Local Revenue Administration

by

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I. Main points:

- Revenue raised by local governments at present is small and needs to go up if decentralization is to be meaningful.

- What are the factors underlying poor revenue performance of local governments: Inadequate revenue powers, inadequacy of trained and motivated staff, corruption or unwillingness of elected bodies to levy taxes and charges at their command.

What could be done to remedy the situation? Widen their powers if so how?; and/or strengthen the administrative capacity of local tax departments? What about corruption?
II. Revenue collection by local governments

- Panchayats on their own raise only about 4% of their total tax revenue (about 1.6% of GDP) – in some states (Bihar, Rajasthan, Manipur & Sikkim) there was no internal revenue generation at all – even in Karnataka only 1% - no change since 1998-99.

- “There has been a phenomenal dependence of panchayats on revenue transfer from both the Union and the state governments.” NIRD finding quoted in TFC report.

- ULBs raise about 40% of their tax revenue but as a proportion of total government revenue only 3.07% - 0.63% of GDP in 2001-02 – Wide variation among states – from 0.07% in Bihar to 2.16% in Maharashtra – only in two other states (Punjab, Gujarat) the ratio to GDP exceeds 1%.

- International comparison (Table 1).
Table 1

The Importance of Three Levels of Government, Selected Countries, 1993-96

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Percent Central</th>
<th>Percent States</th>
<th>Percent Local</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td>1996</td>
<td>79.36</td>
<td>5.82</td>
<td>14.82</td>
</tr>
<tr>
<td>Botswana</td>
<td>1994</td>
<td>99.42</td>
<td>-</td>
<td>0.58</td>
</tr>
<tr>
<td>Brazil</td>
<td>1993</td>
<td>72.42</td>
<td>23.27</td>
<td>4.31</td>
</tr>
<tr>
<td>Guatemala</td>
<td>1993</td>
<td>96.29</td>
<td>-</td>
<td>3.71</td>
</tr>
<tr>
<td>Israel</td>
<td>1994</td>
<td>90.48</td>
<td>-</td>
<td>9.52</td>
</tr>
<tr>
<td>Kenya</td>
<td>1994</td>
<td>94.03</td>
<td>-</td>
<td>5.97</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1996</td>
<td>86.97</td>
<td>9.74</td>
<td>3.29</td>
</tr>
<tr>
<td>Mongolia</td>
<td>1996</td>
<td>77.29</td>
<td>-</td>
<td>22.71</td>
</tr>
<tr>
<td>Paraguay</td>
<td>1993</td>
<td>92.73</td>
<td>-</td>
<td>2.27</td>
</tr>
<tr>
<td>Peru</td>
<td>1996</td>
<td>94.67</td>
<td>0.89</td>
<td>4.44</td>
</tr>
<tr>
<td>South Africa</td>
<td>1995</td>
<td>86.04</td>
<td>3.40</td>
<td>10.55</td>
</tr>
<tr>
<td>Thailand</td>
<td>1996</td>
<td>93.74</td>
<td>-</td>
<td>6.26</td>
</tr>
<tr>
<td>India</td>
<td>1997</td>
<td>63.8</td>
<td>33.4</td>
<td>2.84*</td>
</tr>
<tr>
<td>United States</td>
<td>1995</td>
<td>58.68</td>
<td>25.45</td>
<td>15.87</td>
</tr>
<tr>
<td>Africa/Asia</td>
<td></td>
<td>84.53</td>
<td>1.64</td>
<td>13.83</td>
</tr>
</tbody>
</table>

* Municipalities only.

III. Reasons

- Revenue powers of urban local bodies – not all that small in number – vide Box 1 – for international comparison – but substantial revenue sources not many.
- For ULBs – property tax is the most promising – other countries too rely heavily on PT for local government revenue raising – a classic example China’s Shanghai (Box 2).
- For PRIs only land revenue offers good potential but not exploited.
- Whatever powers are there – mostly constrained by limits set by states.
- Weak and corrupt administration.
- Reluctance of elected local governments to exercise their tax powers – vide Report of SFCs. – 2\textsuperscript{nd} SFC of Rajasthan found that ULBs make no use of the optional list of taxes available to them – even matching grants failed.
<table>
<thead>
<tr>
<th>Box 1</th>
<th>Powers of Taxation of Municipalities in Selected States of India</th>
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<tbody>
<tr>
<td></td>
<td>● Property taxes which Include:</td>
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<tr>
<td></td>
<td>- Water tax</td>
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<tr>
<td></td>
<td>- Water benefit tax</td>
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<tr>
<td></td>
<td>- Sewerage tax</td>
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<tr>
<td></td>
<td>- A general tax</td>
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<tr>
<td></td>
<td>- Education Cess</td>
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<td></td>
<td>- Street tax</td>
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<tr>
<td></td>
<td>- Betterment charges</td>
</tr>
<tr>
<td></td>
<td>● Tax on vehicles and animals</td>
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<tr>
<td></td>
<td>● Theatre tax</td>
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<tr>
<td></td>
<td>● Octroi</td>
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<tr>
<td></td>
<td>● Tax on dogs</td>
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</table>

Box 2  
Real Estate Development in Shanghai

In general in China to obtain a land lease (certificate for land use right), a private entity has to pay an initial lump-sum lease payment (conveyance fee), all conversion costs, all expenditures on servicing land, and other land fees and taxes. At least 28 different fees were imposed on various aspects of real estate development in Shanghai in 2001. The following partial list gives the flavour:

- 0.15% of construction ‘workload’ as administrative fee for construction industry.
- 0.1% of contract amount for enterprises from outside entering city to carry out works.
- 25 yuan/person/month to administrative fund for employing persons from other provinces.
- 0.02% of tender bid for planning tender for national enterprises; for international US$ 100-US$4000 depending on size of investment capital.
- 300-3500 yuan/square meter of greenery for occupying greenery.
- 50-90 yuan/square meter as deposit for provision of greenery in urban districts.
- 0.07% of construction ‘workload’ plus 0.15% of product sales revenue as fee for supervising quality of construction works.
- Up to 0.05-0.1% of construction workload as administrative fee for drawing up construction quota.
- 0.1% of total costs of civil and utility works up to 90 million yuan, and 0.05% above that level as license fee for construction works plus a “license processing fee” of 50% of license fee.
- 0.2% decreasing with value to 0.02% of price of registered reality as initial registration fee.

The motivation for either the imposition or the base of most of these fees is hard to understand in any other than revenue terms.

IV. **Tax administration**

- Involves three interrelated activities – viz., enumeration; evaluation(assessment) and enforcement.
- Corruption corrodes all the three activities.

- Efficient tax administration requires
  - A good information system
  - Monitoring by supervisory officials
  - Simple laws and a tax base that is less susceptible to manipulation.
  - Motivated, honest staff.

Local taxes often fail all these tests.
V. Corruption

- “If the state’s anti-corruption department is to be believed, the revenue department tops the list of corrupt departments with civic bodies, self-government bodies and public health following it in the list” ..... Mumbai Mirror, 5 Nov. 2006.

- Corruption in local revenue administration may not be on a grand scale – but can be sizeable, not always petty.
VI. Room for corruption

- In PT – corruption, main factor for poor revenue efficiency of PT in many developing countries particularly Latin America and also in India.

- In local business taxes (unless levied on the basis of some objective indicators like size of shop, power consumption, number of employees etc).

- Sales tax, hotbed of corruption (Karnataka Tax Commission) – VAT supported to be self policing, yet offers scope for corruption.

- Stamp duties on transfer of properties – scam in India involving loss of Rs. 100,000 million in 2000-01 (Alm et al, WB).

- Octroi – a big source of corruption.

In charges & fees – in allotment of stalls & kiosks – water supply and power – in Delhi 40% of power stolen.
VI. Room for Corruption (contd..)

Questions:

(i) Is local revenue administration inherently and incurably corruption-prone as several experts (like Vito Tanzi) seem to believe?

(ii) What lies at the root of corruption?

(iii) Decentralized governance - facilitates accountability – and so should be less corruption prone. Why then the perception that decentralisation breeds corruption?
VII. Corruption (contd....)

- What drives corruption?

- Theory of economic crimes

- Klitgaard’s handy formula: C = M + D – A.

  Says: ‘C’ or corruption is the combined result of ‘M’ (the monopoly powers of the state), ‘D’ (the discretion available to government agents enforcing the law) kept in check by ‘A’ or accountability.

- Remedies that follow – reduce ‘M’ by privatisation, ‘D’ through mechanisation and having tax bases that leave no room for discretion and improve accountability by giving adequate remuneration to tax officials (rewards too) and improving chances of detection and punishment – employ officials on contract.

- Ultimate remedy: good governance: with enforcement of ‘rule of law’ – strong incentives for government officials to act honestly – most importantly speeding up judicial process – possible with computerisation and some rules regarding judges attendance & disposal - pending from 104936 in 1992 to 26673 in 1996. Also giving citizens a voice – Independent Vigilance Commissions.

Other suggestions: Have multiple officials with overlapping jurisdictions – US & Singapore experience.
VIII. **Improving administration in major local taxes:**

Land & Property Taxes:

- Considered a good revenue source for local government as its base is immobile – also it is like a benefit tax.

- Role of PT as a source of revenue.
  - In the 1990s, fetched 40% of subnational revenue in developing countries (35% in advanced countries).
  - In India – picture mixed – important in Bangalore & Bhopal but not in Mumbai.

- Incidence – opposing views but considered equitable, if paid out of ‘land rent’.

- Ultimately a major support for local autonomy but in practice this is country-specific – in some countries (Chile) it is a central tax.

- In no country it is totally local.
For PT to be essentially local, the rates should be set by the local government.

Modes of assessment -
(i) area based
(ii) value based
(latter, rental value based or capital value based)

Rental value system prone to corruption – in India poor buoyancy of PT caused by corruption & also rent control laws – recent innovation “Unit area based system” with standardised values of lands and buildings with adjustments for location, type, age, usage etc (Used extensively in Central and Eastern Europe). – Helpful in curbing corruption – but cannot capture the value of a property reflecting public services – adjustments tend to proliferate – Netherlands abolished it – also unit value system stands to be regressive – where zones are defined more narrowly, over time unit value assessment can evolve into a market value system – standardised capital value base seems the best choice

Rates – should be reasonable – tends to be high with a narrow base – in Mumbai 187% of RV for residential properties with unmetered water supply & 320.5% for NR properties (where water supply metered, the rates are 83.5% and 112.5%).

PT administration:
(i) property identification
(ii) assessment
(iii) appeals
IX. Other taxes on land

(i) Transfer taxes
(ii) Land Value Increment Tax
(iii) Development Charge – one time levy on developers to finance growth (used in USA & Canada).

- Property Transfer Tax – stamp duties – scams in India – recent innovation – doing away with stamp paper – recommended reforms:
  - exempt taxes on financial transaction
  - reduce the tax rates
  - apply the payment of taxes to specific sectoral expenditures
  - improve valuation and use simple measure to detect fraud easily
  - modernize the process with ‘e-governance’ (Alm et. al. Stamp Duties in Indian States, WB).

- Land revenue – a good tax for Panchayats – crop specific norm based tax – also needs proper record of land holdings – GIS should be helpful – ‘Bhumi’ initiative in Karnataka – problems faced.
X. Other tax sources

- Motor vehicle tax – an important source of revenue in Singapore – as an instrument of environmental protection & curbing congestion – from ownership based to usage based system – not prone to corruption but requires spot checks – suitable more as a state tax

- Octori – Described as “the levy that has every vice – octroi was introduced more than 2000 years ago in the days of the Roman empire when the world was less civilized and the value put on time was lower than it is today. This led Sir Charles Trevelyan to remark the octroi represents ‘the remains of a barbarous system of universal taxation’” – Nani Palkhivala in ‘We the People: The Lost Decades’.

- Business based tax – produces substantial revenue – usually a state or central tax – has several demerits – but some form of business related tax can be a good and elastic source of revenue – extensively used in many countries (Italy, Japan) – rates should be subject to limits – local business tax in Japan, standard rate from 4 to 9.6% - prefectures can levy higher rate upto 110% of the standard – now a new form of local business tax introduced. (net interest, salaries, net-rent) at 0.48% rate & a capital tax on paid up capital.

In early 1970s there was a strike by employees in Bombay Corporation employed temporary recruits – collection increased four fold.

Octroi fetches substantial revenue in Mumbai – alternatives?
XI. Non-tax revenue

- User charges – checking theft of water and electricity – privatisation is ought to be the answer but ultimately calls for good governance – Profession tax, entertainment tax also other options – viable option – piggybacking on IT (VAT)

- Land lease – DDA gets fat sums to land lease – Korea, Hong Kong and Singapore also used land deeds to find infrastructure development.

XII. More promising options:

- Piggy backing – on taxes levied by the Centre and the States – on income – on VAT?

XIII. A dependency syndrome has developed. A change in mind set needed together with a hard budget constraint with more room for local governments to fix the rates.