation of tax burdens; and adoption of local taxes with "exportable" burdens (although not all economists oppose this practice). At the local level, there is more concern with horizontal equity (equal treatment of equal individuals and firms) than vertical equity given the potential spatial inefficiencies created by local redistributive taxation. Equity, however, can be problematic no matter how it is defined because local taxes often fail to cover all sectors, and preferential treatment of certain taxpayers or groups commonly results from tax regulations and weak or selective administration.

One of the most coveted principles of local revenue generation is the need to provide local governments with a degree of fiscal autonomy over a share of revenues sufficient to create a connection in the minds of local voters between the revenue generation and service delivery actions of local elected officials. In reality, the degree of autonomy is often limited by an unwillingness of central government to share power or concerns about local capacity. In addition, local governments may not take advantage of autonomy because they do not know how to do so or they do not want to take responsibility for revenue generation.

It is often recommended that local revenue systems be designed for consistency with other elements of the national fiscal system, including central revenues, intergovernmental transfers, and subnational borrowing systems. Relevant policies include, for example, limiting redundant taxation and embedding incentives for local revenue generation in transfer and lending mechanisms. Inconsistencies in the fiscal framework, however, are not uncommon, with poor harmonization of taxes used by central and local governments, weak incentives for revenue generation in transfer programs (Bahl 2000b; Bird and Smart 2002; Schroeder and Smoke 2003; Shah 2006a), and failure to enforce repayment of local government loans from central government lending mechanisms (Friere and Peterson 2004; Peterson 2000).

Beyond pure fiscal concerns, local revenues are expected to be administratively feasible. The most common prescription is to adopt appropriately simple rules and procedures that are consistent with often weak local capacity and also limit the potential efficiency and equity effects of differential treatment. Administrative feasibility, however, is often compromised by pursuing non-revenue-raising objectives and adopting poorly defined or unduly complex procedures (Bird and Wallace 2003; Ebel and Taliercio 2005; Lewis 2006; Mikesell 2002, 2007; Taliercio 2004, 2005). Also desirable is political feasibility, which is framed in terms of using revenues that are less lumpy or visible (e.g., small payments over time versus large lump sums), that are transparently defined, and that create taxpayer confidence in fair tax administration. In reality, political feasibility is often difficult to determine and achieve in developing country environments where citizens are not used to receiving or paying for services. In addition, politically feasible revenues may be problematic in other ways.

OBSTACLES TO EFFECTIVELY APPLYING THE PRINCIPLES

Relatively weak performance relative to fiscal principles results from a number of factors. First, there are well-known technical trade-offs and complexities inherent in these principles. Certain tax bases, such as sales, turnover, and property, may be potentially productive and buoyant, but they are also difficult to administer, especially where capacity is weak. The above-noted *octroi* is also often productive and buoyant but inefficient. Some efficient revenue sources, such as user charges, may be seen as inequitable. Thus, objectives must be prioritized. A related problem is a common lack of appropriate and reliable information for good revenue policy design and administration.

Second, national politics obviously support or undermine appropriate fiscal decentralization policy.[3] Politics significantly influence which functions and revenue powers are decentralized, how they relate to the larger fiscal architecture, the degree to which the center grants genuine autonomy, and the process and support structures that enable local governments to assume new responsibilities. In many cases, reluctance to decentralize reflects an unwillingness of the center to relinquish functions and resources, but subnational government empowerment can also be used strategically to consolidate power for a single dominant party or the current regime.

Third, national institutional actors that elaborate local revenue powers, design operational procedures, and provide technical and capacity-building support to local governments may not have sufficient capacity to meet their obligations. They may also be uncooperative or antagonistic to each other (Cohen and Peterson 1999; Litvack, Ahmad, and Bird 1998; Smoke 2007; Smoke and Lewis 1996). Battles between ministries of finance and local government, for example, can result in incomplete or inconsistent policies that complicate local assumption of powers.[4] Even within a ministry of finance, aspects of fiscal reform—local revenues, transfers, and lending—may be under different departments that function independently or competitively, resulting in a failure to resolve important policy matters or inconsistency in formal policies and procedures.[5]

Fourth, the role of international development agencies should not be overlooked in developing countries.[6] Although such agencies have arguably modified their behavior over time, they long supported primarily technical approaches to revenue reform, irrespective of whether these approaches were politically and institutionally workable. There is also some tendency to draw on the positive experiences of industrialized and transition countries, recommending reforms that may be more difficult for many developing countries, particularly outside of major urban centers, to implement successfully, such as complex computer-based valuation models for property taxation.

3. The national politics of decentralization are discussed to varying degrees in Bardhan and Mookherjee (2006), Bird and Vaillancourt (1998), Burki, Perry, and Dillinger (1999), Cohen and Peterson (1999), Eaton (2002, 2004), Litvack, Ahmad, and Bird (1998), Manor (1998), Smoke (2007), Smoke, Gomez, and Peterson (2006), Willis, Haggard, and Garman (1999), and Wunsch and Olowu (1990, 2003).

4. In Uganda, for example, the Ministry of Finance and the Ministry of Local Government separately developed local financial management systems. Similar situations have occurred between the Ministry of Finance and the Ministry of Home Affairs in Indonesia.

5. In Indonesia, for example, bureaucratic battles within the Ministry of Finance have been a major factor in obstructing property tax decentralization and subnational borrowing reform.

6. Many references cited in this chapter touch on donor approaches to supporting decentralization, sometimes with specific reference to fiscal decentralization and revenue reform. Some emphasis on donor behavior and coordination is found in Romeo (2003) and Smoke (2000).

Fifth, revenue generation at the local level is inherently political. How local governments use their revenue powers—depending on where local political power really lies—may, for example, overtax or undertax businesses relative to individuals or particular sectors relative to others, creating both behavioral distortions and inequities. Under certain political power scenarios, high levels of autonomy may lead to massive capture by local elites or exploitation of certain groups. Without adequate development and enforcement of a local government framework and adoption of appropriate accountability relationships beyond simple elections, local populations may not be capable of securing their "preferences" from local politicians, which is the basis of fiscal decentralization.

Common Local Revenues, Key Challenges, and Standard Policy Responses

Fiscal decentralization experts often recognize these constraints on implementing local government revenue principles. Their response to these realities, however, has on the whole been fairly limited. Before considering how to advance thinking and practice, it is useful to review a few of the most common developing country local revenues, problems experienced in using them, and standard recommended policy responses. The focus here is primarily on revenue policy and administration reforms, with the political dimension treated more fully below. It is important to emphasize that specific reforms that have worked in some countries will not be applicable everywhere, but the general strategies and principles involved can often help analysts to think about how to improve the situation in a variety of environments.

PROPERTY TAXATION

The property tax, often seen as a mainstay of local revenue, is known to suffer from design and administration problems that are often particularly severe in developing countries (Bahl 1979; Bahl and Linn 1992; Bahl, Martinez-Vazquez, and Youngman 2008; Bird and Slack 2006; Dillinger 1992; Franzsen 2003; Kelly 1993, 2000, 2003; Lewis 2003a; Oates 2001; Rosengard 1998). First, some developing countries, in pursuit of policy or political goals, tax certain types of property more heavily than others through higher assessments and rates. In the case of business properties, for example, this practice could lead to relocation or shifting the tax burden through higher prices to the very residents that differential treatment is trying to protect; alternatively, exporting could occur. A central policy recommendation is to reduce or eliminate differentials in assessment ratios and tax rates on different classes of property. This practice limits incentives for tax avoidance and evasion, such as attempts to have property classified differently, to seek special exemptions, or to subdivide plots.

Second, problems associated with the complexity and infrequent application of valuation procedures, such as inefficiencies, inequities, and stagnant tax bases, are well known and pervasive. There has been a movement to adopt simplified mass assessment procedures that use a limited, standard set of land and building characteristics, with some evidence of improved yields and lower administration costs. In addition, provisions to revalue at regular intervals and to index between valuations can improve revenue buoyancy.

Third, collection long received less attention than valuation reform in developing countries. Indonesia's property tax reform in the late 1980s and 1990s was among the first to replace a valuation-led strategy with collection-led reform (Kelly 1993). This reform was justified by the argument that improved valuation would have a limited impact on yields without improved collection. Key elements of collection-led reforms include legal provisions that broadly define liability, permitting renters to deduct property tax payments from rent; steps that improve taxpayer convenience, such as more accessible payment points and simpler procedures; and enhanced enforcement, such as higher penalties for nonpayment and seizure of properties in default.

Fourth, conventional property tax administration requires considerable information: on parcels and characteristics of land, owners and users, assessments, billing, and collection. This severe problem has been tackled in various ways, such as by trying to reduce the amount of information required (mass appraisal as noted above); by using and coordinating with existing sources of data; and by improving the use of technology to record, update, and manage information for tax administration.

OTHER COMMON LOCAL REVENUE SOURCES

Beyond the property tax, user charges and business-related fees are among the most common local revenues in developing countries. Experts generally agree that user fees are often under- and inappropriately utilized (Bahl and Linn 1992; Bird 2000; Bird and Tsiopoulos 1997; Crane 1994; Whittington 1991). The case for their use is powerful, including improvement of the consumption-cost connection and the enforcement benefits of being able to exclude nonpayers. There are also challenges, however, such as choosing among pricing schemes with different implications for cost recovery and efficiency, administrative and political barriers to collection, reluctance or inability to raise charges over time, and equity concerns about how charges affect the poor.

Recommendations must be made in terms of the context of specific sectors and countries, but evidence that people are willing to pay something for services if adequate quality and reliability are maintained, and successful reform experiences, suggest general approaches. There has been movement to simplify and be more transparent about charge structures. Raising charges incrementally seems more acceptable than large increases. Cost recovery can be improved while offsetting equity concerns through various means—use of alternative service technologies in low-income areas (e.g., communal water taps), appropriate price discrimination schemes (to reflect community standards or variations in price elasticities of demand), and adopting flexible ways to cover prohibitive service "entry costs" (e.g., water system connection), among others. Collection can also be improved under certain conditions through contracting third-party agents (e.g., private firms for network services and community organizations for local services).

In developing countries, business-related taxes and fees can be productive in absolute terms and with respect to total local revenues (Bahl and Linn 1992; Bird 2001). Perhaps most widespread are business licenses and market fees, but problems are common. License fees often duplicate fees charged by higher-levels agencies (such as a ministry of commerce) that are more likely to be paid. In addition, the fee structure often seems arbitrary, with no clear justification for differences in fees across professions or merchants, and widely varying charges across jurisdictions that could induce movement of economic activity. Finally, enforcement is commonly inconsistent, due to both administrative weaknesses and political interference.

Recommended reforms include giving local governments sole access to licensing and requiring fee structures based on clear standards, often according to a centrally defined allowable range of fees. A commonly cited example of good practice is the single-business permit in Kenya, which grants to local governments exclusive rights to levy and collect business licenses but sets national guidelines intended to improve efficiency and equity (Devas and Kelly 2001).

Some subnational revenue options tend to be less universally used or relevant, primarily for intermediate tiers (states, provinces, regions) or large urban areas (Bahl and Linn 1992; Bird 2001; Shah 1994). Motor vehicle taxes and licenses, for example, can be productive and structured to promote efficiency and to target wealthier people. Natural resource taxes can also be lucrative. They are generally collected and shared by the center or are relatively easy to collect. With some exceptions, however, motor vehicle and natural resource taxes are normally reserved for higher tiers or heavily defined and regulated by the center.

Another exceptional example of productive local taxes is the regional services council levy, a payroll and business turnover tax in South Africa. It is a major source, but primarily benefits urban areas. Potentially problematic, it can harm businesses, undermine tax bases, and adversely affect equity if raised too high or passed to consumers (Bahl and Solomon 2003). Similarly, Uganda uses the graduated personal tax, an unusual hybrid of a pay-as-you-earn income tax, a presumptive income tax, a wealth tax, and a poll tax. It is poorly designed and implemented, and politically contentious, but outside of Kampala, the revenue-diversified capital, it accounts on average for 70 percent of local revenues (Smoke 2002). Despite recognized concerns with such sources, their revenue productivity discourages reform, unless they can be replaced with a source that is revenue neutral or more productive.

Some analysts frustrated with poorly performing traditional local taxes make the case for a different approach. They argue that the property tax is costly and difficult to administer and that even a well-administered version cannot finance major social expenditures. Moreover, subnational business taxes are often poorly structured and administered. These realities have generated calls to adopt subnational value-added taxes (VAT) or business-value taxes, a VAT levied on the basis of income (production, origin) rather than consumption (destination) (Bird 1999, 2001, 2005). A subnational VAT can be complicated, but there are ways to mitigate likely problems. Such taxes will not work for small- or low-capacity local governments, but proponents argue that a dual approach could be taken. Smaller local governments could use (in conjunction with user charges) business licenses, such as the Kenyan single-business permit mentioned earlier. Regional and metropolitan governments could use the business-value tax.

Although positive reforms have been realized, and useful proposals to strengthen local yields have been advanced, weak revenue generation and poorly designed subnational revenue systems remain among the most prominent flaws of decentralization in developing countries. Even where progress has been made, it is more common for individual local revenues to be improved than for broader systemic reform that has greater potential for major impact.

Neglected Aspects of Local Revenue Reform: Politics, Governance, and Implementation

Many of the constraints on local revenue reform outlined above are recognized both in the academic literature and in practice. For example, analysts commonly identify trade-offs inherent among local revenue principles and try to help policy makers understand options available to them and the implications of each choice. They also typically emphasize the importance of developing good frameworks as well as sound systems and procedures through which to implement local revenue policies.

On the other hand, beyond vague discussions of the need for "political will," analysts often deal superficially with political and institutional dimensions of revenue generation, perhaps the most important factor constraining performance. In addition, limited attention is paid to local revenue policy implementation beyond recognizing that administrative systems and capacity to operate them must be built. This point is particularly important given that, in many developing countries, the desired system identified by using normative revenue principles is often not easily or quickly attainable. Moreover, a potentially close link exists between political and institutional constraints and implementation. If the latter is approached strategically, a good revenue system might be built gradually over time in a way that responds to, and helps to overcome, constraints.

POLITICS, GOVERNANCE, AND FISCAL BEHAVIOR

The academic literature across various disciplines includes several approaches to the political economy of taxation (Addison and Levin 2006; Bräutigam 2008; Moore 2004, 2007; Sabates and Schneider 2003; Schneider 2003; Therkildsen

2001). Broadly speaking, the authors attempt to explain the composition and level of taxation, and, to varying degrees, how they are related to state structure, capacity, and the relationship between the state and civil society. Main approaches include the traditional public finance approach, which focuses on understanding the effects of taxation on economic development and other public goals; a taxpayer approach examining how ideology, value, and culture influence willingness to pay and compliance; a political institutions approach that uses historical analysis to explain state capacity and tax system development; a crisis-based approach that considers how war and conflict drive tax expansion and modernization; and a fiscal contract approach, which analyzes how revenue-maximizing governments "negotiate" with payment-minimizing taxpayers by offering state-provided benefits. Some literature focuses on issues related to decentralization. For example, a study of 68 countries found that politically decentralized regimes tax citizens less than more centralized regimes, but it did not disaggregate national and subnational revenue levels (Schneider 2003). Aspects of these various analytical approaches are relevant for local taxation.

There is also a more general (non-taxation-specific) empirical literature on how national political institutions and contextual factors affect the behavior of elected officials and outcomes that result from state action. Limited work on decentralization examines various relationships between government structures, governance measures, and outcomes.[7] This literature, however, often takes either a "macro" perspective, focusing on cross-national comparisons, or a "micro" perspective, focusing on particular cases. Comparative econometric studies document broad patterns, and case studies illustrate details of complex relationships among politics, governance, and decentralization (Ahmad and Tanzi 2002; Bardhan and Mookherjee 2006; Bird and Vaillancourt 1998; Cheema and Rondinelli 2007; Smoke, Gomez, and Peterson 2006). The comparative studies, however, do not capture key details of structural design or political variables, and their broad findings provide a weak basis for concrete reforms. Case studies, on the other hand, vary in focus and in the way they collect and use evidence, so their broader relevance is also unclear. Much practitioner literature leans toward prescriptive advice and "snapshots" of cases that illustrate this advice with relatively limited consideration of if and how to replicate or modify it elsewhere (UNCDF 1999, 2006; UNDESA 2005a, 2005b; UNDP 2000, 2004; USAID 2000; World Bank 2000, 2004). Both the academic and the practitioner literatures on the relationship between politics/governance and outcomes tend to focus primarily on expenditures and service delivery rather than revenue generation.

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7. Recent political science literature is reviewed in Hoffman and Gibson (2006). Some relevant economics literature is reviewed by Martinez-Vazquez and McNab (2006), who find evidence of a bidirectional and temporal relationship between fiscal decentralization and democratic governance.

THE POLITICAL DIMENSIONS OF LOCAL REVENUE GENERATION

The politics of local revenue reform can be critical, a fact recognized to some extent by much of the literature referenced in this chapter. At the national level, even with agreement to assign revenue sources to local governments, efforts to limit the autonomy with which they are executed are common. Many decentralization frameworks, for example, devolve the property tax, but onerous regulations and arbitrary central interventions can undermine local autonomy and limit productivity.[8]

The greatest political obstacles to local taxation are often found at the local level. Although property tax, for example, is considered to be a good local tax, it is very visible. It is not hidden in income deductions or purchase prices, and known inequities in administration can create local resistance. Concentration of land ownership and a stark division in developing countries between the rich and elite, on one hand, and the poor and marginalized on the other hand, also complicate the use of this tax. Cultural traditions and ethnic loyalties can lead to politicization of revenue-generation activities in ways that undermine tax yields and taxpayers' sense of fair treatment. For example, taxing land or livestock can be contentious in some situations, and residents from the same ethnic group as the tax collector may be treated favorably. Enforcement can be arbitrary or politicized, even if a local government has reasonable capacity. Perhaps most fundamental is that local residents may be unwilling to pay if they do not believe that they are getting adequate services or those that they want.

The preceding discussion highlights that politics is at the core of local revenue generation. Indeed, fiscal federalism assumes some means for local governments to discern citizen preferences and be responsive to them in how revenues are raised and used.[9] The normative, technical approach to local revenue analysis, however, barely addresses governance and accountability reform beyond promoting elections and recognizing the need for transparent, rule-based procedures and taxpayer appeal mechanisms. Without significant governance mechanisms and a willingness and ability of local residents to use them, local revenue generation is likely to remain limited.

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8. Some degree of regulation by the central government is justified. Without it, substantial local variations in tax base definition, assessment ratios, or tax rates can create problems and complicate local tax effort comparisons needed for national policy design and enforcement in a particular country. Such regulation, however, must be defined in a way that limits political manipulation.

9. Useful reviews of decentralization and governance from various perspectives, none particularly focused on revenue generation, are provided in Blair (2000), Cheema and Rondinelli (2007), Crook (2003), Manor (1998), Olowu (2003), Ribot (2004), Ribot and Larson (2005), Schneider (1999), Shah (2006b), Shah and Thompson (2004), Tendler (1997), and Wunsch and Olowu (2003).

Some key local governance instruments, such as credible and competitive elections, are obviously not within the local fiscal realm, and they are in any case a blunt instrument for improving accountability. Other mechanisms, however, such as town meetings, oversight boards with private-sector and nongovernmental organization (NGO) representatives, participatory planning and budgeting, and social auditing of local resource use have been widely explored. These mechanisms can be useful in promoting public understanding both of how revenue sources are defined and levied and of how the proceeds are being used for local expenditures. Improved political mechanisms, more broadly based participation, and better local services can alleviate political obstacles to more effective use of local taxes (Blair 2006; Commins 2006; Manor 2007; Platteau 2006). Some authors have argued that a closer relationship between local governments and citizens through such processes can help to develop local social capital (de Mello 2002).

There are at least three important caveats to these broad claims. First, accountability mechanisms can be just as "technical" as fiscal mechanisms. For example, rules and processes for participatory budgeting or planning, including how they treat local revenue generation, can be well articulated to meet normative principles, but what matters is how they are applied. If participation is token or noninclusive, broad improvements in service coverage, quality, and willingness to pay local taxes should not be expected. If such mechanisms are captured by political and economic elites—even powerful but nonrepresentative citizen groups or NGOs—their effect will be limited or different than intended. In some countries, particularly for highly local or village decision-making processes, participation is mandatory or requires a minimum involvement of underrepresented groups (e.g., a certain percentage of women), but such rules do not automatically make participation meaningful.

Second, the use of accountability mechanisms requires a degree of awareness, capacity, and interest on the part of citizens. Local budgets or participatory forums may be available to the public, but people may not know it and may not know how to access, interpret, or use them. Similarly, mechanisms to appeal property tax assessments or local business license fees will not be effective if people do not know about them or face barriers in using them, such as lack of appropriate knowledge, poor access to advice, or intimidation.

Third, only limited empirical evidence provides specific guidance on how to incorporate political considerations in analyzing local revenue reform. There are, however, a few studies that provide useful insights into the political nature of local revenues in particular countries, such as why residents comply with or evade local taxes. In Tanzania, for example, local tax compliance is positively related to factors such as ability to pay and the (perceived) probability of prosecution, and it is negatively related to oppressive tax enforcement, taxpayer harassment, and weak satisfaction with public services (Fjeldstad and Semboja 2001). Although that study suggests that unduly harsh treatment may backfire, a more focused study of the same country found that some element of coercion enhances local government revenue performance. The ability to enforce depends on the power and capacity of local governments and the insulation of revenue collection from direct influence by elected councilors (Fjeldstad 2001).

In South Africa poor compliance in service charge payment is commonly blamed on poverty and a sense of entitlement to national subsidies. Recent research, however, finds that although inability to pay is important, there are great variations in compliance within and between communities with similar socioeconomic characteristics (Fjeldstad 2004, 2005). A key factor is the extent to which citizens perceive local governments to be acting in their interest, which includes their level of satisfaction with services provided and a sense that other citizens pay a fair share. Similar sentiments emerge from a survey in Uganda. Only 11 percent of respondents believed that local tax payments were substantially used to improve services; 46 percent said to some extent, and 32 percent saw little service benefit (Kjaer 2004, 2005). A strong majority of respondents—75 percent—indicated a willingness to pay more if local governments did more for the community.

In Senegal tax compliance decreased substantially after collection was devolved to local councilors (Juul 2006). Compliance was greatest for foreigners and newcomers, who used payment as a way to be recognized as community members and to block attempts by local elites to deny them their civil rights. Reasons for noncompliance included lack of service provision and weak general confidence in local authorities. In contrast, evidence from the city of Porto Alegre (Brazil), famous for pioneering participatory budgeting, used local participatory mechanisms to mobilize support for tax reform and compliance (Schneider and Baquero 2006). Throughout the 1990s, tax avoidance decreased and revenue collection increased impressively. From 1989 to 2004, local tax effort increased 338 percent, which far exceeded economic growth, and the revenue increase occurred during a time when intergovernmental transfers were also rising rapidly.

Other studies document how the structure of local revenues influences the way local politicians use them. For example, a study of local budgets from Tanzania and Zambia found that local governments devote a larger budget share to public service delivery as local taxes increase (Hoffman and Gibson 2006); a higher share of local resources from intergovernmental transfers and foreign assistance, however, is associated with a larger budget share for employee benefits and administrative costs. Also relevant is how revenue distributions within a local government can be distorted by local politics. Education allocations in Uganda, for example, often did not reach intended end-users (schools) over a five-year period. Schools received on average only 13 percent of allocations, with the bulk captured by local officials (Reinikka and Svensson 2004). Within local governments, the great variations in percentage of allocation realized suggest that certain schools had power to claim more of what they were due. Such a situation should be expected to influence willingness to engage in local affairs and to pay local taxes.

Some evidence also suggests that commonly recommended revenue reforms can be sidetracked by unanticipated behavioral adjustments. Recent work on private collection of local taxes in Uganda, for example, finds that such efforts can improve revenue growth and stability (Iversen et al. 2006). Revenue leakage, however, may remain significant: it is merely shifted from the collection point (the collector–taxpayer transaction) to the district administration (the contractor–local government transaction). Although not local specific, recent research on the Uganda Revenue Authority, which was established to reduce corruption, finds that behavior of individual actors in the revenue collection system substantially depends on the interests of social groups to which they belong (Fjeldstad 2006). In effect, social relations can undermine formal bureaucratic structures and positions. Thus, technocratic reforms supported by donors and halfheartedly or opportunistically (in search of other objectives) embraced by local bureaucrats do not adequately recognize that progress in tax administration depends on stimulating changes in the behavioral culture of the civil service. Even with major changes in structures and procedures, reform does not happen easily.

The empirical literature is difficult to synthesize. Not only is it limited, but the focal issues being studied vary, the authors employ diverse methods, and the studies are generally based on only one or two countries. In addition, factors underlying documented behavior are not always well explored. One conclusion, however, is reinforced by this empirical work—the nature and quality of local governance are likely to significantly affect how local revenue is generated and used, as well as how citizens perceive and react to local government fiscal behavior.

IMPLEMENTATION

In recent years increased attention has been given to implementing and sequencing fiscal decentralization (Bahl and Martinez-Vazquez 2006; Burki, Perry, and Dillinger 1999; Ebel and Weist 2006; Falleti 2005; Litvack, Ahmad, and Bird 1998; Shah and Thompson 2004; Smoke 2006a, 2000b, 2007; Smoke and Lewis 1996). With one exception (Ebel and Weist 2006), this literature does not specifically focus on local revenues, but the basic approaches to thinking about implementation are relevant. Even the best-designed local tax on a high-value base may not be productive unless care is given to how it is implemented. Local governments need to develop good procedures and capacity to use them. At the same time, citizens and businesses must learn to pay taxes, which means being satisfied that local governments are being responsive and treating them fairly.

Decentralization (including local revenue) implementation comprises both national and local dimensions and can be accomplished in a variety of ways. At the national level, on one extreme, national framework implementation becomes the responsibility of individually acting central ministries and local governments. They must adjust to the new framework, develop capacity for their role in it, and adopt its provisions. This approach might be called "sink or swim." On the other extreme, a central government might pursue a highly managed process for gradually implementing the framework provisions according to criteria. Under such an approach, nothing is automatic, and the framework is implemented according to central decisions. This approach might be called "paternalistic."

Neither of these extremes makes sense in most developing countries. The "sink or swim" approach would work well only where central ministries are likely to comply with decentralization mandates, the discipline of a hard budget constraint is institutionalized, local governments have a minimum capacity, and citizens have enough power and experience to hold local governments accountable. A purely "paternalistic" approach, however, is also problematic. In many developing countries, some subset of local governments is capable of responsibly managing their fiscal affairs, and they should not be hampered by central control over assumption of their legal rights, including those related to autonomous revenue generation (Bahl and Smoke 2003; Smoke 2004).

Compromise is possible through objective differentiation among local governments. Those with certain capacities can, essentially, be left to "sink or swim," whereas others might more gradually assume responsibilities and be targeted with evolving capacity building and technical assistance as they move toward autonomy. Under such an asymmetric, "developmental" implementation strategy, the target systems may be the same, but the path to attaining them need not be. The danger, of course, and the reason many analysts have reservations about this approach, is that politicized, subjective assessment of which local governments are ready to do what, can undermine the process. As a result, local governments might be brought into the reform effort at a level inconsistent with their capacity, and some may be stalled at early stages of reform that leave them with limited authority and autonomy. Such problems, however, can be managed if the process is appropriately defined and implemented; moreover, given how poorly other approaches have performed in developing countries, it is at least worth considering a more strategic process.

If properly conceived, local revenue reforms can be linked to broader efforts to build capacity, including governance, and they can be structured to improve performance progressively. The central government has considerable leverage, with the possibility of using access to rights, resources, and technical assistance to encourage adoption of new revenues and procedures, accountability mechanisms, and other local reforms. Using such leverage implies that, at least to some extent, local autonomy in developing environments should be earned. High levels of local autonomy in the absence of a minimum of capacity to assume functions responsibly and some degree of accountability to local citizens are a well-documented recipe for poor performance. At the same time, in some cases local officials may be able to undermine central controls: because the center does not have the capacity to monitor them, because local officials are powerful, or because they are able to raise local revenues through extrabudgetary means that escape central detection. In addition, central agencies must have the capacity and disposition to design and implement fair controls in the first place. In short, this path is difficult to follow and would need to be carefully explored and structured.

The specific situation will also differ among developing countries that are at different stages of reform. Some countries already have a local revenue system that they are trying to improve. Others are transferring portions of a centrally managed system to local governments, sometimes along with staff. In still other cases, new revenues are being created for new local governments. Such differences in the nature of the system—along with the political and institutional factors outlined above—should inform the strategy that would be developed in a particular country.

At the local level, the notion of an implementation strategy takes on a different meaning. Even the most capable local governments may need to selectively implement local revenue reforms that require major changes in the nature and level of what residents pay for local services. Simple and more politically acceptable reforms could be undertaken before more complex or controversial ones, which could be phased in later. For example, in places where movement to full property valuation is intended and current valuations are low, assessment ratios could be phased in and related to specific improvements in service delivery. Similarly, to avoid harsh equity effects, undesirable changes in service use, or administrative and political resistance, user charges could move gradually toward cost recovery. New systems and procedures could be tested through pilot programs, allowing for improvements before wider adoption.

Institutional innovations can also be used to help overcome some of the constraints discussed earlier. Adoption or tailoring of citizen engagement and oversight mechanisms can facilitate public acceptance of local tax reforms, as some of the empirical work reviewed above suggests, and public education campaigns may promote improved citizen awareness and compliance. User committees for specific services have sometimes been strategically used to connect citizens to local government service delivery and associated revenue generation, although they have also bypassed and undermined local governments in some cases (Manor 2004). Working with community groups on service delivery and revenue generation for local services such as trash collection can be productive and benefit both local governments and the community groups.

It is also worth noting that capacity building, a key to implementation, is usually treated in a perfunctory, boilerplate way (Green 2005). Local revenue experts recognize the need for capacity building so that local government employees can manage revenue generation effectively, and training and technical assistance are often provided. Capacity building, however, can be "supply driven" (by the center) or "demand driven" (by local governments). In addition, training can be "classroom based" or "on the job." Many developing countries continue to focus on traditional supply-driven classroom training. Anecdotal evidence and a growing consensus suggest that "on the job" training specifically demanded by local governments for particular tasks they are currently implementing is a better way of developing and retaining skills. Thus, having a general course at a training institute on property valuation or determining costs to calculate user charges may be less useful than, or should at least be supplemented by, "on the job" training provided as local revenue administration employees are undertaking these functions. Although not strictly a local revenue issue, how capacity building is handled may well affect the ability of local revenue administrators to perform effectively.

POSSIBLE STRATEGIC ROLE FOR ALTERNATIVE MECHANISMS

Most of the discussion here focuses on the standard mechanisms of fiscal decentralization used in formal intergovernmental systems. In least developed countries with weak local governance traditions, a number of alternative funding mechanisms have been used to improve the climate for general decentralization (Romeo 2003; Smoke 2007). These improvements can be made in ways that promote responsible fiscal behavior and even stimulate local revenue generation.

International donors have long supported various special funding mechanisms for local governance, such as community development funds, microproject funds, small-town development funds, and social funds. These initiatives have been taken primarily in least developed countries or in poor areas of better-off developing countries. Typically, the resources (which may be on or off budget) finance local development projects identified through dedicated planning, budgeting, financial management, and participatory processes. If local governments are new, or not yet operational, these processes can pilot mechanisms that support the development of formal local government procedures. If local governments exist but are weakly accountable, temporary separation of these processes from regular planning and budgeting can partially insulate them from common local government financial problems, such as resource leakages or disbursement delays. These mechanisms can help to build local governance and technical capacity, although they often ignore how to deal with recurrent revenues for operating and maintaining the facilities they finance. They can also become counterproductive if they are not eventually integrated into formal local government systems.[10]

Perhaps most directly relevant for present purposes is the Local Development Fund, or LDF (UNCDF 1999, 2006). It differs from the other funds noted above in two key respects. First, it provides local governments not with project-specific funding, but with a block of funds that function like an unconditional

10. This point is particularly true for social funds, which often provide resources to local NGOs and community-based organizations as well as local governments. Formal links to local government can be planned, and these mechanisms can enhance local capacity and governance where democratic decentralization has not been formally adopted. See Romeo (2003) and Tendler (2000) for a discussion of social funds.

transfer, subject only to procedural and legal controls. A participatory resource programming process requires local prioritization of activities within a resource envelope—the essence of true planning and budgeting—rather than developing a list of projects that local governments apply for without guaranteed funding. Second, LDF funds can be partially used for recurrent expenditures, and they often include requirements or incentives for local governments to generate their own revenues. This approach can begin to create in the minds of citizens a linkage between paying for and benefiting from collective services and a culture of civic engagement.

Strategically Bridging the Technical and Political Aspects of Local Revenue Generation

All local revenue reforms in developing countries bridge technical and political matters to some degree. There is often a strategic element as well. Many technical aspects of reform discussed earlier, such as simpler and more transparent property valuation, incrementally raising assessment ratios or user charges, or convenience-enhancing payment mechanisms, are a strategic response to political constraints on revenue compliance, even if they are not framed in this way. Most of these reforms, however, involve procedural changes, falling short in building a stronger direct connection between local governments and the citizens who are expected to pay local revenues. Most of them are also partial and ad hoc, focusing on a single problematic aspect of the local revenue system that may not be sustainably fixable without attention to other matters.

Sometimes a more limited approach is the best that can be done given political realities, and it is often, but not always, better than nothing. Given the common and pervasive weaknesses in local revenue performance, however, it is worth thinking more broadly and carefully about how to approach reform. Although there are no “best practice” cases to draw upon, there are elements of “potentially better approaches” embedded in some cases, examples of which appear throughout this chapter. It is also useful to think about how national and local governments in a particular country have collectively attempted to improve local revenues. The cases of Kenya and Cambodia are instructive.

CENTRAL COORDINATION AND LOCAL CONSULTATION: IMPROVING LOCAL GOVERNMENT REVENUES IN KENYA

Although local government performance has long been dismal and token reforms have been common (Smoke 1993, 1994), recent developments have pushed Kenya to more serious action (Smoke 2003b; Steffensen, Naitore, and Tideman 2004). Intergovernmental fiscal reforms began in the late 1990s through a joint Ministry of Finance (MOF) and Ministry of Local Government (MLG) effort. Evolving political pressures provided an opening. Improved cooperation between these two key central agencies was facilitated by a change in senior MOF leadership and the (only partly intentional) deployment of motivated, well-placed technical staff and advisors in both agencies.

A key early step was the nearly simultaneous abolition of the problematic local authority service charge (LASC) and institution of the local authority transfer fund (LATF) to replace lost LASC revenues. The LASC was essentially a revamped version of the graduated personal tax, the poorly structured and contentious revenue source noted earlier in reference to Uganda. The LASC demise was generally welcomed, and its replacement by a transfer did not much affect local revenue autonomy because the LASC structure and rates were nationally regulated. The LATF involved several improvements in the Kenyan context. In addition to setting aside a share of the national income tax for local governments, a special treasury account was created to protect LATF funds, a broad-based advisory committee including nongovernmental actors was formed to manage the transfers, and clear fund disbursement rules were issued and generally enforced.

Perhaps the greatest LATF innovation is linking it to adoption of broader reforms being promoted through a larger local government reform program outlined below. Although LATF is allocated through an objective, transparent formula, portions of these allocations can be withheld if local governments do not meet specific reform program conditions, such as adopting streamlined budgeting guidelines. Some have criticized this program as an infringement on local autonomy. Others see it as strategic. Proponents of this latter view do not believe that the central government should control how legally empowered local governments spend their resources (beyond legitimate use of conditional transfers for national priorities). Instead, they argue that it is reasonable in developing country environments for the center to require local governments to adopt basic procedures and processes that help improve transparency and accountability, especially where local accountability mechanisms taken for granted in the West often do not exist and civil society is relatively weak.

The MOF/MLG alliance has also been promoting local revenue improvements and better financial management. The above-noted harmonization of central and local business licenses through the single-business permit provided a productive local revenue with some discretion in setting rates and guidelines to reduce erratic treatment of businesses within and across jurisdictions. More attention is now being given to poorly administered property rates, which have great unmet potential. The Rates Administration Management System, which initially involves updating fiscal cadastres and adopting appropriately simple computer-assisted mass appraisal systems, is being piloted, and the Integrated Financial Management System is being developed to enhance procedures and incentives for recurrent and capital budgeting, cash-flow management, and financial control. There are some broadly strategic aspects to Kenya's reforms. The finance elements outlined above have been reasonably well conceived and coordinated. They are embedded in a broader set of reforms promoted by the Kenya Local Government

Reform Program (KLGRP), which pilots local fiscal and institutional structures as well as efforts to build local accountability and capacity. The KLGRP involves an element of negotiation regarding specific reforms participating local governments will undertake in a given year; thus, they can be held responsible to the terms of their agreement. At the same time, certain procedural reforms are expected of all local governments. The funds provided through the LATF, for example, must be programmed through a Local Authority Service Delivery Action Plan, which requires citizen participation and other formalized procedures. Technical assistance and capacity building are targeted to specific tasks at hand, rather than relying fully on the traditional system of standardized classroom learning at the Government Training Institute. Many participating councils have improved services and revenue generation. The quality and effects of participation have not yet been well evaluated, but this effort is the first documented attempt in Kenya to link governance mechanisms to local government finance reforms (Republic of Kenya 2005).

At the local level, only limited study of revenue performance has been conducted. Elite capture has long been a problem in Kenya, but the return to a multiparty system and growing pressures from dissatisfied businesses and citizens seem to be slowly improving accountability in some places. Documented experiences of citizen input into local fiscal decisions include local government negotiations with chambers of commerce and civil society groups, such as market merchant associations and NGOs, over increases in property taxes, market fees, or user charges, usually in connection with promised road maintenance, market improvements, or other service enhancements. Such practices are a step toward including governance in local revenue development processes. Another promising sign is increasing activity of the Association of Local Government Authorities of Kenya in advocating for citizen participation, providing training for such participation in local government decision-making processes, and supporting neighborhood and resident associations.[11]

Kenya is no model of good intergovernmental fiscal performance, either generally or with respect to local revenue generation, and it is also not known for being strong on local governance. Many problems remain in the overall public fiscal system: a stark bifurcation between a deconcentrated provincial administration system connected to the national budget and the semiautonomous local government system, generally poor linkages between planning and budgeting, and budget execution weaknesses, among others. After decades of inaction or blockage, however, central and local governments are taking limited steps to make the system work better. Some of these efforts have potential broader relevance for other countries with elements of a local government system already in place.

11. More information on these activities can be found at www.algak.net.

STRATEGIC GRADUALISM: CREATING A LOCAL REVENUE SYSTEM IN CAMBODIA

Cambodia's deconcentrated administrative system fell into disrepair during decades of postcolonial civil war and turmoil.[12] A peace accord in 1991 ended major hostilities, and elections for a new national government were held in 1993. The groundwork for the local government system was laid by donor experiments. A postconflict resettlement, reconciliation, and service delivery program initially funded by the United Nations was transformed into a local institution-building and governance program in the late 1990s. This process of transformation was facilitated by piloting the adoption of the LDF model described above, which set up basic institutional structures and procedures to plan, finance, and deliver simple local services. Based on the success of this experience, the country began a formal, modest process of decentralization to elected governments at the commune (subdistrict) level in 2002.

The early focus of decentralization in Cambodia was on building political credibility and basic technical capacity, so it was not particularly driven by the conventional principles of fiscal decentralization. No major functions or revenues have been devolved, and local governments rely almost exclusively on intergovernmental transfers. The transfers, however, are structured such that local citizens participate in deciding how to use them and must make a contribution toward activities financed by them. This process familiarizes residents with the concept of paying for services they want and forces them to think about how to raise funds from the community.

With a basic system in place, policy discussions have turned to formal functional and revenue assignment. On the revenue side, four possibilities are being explored. First, certain provincial revenues are being considered for reassignment or sharing with communes, including business licenses and market fees. Second, commune authority to impose user charges for services they deliver is likely to be formalized. Third, transforming the local contributions made by commune residents to partially fund former LDF-financed infrastructure projects into a betterment levy is under consideration. Finally, discussions are beginning on designing a property-based tax to the communes. A process for considering these proposals is currently being developed.

Property taxation has particularly significant revenue potential and involves key political dimensions. Initial reform proposals also include interesting strategic elements. The 2001 decentralization law assigns the property tax to communes, but discussions on implementation have moved slowly, for at least two reasons. First, property-related data are limited. Land registration is problematic, with many competing claims, inconsistent cadastral maps in the few areas

12. This section is drawn from the limited available literature on decentralization in Cambodia, including Blunt and Turner (2005), Smoke (2006b), Smoke and Taliercio (2007), Turner (2002), and World Bank (2003), and the author's personal experience there since 1995.

where they exist, and no generally functioning ownership dispute adjudication system. Property sales information is considered unreliable, including the data used for a provincial land transfer tax. Progress in dealing with these problems has been minimal.

Second, despite the legal mandate, the property tax is politically contentious. Senior politicians, including the prime minister, have publicly attacked it. This reaction results in part from the typical political reluctance to tax constituents, but there is a historical dimension as well. Citizens in rural areas associate property taxation with a reviled agricultural tax imposed during the Vietnamese occupation that followed the removal of the Khmer Rouge regime. Perhaps more important is that many citizens were getting no public services until recently and would surely not associate payments to local administrations with benefits. The emerging commune governments are gradually changing this situation, but expenditures remain small and centrally financed. Improvements to date have by no means eliminated opposition from politicians and bureaucrats to adopting a property tax, particularly as the country enters a new electoral cycle.

Two recent developments suggest that property taxation may get back on the agenda after commune elections in 2007 and national elections in 2008. First, the commune governments are increasingly strapped for recurrent revenues. Second, the central government is under growing pressure to ensure that the nascent local governments have enough resources to deliver basic services. Some recent tentative research on commune revenue options suggests the high revenue productivity of even a very low property-based tax relative to current commune revenues. The once recalcitrant tax department in the Ministry of Economy and Finance seems willing to consider property taxation as part of the national Public Financial Management Reform Program, and some local government officials are increasingly open to the idea.

At the same time, given all of the constraints, it seems unlikely that a "typical" property tax is feasible in the near future, even in urban areas. The modest proposal on the table—intended to ease political concerns and take account of the weak state of information and administrative capacity—is to frame a new property-related revenue source in a simple way as a general user charge. If local governments can charge for a specific service, they would be encouraged to do so, but there would also be a commune service levy (CSL) introduced as a general source of revenue. The CSL is proposed to be based on a few very simple characteristics of land and property, with appropriate variations, for example, between urban and rural areas.

A number of proposed features of the CSL are intended to deal with specific constraints. First, its proceeds could be dedicated to functions prioritized in participatory planning and budgeting exercises, likely reducing public opposition. Second, steps could be taken to alleviate onerous administrative challenges. Commune councils could assist with land dispute adjudication; in the absence of another credible mechanism, some have already assumed this function, and the central government seems to accept their decisions. In addition, self-declaration of the land and property characteristics on which the CSL would be based could help to surmount massive data deficiencies. Communes are small so that it would be difficult to dramatically misreport data. In some areas with more advanced civil society development, emerging citizen watchdog groups could play a role and serve as a model for other areas. The Ministry of Lands is piloting a GIS-based land information and registration system that is operational in about 40 of the 1,621 communes. Locally self-reported data could feed into and be checked against this system.

Progress in adopting these proposals to date has been limited, but policy discussions have raised awareness about options and generated some enthusiasm for reform. The need to enhance local revenues will only continue to grow. Details clearly need to be worked out, but momentum is gathering to pilot a simple, politically sensitive system that could lay the foundation for developing a true property tax in the future. This specific aspect of reform—as well as the general approach that Cambodia has taken to decentralization and local fiscal reform, which includes a number of strategic elements—is likely to facilitate moving to the next level in local revenue development. It could also provide useful ideas for developing local revenues in poor, weakly capacitated countries or in underdeveloped areas of other developing countries.

Is a Broader Approach to Revenue Reform Really Possible?

Local government revenues are considered to be a core requirement of fiscal decentralization. Successful local revenue generation, however, has been elusive. Unexceptional performance seems to be the norm in developing countries. Considerable attention has been paid to this problem, but much of it has been directed toward the development of policies, structures, and procedures that are primarily intended to meet normative technical standards of revenue design and administration. The politics of local revenue generation have received considerably less attention, even though they are probably the most fundamental determinant of good performance. Enough is known from empirical research and the casual observations of those engaged in the field to be sure that politics and governance matter. Less is known about exactly how they matter and how to take them into account in an operationally productive way in general and under particular circumstances. In addition, although there are often tactical aspects of revenue design and attention is typically given to capacity building, the implementation of local revenue reform has not been given the degree of deliberate, integrative, and strategic consideration that it merits.

At some level, it is legitimate for fiscal experts to focus on technical aspects of revenue system design and leave the politics and implementation to others. Such experts have particular training, which influences how they think about local revenue generation, what their specific interests are, and what they feel they have to contribute. In addition, those working on local revenue policy have often been hired for specific tasks by a government or donor agency. Even academics may have access to relevant data and policy makers only through a contract to provide specific policy advice. It is also important to recognize that the influence of outsiders on some constraints is invariably limited. Analysts can inform policy debate, but they rarely have much direct influence over political and bureaucratic behavior in the design and implementation of local revenues at either the national or the local level. Still, these challenges and limitations do not excuse ignoring factors that commonly prevent the potential benefits of technically well-conceived reforms from being realized.

A few general recommendations can be suggested. First, the design of local revenue systems should specifically pay attention to mechanisms for connecting with taxpayers. A great deal of knowledge and experience on citizen participation and local governance are available to draw on, but very little of it focuses on revenue generation. Second, greater effort can be made to consider how to implement local revenue reforms more strategically in the context of the larger decentralization and public-sector reform agenda. Some possible tactics were suggested above, but this topic merits much more careful and systematic consideration. Third, more formal research on the political and strategic aspects of local revenue reform is clearly needed. Such work could push our understanding of local revenue generation to a new level and have great relevance for the future design and implementation of local revenue systems in developing countries.

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