UNIT 1 FISCAL DECENTRALISATION- A GLOBAL OVERVIEW

Structure

1.1 INTRODUCTION

Financial responsibility is a core component of decentralisation. If local governments and private organisations are to carry out decentralised functions effectively, they must have an adequate level of revenues –either raised locally or transferred from the Central Government– as well as the authority to make decisions about expenditures. Fiscal decentralisation can take many forms, including:

a) Self-financing or cost recovery through user charges;

b) Co-financing or co-production arrangements through which the users participate in providing services and infrastructure through monetary or labour contributions;

c) Expansion of local revenues through property or sales taxes, or indirect charges;

d) Intergovernmental transfers that shift general revenues from taxes collected by the central government to local governments for general or specific uses; and

e) Authorisation of municipal borrowing and the mobilisation of either national or local government resources through loan guarantees.

In many developing countries, local governments or administrative units possess the legal authority to impose taxes, but the tax base is so weak and the dependence on central government subsidies so ingrained that no attempt is made to exercise that authority.

Developing and transition countries with population over five millions have adopted some form of transfer of fiscal level from Central to Sub-national government (local government). Even highly centralised countries like Kingdoms of Jordan and Morocco have also inherited fiscal decentralisation. As Robert D Ebel opined, the issues that each decentralising country faces are at the same time very different and very similar. The differences arise from the diversity in national economic and demographic structure, institutions, traditions, geography and access to new technologies. As for instance, while designing local property tax systems, Middle Eastern policymakers often take into consideration a complex combination of national, colonial and local tribal law. But the concept of markets as a basis for land valuation is relatively straightforward. In contrast, in (some) countries property rights are well organised, however, the market concept is yet to be sufficiently accepted so that it can serve as a guide for wide spread adoption of *add valorem* taxation. When we look into the world wide fiscal decentralisation, differences and similarities are there. But similarities provide broad policy framework and also it will address the policy options of different countries which will help us to learn from each others experiences. The structural adjustments and the world wide open economy is the basis for policy similarities all over the world. Due to the opening of market economy, the sub national governments (municipalities) cannot restrict the movements of goods and services as well as it cannot control the labour and capital. So, this situation changes the fiscal policy of sub national government.

In this Unit, we will learn about different countries (both developing and developed countries) experience of fiscal decentralisation as case analysis.

After studying this Unit you should be able to:

- Describe the need for fiscal decentralisation;
- Explain the different models of decentralisation with suitable examples; and
- Analyse the cases of fiscal decentralisation in developed, developing and transition countries

1.2 FISCAL DECENTRALISATION: EXIGENCIES AND DIMENSIONS

1.2.1 Exigencies of Fiscal Decentralisation

In the entire world, fiscal decentralisation is associated with issues ranging from the broad issues of achieving a desired degree of both vertical and horizontal balance, to more narrow (but not less important) concerns of expenditure impacts of unfunded mandates imposed by "higher levels of government" and economic and political restrictions, and on the choice of local revenue sources. In this regard, it should be noted that western countries that have relatively long traditions of fiscal decentralisation have much to gain from fiscal decentralisation debate-and research – that is newly emerging in the transition economy (Hegebus and Tosics, Peteric). Apart from this reason the following reasons have also likely to be contributed:

- The reactions from the below to long years of extensive central control.
- The fiscal expediency, where the central governments to ease their own strained finances by reducing transfers and shifting responsibilities down often with little or more regard to the ability of sub national government to pay for their new responsibilities.

With the following assumption the fiscal decentralization has emerged:

- The establishment of performing inter governmental system will execute the economic reforms adopted by the national government.
- To strengthen the economic reforms at the local level, developing and strengthening autonomous local governments is essential and rationalizing the inter-governmental fiscal relationship is also essential.

- The fiscal reform will bring comprehensive changes thus bringing reforms is not difficult politically.

1.2.2 Dimensions of Fiscal Decentralisation

There are three basic dimensions for fiscal decentralization.

i) Devolution

ii) De-concentration

iii) Delegation

i) Devolution

Independently established sub national governments are given the responsibility for delivery of public services. The authority will impose fees and taxes for those services. The sub national governments have flexibility to select the services to provide to their citizens. The sub national governments will get some types of financial support from the national government. The example of this model is given in Box 1.1.

Box 1.1: Water Supply in Hungary

In Hungary, the law on Local Municipalities Act No.33 of 1990 made the drinking water supply as the obligatory duty of the municipalities. The law authorised municipalities to establish municipality institutions or companies to operate public utility services. The managers of these companies were also assigned by the municipalities. Furthermore, the law declares that the public utilities belong to the basic property of the municipalities. The municipalities had to create a new structure of public utility water service in accordance with the changed conditions. The most visible change in the Hungarian public utility water service was the fragmentation of the service provider companies and their numbers increased from 28-350. The mechanism of the specification of water and sewage fees also changed fundamentally. The representative body of the municipalities become the price authority of the municipality owned water works companies.

Reference: MRI, Budapest, 1999 and Inter Governmental Fiscal Relations and Local financial Management, Distance learning module, Central European University, Summer University Programme.

ii) De-concentration

De-concentration is the establishment of Central Government offices at the regional level with some autonomy in decision making, but the centre should approve all deviations from normal practice. You will learn the above definition by applying the following country example from Poland as given in Box 1.2.

Box 1.2: Polish Decentralisation in the 1980s

In the 1980s Poland was divided into 49 Voivodships, and, at the local level 2365 Gminy. The imposition of Martial Law in December 1981 (in effect until July 1983) shifted the balance of power between central and local administrative branches. By the end of 1980s Voivodships had achieved a considerable independence from the central government, with central intervention circumscribed by constraints on information to access political activities. Voivodships were responsible for numerous public services, including health, welfare and transportation, while Gminy were mainly responsible for local services, including garbage collection and public housing maintenance. Although the Gminy had some autonomy, it was not clearly delineated or guaranteed. De-concentration reforms, though accompanied by some devolution of power, essentially transferred authority within an integrated administrative system. Lower administrative levels remained subject to central control.

Bird-Ebel-Wallich: Decentralisation of the Socialist State, World Bank 1995

iii) Delegation

Delegation is an intermediary between devolution and de-concentration. In this, sub national governments are given responsibility to deliver certain services but the Central Government will supervise and provide some forms of finance. All these types may fit in between centralisation and decentralisation. But federalism is different in which public sector decisions can be taken at various levels of government. But in unitary system sub national government act as an administrative unit of national government. You can understand this concept by reading the case study given in Box 1.3.

Box 1.3: Social Services in Estonia

In Estonia the health care regulation law leaves only special medical services to be handled at state level, which means that providing health care should basically be the task of local authorities, and most of the hospitals should be placed under state government administration. Considering the small size of Estonia's local authorities, the individual authorities should form hospital alliances (in most cases one for each county) for the administration of hospitals, through which the communal, construction and remodelling expenses could be financed. Treatment expenses will be covered through the system of health insurance. In practice, the Ministry of Social Welfare has financed the communal and remodelling expenses for all hospitals, up until now.

A similar problem exists with nursing homes, which are financed primarily by the Ministry of Social Welfare, even though, according to law, nursing homes, as a rule, should be in the possession of local governments and financed out of local budgets.

Source: http://www.ceec-logon.net

1.3 MUNICIPAL FINANCE

To strengthen the fiscal domain of municipalities there are different ways. Municipal development funds and intermediaries is one such. The municipal development fund is defined as a pool of money operated at a level above the individual local government primarily for investment in infrastructure. Municipal development intermediaries are the institutions which manages the municipal development fund such as banks or government agencies.

At the global level, municipal finance is broadly categorized into three types:

i) Institutional Borrowing

ii) Municipal Development Fund

iii) Municipal Bunds

In the fiscal decentralisation the municipal governments are augmenting the resources from different sources like borrowing from financial institutions, user charges, transfers, issuing of bonds, loans from financial institutions etc. The banks which finances the municipalities was first started in the United States (US) and later European countries adopted. The case study given in Box 1.4 will explain you further:

1.3.1 Borrowing from Financial Institutions

Box 1.4: The Municipal Bank in Slovakia

The First Communal Bank in Slovakia was established by several municipalities as a specialized bank for the municipal sector in 1993. In 1996 the bank obtained a universal banking license allowing it to operate as a regular commercial bank. Currently, 367 municipalities have 19.62% share in the bank. The majority stakeholder in the bank is Dexia Kommunalkredit holding with a 78.4% stake. This group took over the bank in 2000 as part of its strategy to become the key bank for the municipal sector in Central and Eastern Europe.

During its ten year history the bank focused on the municipal financing sector, as well as the retail and corporate sectors. After the entry of the Dexia group, the bank decreased its activities in the corporate sector and focused primarily on the municipal sector and utilities. According to the bank, the municipal sector is less risky to do business than with corporations. The overall volume of credit funds provided to municipalities is around 3.5 billion Sk. Of this total, about one percent of the loans have repayment problems. Starting in 2000, the bank decreased the volume of credits provided to the private sector and increased its credit involvement in the municipal sector. In the course of the last five years over 75% of all credit funds provided to municipalities has come from the bank. Further areas of service to the municipal sector are deposits and consultancy in municipal and project financing. The bank accounts for 40 to 50% of total municipal deposits in the Slovak banking sector.

The bank also engages in the financing of environmental and investment projects supported by special state funds. The bank is an administrator for the financial funds of the State Environmental Fund and the State Fund for Housing Development. Additional activities of the bank include: mobilisation of sources and funds of municipalities; municipal bond issues; funding activities directed to renewal of municipalities; separate care of the municipal financial funds; depository activity for the first-owners' associations; leasing and consultancy.

Source: Local Government Borrowing, Open Society Institute (OSI), Budapest, Hungary, 2004

1.3.2 Municipal Development Fund

A "Municipal Development Fund" (MDF) is defined as a pool of money operated at a level above the individual local government, primarily for investment in infrastructure. The MDFs are managed by different institutions such as banks or government agencies. These are the "Municipal Development Intermediaries" (MDIs).

With very few exceptions, Western European countries as well as Japan have had for decades a well established MDI channelling investment credit to local governments. In many European countries, these institutions were established also to provide a reliable outlet for private savings. Over the past several decades MDFs have spread rapidly through Asia, Latin America, and Africa. In many of these countries the financing of capital infrastructure has been combined with objectives for longer term institutional development.

The main objective of development funds is to mobilise resources from private lenders, central government, donor agencies, and local governments themselves, and make them available for investment in urban infrastructure. A second objective is to strengthen the operation capacity and efficiency of local governments by assisting them in the design, appraisal, and execution of investment programmes, rationalisation of programmes moving away from *ad hoc* investment practices, and injecting rational criteria in the geographical and sectoral distribution of funds. Development funds are best suited to address the needs of smaller cities which tend to lack skilled administrators and lack access to capital markets. Development funds also provide a way to adopt larger projects.

The most common approach in Western Europe has been to introduce an autonomous institution with a legal and financial identity separate from the Central Government. However, there is great variance in the real degree of autonomy and the precise nature of the institution. The examples are as follows:

Municipal development banks which are primarily concerned with financing municipal investment include Belgium and Danish Municipal Credit Associations, Bank for The Netherlands Municipalities, and the Municipal Bank of Norway. In all these cases municipal government representatives control the management board.

Municipal or local government windows within institutions established to manage state controlled pensions and insurance funds. This is the case in France, Italy, and Spain. In these cases, management is appointed by the central government but municipal governments are represented in the decisions. The British Public Works Loan Board is 100 percent controlled by the Central Government, but half of the board draws membership from local governments.

Direct administration by the central government is the mode adopted by many developing countries. The central agency is the Ministry of Local Development or the Interior, or, in some cases, the Ministry of Finance. Problems with some of these new funds included lack of capacity for sustained assistance, under-capitalisation, poor loan repayment discipline.

In Western Europe and Japan most of the activities of MDFs are funded by direct access to financial markets. However, the initial subscription of shared capital by either central or local governments, though not representing any significant resources for lending, has been important in establishing credibility and control. Additional resources are tapped by competing for private savings deposits. Other financial institutions (banks, insurance companies and pension funds) have been major sources of funds either through the purchase of bond issues or through directly negotiated deposits. In contrast, developing country MDIs have been largely financed with public funds. Even though most of these institutions have the power to issue bonds, most of them do not.

MDFs lend money to local governments for long-term investment at preferential rates which cover interest and administration costs. In some cases, there are elements of grant or subsidised interest. These take different forms, such as matching grants attached to loans that vary with the repayment capacity of the local government or with the type of the project. Most often, eligibility is unrestricted in which the allocation of funds depends on the bids of individual authorities. In some cases, local governments, especially large units, are given a maximum quota.

Assessing debt service capacity of local governments is one of the most difficult aspects of managing a MDF. In most cases, the policy is to rely on the statutory limitations established in the law, stating a maximum ratio of debt or debt service for local government revenues. However, in the case of self-liquidating investment, as for public utilities, the limitation depends on the internal financing viability of the enterprise and not the local government *per se*. There are exceptions to this rule. For example, the *French Caisse de Depots* bases it's lending to local governments on financial forecasts, not on debt service ratios.

(Adapted from "Latvia: Local Government Expenditures and Resource Transfers" The World Bank, Report No. 14470-LV, July 20, 1995 and based on "Municipal Development Funds and Intermediaries," by Kenneth Davey, Background Paper for the 1988 World Development Report, The World Bank, July 1988.)

1.3.3 Municipal Bonds

The USAID and the World Bank introduced municipal bonds in transition and European countries based on American experience. Unlike other borrowing there are two reasons which restrict the development of bonds in transition and developing countries.

i) There is no tax exemption for the citizens purchasing bonds in transition and developing countries which restricts the interest of the citizens. But tax exemption is given in US and Central and Eastern European countries.

ii) Reforms in bond market will encourage the citizens to invest.

The example given in Box-1.5 is the best practice in US with regard to bond market.

Box 1.5: Diversification in the US local bond market

In most transition countries, local bond markets are still largely dominated by general obligation bonds, issued against the full faith and credit of the issuer. As markets develop, however, local governments will tend to diversify their borrowing instruments and rely more on structured bond instruments.

The US bond market provides a vivid illustration of the wide diversification of instruments. Beyond the general obligation bonds, the US local bond market offers a wide range of revenue bonds that are issued for project or enterprise financings, in which the security for the bond is the revenue generated from the financed projects. For example water revenue bonds are issued to finance the development of water treatment plans, pumping stations, distribution systems etc., with revenues from connection fees and water charges paid by users. The so called tax allocation bonds are used in the construction sector, secured by additional property taxes collected from new or improved property.

In addition to these various bond structures and instruments, the US market has been characterized by the emergence of a wide array of internal and external credit enhancement structures for municipal bonds, such as refunded bonds, insured bonds, bonds backed by letters of credit, etc.

Source: *Building Sub-national Debt Markets in Developing and Transition Economies. A Framework for Analysis, Policy Reform and Assistance Strategy*, Michel Noel, World Bank Policy Research Working Paper 2339, May 2000

In this session you read about the importance of financial decentralisation and now answer the questions given in Check Your Progress-1

Check Your Progress 1

Note: a) Write your answer in about 50 words

b) Check your answer with possible answers given at the end of the unit

1) Differentiate between Devolution, De-concentration and Delegation.

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2) Define Municipal borrowing and what are the different types of Municipal borrowing?

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1.4 FISCAL DECENTRALISATION IN DEVELOPED COUNTRIES

The fiscal decentralisation of a few developed and transition countries are narrated below.

1.4.1 United States

The United States has a loose and flexible structure of fiscal federalism. The key point of the US local government finance system is the absence of too many specifications. State governments assign local governments taxes and their maximum rates. Rules are clear on whether local governments may seek voter referenda on fiscal decisions such as tax rates, new borrowings and so on. They can formulate their own user charges. On the whole, local government revenues finance about 40 to 70 percent of the expenditure.

Some of the important sources of fiscal earnings of the local governments are:

i) Property tax

Property tax amounts to 70-75 percent of all local tax revenues in USA. The tax is based on capital value of property (often at a rate exceeding 1 percent). It gives a stable source of local funds to local government. It provides a degree of independence to the local bodies from the state and federal governments.

ii) Local option Income tax

State like Alabama, Arkansas, Delaware, Georgia, Kentucky, Indiana, Maryland, Michigan, Missouri, New York and Pennsylvania authorise their municipal authorities to levy local income tax. Some states like Georgia mandate a local choice of either an income tax or a general sales tax. While local jurisdictions usually collect the local option income tax themselves, some states like Indiana and Maryland collect it on behalf of their local governments by piggy-backing onto state income taxes.

iii) General Sales tax

This tax is generally popular among taxpayers, because it is collected in small amounts with many transactions. Local rates of this tax ranged from 0.25% to 6% in the United States in 1993.

iv) Excise Taxes

Excise taxes are sales taxes imposed on specific goods and services and are most commonly assessed on lodging, alcoholic beverages and tobacco products, utilities and motor fuel (local option gasoline tax). Some local jurisdictions levy an excise tax on new construction.

v) User Charges and Fees

User charges and fees pay for the cost of operating and maintaining public facilities and services, as well as repay outstanding debts. Road tolls, park admission fees and water and sewer charges are representative user fees in the United States.

vi) Revenue Bonds

Revenue Bonds are designed to finance revenue-generating facilities, backed by a stream of revenues pledged from user charges for services like water supply, sewerage, drainage, toll roads etc.

1.4.2 Canada

The main sources of municipal finance in Canada include: property tax, business tax, special taxes to raise revenue to pay for a specific service or purpose and local improvement taxes. Some of the services taxes imposed by the local governments are waterworks tax, sewer tax, boulevard tax, dust treatment tax, paving tax, ambulance service tax, fire protection area tax, drainage ditch tax, tax to provide water supply for the residence of a hamlet and recreational service tax.

Local improvement taxes in Canada are generally in the form of betterment levies linked to benefits accruing to specific local areas due to the provision of infrastructure as a result of implementation of local improvement plans.

1.4.3 United Kingdom

The fiscal decentralisation in UK is more systematic and well decentralization. The finance regimes of local authorities in England includes, as follows:

i) A system of non-domestic rates, being a property tax levied on industrial and commercial property- set by the Secretary of State for Environment for England and Wales, collected into the national pool and then distributed among the local jurisdictions based on adult population,

ii) A system of exchequer grants to local authorities, principally the Revenue Support Grant (RSG) designed to compensate local authorities are also able to participate in partnerships with the private sector under the Private finance Initiative, and

iii) A system of local domestic taxation, known as the Council tax.

1.4.4 Hungary

Hungary is the most decentralised country in the central and eastern European. In the year 1990, the local government act of Hungary brought fundamental changes in financing Hungarian local governments. The act regulates the scope of mandatory services that local governments can supplement with other services according to their needs. The act regulates the structure, service financing, assets and revenues of local governments. The act also gives more local autonomy. In this process, actors like businesses, banks, investors are considered to be important partners in the budget process. The act also considers local citizens are important in decision making process and this will strengthen the democracy. This act also delegated broad economic and political authority to local government making region.

The four year programme “Modernising Municipal Financial Management” in Hungary was launched in 1996 with the following objectives:

- Include revenue and expenditure breakdowns of municipal activities that provides a clear picture of how much the municipality spend on various items.
- Documents should be suited in identifying and pursuing the strategic sectoral and programme goals of the municipality.
- Monitoring should be ongoing, focused on issues and outcomes.

- Format and content should be comprehensible and informative to specialist citizens and other participants in municipal financial management.

The notion of programme budgeting was applied during the project period. The programme budgeting approach transform the local budget from a simple accounting, control oriented into a tool for promoting effective and accountable management of city resources. The programme budgeting relates revenues and expenditures to municipal goals, objectives, strategies and anticipated outcomes.

1.5 FISCAL DECENTRALISATION IN DEVELOPING COUNTRIES

The fiscal decentralisation in a few developing countries narrated below are

i) China

ii) Brazil

iii) South Africa

1.5.1 China

China's fiscal system is highly decentralized among the 31 provincial, 331 prefecture, 2,109 county and 44,741 township-level units. Nearly 70 percent of total public expenditure in China takes place at the sub- national (that is provincial, prefecture, county and township) level of which more than 55 percent takes place at sub-provincial levels. Key sub-national expenditure responsibilities in China include sub-national administration, local capital construction, basic local services, maintenance, repair and operation of urban infrastructure, primary and secondary schooling, health and hospitals, support for agricultural production, price subsidies, poverty alleviation, cultural and heritage protection, environmental conservation, local and regional development and physical planning.

The revenue assignment between Central and Sub-national Governments after 1994 reforms stands as follows.

- Central revenues in China comprise import tariffs, consumption taxes, income taxes, import-related consumption taxes and VATs, taxes imposed on banks, non-bank financial institutions and insurance companies (including business taxes, income taxes and the urban maintenance and development tax) and taxes on railroads.

- Sub-national revenues consist of business taxes(excepting taxes imposed on banks ,non-bank financial institutions, insurance companies and railroads), company income tax(excluding local banks, foreign banks and non-bank financial companies), personal income tax, urban land use tax, urban maintenance and development tax (excluding banks, non-bank financial institutions, insurance companies and rail roads), fixed asset capital gains tax, house property taxes, stamp taxes, agriculture and related taxes, tax on contracts and land-value increment taxes.

- Shared revenues include VATs (75 percent central and 25 percent, sub-national governments), stamp taxes on security exchange (50:50 sharing) and resource taxes.

1.5.2 Brazil

In Brazil, municipalities are granted full autonomy. The consumption and production taxes are assigned to all three levels of government. The main municipal taxes in Brazil are those on services (ISS) and urban property (IPTU). ISS rates are set by the municipalities, subject to ceilings introduced by the federal government. IPTU is levied on the capital value of land and buildings.

Based on Constitutionally mandated revenue sharing, the municipalities are entitled to:

a) 25 percent of the revenue from state Value Added tax (ICMS) ,

b) 50 percent of revenue from the state tax on motor vehicles registration (IPVA)

c) 22.5 percent from the federal Value Added Tax (IPI) and income Tax (IR),

d) All revenue from the income tax held at source (IRPF) and paid by the municipalities or by their decentralized agencies,

e) 70 percent of revenue from the federal financial-transactions tax levied on transactions with gold (IOF-Quro)

f) 50 percent of revenue from the federal rural-property tax (ITR). Municipalities also receive compensatory transfers and transfers related to healthcare and investment programmes.

1.5.3 South Africa

The using of application called measuring expenditure needs approach in South Africa transfer fiscal resources equitably to the provinces (South Africa 2006). The equitable share formula applicable for 2006–08 focuses almost entirely on need factors, with only a 1 percent weight given to negative needs (per capita GDP). The formula uses the following shares:

- A basic share (14 percent weight) is derived from each province's share of the national population.
- An education share (51 percent) is based on the size of the school-age population (5–17) and the average number of learners (grades R–12) enrolled in public ordinary schools over the past three years.
- A health share (26 percent) is based on the proportion of the population with and without access to medical aid.
- An institutional component (5 percent) is divided equally among the provinces.
- A poverty component (3 percent) is based on incidence of poverty.
- An economic output component (1 percent) is based on data on GDP by region.

1.5.4 Commonwealth Countries

There are two models that are typical for local government revenues in developing countries of the Commonwealth:

i) Local government rely very much on their own sources of revenues especially taxes user charges/ fees (i.e. Zambia & Swaziland);

ii) Local governments are heavily depended on transfers from central government &/ or donor contribution (i.e. Ghana).

The source of revenue of local self governments of different Common Wealth Countries are given in table below:

Country	**Source of local government revenue**
Australia	Grants and general or special purpose payments of federal and state governments comprise 23 per cent of local government revenues. Other sources included tax on immovable property, fees and fines, net operating surplus of trading enterprises and interest.
Bangladesh	Taxes, rates, fees and charges levied by local bodies, rents and profits accrued from their properties and money received through its services. Government grants, international project funding and loans raised by local bodies are additional sources of income. Taxes are the most important source of income, while loans and voluntary contribution are rare.
Cameroon	Council taxes, business levy and licenses.
Cyprus	Municipal taxes, duties and fees.
Fiji Islands	Revenues from land tax (town tax) and other local incomes such as grants-in-lieu, rental fees, market and bus station fees, business license fees, building fees and parking fees. Most councils also loans from the local capital market. Grants from central government are rare.
Ghana	Taxes, user fees and charges.
India	Tax revenue- properties, *octroi*, professions and vehicles, non-tax revenue- licenses and service charges, grants-in aid and state/Central Governments loans and borrowings.
Kenya	Fees and charges, water and sewerage fees, local property taxes and business permits.
New Zealand	Property rates, user charges, fees, fuel taxes and returns on investments. Some central governments financial assistance. The rating and charging powers have been provided for in law since 1988 and are important sources of local tax revenue.
Malaysia	Local taxation (assessment rate, rents and fees for services, grants/ subsidies given by state or central government. Some local authorities receive grants-in-lieu of rates. Other sources include miscellaneous forms of charges and fees (licenses, payment for various forms of services, rental penalties and compounds and interest).
Pakistan	Tax and *octroi* (comprising 60 per cent of local governments' revenues) and non-tax sources. Property related taxes (such as local rates or leases on all land assessable to either rent, land revenue or use). Tax on the transfer of property and *octroi* are the largest sources of revenue.
Sri Lanka	Rates, taxes duties, fees, fines, penalties and other charges as well as money from sales, leases or other transactions, revenues derived from properties and grants from other governments' spheres.
Source: Kevin Sproasts, Local Government in Asia an the Pacific: A comparative analysis of fifteen countries; and CLGF (2005)	

In this session you read about the financial decentralisation in various countries and now answer the questions given in Check Your Progress-2

Check Your Progress 2

Note: a) Write your answer in about 50 words

b) Check your answer with possible answers given at the end of the unit

1) Discuss Fiscal Decentralization in Canada.

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2) Discuss the Measuring Expenditure needs approach in South Africa to transfer fiscal resources equitably to the provinces.

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1.6 LET US SUM UP

In this we have discussed the different experiences of fiscal decentralization in different countries. Decentralisation has to be looked from different perspectives like political, social and economic perspective. In this Unit, fiscal decentralisation was explained from economic perspective. The transition countries are vigorously implementing fiscal decentralization. Developed countries like US and Canada have evolved fiscal decentralized structure. In worldwide fiscal decentralisation is considered as a viable option to address socio economic political issues. But due to lack of political will and untrained man power has restricted developing countries to implement fiscal decentralisation unsuccessfully.

1.7 REFERENCES AND SELECTED READINGS

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1.8 CHECK YOUR PROGRESS – POSSIBLE ANSWERS

Check Your Progress 1

1) **Differentiate between devolution, de-concentration and delegation.**

   In devolution, independently established sub national governments are given the responsibility for delivery of public services. The authority will impose fees and taxes for those services. The sub national government have flexibility to select the services to provide to their citizens. Whereas de-concentration is the establishment of central government offices at the regional level with some autonomy in decision making but the centre should approve all deviations from normal practice. Delegation is an intermediary between devolution and de-concentration. In this, sub national governments are given responsibility to deliver certain services but the central government will supervise and provide some forms of finance.

2) **Define Municipal Borrowing and what are the different types of Municipal Borrowing?**

   In the fiscal decentralisation the municipal governments are augmenting the resources from different sources like borrowing from financial institutions, user charges, transfers, issuing of bonds, loans from financial institutions etc. To strengthen the fiscal domain of municipalities there are different kinds of municipal borrowings which are discussed as follows:

a) Municipal Development Fund: A "Municipal Development Fund" (MDF) is defined as a pool of money operated at a level above the individual local government primarily for investment in infrastructure. The MDFs are managed by different institutions such as banks or government agencies. These are the "Municipal Development Intermediaries" (MDIs).

b) Municipal Bonds: The USAID and the World Bank introduced municipal bonds in transition and European countries based on American experience.

Check Your Progress 2

1) Discuss Fiscal Decentralization in Canada.

The main sources of municipal finance in Canada include: property tax, business tax, special taxes to raise revenue to pay for a specific service or purpose and local improvement taxes. Some of the services taxes imposed by the local governments are waterworks tax, sewer tax, boulevard tax, dust treatment tax, paving tax, ambulance service tax, fire protection area tax, drainage ditch tax, tax to provide water supply for the residence of a hamlet and recreational service tax.

Local improvement taxes in Canada are generally in the form of betterment levies linked to benefits accruing to specific local areas due to the provision of infrastructure as a result of implementation of local improvement plans.

2) Discuss the Measuring Expenditure needs approach in South Africa to transfer fiscal resources equitably to the provinces?

The using of application called measuring expenditure needs approach in South Africa transfer fiscal resources equitably to the provinces (South Africa 2006). The equitable share formula applicable for 2006–08 focuses almost entirely on need factors, with only a 1 percent weight given to negative needs (per capita GDP). The formula uses the following shares:

- A basic share (14 percent weight) is derived from each province's share of the national population.
- An education share (51 percent) is based on the size of the school-age population (5–17) and the average number of learners (grades R–12) enrolled in public ordinary schools over the past three years.
- A health share (26 percent) is based on the proportion of the population with and without access to medical aid.
- An institutional component (5 percent) is divided equally among the provinces.
- A poverty component (3 percent) is based on incidence of poverty.
- An economic output component (1 percent) is based on data on GDP by region.