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Local Government Finances in Peru

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FOREWORD

As part of a growing concern with fiscal operations in the Third World there is a growing body of fiscal studies of local governments in developing countries. For the most part, these studies have been concerned with the finance of large cities, particularly national capitals. In this paper the author addresses issues of fiscal decentralization in Peru from the point of view of the revenue potential of smaller outlying governments, namely provinces and districts. The analysis is built in large measure on data and information collected on site in a variety of small, isolated local governments. The paper's focus is on the fiscal adequacy of local revenue systems but it includes consideration of closely related budgeting and administrative issues. It also provides an analysis of some of the most serious problems which confront local revenue administration as well as programs designed to facilitate fiscal self-sufficiency of local governments. The paper sets out recommendations for changes in the tax structure and for administrative reform which would enhance the revenue-raising potential of local governments.

This paper is one of a series devoted to questions of local government finance in developing countries. It, like most of the work represented in the series, has been carried out under the Local Revenue Administration Project of the Metropolitan Studies Program, through a Cooperative Agreement with the United States Agency for International Development.

A Spanish version of this paper entitled "Evaluación Preliminar de las Finanzas Municipales en el Peru" is also available from the Local Revenue Administration Project. A full list of titles available under the Peru project is appended to this Report.

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LIST OF TABLES

I. INTRODUCTION

The purpose of this report is three-fold: first to present a brief overview of the system of local government finances in Peru; second to consider some of the strengths and weaknesses imbedded in the operation of that system; and third, to indicate some specific policy direction which, if pursued, would likely enhance the potential and operations of the local government fiscal system in Peru.

This report consists of four parts. The remainder of this part presents the background and a synthesis of many of the considerations, observations and evaluations arising out of this effort. Part II examines some recent trends in Peruvian local government finances and provides comparisons with other developing countries. Part III consists of an evaluation of the major sources of revenues controlled by district government. Part IV, concerned with management and administration, focuses on budgeting and management. Where appropriate, possible policy directions are identified.

Background

Objective and Method

This report was prepared following a series of on-site visits during a brief stay in Peru, March 9 to 21, 1981. The objective of the trip was to undertake an initial assessment of (a) the availability of local government budgetary data, in particular revenue and expenditure data, (b) the budgetary practices and capabilities of district and provincial governments and (c) fiscal circumstances of local governments. It was originally anticipated that this two-week trip would involve on-site visits to district governments, provincial capital district governments in the departments of Cajamarca and Junín, and to various central government agencies and offices in Lima. The rains precluded travel to Junín, necessitated an extention of the stay in Cajamarca and reduced the time available for research in the central offices in Lima. Copies of a brief report prepared at the end of the trip at the request of the project director are contained in the Appendix.[1]

Interviews were undertaken and some assorted data were collected from three provincial capital districts (Celendín, Cajabamba and Cajamarca) and three outlying districts (Jose Galves and Sucre in Celendín and San Marcos in Cajamarca). Mayors, secretaries, treasurers and/or accountants were asked about budgetary practices and revenue and expenditure performance. They were queried about their districts or provinces and what they knew of other districts or provinces. In every instance we were impressed by the good will and cooperation of all the officials interviewed. They deserve, and we offer them, many thanks for the generous provision of their time and their conscious efforts. The major impressions derived from the interviews are presented in what follows. It must be emphasized that they are based on a selected set of local governments. They should be verified, amplified and/or amended by additional study. However, it should also be noted that the impressions from the work in the province are consistent with information provided by central government officials in Lima.

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[1]Some parts of the End of Trip Report have been incorporated in this document.

Preliminary Observations

In the areas visited there exists marked differences in the level of budgetary technical expertise. The background and training of personnel and the overall quality of practices are generally better in the larger districts. In smaller outlying districts it is often the case that budgets are the responsibility of the Mayor or his secretary if he has one. In these small areas there is an acute awareness of the lack of budget and accounting expertise. Larger districts are often served by an accountant although in many instances they may have little formal training for the position. In the largest area visited, the staff appear to be ample and capable. Perhaps because of the differences in local government personnel, there are a variety of budgetary and fiscal practices in effect and the reporting and monitoring of them is uneven and in some, perhaps many areas, weak.

All local governments seem to feel that they lack the resources to do much more than maintain their current level of services. With few exceptions, all felt that they have little, if any, autonomy in matters related to raising revenues on service provisions.

These impressions and the evaluation and analysis to follow, tentative as they must be, imply that there is ample room for improvement in the fiscal circumstances of the districts and provinces in Peru. It would seem that the improvement of accounting expertise in local government, some alterations in the structure of the property tax (provision and application of effective evaluation and payment mechanisms and effective sanctions against delinquencies), more consistent accounting and reporting practices and some alternatives in the intergovernmental aid system would greatly enhance the operation and effectiveness of the local government fiscal structure in Peru. The accomplishment of the policy initiatives indicated in this report will likely require the central government to intervene in areas where it has not been active, or expand its influence where its operation has not been fully effective. The simple reality is that decentralization can proceed and be effective only when it is grounded in a solid foundation of central government support.

Synthetic Review

This report is focused on the existing system of local government--primarily districts and provincial capitals--in Peru. It begins with an overview of the recent government finances which highlight three important facts: (1) the public sector in Peru is a highly centralized one in which local governments have played a minor role by any standards; (2) local government's place in the public sector has been shrinking; and (3) the amounts of real resources channeled through the country's district governments has declined absolutely and markedly.

The evaluation of the fiscal operations of local government contained herein is far from comprehensive. It was not intended to be so. Rather, in a limited context with resources which turned out to be even less than promised, this effort has raised a number of serious issues about the possibilities for greater local government participation in Peru's program of decentralized development. The brevity of this undertaking dictated that many important aspects of local government operations could not be evaluated and that those that are considered have been treated in something less than a complete manner. There remains much to be done to complete the basic information necessary as a guide to sound planning and public policy.

Primarily, the considerations here have been focused on intergovernmental relations, property taxation and district administration. Some of the problems considered are structural, some are operational, none seem to be intractable. But just as decentralized development is a long-term strategy, efforts to improve local governments and to mobilize their efforts will also take time.

Budget Data

A basic knowledge of revenue raising capacity and tax efforts is an essential element of any strategy to improve local government operations. It is all the more important in a country like Peru where the resources that the central government can make available are so limited that it is just not possible to provide what would be desired for all districts. The success of the decentralized development thus depends crucially on the central government's ability to channel resources and allocate its aids to those areas and activities which will most effectively enhance and reinforce local participation in the decentralization effort. But this can be done only if accurate information about the scope and nature of district activities and capacities is collected and made available in usable form. Most frequently, the budget and accounting records of local governments are the sources of such information. The Ministry of Finance (MOF) recognizes the importance of having such data and is pursuing efforts to collect it.

The primary shortcomings of the local government budget data are that it is incomplete and much of what is available is difficult to interpret because budgetary reporting procedures are not always consistent. On the first count, it should be noted that the MOF has initiated efforts to regularize at least the collection of annual budgetary information. Its efforts, however, are hampered by the fact that they essentially must rely on the voluntary compliance of local officials for whom the fruits of such endeavors are not obvious. That the MOF efforts have been as successful as they have is probably indicative of a basic professionalism on the part of the vast majority of district administrators and their willingness to lend their efforts to the strengthening of the local government system.

However, this activity must be expanded and strengthened if there is to be any hope of moving beyond the deficiency of a system of voluntary requirements. This could be accomplished by a strengthening of the current data collection activities of the MOF. There are other institutions which have been charged with the collection of the same type of data, i.e., National Planning Institute, Controller General and the Ministry of the Interior. It would seem, however, that the MOF would be the appropriate place to house this task for, as part of its responsibility as the nation's accountant, it has the obligation to collect expenditure and revenue data from all governmental units.

With regards to the consistency of budget data, it should be noted that while the production of national accounts as well as decentralized planning may be served by comprehensive data, it cannot be said that the data which is currently reported by local governments is wholly sufficient to any of these tasks. As will be indicated in what follows, there are several difficulties in the existing budget reporting system. In part, this can be attributed to the fact that revenue collection procedures differ among the provinces. In part, it results from procedural differences in the way provincial capitals channel aid funds to the districts. These cause problems that should be remedied for, as things now stand, much of what is reported is misleading. Certainly with some greater care and explanation of basic classification and accounting procedures, local government budgeting and reporting could be greatly improved. It would seem that the place to start is in the provincial capital as the provincial treasurers have a pivotal role both as the provinces' principal fiscal officer and in their capacity as advisor to the districts. One way to leverage that position to improve the administrative capacity in the districts would be the generalized use of integrated budgets. But this may work only if the provincial government can provide the direction and guidance to districts. Success would also depend on the existence of a mechanism to encourage careful accounting. The means to achieve this may be easily available if there were an auditing requirement as a prerequisite to the distribution of funds from provincial capitals to the districts.

Be that as it may, the importance of a strong and accurate reporting system extends beyond the usual accounting purposes. It simply is the best source of a large part of the information that is prerequisite to the type of serious planning which must underlie any attempt to integrate local governments in a decentralized program of investment in the nation's infrastructure. Moreover, it would be a primary source of the data necessary for any future evaluation of the ongoing attempts to enhance resource mobilization through local governments. But efforts to decentralize the selection of sites for public infrastructure investments are in process. Thus, the need for the information necessary to judge the capacity and efforts of local governments is immediate and urgent. These needs could be accommodated by an initial comprehensive evaluation of local government revenue raising capacity and tax effort. T is too, would necessarily add to what at this point in time must be considered a deficient understanding of the factors governing local government operations.

Intergovernmental Aids

One factor whose effect on local governments has not been given its dues is intergovernmental aid. The general conception is that the districts are greatly dependent on aids both from the central government and the provincial capitals. Regretfully, the way that local governments classify their revenues makes difficult even a rough measure of their dependence on central government support of their current operations. What is certain is that district government operations are affected by that aid but just how and why is uncertain and it appears to be independent of the central government's intent for providing operational aid. As no detailed study of the impact of intergovernmental aid in Peru has been undertaken, its impact can only be surmised.

In fact, many districts are uncertain about the nature, purpose, and amounts of central governmental aids they may receive. If anything, their view is that, while the central government and its agencies may be responsible for major investment projects, the provincial capitals are must more likely to be the source of funds to support their day-to-day operational expenditures. Moreover, the districts, as well as the provincial capital, appear to consider this type of aid as simple general fund support. If they do, then it could be expected that the impact of intergovernmental aid on local resource mobilization would be much like that which studies of other countries have established. That is, general fund aid probably reduces tax efforts and increases employment levels and wage costs as much or more as it entices local revenue mobilization or service level increases. Certainly these are not desirable outcomes in a country intent on encouraging local revenue mobilization. What would have to be changed in order for intergovernmental aid to stimulate local government revenue mobilization cannot be explicitly stated, as it is not known exactly how the current system affects their operations. What can be said for sure is that it is possible to design systems which could provide the positive incentives to activate greater local initiatives. It would seem that any serious attempts to stimulate local initiatives dictates that a factor as important as intergovernmental aid in Peru be leveraged to its maximum advantage. A first step towards this goal is an evaluation of existing intergovernmental aid programs. A necessary element of this must be a careful examination of their impact on local government operations. Such an assessment should be of first priority in Peru's program of fiscal decentralization. The next step would be to consider the types of aid programs which could be designed to enhance local revenue mobilization.

It should be noted that part and parcel of a system designed for specific purposes, is the need to monitor its implementation. If the intent is to enhance local revenue mobilization, i.e., increase tax effort, then there must be a means to measure success. As this is generally accomplished with the types of information regularly collected by local governments, i.e., tax collection, all the more reason for concern with the budgetary and accounting operations of local governments and the collection of budgetary information.

Local Government Investment

Given the current environment, the ability of district governments to mobilize resources to contribute to the program of decentralized planning and investment is greatly limited. In part, this is due to their limited revenues.

To some, self-financing investments are seen as the means of circumventing this constraint. But increasingly, it is becoming clear that a successful program of local government self-financing investments is difficult to achieve. Setting user charges at cost recovery rates is not always an easy matter. But more importantly, there is always the issue of for what should user charges be charged. In many cases, e.g., water and electricity, there are very efficient ways to meter use. However, their cost may be prohibitive. There are alternatives which seem to work in other places. Commonly, user charges are determined in relation to the use and value of property serviced. This is an easily implemented method particularly in urban areas but for obvious reasons it works best where there is well functioning property tax. Regretfully, the necessary development of property cadastres for effective property taxation, let alone for other purposes, is yet to be initiated, let alone achieved.

But increasing local revenues alone will not likely enhance districts' investment activities. This follows from a perception they have which, though not wholely inaccurate, is widely held. That is that revenues which are not spent in one year must be carried over and spent the following year. Any such inclination to spend rather than save is enhanced by the fact that local governments have little experience with the banking sector. In fact, for most local governments there is no advantage in attempting to accumulate saving funds simply because there is little compensation for the loss in purchasing due to inflation. This is not to say that there is no possibility of enticing local governments to build up stocks of savings which could be used as the counterpart funds on down-payments generally associated with long-term investment. But it is unlikely that such behavior will spontaneously evolve in the foreseeable future.

That local governments have not been integrated into the banking system is not unusual in developing countries. In fact, where local governments have developed banking relations they have done so primarily as a result of the establishment of an institution developed primarily to cater to their needs. There are a variety of such institutions in Latin America. The benefits to developing a municipal development bank in Peru would probably be substantial. Just how it should be developed, capitalized and what its span of operation should be, are difficult questions. The experience of municipal banks in other countries has been varied. But there has been no systematic evaluation which could help identify how best to structure the operations and efforts of such a bank. This is not to say that Peru should reject this possibility. Rather it is to call for care in the consideration of the possible range of activities, responsibilities, organizational forms and program structures which could be operationalized in the form of a municipal development bank. Equally, it should be emphasized that the organization of such a bank should not be undertaken without due consideration of the needs and more importantly, the capacity of the local governments. That such knowledge cannot be said to exist in Peru is just reason for caution but not for lack of action. The first step would seem to be a careful assessment of the fiscal circumstance, capacities and needs of Peru's district governments. Equally important, there should be due consideration as to the role local governments might play in the capitalization of such a bank.

The Property Tax

One factor which greatly hampers any attempts to enlarge the role of local governments in Peru is the property tax. In most advanced countries and in many developing countries, it is considered as a basic revenue source. Generally in Peru it has not been very productive. Its potential as a revenue base for local governments is greatly limited by its current structure. Property rolls and evaluations are less than complete and collection procedures are deficient. Moreover, the basic tax structure and the way it is administered confronts property owners with both the opportunity and incentive to evade taxation. Perhaps more importantly, there is little or no reason for the districts outside of the provincial capitals to lend any efforts to the cause of improving the operation of the tax.

It is unlikely that collection efficiency or the revenue productivity will improve without some alteration of the basic structure and operation of the property tax. To be sure, an overhaul of the property tax is no minor undertaking. But it is one that should be initiated. As has been demonstrated in many other countries, improvement in the property tax can pave the way for a significant upgrading in the activities of local governments. In part, improved property taxation can provide the funds to expand service levels and to invest in public infrastructure. It also has been known to enhance the operation of other revenue sources. For example, it is not uncommon for some user fees, e.g., electricity and water rates to be levied in relation to the development and use of property. The property inventories that are a part of effective property taxation have, in other countries, e.g., Honduras, had the important side product of identifying the full range of taxpayers for other local taxes, e.g., business license taxes. Beyond these is the fact that increased values of property are a sure accompaniment to economic growth. When local governments can tap this growth, they are much more likely to be able to accumulate the collateral necessary for developmental investments.

Many elements of the basic machinery for a well functioning property tax are in place in Peru. What is needed most is a more efficient mode of collection. To be sure, this is an endeavor which could be accomplished without great expense.

The Role of Provincial Capitals

Provincial capitals play a major role in Peru's system of local governments. The use of integrated budgeting has recently reinforced their pivotal role as the fiscal seat of the provinces. Perhaps of even greater import is the fact that the districts look to their provincial capitals for direction and assistance. Because of this, it may just be that the fulcrum to leverage greater district participation in the program of decentralized development is housed in the provincial capitals.

As they operate now, provincial capitals generally do not make effective use of that leverage. Indeed, there have been little incentive for them to do so. Rather, they operate in a system which provides neither the mechanism nor the incentive for improved districts' administration. However, it is likely that with some significant but not monumental alteration in the structure of the property tax and in the program of central government aid to local governments, provincial capitals could effectively be the vehicle for the mobilization of district governments. But there must be some mechanism to encourage capital districts' undertaking of an expanded role. In many countries, the distribution of central government aid has effectively served the purpose. It could do the same in Peru. For example, distributing to the provincial capital some part of central government aid in relation to tax effort and collection efficiency in the province as a whole, would likely spur substantial improvements.

II. TRENDS IN THE PUBLIC SECTOR

Preliminary Considerations

The system of government finance in Peru is a highly centralized one in which the central government collects most of the revenues and does most of the spending (i.e., 96 percent in 1979).[1] Within the central government there are a number of separate ministries and public enterprises which have had the major responsibilities for the planning and provision of basic services both within the urban areas and in the outlying and rural areas of the country. Historically, local governments have at least titularly shared some of these responsibilities, and presumably they will participate more in the future.

Local government in Peru consists of three levels: Departments which are divided into provinces which in turn are composed of districts. In all, there are 24 departments (including the constitution province of Callao) 113 provinces and 930 districts. Each province has a capital district and the departmental government is located usually in the capital district of the principle province. With few exceptions, the districts and provinces, like the departments, are primarily rural in nature.

Each of the three levels of local government have had some responsibilities for the provision of public services, but the provinces and the districts, historically, have been the more important. The direction of the current intent on decentralized development is to expand the range of local government investment and operations, particularly in

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[1] Cuentas Nacionales del Perú, Oficina Nacional de Estadística, Dirección General de Cuentas Nacionales, Lima Perú, 1980.

such basic services, as water, sewage and sanitation, roads, public health and electricity, as well as others. Historically, local governments' contribution to the development of public infrastructure has been quite small (see Table 1). Moreover, it has been dwindling while the level of central government and public enterprise investment has increased quite markedly. In fact, the investment activity of local governments, amounts to less than 1 percent of the capital spending of either the general government or of the public enterprises. Clearly, the level of investment undertaken by local governments will have to increase many-fold before they could claim anything more than a token partnership in public investment.

It could be argued that the small amount of investment simply reflects a lack of opportunity or interest of local governments in developing public infrastructure. The evidence, however, does not support such a contention. In their budget proposals, local governments have generally petitioned for and been authorized to undertake investment spending at levels significantly higher than they actually accomplish (see Table 2). Even more stirring is the fact that local governments' ability to accomplish the investment plans has consistently declined and by the end of the 1970s they were accomplishing less than half of the then authorized spending. Clearly, there is something impeding local governments' ability to realize their investment plans.

A step toward alteration of this setting has been the New Municipal Law. It calls for the establishment of a system of infrastructure planning which involves the coordinated action of the central government ministries, departmental planning groups, and local governments. The intent is to

TABLE 1

GROSS GOVERNMENT CAPITAL FORMATION
(millions of soles)

	General Government	Public Enterprise	Local Government
1975/76	14,897[a]	29,948[a]	1,078
1977	25,398	31,269	731
1979	65,560	75,976	399

[a]mean of 1975 and 1976

SOURCE: *Cuentas Nacionales del Perú*, Oficina Nacional de Estadística, Dirección General de Cuentas Nacionales, Lima, Perú, various years.

TABLE 2

AUTHORIZED AND ACTUAL LOCAL GOVERNMENT CAPITAL INVESTMENT SPENDING
(thousands of soles)

	Authorized	Actual	Authorized Not Undertaken	Difference
1975/76	1,450,000	1,078,000	372,000	74.3
1977	1,133,053	730,683	402,370	64.5
1979	812,038	398,731	413,307	50.9

SOURCE: Cuentas Nacionales del Perú, Oficina Nacional de Estadística, Dirección General de Cuentas Nacionales, Lima, Perú, various years.

enhance the role played by district governments in the development of infrastructure.

But, as has been indicated, it is not a lack of projects nor the authority to undertake them which has held back local government investments. If it is not for want of opportunity, what, then, can account for the decline in capital investments? One could develop a variety of hypotheses but the general inclination is to assume that the revenue raising and administrative capacities of district governments have been the principle obstacles to their contribution to the expansion of the nation's public infrastructure.

It is much too soon to say whether broad based infrastructure planning and improved intergovernmental coordination will enhance the ability of local government to actually accomplish their intended investments. But even if local governments expand their investment activities, the districts' limited administrative and revenue raising capacities give rise to a rather difficult question which may be of primary importance. If the types and levels of service provided by the districts are expanded, how will they obtain the resources needed to cover the recurrent costs of their operations, maintenance and repair and to support a growing general government administration? Simply stated, the question is whether local governments will be able to support a program of additional activities over the long haul. The analysis which will be presented leads to the conclusion that the circumstance in which local governments operate will likely mitigate the effective participation of most district governments in the expansion of the local government sector.

Centralization of the Public Sector

The 1970s began as a period of relatively moderate growth in the Peruvian public sector (Table 3). For the first four years, total government expenditures increased at annual rates slightly below 20 percent. The year 1975 marked the beginning of a period of rapid growth during which annual public expenditure increments generally exceed 30 percent and were as high as 60 percent (1976-77). Although it would seem that such substantial growth in government expenditures would signal a growing importance of the public sector, that is not the case. The fact is that during the seventies, the government sector grew at a rate commensurate with that of the economy as a whole. The result was that the government's share of the economy in 1979 (13.7 percent) was about the same as it had been in 1970.[1]

The growth of the local government sector parallels that of the total government sector; modest increases between 1970-74 with major increments in the latter half of the decade (see Table 3). However, between 1970 and 1978, the growth of the local governments lagged behind that of the overall government sector. By the end of the decade, the share of local government in the public sector had declined by 15 percent (i.e., from 4.32 to 3.65 percent) and this, despite a doubling of local expenditures between 1978 and 1979. Thus, the decade of the 70s was one of substantial centralization in the public sector and a decline in the relative importance of local government in the economy as a whole.

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[1]Cuentas Nacionales del Perú. Oficina Nacional de Estadistica, Direccion General de Cuentas Nacionales, Lima, Perú, 1980, p. 115.

TABLE 3

TRENDS IN PERUVIAN GOVERNMENT[a] EXPENDITURES: 1970-1979

Year	(1) Total Government (Millions of Soles)	(2) Total Local Government (Millions of Soles)	Local as Percent of Total Government
1970	30,372	1,312	4.32
1971	34,672	1,489	4.29
1972	40,776	1,701	4.17
1973	48,407	1,904	3.93
1974	57,121	2,164	3.79
1975	81,752	2,727	3.34
1976	107,838	3,165	2.93
1977	173,495	5,043	2.91
1978	225,515	6,061	2.69
1979	346,382	12,627	3.65

[a]Final consumption expenditure.

SOURCE: Cuentas Nacionales del Perú, Oficina Nacional de Estadística, Dirección General de Cuentas Nacionales, Lima, Perú, 1980, p. 115.

Increasing Local Government Dependence on Intergovernmental Transfers

At least during the latter part of the decade, the centralization of Peru's public sector has been accompanied by another trend. In 1975-76 transfers to local government accounted for about 17 percent of local spending. By 1979, the ratio of transfers to local expenditures had increased markedly, i.e., to 34 percent.[1] Thus, at the same time as their relative importance was declining, local governments were becoming increasingly dependent on intergovernmental transfers. Thus, the picture presented by these data is one of diminishing importance of local governments and their growing dependence on the central government.

The Declining Local Sector

In a much more significant way, the experience of local government has importance which extends beyond its position relative to the central government. Simply stated, the relative decline in the local sector calls to question the ability of subnational government units to maintain the service levels they have provided, let alone expand them to accommodate their growing populations. In one sense it appears that because local government expenditures have increased so much faster than population that per capita local spending has increased consistently and rather markedly for the period as a whole (Table 4). However, when expenditure levels are adjusted for inflation, the picture is much less bright. For most of the

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[1]These percentages calculated from data presented in Cuenta General de la República, Vol. 5, Gobierno Local, Ministerio de Economía y Finanzas, Dirección General de Contabilidad, 1975-76 and 1979.

TABLE 4

TRENDS IN PERUVIAN LOCAL GOVERNMENT EXPENDITURE GROWTH

	(1) Real Local Government Expenditures (in thousands)	(2) Per Capita Local Expenditures	(3) Percentage Increase in Per Capita Expenditures	(4) Real Per Capita Expenditures	(5) Percent Increase in Real Per Capita Expenditures
1970	1,644,900	97.57	---	122.33	---
1971	1,747,850	107.66	10.34%	126.38	3.31%
1972	1,865,880	119.59	11.08	130.97	3.63
1973	1,904,000	130.16	8.84	130.16	-0.62
1974	1,851,630	143.85	10.52	123.09	-5.43
1975	1,887,200	176.28	22.54	121.99	-0.89
1976	1,640,830	198.28	12.87	103.15	-15.44
1977	1,893,870	308.70	54.86	115.78	12.24
1978	1,442,000	360.36	16.89	85.73	-25.95
1979	1,791,420	730.18	102.63	103.59	20.83

SOURCE: Cuentas Nacionales del Perú, Oficina National de Estadística, Dirección General de Cuentas Nacionales, Lima, Perú, 1980, p. 115.

seventies the price level increased more rapidly than both the level of per capita and total local government expenditures and in many years, much more so. In fact, it was only the doubling of per capita expenditures between 1978 and 1979 which stemmed the tide of a decade of continual annual declines in the real level of per capita spending on the part of local governments (Table 4). Be that as it may, it is still the case that the amount of real resources which local governments were able to allocate to their constituents declined (from 122.33 to 103.50 soles) by a full 15 percent during the decade. And this occurred despite and above noted growth in intergovernmental transfers.

Local Government Revenue Sources

The above noted increasing dependence of local government on intergovernmental transfers during the latter part of the 1970s was not the only change in their reliance on various revenue sources (Table 5). As the data indicate, with one exception (sales of goods and services) the growing dependence of local government on transfers was accompanied by a declining importance of most other revenue sources. In particular, the contribution of revenues from user charges and from other own source income (essentially taxes) to local government coffers have decreased markedly. It would seem that the logic involved in the calculation of proportions would dictate that the importance of at least some, if not all, local government own revenue sources would fall whenever one item increased to the extent that transfers did during the 1970s. However, such logic is misleading for it ignores the fact that the importance of any source depends on growth in revenues derived from it as well as the increase in revenues from other

TABLE 5

LOCAL GOVERNMENT DEPENDENCE ON VARIOUS REVENUE SOURCES: 1975-76 AND 1979

	1975/76	1979
Taxes		18.45%
User Chargers	23.85%	18.08
Sales of Goods & Services	8.97	11.96
Fines	.93	1.34
Current Transfers	17.70	32.82
Other Own Source Income	32.23	26.31
Balance Carryover	10.20	6.56
Debt	4.84	0.10
Total[a]	100.00	100.00

[a]Total includes items not shown separately.

SOURCE: Cuentas Nacionales del Perú, Oficina Nacional De Estadística, Dirección General de Cuentas Nacionales, Lima, Perú, 1980.

sources. Simply stated, if local governments had increased their taxes, user charges, etc., at rates commensurate with the growth in their income from transfers, their dependence on own source revenues and on transfers would not have been altered. But they did not.

One popular notion throughout the world is that when transfer payments increase, local governments use them rather than locally raised revenues to increase the levels of existing services and/or add new ones.[1] The growing importance of transfer income to Peruvian local governments and the fact that the real value of all resources channeled through local governments were the same in 1979 as in 1973 (Table 4) would seem to be consistent with such an explanation. Certainly there is nothing in the recent experience of Peruvian local government finance which would indicate that the intergovernmental grants and transfers have elicited any overall increase in tax efforts or have stimulated local revenue raising efforts.

In fact, simple substitution of transfers for locally raised revenues would imply at least constant levels of spending. But local governments did not keep up their spending levels. In fact, in real terms, per capita expenditures by local government generally declined throughout the 1970s. Obviously, without the sizable growth in transfers, real local government spending per capita would have declined even more than it actually did. This would seem to imply two possibilities. The first is that local government revenue systems are structured in a way which makes them

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[1]For discussion of this issue, see Richard Bird, "Intergovernmental Fiscal Relations in Developing Countries," World Bank Staff Working Paper No. 304 (Washington, D.C.: The World Bank, October 1978), p. 30.

unresponsive to population and economic growth. The other is that the structure of the intergovernmental system is such that it induces local governments to reduce their own revenue raising efforts.

In truth it is highly probable that elements of both of these possibilities have been operative. How they have been, why they have been and where they have been are extremely important questions, for their answers are the guides to effective public policy. For example, if the transfer system does lead to a reduction of local revenue raising efforts, then it can be restructured and it is possible to do so in a way which can elicit rather than retard local government revenue raising efforts. Alternatively, if local revenue structures are unresponsive to the needs of growing populations, they too can be restructured so as to be more productive. But the cure must be tailored to the malady and the cure for one is almost certainly not the cure for the other. Regretfully, a full consideration of the possibilities is beyond the scope of this paper, but the consideration in later sections will provide some guides to policy. Still, what is evident at this point is that the local government revenue system is deficient and will probably not be able to provide the resources necessary even to main current service levels let alone add to them. Equally clear is the need for a systematic evaluation of the revenue productivity of the local revenue raising system in Peru.

Comparisons With Other Developing Areas

Fiscal Decentralization

While the foregoing has considered the position of local governments, it has given no idea as to how the Peruvian situation compares with other developing countries. Detailed comparisons are not possible as the data on local government finances in developing areas is scant and difficult to come by. However, with the data which is available it is possible to see how the Peruvian local government situation differs from that of its neighbors and developing countries in other parts of the world as well.

Turning first to the issue of fiscal centralization, the most comprehensive available information on the importance of local governments has been gathered by W.S. Kee. For a sample of 45 developing countries, he found that on the average, subnational governments account for about 24 percent of total government expenditures (Table 6). His data also show that there exists wide latitude in the role for local governments in national fiscal systems and that in many countries a substantial amount of fiscal decentralization exists. In several countries, local governments have played the dominant role, however, in most, the central government has been the major partner. Still, the fact is that even where the central government has had major spending responsibilities, local government roles differ widely.

Given the limited spending on the part of local governments in Peru, its fiscal system can only be characterized as highly centralized. There are a number of countries which are similarly situated but few of these are Latin American. In fact, Peru appears to have one of the most centralized fiscal systems in Latin America and to the extent that the data in Table 6 is representative, in the world as well.

There is a general conception that fiscal decentralization accompanies economic growth. On this account, it would be expected that Peru and other

TABLE 6

SUBNATIONAL GOVERNMENT PERCENTAGE SHARE IN TOTAL GOVERNMENT CURRENT EXPENDITURE, 1968 (less developed countries)

Countries with Large Subnational Government Share		Countries with Medium Subnational Government Share		Countries with Small Subnational Government Share	
Brazil	65.8 (51.3)	Korea	28.9 (36.9)	Malaysia	9.3
Colombia	54.2 (40.6)[a]	Nicaragua	27.7	Rhodesia	8.9
Chile (1967)	52.7	Nigeria (1969)	27.4	Panama	8.8
India	52.3	Malagasy	25.8	Tunisia	8.2
Mexico	47.5	Ireland	21.5	Senegal	7.8
Pakistan	44.5	Portugal	21.5	Sierra Leone	6.3
Uruguay	44.4	Botswana	20.5	Fiji	6.2
Ecuador	41.4	Philippines	20.4	Thailand	5.7
Venezuela	41.2	Honduras	20.1	Jamaica	5.6
South Africa	40.1	Kenya	18.9	Mauritius	5.5
Cameroon	40.0	Trinidad	18.3	Chad	5.3
El Salvador	39.2	Algeria	14.7	Peru	3.8
Costa Rica	37.5	Guatemala	13.7	Zambia	1.8
Bolivia	37.2	Turkey	10.9	Swaziland	1.3
				Lesotho	1.2
				Ceylon	0.1 (5.2)
Median	42.9	Median	20.5	Median	5.7
Mean	45.6	Average	20.7	Average	5.4

[a]For 1967.

SOURCE: Woo Sik Kee, "Fiscal Decentralization and Economic Development" (Washington, D.C.: The World Bank, 1976), mimeo, as cited in J.S. Linn, "Urban Finances in Developing Countries," Urban Finances: Emerging Trends, edited by Roy Bahl, in Urban Affairs Annual Review, Vol. 20 (Beverly Hill, California: Sage Publications, 1981).

countries similarly situated would have centralized fiscal systems. However, many countries whose economies have reached a level similar to that of Peru have more decentralized fiscal systems. In particular, the fiscal systems of Latin American countries generally appear to be among the more decentralized (Table 6). This would seem to imply that decentralization may be more pronounced in Latin America than in other areas of the world. The fact that neighboring Bolivia and Ecuador as well as other Latin American Countries even less advanced than Peru, e.g., Nicaragua, have decentralized fiscal systems, would seem to suggest that Peru is out of step with a cultural inclination toward decentralization. Whether Peru's continued industrialization and urbanization will induce greater fiscal decentralization is a matter of conjecture. That it didn't during the 1970s is a matter of fact (Table 1).

<u>Dependence on Revenue Sources</u>

Questions about the relative dependence of local government on various revenue sources can be considered only in a very rough fashion, for the readily available data is not well suited for the task. The data which is available pertains to large cities rather than the whole of the local government sector. The shortcoming of this data is that some revenue sources are more easily cultivated in cities than in small urban settlements and rural areas. Still, it can be taken as a means of considering what continued urbanization might mean for the dependence of Peruvian Districts on various revenue sources.

Generally, in Peru, local governments raise two of every three dollars (65.6 percent) they spend from local revenue sources (Table 7). This reflects a degree of local dependence on external sources (34.4 percent)

TABLE 7

FINANCING OF LOCAL PUBLIC EXPENDITURES IN SELECTED CITIES:
PERCENTAGE DISTRIBUTION BY TYPE OF REVENUE

		Locally Raised Revenue				Revenue From External Sources			
City	Year	Total Local Revenue	Local Taxes	Self-Financing Services	Other Local Revenue	Total External Revenue	Grants and Shared Taxes	Net Borrowing[a]	Total
Francistown (Botswana)	1972	102.9	46.8	56.1	---	-2.9	1.9	- 4.8	100.0
Mexico City (Mexico)	1968	101.9	70.9	5.2	25.8	-1.9	8.9	-10.8	100.0
LaPaz (Bolivia)	1975	97.0	61.9	3.6	31.5	3.0	9.0	- 6.0	100.0
Tunis (Tunisia)	1972	93.9	36.8	7.1	50.0	6.1	0.7	5.4	100.0
Kitwe (Zambia)	1975	92.7	35.0	53.1	4.6	7.3	2.2	5.1	100.0
Valencia (Venezuela)	1968	90.8	44.8	13.4	32.6	9.2	9.2	---	100.0
Lumbumbashi (Zaire)	1972	90.5	72.8	---	17.7	9.5	9.5	---	100.0
Rio de Janeiro (Brazil)[b]	1967	88.4	74.5	7.2	6.7	11.6	1.7	9.9	100.0
Amedabad (India)	1970/1	86.3	38.6	41.8	5.9	13.7	4.2	9.5	100.0
Bombay (India)	1970/1	84.6	37.9	38.7	8.0	15.4	1.0	14.4	100.0
Karachi (Pakistan)	1974/5	84.1	67.6	2.2	14.3	15.9	2.8	13.1	100.0
Seoul (Korea)	1971	80.0	30.3	36.3	13.4	19.9	15.8	4.1	100.0
Jakarta (Indonesia)[c]	1972/3	78.8	40.6	15.2	23.0	21.1	21.1	---	100.0
		(81.9)	(43.7)	(15.2)	(23.0)	(18.1)	(18.1)	---	(100.0)
Lusaka (Zambia)	1972	78.2	39.3	36.9	2.0	21.8	6.0	15.8	100.0
Cali (Colombia)	1974	74.4	15.6	57.5	1.3	25.7	2.8	22.9	100.0
Calcutta Corp. (India)	1974/5	73.8	64.4	---	9.4	26.2	19.4	6.8	100.0
Cartagena (Colombia)	1972	70.4	23.3	43.3	3.8	29.6	12.8	16.8	100.0
Mbuji-Mayi (Zaire)	1971	70.2	66.5	---	2.7	29.8	29.8	---	100.0
Manila (Philippines)[d]	1970	70.0	55.0	10.0	5.0	30.0	30.0	---	100.0
Bukaru (Zaire)	1971	69.9	67.4	---	2.5	30.1	30.1	---	100.0
Madras (India)	1975/6	69.2	54.5	3.7	11.0	30.8	25.1	5.7	100.0
All Local Govts. (Peru)	1979	65.6	19.0	18.6	28.0	34.4	---	---	---
Bogota (Colombia)[c]	1972	62.5	13.7	48.5	0.3	37.3	14.0	23.5	100.0
		(72.4)	(23.6)	(48.5)	(0.3)	(27.6)	(4.1)	(23.5)	(100.0)
Tehran (Iran)	1974	46.9	42.8	---	4.1	53.1	45.2	7.9	100.0
Kingston (Jamaica)	1971/2	30.1	23.9	2.7	3.4	69.9	67.2	2.7	100.0
Kinshasa (Zaire)	1971	26.9	25.4	---	1.5	73.1	73.1	---	100.0
Median		78.8	42.8	7.2	6.7	21.1	9.5	5.1	100.0
		(76.6)	(46.0)	(19.3)	(11.2)	(23.4)	(17.7)	(5.7)	(100.0)

TABLE 7 (CONT.)

[a]Net borrowing consists of loan financing minus net changes in financial assets or reserves.

[b]Due to exclusion of autonomous agencies the contribution of self-financing service revenues and that of all locally raised revenues are probably understated, while the remaining entries are overstated.

[c]Figures not in parenthesis include shared taxes under grants; figures in parenthesis include shared taxes under local taxes.

[d]Total revenues are used instead of total expenditures.

SOURCE: Johannes Linn, "Urban Finances in Developing Countries," in Urban Government Finance: Emerging Trends, edited by Roy Bahl, Urban Affairs Annual Reviews, Vol. 20 (Beverly Hills: Sage Publications, 1981); and Cuentas Nacionales Del Perú, Oficina Nacional De Estadistica, Dirección de Cuentas Nacionales, Lima, Perú, 1981.

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which is substantially greater than the majority of the areas listed in the table. In Peru, local taxes contribute a comparatively small share to expenditures (19 percent) but self financing services (user charges) make an average contribution (18.6 percent) while other revenue sources contribute more to the funding of local expenditures than they do in a large number of cities in developing countries. This would seem to imply that, relative to other developing countries, if local revenue raising efforts are weak in Peru, it can be traced to underutilization of taxes. While it could be argued that this pattern would be different if Peru were more urbanized, the situation in Lima provides no such indication. In the capital province, transfers are less important and the share of expenditures funded from local sources (80.2 percent) is high relative to all local governments in Peru and to the majority of the cities listed in the table as well. The indication is that in Lima, local revenue raising effort has not been deficient. In another regard, however, the pattern in Lima is much the same as it is for all local governments in Peru. The reliance on local taxes is relatively low (36.0 percent) while self financing services (25.8 percent) and other revenue sources (18.4 percent) provide comparatively large contributions to the funding of local government expenditures. Once again it appears that the weakness in local government revenue raising in Peru can be traced to low tax effort. To compensate for this, self financing services and other local revenue sources have been cultivated to a greater extent than is typical in most developing countries. That the dependence on taxes in Lima is much the same as in other local governments in Peru indicates that degree of urbanization would not likely alter the pattern of local government under-utilization of taxes as a source of revenues. This being the case, there must be something more directly related to the local government revenue raising structure which accounts for the underutilization of taxes by Peruvian local governments. That is to say that imbedded in the local government revenue raising system is some important weakness in the structure of taxation which has restricted local tax capacity.

Finally, given Lima's dominance of the local government sectors, it goes without saying that aggregate data probably reflect its operations as much or more than all other local governments. If this is the case, and it is, then many of the above stated suppositions about Peruvian local governments can be stated more forcefully for those outside of Lima. In particular, outside of Lima, local reliance on transfers must be much greater than the national average (34.4 percent) for it is much lower in Lima (19.8 percent). Conversely, outside of Lima, local reliance on taxes must be even lower than the national average (19 percent) for it is so much higher in Lima (36 percent). The same can be said for self financing services (25.8 percent as 18.6 percent). Alternatively, outside of Lima, reliance on other local revenue sources, e.g., fines, sale, rental, must be even larger than indicated by the national average.

III. LOCAL REVENUES

On March 16, 1981, the Government of Peru issued the New Municipal Law, Decree No. 51. One objective of the "New Law" was to provide municipal governments with access to revenue sources so that they may better be able to service the needs of their constituents. The only real contribution of the "New Law" appears to be the combination of sources previously available to Provinces and to District councils into a general set of municipal (district and provincial) revenue sources. The most prominent modification in the "New Law" is the resources to be transferred to local governments for the purpose of providing decentralized public services. The uncertainty of revenue applications makes the extent of "New Law" impact on the future of local government in Peru difficult to judge.

There are four major sources from which municipalities can raise current revenues: municipal administration taxes, principally property taxes, user charges and fees (tasas), sales of goods and services, and property rentals.[1] With the exception of the tax on non-commercial property, District Governments have the power to set and to change the rates at which these taxes, user charges, and fees are imposed. In fact, some districts have recently increased the rates associated with a number of fees and user charges. However in most districts, rates are changed much less frequently than would be necessary for them to even keep up with inflation. While this could lead to questions about the degree of fiscal stress and the seriousness of district revenue raising efforts, we will see

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[1]The other major budgetary classifications of current own source revenues are contributions, fines, and balance carry-over.

that the hesitancy to raise local rates, fees and charges may be quite a reasonable response to the circumstances which confront at least some districts.

A recent study, based on an aggregation of District budgets, has indicated that transfers have been a major revenue source to local governments.[1] It is also indicated that taxes (Impuestos de Administracion Municipal) account for a relatively small proportion of the (own source) revenues collected in most provinces while that non-tax revenues were the more important source. A review of more recent (Table 8), data seems to verify this at the Provincial level, but it does much more. It indicates that non-tax sources have been a prime importance to the Districts and that the importance of taxes as a source of local revenues is reported to vary greatly among them. Moreover, dependence on property taxes is cited as heavy in some districts.[2] The differences between the findings based on District data (Table 8) and those of the previous study of Provincial aggregates, highlight two important points. The first is the hazard of attempting to describe the fiscal condition of municipal governments from any analysis based on provincial aggregates of district data. The second is that there appears to be a great deal of difference among districts in the extent to which they draw revenues from the various revenue sources which they control.

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[1]Van Walleghen Malaga, René, Pedro De Las Casas Grieve, Jorge Trelles Montero, and Raúl Sanchez Manzanares, Estudio de Municipalidades en el Perú Para el Programa de Desarrolo Regional Integrado de AID (Lima, Peru: November 1976), mimeographed.

[2]The other major source of tax revenues is generally the tax on non-athletic public performance (Espectáculos No Deportivos).

TABLE 8

OWN SOURCE REVENUES OF SELECTED PROVINCES AND DISTRICTS
(thousands of soles)

	Own Source Revenue	Percent Distribution		
		Taxes	Property Taxes	Other
Province				
Cajamarca[1]	34,873	24.48%	13.21%	75.52%
District				
San Marcos	1,651	1.76	1.75	98.24
Magdalena	335	30.45	29.85	69.55
Nomora	354	39.55	28.24	60.45
Llacanora	72	50.00	50.00	50.00
Chetilla	205	17.07	4.87	82.93
Matara	397	19.90	19.64	80.10
Province				
Cajabamba	9,294	12.15	6.84	87.85
District				
Cajabamba	7,156	21.10	10.48	78.90
Sayapullo	505	7.72	5.94	92.28

[1]All provincial data refer to closing budgets 1978 district data taken from final 1980 budgets.

SOURCE: Municipal Budgets.

But it must be emphasized that any revenue considerations, based on generally reported budget accounts of either district or provincial capital budgets, must be considered with care. All local governments simply do not classify their receipts in the same categories. What some identify as property tax collection others report a transfer (in their expenditures account) to the provincial district. Still others class as intergovernmental receipts the property taxes they collect. This lack of consistency can be attributed in part to the lack of clarity in and understanding of the national prescribed form for district budget and accounting. This kind of confusion is likely to exist any time when the budget and accounting forms are not tailored to the nature of the fiscal operations of those charged with the record-keeping.

In this regard, the system of local government accounting in Peru is deficient. The accounting forms are simply not used in a consistent fashion by local governments. Whether this can be attributed to the nature of the prescribed forms cannot at this point be said. However, the field interviews with local governments suggests that the problem is more likely one of a failure on the part of the central government to provide local governments with a full understanding of the importance and process of municipal accounting.

Still, these considerations imply the possibility of wide variation in the ways district governments have arranged that part of their fiscal domain which they control. A full understanding of the factors which lead to these differences would require a great deal more effort than is possible within the limited scope of this study. Thus, the considerations here must be narrowed.

The approach in this study is to concentrate on two major elements of the municipal revenue system. The first is the property tax. Its importance derives from the fact that around the world it is the principle source of municipal revenues which can be used for general purpose and it has the greatest revenue raising potential. Moreover, it is generally considered to be the principal source for the funds with which local governments may subsidize provision of socially desirable goods and services. Thus, it could provide monies needed to support the general operations of district government and, even more importantly, it could provide funds for new investment undertakings and/or for the supply of services. The second major element is user charges.[1] In areas like Peru where municipal governments are far from rich, and tax funds are not plentiful, user charges may be an important element in the fiscal repertoire of local governments. First they can provide an efficient way of paying the costs associated with the provision of a variety of services. When correctly administered, user charges based on the cost of provision reduce the possibility of waste and inefficiency. Second, they allow users to reveal the values they place on goods or services. When there is a willingness to pay the costs of production, consumers, in effect, are revealing that they value the resources used up in production. When there is no such willingness, consumers are indicating that the resources should be put to better use in the production of goods or services which they value more highly and for which they are willing to pay a price which will

[1]User charges will be considered below.

cover costs. While it can be argued that, although they may be efficient, appropriate user charges may impose a burden on the poor. It cannot be denied that the payment of a user charge means that the poor will have less funds available for other uses. However, unless funds are readily available to subsidize such goods, they may not be produced at all. Thus, the third and possibly most important reason is that user charges may be the only means by which some service can be provided to those who desire them.

Property Tax

The property tax in Peru is structured as a provincial rather than district tax. The tax roll is housed and tax collection is centered in the provincial capitals. In some provinces local districts operate as collection agents but any claims they may have on property tax proceeds exist at the discretion of the provincial capital.

The tax is levied on the totality of property owned by each owner rather than on an *in rem* basis; i.e., separately for each parcel owned. In combination with the progressive rate structure this serves to impose the heaviest burden on those who have property holding of large value whether it be a single or multiple property holdings. Arrangements such as this are commonly thought to serve the purpose of equity, benefitting the poor at the expense of the wealthy. But in some contexts and, more particularly in Peru, it may be that what is intended to serve the cause of equity does not. This can happen if tax burdens on the wealthy are so high that they provide powerful incentive to avoid or evade taxation and thus reduce the amount of monies available for spending on services to benefit the poor.

That this is the case in Peru cannot be documented with the available data. However, as will be argued below, it would be surprising indeed, if the property tax in Peru is as progressive as it's structure might imply.

Alternatively, there is another implication of progressive taxation in the form operative in Peru. By progressively taxing all land of a property owner, the increasingly higher tax burden may retard the accumulation of properties by the wealthy and thus favor widespread ownership of property.

As is the case with virtually all tax analysis, the discussion which follows will focus on the base and the rate of the tax. The purpose is to explore some of the likely revenue implications of the current tax structure. Closely intertwined are major issues of tax administration which will be noted where relevant.

Tax Base Scope

There are two distinct classifications of property which local governments are empowered to tax: improved urban and rural non-commercial property and unimproved urban land.[1] The particular classification of property in terms of its use has potential disadvantages as well as a potential advantage that are worth mentioning.

The restriction of the tax on improved property to non-commercial uses in effect exempts commercial activity from the municipal tax on property values. They are, of course, liable for other types of taxation. In small

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[1]Of the two, the tax on commercial property is by far the more important. It accounts for 93 percent and 96 percent of property tax revenues in Cajamarca and Cajabamba respectively. In Lima and Callao, local governments are empowered to tax delapidated or uninhabitable farms.

urban areas and those which are essentially rural, this is probably of little consequence as the commercial development of land is unlikely to have been extensive. However, in the larger, more urban districts which have been the centers of commercial development, the exemption of commercial property removes what may be rather large numbers of properties from the property tax rolls. Still, as growth and commercialization go hand-in-hand, the loss of revenue potential to the provinces will likely be expected to increase as the economy proceeds and larger numbers of land parcels become commercialized and are taken off the tax rolls. Where this occurs, provincial governments will have to rely more heavily on other sources for revenue increases.

It should be noted that commercial properties or at least the activities which they support cannot totally avoid contributing to the support of municipal governments. There are a variety of other taxes and fees which apply to these activities, e.g., professional licenses, taxes on public displays and public parking lots. However, the rates at which these taxes and fees are applied generally appear to be favorable in comparison with the tax on property. Primarily these are district rather than provincial taxes although the revenues from public events and professional license taxes are shared between the two. Still, incentive for commercialization arising from commercial land property tax exemption, enhances revenue prospects for district governments. It might be expected that over time, district governments will fare better than if the property tax were structured differently. Whether this will happen depends on how effectively district governments collect their taxes. From our limited review, it appears that collection efficiency is low in most districts and this implies that whatever the property tax incentive to develop property commercially may be, it will have little impact on the revenues of district governments.

A second disadvantage of this restriction on the property tax is that it limits the potential use of property and property values as a basis for other financing mechanisms. For example, betterment charges and valorization levies have been employed in several developing areas as a means of recouping the costs of infrastructure investments in such things as water supplies and roads.[1] In essence, these are ways of assessing costs of projects to beneficiaries (landholders) in relation to value of benefits received, measured in terms of increased values of property. As such, these can provide efficient means of financing capital projects which generally conform to the standard of equity.

Similar mechanisms have played a role in the financing of recurrent costs of other basic public services like water and services and electricity. In this case tariffs or charges for amounts used are scaled according to the value, size, and/or use of the property served. The application of charges for services rendered in this fashion can provide a means of covering recurrent cost in a manner which conforms to general concepts of equity.

Levied as they are against property, financing mechanisms like these can be effectively and equitably used only when they can be applied to all

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[1] For a review of some countries' use of these mechanisms see Jorge Macon and José Merino Mañon, Financing Urban and Rural Development Through Betterment Levies: The Latin American Experience (New York: Praeger Publishers, 1977), p. 47.

benefitted properties whether involved in agrarian, commercial, industrial or residential use. The fact that the municipal tax on property values in Peru does not apply to commercial user does not mean that benefit taxes, valorization charges or user fees could not be applied. Rather, it means that either they would have to be limited to properties in non-commercial use or the property rolls would have to be expanded for this purpose. The first alternative could be considered an equitable means of financing that part of a project beneficial to non-commercial property owners. The second alternative would require the special assessment of commercial property. In fact, such an undertaking would be far from impossible. While not applied to value, the municipal license tax is based on a measure (squared meters) of property. It is possible and in fact it is quite common to derive taxable property values from area measures.[1] But if commercial property values are to be estimated for these purposes, they would be available for the purpose of general taxation. Moreover, if they were estimated for general tax purposes, it is more likely that valorization and betterment levies could be applied.

The lines of thought traced out above indicate that the base of the property tax, if broadly defined, can provide the foundation for user cost financing of the initial and recurrent cost of public infrastructure projects. <u>Thus, the proposal here is that the tax on improved property be expanded to include commercial property, that it be applied to property</u>

[1]For a discussion of the application of these in the Latin Americas context, see William A. Doebele, Orville F. Grimes, Jr., and Johannes F. Linn, "Participation of Beneficiaries in Financing Urban Services: Valorization Charges in Bogotá, Colombia," <u>Land Economics</u>, Vol. 55, No. 1 (February 1979): 73-92.

values rather than areas, and that the integration of the bases of property taxation and some user charges be seriously evaluated.

Turning to another side of the issue, it is a strongly held proposition in the literature of property taxation, that under certain conditions a distinction between improved and unimproved land can be very beneficial.[1] In particular, the ability to subject the two types of land to differential taxation can be a means of encouraging the development of unimproved land. This, however, will not follow from the separate classification of improved and unimproved land alone. Rather, the incentive to develop unimproved land comes from levying the tax on the higher value that the property would have if it were developed in a manner consistent with its inherent advantages, e.g., soil quality, topography and location. What this means is that if there were two properties that were identical in all respects except that one has been developed and improved while the other remained unimproved, the two would be subject to equal taxation. Of course, this means that the tax on unimproved land is heavy relative to that on improved land. The owner can moderate the heavy tax burden by undertaking construction and/or improvements, i.e., developing the land, and the resultant increase in the value of the property will alleviate what had been a relatively heavy tax burden. Thus, differential taxation of improved and unimproved land by penalizing the holding of land in its unimproved state can provide an incentive for development. Generally, the advantages of this type of differential taxation have been

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[1]Richard Netzer, "The Local Property Tax," in Property Tax Reform, edited by George Peterson (Washington, D.C.: The Urban Institute, 1973).

cited in the context of developing urban areas. However, it should be equally effective wherever there are opportunities for land development.

Whether the potential for the use of taxation of unimproved property as an incentive to development has been generally recognized in Peru is unlikely. That it could and should be can be affirmed. Thus, it would seem appropriate to propose that tax policy include a provision for the taxation of unimproved land as if it had been developed for use in a realistically productive manner.

But the implementation of such a policy is sufficiently difficult to dictate that it be a long-run goal rather than an immediate policy objective. The most obvious problem is that of determining the value that an unimproved parcel would have if it were to be improved. There are a variety of ways by which this could be accomplished. However, because they require sophisticated and intricate procedures and calculations, they may be too cumbersome to be used except in the largest urban centers. Alternatively, the same objective could be at least partially achieved by taxing unimproved property at higher rates than improved property. This could alleviate the need to estimate the value that an unimproved property would have if it were to be improved. Thus, the policy proposal is that at least in urban areas, unimproved property should be taxed at rates higher than that applied to improved properties.

Finally, whatever types of property compose the tax base, the effective use of a comprehensive list of properties whose taxable values are adjusted with changes in property values and an effective means of enforcing compliance are essential for effective property taxation. On both accounts, the local property tax in Peru is extremely deficient.

Moreover, there are elements within the current administrative structure which lead to neglect rather than provide an incentive for improved local property tax administration. Many of these will be mentioned in what follows.

Tax Base Evaluation

The basic element of a property tax is a list of taxable property which identifies the taxable value. In Peru, such a list, i.e., the property registrar is not the result of any systematic effort on the part of district governments. Rather, the list of properties to be taxed and their values are obtained by means of self-evaluation on the part of the owners. That is, by law each property owner is directed to report the value of all his properties and pay his taxes in the capital district of the province in which he lives.

In general, local government officials, particularly in the smaller district, believe that there are a large number of property owners who are not in compliance with this law. Statements from local officials like "if all owners reported their property, revenue from the property tax would double" and "most wealthy property owners do not pay the property tax" are common. So too is the expressed personal knowledge of owners who have not reported or who under-report their properties. These are symptomatic of the problems of the self-evaluation system. In part, this under-reporting is perceived as a general phenomena, i.e., "everybody does it."

However, there are particular segments of land which are generally believed to not be listed on the tax rolls. These are the cooperative estates which were set up as a result of land reform. Originally these properties were exempt from property taxes during their initial period of organization and operation. That period has lapsed but it is believed that generally these properties have not been added to the tax rolls. To the extent that they haven't, the provinces where they are located are not receiving the taxes they should. If the cooperatives are as productive as many local officials allege, the loss of revenues is even greater than the amounts of land involved might lead one to expect. When queried why this as well as other under-reporting were allowed to exist, local officials responded that there were simply no effective legal remedies enabling them to deal with rich and powerful landowners. While most frequently expressed in the smaller areas, this sentiment was also voiced in the larger provincial capitals.

If it is the larger and/or wealthy landowners who can evade property taxation, then the small poor landowners must bear an even larger share of the property tax burden than is intended. Such a violation of the cannons of equity calls for remedied action. However, it is unlikely that more effective imposition of the property tax could be accomplished within the current administrative structure of the property tax. Indeed, the current manner in which the property tax is administered, i.e., self evaluation and ineffective means of enforcement, provide few if any incentives to more effective property taxation. The system is structured and operates such that, payment of property taxes has many of the characteristics of a voluntary contribution. The lack of effective incentives to enforce accurate property evaluation and tax collection is an inefficiency in the system which inevitably results in the loss of substantial amounts of revenue and an inequitable distribution of the burden as well. Corrective policy should be directed toward the establishment of an accurate property registrar, cadastral system and effective means of tax collection and enforcement. Local government development and decentralized provision of public services have not and probably cannot be achieved in their absence.

Tax Collection

The ways in which property taxes are payed and revenues accrue to the Districts both contribute to the inefficiency of the system and the lack of incentives to improve its operation.

The crux of the problem can be traced to the fact that provincial capitals acting in their role as Treasury for all districts in the province are the repository for tax revenues, including property taxes. Most owners of land in outlying districts pay their tax in the provincial capitals.[1] In general, there is no problem with this type of collection procedure. In fact, provincial capitals acting as Treasury for the districts is probably reasonable and efficient. The problem arises from the fact that there is no clear relation between the tax liability against property located in a district and the revenues which the district receives. This is so because the provincial capitals do not simply collect and hold tax receipts for the various districts. Rather, such revenues are part of the provincial district's general funds although they often constitute the source of transfers from the provincial capital to the districts.[2] In practice, the

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[1]The most common exceptions to this generality are isolated, small districts. For example, in the Province of Cajabamba, the District of Suplezo collects and retains tax on property located in the district. Interviews in the Province of Celendin indicate that this type of autonomy is common as most districts are relatively isolated.

[2]Apparently this is characteristic of provinces which practice integrated budgets. The procedure in provinces which do not follow this practice may be quite different. For example, in one rural province, the

actual amount transferred to any district is a matter of negotiation and may or may not be related to the revenues obtained from the taxation of property in the district. In the districts there is no clear or strong link between tax proceeds from property located in a district and the revenues available for district use. Thus, it is quite possible perhaps even probable, that a district could successfully mobilize efforts to improve tax collection without any change in the revenues it would receive. In effect, there is no clear incentive for districts other than the provincial capital to expand their efforts to improve property tax performance. What is missing is a clearly identified relation between the taxes imposed and collected on property in a district and the revenues the district receives. The additional revenues promised by an operative link between tax collections and revenues received by districts, would provide them with an incentive to improve tax collections. The obvious policy proposal is that there be established a full accounting of tax collections on the basis of the location of property; that districts be informed of the level of tax collection derived from property located within their boundaries and that the level of revenues received directly be related to the amounts derived from property in the district. In addition, districts should be informed of the identity of delinquent taxpayers and the amounts they are in arrears. This at least would provide the districts an incentive to increase collection efficiency and the information necessary to do so.

(cont.) districts retained the taxes paid to them. However, to the extent that owners of land in outlying districts paid their taxes in the provincial capital, these revenues remained in the provincial capital.

While development of a cadastral system is a long-term proposition, it is generally viewed as essential to effective local government and can be realized only if initiated. In this regard it may be most practical to operate in phases beginning with the provincial capital districts and larger urban areas. However, universal application of penalties for tax evasion need wait upon only the determination of the types of penalties to be imposed and schedule for their imposition. Among them are fines and penalties, but they would require additional administrative apparatus. An alternative which has the appearance of easy implementation would be to establish proof of tax payment as a requisite to any other dealings with governments. The possibilities are numerous, at the extreme is the confiscation of property. What would be appropriate in Peru remains to be determined, but this does not reduce the need or the desirability for prompt action.

Tax Structure

The current rate structure (Table 9) embodies a set of tax rates which increase from .06 percent to .75 percent of taxable values. By comparative standards these rates are of the same order of magnitude as those imposed in many developing countries. In fact, if anything, the Peruvian property tax rates may be a bit on the low side.[1] Thus, it appears that the tax is not particularly burdensome. It will be argued below that, as low as these tax rates are, there is reason to believe that actual tax burden falls far

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[1]Roy W. Bahl, "The Practice of Urban Property Taxation in Less Developed Countries," in The Taxation of Urban Property in Less Developed Countries, ed. by Roy Bahl (Madison, Wisconsin: University of Wisconsin Press, 1979), Table 1.5.

TABLE 9

RATE STRUCTURE OF THE NON-COMMERCIAL PROPERTY TAX, 1980

Taxable Value (Soles) From	To	Tax Rate
S/	S/ 2'575.000	0.06%
2,575.001	9'785.000	0.20
9,785.001	20'600.000	0.30
20,600.001	33'475.000	0.45
33,475.001	46'350.000	0.55
46.350.001	61'800.000	0.65
more than 61,800.001		0.75

SOURCE: Decreto Ley No. 22832.

below what they indicate. But it is the case that the rates of the tax do not appear to be particularly high at least relative to those of other developing areas.

When considering matters of equity, progressive rate structures, i.e., higher rates applied to higher value property, are generally thought to be best as they distribute the burden most heavily on the more wealthy. On these grounds the Peruvian property tax with its progressive rate structure, appears to fair well. By comparison, the property in developing areas is often levied at constant or declining rates.[1] Thus, in a comparative sense the tax structure in Peru may be even more equitable than might be expected.

Turning to the issue of responsiveness, progressive rate structures are considered to be particularly beneficial. This follows from the fact that increases in value translate directly into more than proportionate increases in tax revenues. One way to measure this responsiveness is in terms of the elasticity of the rate structure. In the case at hand, as the elasticity is 1.62, the tax appears to be highly responsive, i.e., a 1 percent increase in property values generates a 1.62 percentage increase in tax revenues.

This is a fairly high value and rightfully leads to the expectation that property tax revenues should be responsive to the increasing value of property in Peru. Regretfully, there is no readily available data which could be used to determine the validity of such expectations. Those who

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[1] Ibid.

are closest to the property taxes--local Mayors, accountants and provincial treasurers--would be quite skeptical of any statement implying that the property tax is structured to be highly responsive to economic growth.

As has been mentioned, they attribute this at least in part to administrative deficiencies. Many large and valuable landholdings are not on the tax rolls, the values of properties on the tax roll are often understated and delinquencies are not pursued. These are perhaps a natural consequence of a self evaluation system, but the general lack of incentives for local officials to effectively administer the tax, all but guarantees that tax evasion will be prevalent.

The remedies are obvious although not necessarily easily implemented. Accurate and operative cadastres, property registrars, and property evaluating mechanisms are the prime request. Even with these, evasion will continue unless sanctions are imposed on those who fail to pay the full amount of their tax liabilities. This implies the need for a system of tax penalties which are effectively administered. It may seem that district officials who are closest to the problem, may be in the best position to impose penalties on delinquents. But, particularly in small and rural districts, among neighbors and friends, effective administration would likely be compromised by personalism or the power of the wealthy.

Provincial government, a step removed from district taxpayers, is likely to be somewhat more insulated and provide more efficient tax administration. As provincial capitals generally operate in this capacity, the implication is that their position as property tax administrator be strengthened by the development of penalties for tax evasion. But even here, the degree to which public officials could be isolated from political pressures may not be sufficient. It may well be that professional operation of the property tax system, at least in the billing, collection and the administration of penalties to delinquents, may be most effectively placed at even a higher level such as the department. But this cannot now be confirmed. Rather the suggestion here must be that the operation of the tax, particularly in its administration, needs to be more fully considered and evaluated.

There is another weakness in the tax structure which likely exacerbates the problem of under evaluation associated with a self-reporting system. It, too, may produce a loss of revenues that can be expected to grow as property values increase, undermining the responsiveness of the tax to economic growth. This problem arises from the fact that an increase in property value leads to higher tax rates. Indeed, this is the nature of a progressive rate structure. But it is not the fact of progression which is problematic. Rather, in Peru, the degree of rate structure progression is such that it provides a stronger incentive to under-report taxable values which increase markedly the further up the tax scale a taxpayer finds himself. Simply, tax liability increases much more than proportionately to an increase in taxable value.

The extent of the incentive to under-report is difficult to gauge from the structure of the tax (Table 9) for it shows only the average rates. A more appropriate gauge of the negative incentive is the marginal tax rate, i.e., the amount of additional taxes which are levied as reported property values increase.

The marginal tax rates associated with the current property tax rate structure are given in Table 10. They indicate that, for example, an owner

TABLE 10

MARGINAL RATE STRUCUTRE OF NON-COMMERCIAL PROPERTY TAX, 1980

Taxable Value (Soles) From	Taxable Value (Soles) To	Marginal Tax Rate
S/	S/ 2,575,000	
		.237%
2,575.001	9,785,000	
		.369
9,785.001	20,600,000	
		.642
20,600.001	33,475,000	
		.760
33,475.001	46,350,000	
		.932
46,350.001	61,800,000	
		1.068
more than 61,800.001		

SOURCE: Calculated from Table 9. Marginal tax rates calculated at the mean taxable value in each value class.

who reports a value of say. S/6,180,000 for a property whose value is S/15,192,500 saves about S/3,321.750 in taxes. If he were to report the actual value of his property, his tax bill would more than triple. This is a rather substantial difference and undoubtedly constitutes a very strong incentive to under-report.

Equally important is the fact that the marginal tax rates increase. This follows directly from the progressive rate structure. That they increase so much and so rapidly means that the strong incentive to under-report taxable values is even greater the more valuable the property. In essence, there is built into the rate structure of the property tax an incentive to under-report property values which is substantial for all, but which get larger as the value of property increases.

The obvious negative aspects of this incentive are the under-reporting of values and the attendant revenues lost to local governments. Perhaps more important, the high marginal tax rates can be seen as an enticement to non-compliance with the law, something that should not be built into the law itself. The property tax rate structure should be altered to reduce what are rather strong financial incentives to illegal behavior. This could be accomplished in a variety of ways. One possibility would be that all properties be taxed at a single flat rate. This is a common procedure across the world. Equally common are two arguments against it. The first is based on an equity argument. Simply stated a single flat rate tax imposes the same relative burden on the poor as on the middle class and the wealthy. To many, fairness dictates that the poor should not be so burdened and thus, taxes should fall more heavily on those with higher incomes. This argument is well taken, particularly in a country like Peru where pockets of poverty are so widespread. This is not to say that equitable or fair treatment of the poor cannot be accommodated with a single flat rate tax, for they can be. In fact, all that needs to be done is that the poor and their low valued property be exempt from the property tax. This is not an uncommon measure and is one that should be given serious policy considerations.

The second argument which could be raised against the shift to a single flat property tax rate is that a progressive rate structure enhances the responsiveness of a tax to economic growth and thereby makes it easier to meet growing service needs. There are strong merits to this contention, and they, no doubt, were voiced when it was decided to adopt a progressive structure. However, acceptance of the argument does not mean that the existing rate structure and its disadvantages must be retained. [illegible] is possible to retain the desirable features of a progressive structure while moderating the strong negative incentives associated with it. This could be accomplished by increasing the number of property value classes and/or smoothing out the increase in marginal tax rates. Given that it is possible to restructure the tax while retaining revenue responsiveness, <u>the policy proposal here is that the property tax rate structure be altered by reducing the progressivity of tax structure, increasing the number of rate brackets and by providing for tax exemption for the lowest income property owners</u>.

<u>User Charges</u>

The fees, rates, tariffs or more generally, the prices charged for the user or consumption of goods and some services provided by governments are generally categorized as user charges. They have appealed for a variety of reasons, but the most important are related to efficiency and self-financing. The efficiency of user charges relates to the fact that they provide a means of gauging the desire for the good or service to be provided. In essence, when users are willing to pay a price for a good or service, they in effect are signaling their preferences and desires for these, rather than other use of scarce resources.

In the context of local government operating with limited financial resources, the self-financing aspect of user charges is particularly desirable. When revenues from taxes and other sources are difficult to come by, adding to the range of goods and services provided may be restricted totally or in part to those which can be provided for a fee, charge, or price.[1]

The revenue raising appeal of user charged financed services need not be limited to their potential for self-financing. In many areas, user charges are considered advantageous not only as a means of cost recovery, but as a means of expanding the general funds available to local governments. Particularly in areas where the tax burdens are high or where taxes are difficult to impose and/or collect, user charges appear as an alternative to more strenuous taxation. It is not uncommon for user charges to be set at levels which exceed the cost of providing a particular

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[1]For an evaluation of some means of imposing user charges in the context of developing countries, see Roy Bahl, David Greytak, Kenneth Hubbell, Larry Schroeder and Ben Diokno, "Strengthening the Fiscal Performance of Philippine Local Governments: Analysis and Recommendations," Research Report, Local Revenue Administration Project, The Maxwell School (Syracuse, NY: Syracuse University, 1981), Part II.

service and for the profits to be transferred to the general fund coffers of the sponsoring government. In effect, the transfer of profits constitutes a 100 percent tax on the profits of the activity in question. While user charges may be seen as an alternative to traditional taxes, they are in reality a specific tax paid by the users via charges or prices which exceed cost recovery requirements. Thus, user charges can be seen as a selection of a specific narrowly-defined base and extraction of revenues from the user group rather than raising revenues from those who pay the more traditional form of taxation.

While user charges may be an expedient means of increasing local government revenues, their use constitutes a judgment that those who pay the user charge, rather than other taxpayers, are to be burdened with a greater share of the cost of government. That is to say that there may be very serious equity issues to be considered in the use of user charges as general revenue raising mechanisms. This may be particularly important when general fund support is sought through user charges in the provision of goods and services to low income population.

Generally, where user fees are applied there is less than full cost recovery. In this case, the direct beneficiaries do not suffer the burden of operating deficits. Whether the subsidies necessary to cover deficits are provided by local or higher levels of government, they come ultimately from taxes or other receipts. Here too, there must be a concern with equity for if the subsidies are drawn from the revenues which are raised in a regressive manner, it is the poor who bear the burden.

The issues of subsidy, cost recovery and profitability are not solely matters of the equity of revenue raising. They extend to much more mundane issues which, if not held in clear focus, can result in user charges counter to stated objectives and perceived consequences. In the current context, two issues are of importance and will be considered. The first is the conception of self-financing and the related matter of subsidies. The second has to do with administrative matters--budgeting--and the particular difficulties smaller local governments encounter in self-financing operations.

Self-Financing

The obvious conception of a self-financing activity is one which raises revenues sufficient to cover the cost of providing the good or service. However, there are factors which may lead an official of one level of government to deem something as cost recoverable while, at another level, the conception may be quite different. The issue is one of the conception of cost.

Full cost recovery is dependent upon the ability of a project or activity to generate revenues at a level high enough to pay for all costs. From a general perspective, this means that over the lifetime of the project, the revenues are sufficient to cover the day-to-day cost of operations and maintenance, e.g., wages and salaries, costs of materials and supplies as well the cost of structures, land, etc., required to set up this operation, i.e., capital costs. Most would not argue with this conception of cost as having current operations and a capital components. Most would also not argue that if district governments in Peru, particularly in small and rural areas, are to provide only those services whose capital costs (e.g., the construction of the basic facilities), they can pay, they will have little to offer their constituents. The situation is similar in most developing countries. However, in many there exists a variety of capital grant subsidy programs designed to facilitate local governments' initiation of new facilities and services.

Most frequently, capital subsidy programs are provided through agencies or departments of the central government. Some are in the form of an outright grant but, increasingly, they involve loans at preferential terms. In the case of outright grants, cost recovery is often evaluated in terms of operating costs alone while in the case of loans, cost recovery is measured in terms of amortization costs plus operating costs. For the operating government, this is quite reasonable as most fiscal operations are considered in terms of costs incurred. From the national perspective, the case is quite different as the cost of a project is not simply the level of capital expenditures or even the amortized value of a loan at favorable terms. Rather project cost must be evaluated either in terms of alternative uses of the invested fund or the cost to the taxpayers from whom the funds are raised. The market rate of interest is the best measure of the value of investment funds as it reflects the returns to capital in the economy as a whole. Whenever capital is provided as a grant or at a favorable rate of interest, the liabilities incurred by borrower will be less than the true cost evaluated at market interest rates. It follows that what may be cost recoverable to the borrower may not be so when considered in the broader context of the national economy. Taking the next step, what may be considered profitable in the view of local government may be a loser from the national perspective. Thus, there is a need for caution in developing grant and subsidy programs to strengthen local government revenue raising capacity.

Certainly, there are times where the objective of profitability or cost recovery becomes subsidiary to other goals. In these cases, it is important to recognize the general principle that the subsidy should be provided by the government whose goals are being served. If the activity facilitates the achievement of a national objective, such as providing services to the poor, central government subsidies are appropriate. When the goals to be served are those selected by the local jurisdiction, they should be financially responsible for their accomplishment.

It is not uncommon for subsidy policies to be designed to entice local government to undertake activities and provide services which otherwise may be unattended. But even here, there is built into government operation a method of cost consideration that can produce an inflated view of cost recovery. It is common for local governments, particularly smaller ones, to consider investment costs as part of general government obligations, which it may well be, and to evaluate cost recovery on the basis of operating costs alone.

Clearly such a conception will overstate the prospects for cost recovery and profitability with the likely result that too much will be invested as local governments seek to expand apparently solvent activities. When this occurs and capital costs are paid out of general revenues, local taxpayers are providing a subsidy to those who benefit from the investment. There are grounds which may justify such a pattern of subsidies. But one thing is sure; an investment whose amortization requires taxation should not be justified on the basis of a profitability calculated only in terms of operating costs.

To be sure, there are activities where tax subsidies from either the central or local government can be justified. Regretfully, justification for subsidies have often been based on general grounds such as civic improvement and the like. There are places for modern markets, attractive plazas, paved sidewalks, indoor plumbing, etc. But, it may not be appropriate that every local government provide them particularly when searching for additional revenue sources.

Cost recoverability should not always deter local governments from meeting a need. Central (or departmental) subsidies may be appropriate and available. There are other arrangements which may be employed. In particular, specialized agencies and departments of central governments commonly undertake activities which could be the responsibility of local government. It could be argued that in the context of a decentralization policy the responsibility for service provision should be given to local governments. While perhaps consistent with political objectives, such a policy must confront the reality that some activities may never be able to recover operating costs when undertaken separately by individual local governments. Water supply and electricity are perhaps the best examples, but there are others which are not so obvious, e.g., public markets, roads.[1] In many cases the crucial factor is the size of the market relative to the cost of production. In fact, there is some evidence that cost recovery for some activities which are thought to be appropriate for

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[1] For a more extensive discussion of the factors affecting the prospects of cost recovery for local government projects, see Bahl, *et al.*, "Strengthening the Fiscal Performance of Philippine Local Governments: Analysis and Recommendations," Chapter 6.

virtually all local governments, e.g., public markets, may require a volume of activities which can be supported by the local jurisdictions only if the population is as large as 30-48 thousands.[1]

These considerations imply that policies designed to stimulate self-financing activities and encourage user charges must be evaluated with care, particularly in the calculation of costs. In part, this caution is dictated by the need at the national level to employ scarce investment funds most productively. Equally important, at the local level, is a need to insure that self-financing is not just a fiction authored by accounting conventions. That general accounting procedure can give a misleading indication of cost recovery has been documented.[2] If miscalculations lead to unprofitable investments, the fiscal plight of local governments may be worsened. Thus, the need for a carefully considered policy and thorough feasibility studies is part and parcel of any program to aid and/or stimulate local governments' investment in user charge financed activities.

<u>Administrative Considerations</u>

Beyond the complexities of technology and market size, there are administrative and management factors which may make difficult the determination of costs, let alone the realization of cost recovery. The difficulty is that operations catering to small areas do not often impose worker requirements sufficient to justify a full staff compliment particularly in the area of management and bookkeeping. Thus, they often

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[1] Ibid., Chapter 7.

[2] Ibid.

function as part of general government operations with the clerical, management and supervisory duties undertaken by general government employees. This may well be appropriate but it is difficult to calculate the cost of the portion of time government administration and clerical staff spend on activities. If this isn't done, it is probable that full cost will not be calculated and user charges set too low. Under these conditions, raising revenues in excess of assigned costs may give the illusion, but not the reality, of cost recovery.

It is also the case that when government employees are involved in the operation of user charged financial activities they cannot participate in other governmental functions. It is conceivable that even the modest work requirements of a small undertaking could necessitate the addition of government clerical and administrative workers to the general budget. That is, there is an implicit subsidy to the user charge activity. There are two important facts that follow. The first is that what may appear to be cost recoverable may in fact, increase general government costs and the needs for increased taxation. Second, given scarce resources, it may be that local government personnel could be more productively employed in alternative pursuits. For example, they could be involved in activities to enhance property tax administration and/or collection.

The implication of the above is that the measurement of full costs, let alone the realization of full costs, is likely to be quite difficult for smaller governments. In part, this is a cost accounting and budgeting problem. As we shall see in what follows, the current circumstance of most districts, including the smaller provincial capitals, are such that they probably are not well suited for the undertaking of many, if any, cost recoverable activities. This is not to say that they should refrain from such undertakings. In fact, user charges are widely applied and contribute to about 18 percent of local government expenditures. What is not known and what could be known only with additional study is whether the services so financed have been cost recoverable.

Previous studies have indicated that most of the user cost financed services of local governments hold forth the potential for cost recovery only when operated in large urban areas. The prospects of some capital intensive services, such as large scale irrigation and electricity, are much better when provided on an area-wide basis. Whether they are run as cooperative ventures of a number of small districts, as an element of higher level of government, e.g., province or department, or out of a central government agencies, is at this point not an issue. Agglomeration of districts into service areas which are bigger and more likely to support such services in a cost recoverable way may be accommodated by any of the above arrangements as well as others. What is needed is a strategy guiding investments which recognizes the interdependence among local governments and includes and, where appropriate, fosters cooperative undertakings by several governmental units.

Beyond market size considerations, there is the management and accounting argument given above. The staff and skill necessary to manage a public operation are likely to be more available and better used and accounted for in the larger units. Finally, to the extent the goal of higher levels of government are to be served by user cost financing, deficits should be their responsibility. Their access to a wider range of revenue sources and broader tax bases also means that they can more easily cover deficits when they arise.

These considerations coupled with the low income levels of most districts imply that the district level is most likely not the appropriate level of government for housing many user cost financed activities. What exactly would be the appropriate level can't be said at this point. But it would be a mistake to rule out the participation of the relevant central government departments and agencies.

IV. BUDGETING AND MANAGEMENT

A recurrent theme which cuts through much of the discussion about the integration of local governments in a decentralized development strategy is that of organization and management. Here the concern is not whether local governments have access to revenue sources which can be exploited to enlarge their role as resource mobilizers. Rather the concern is that those local governments with the necessary financial basis and those that could develop it may not have the capacity to effectively manage such efforts and/or that such efforts may be less effective because they are governed by a system which is conducive neither to consistent effort nor long-term planning. That is to say that the impediment to more effective district participation in decentralized development may be that of management capacity and organizational structure. The purpose here is to consider some of these issues and to suggest some ways in which they could be improved.

Conformity and Consistency

The basic management tool of local governments is their annual revenue and expenditure accounts. Each District has the responsibility of drawing up these budgets, submitting them for central government approval and then operating in the confines set by them. The certification of the basic accounting forms by the Minister of Finance requires their use by all local governments. Our field research has indicated that local governments are aware of these basic obligations. However, their effective exercise of these obligations can be easily questioned. In particular the degree and detail of budgeting and accounting practices appears to depend on the size of the district. Large districts and provincial capitals seem to use the prescribed forms. Some of the smaller, outlying districts do not follow established guidelines. In the case of some small outlying districts, budgetary information is oftentimes presented in the form of a brief letter to the provincial government. Moreover, at the time of our visits, only one district had developed a completed budget for the current year. Others were at various stages of the process, and one had not yet started. As annual budgets were to be submitted in December, three months prior, one would have to question the efficiency of local government budgeting. One is always hesitant to generalize from limited experience, but the implication of a lax attitude about conformity to budgetary deadlines need not be based on field experience alone. The Ministry of Economy and Finance reports that, historically, a substantial number of local governments have failed to comply with their legal obligation to submit budgets for review and approval.

In addition, they report that the number of districts and provinces which have met the obligation has declined. Whether this is reflective of a local government's inability to manage and account for their operations is but a supposition. It is however, an indication that local government management procedure leaves much to be desired.

For the point of view of local governments as well as that of any one else compliance with deadline for budget submission may be an arduous and valueless exercise. Indeed, the prevailing sentiment among at least the smaller governments in Peru is that compliance itself is the only value to conformance with MOF budgeting procedures and reporting. Their sentiments may be correct. As there are neither rewards for compliance nor penalties for failure, there is little incentive for local governments to adhere to the prompt and accurate cannon of budgetary practices.

These considerations give rise to the suggestion that the fiscal circumstance of local governments may suffer from a lack of managerial professionalism and that in the case of budgeting, there is little incentive for improvement. Whether local governments would be responsive to incentives designed to elicit compliance with budgetary regulation can only be surmised. However, given the stringency of their fiscal circumstance, it is likely that with a few changes in existing procedures, the behavior of local governments could be significantly altered. In particular, to meet their expenditure requirements virtually all local governments are heavily dependent on the transfer of resources (grants) from the central government. <u>The policy proposal here is that the transfer of funds in support of the current operations budget of a local government be contingent upon the compliance of the local government with regulations concerning the review and approval of their annual budgets.</u>

It is one thing to design incentives to elicit the desired outcome. Whether they are effective depends both upon their enforcement and the ability of the local governments to carry out the task. It would seem that the enforcement component of the above policy proposal could be implemented with little more than a coordination between the offices in charge of budget review and those empowered to transfer funds to local governments. The issue of local government administrative capacity will be considered in a later section.

Meeting budgeting deadlines is not the only shortcoming of local government in Peru. There are problems in classification and recording which appear to be particularly severe in the case of the property tax and intergovernmental transfers. In general, the property tax is designed to be administered and collected by the provincial capital. However, in some provinces some or all of the districts operate as collection agents for the provincial government. Some of the districts retain these collections rather than transfer them to the provincial capital. In such cases the collections may be listed as district property tax revenues. Those districts which transfer property tax collection to the provincial capital may or may not list them as a local revenue source. Those that do will also list them as a transfer (intergovernmental) in their expenditure account. In addition, some districts which do not record property tax collection as a revenue item may list the transfer of property taxes collected as a transfer in their expenditure account. Since district collections of the property tax are not consistently recorded, there is but a slim possibility of extracting accurate or consistent measures of revenue dependence or tax burdens.

The case is similar at the provincial level. The property taxes collected by the provincial capital district will generally be recorded as property tax revenues in their accounts. In some cases, so too will be the taxes collected by a district which does not transfer its collections to the provincial capital. In some provinces, tax collected by the districts and transferred to the provincial capital will be listed as property tax collections on the revenue ledger. More commonly, transfer property tax collections will be classed simply as transfer income in the revenue account. In such cases the entry property tax revenues in the provincial capital ledgers will be understated. Moreover, as it is common for provincial districts to list but one entry for transfers in their revenue accounts, interlocal transfers (district collection of property taxes) are combined with other (especially central government transfers) transfer receipts. As the property tax is a provincial tax and a transfer, these practices will certainly overstate the dependence of local governments on central government transfer payments.[1]

Judging from statements of local officials, the inconsistency in budgetary classification of these important items is in part due to the lack of experience with accounting and budget forms. It is also due to the failure to communicate the detail of accounting procedures. But equally, district governments have little incentive, and in many cases, no capacity to overcome these deficiencies. To them, accounting is a required exercise, the rewards to which are limited primarily to its accomplishment.

Incentives could be designed to enhance attention to scheduled deadlines. However, there is no assurance that more accurate accounting would take place. What is needed is a mechanism to induce local governments to address government accounting with technical expertise and a sense of the importance due the matter. The central government initiation and support of the integrated provincial budget is a first step.[2] However,

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[1]As a sidelight, this lack of consistency in reporting must call into question any attempt to use local government budgets for either the development of national aggregates like the national accounts or for broad based comparative analysis like that of Van Walleghen _et al_.

[2]Article 55, Ley del Presupuesto de la República, para 1981 (Ley No. 23233), Lima, Perú, 1981.

while all provinces could use the integrated budget approach, not all do so. The general conception is that integrated budgets are used primarily by the provinces where Department capitals are located and by some of the more economically advanced provinces.

Even among those that practice integrated budgeting, the classification problems mentioned above would likely prevail. One must conclude either that district and provincial governments lack the capacity to learn and adhere to established accounting conventions or they have no incentive to use them. As was indicated above, tying intergovernmental aid to the compliance with accounting requirements could provide the incentive. Unless there is some monitoring of accounting practices, consistency and accuracy of local government accounting will probably not be enhanced. Even in the most advanced societies, accurate and consistent accounting is attributed to the careful scrutiny associated with regular and detailed audits. That local governments are not confronted with the prospect of a thorough audit of their accounting explains part of their poor performance. Lack of routine audit procedures is an outgrowth of the neglect of local governments characteristic of Peru's historical development. It could be easily overcome by establishing an auditing procedure tied to the reporting requirement identified above. The policy implication is that an audit process be tied into a budget reporting requirement as a pre-requisite for the allocation of central government aid. Whether this audit function should be placed at the provincial, departmental or central government level is a policy matter that is of some significance.

While a move toward decentralization would seem to imply that accounting oversight activities like budgeting should be decentralized, there are contrary arguments. In particular, if the central government is to support the decentralization effort by providing even limited resources, it needs guidance, if it wishes to take a compensatory role and/or provide incentive for local resource mobilization. On either count, there will be a need for consistent and accurate information. If aid is to be channeled to the poor there must be a means of accessing local revenue availability in a way that accurately compares the resources of one district with those of another. If incentives for improved performance are to be a part of central government program, there is a need to measure and compare local revenue raising efforts. In either case, the fact that central government funds are limited and must be allocated among the departments, provinces, and districts dictates that considerations such as these be based on information that is consistent and comparable among areas. In this regard, a value of decentralization, i.e., the ability to do things independently and differently, may be a detriment to the efficient realization of the general goal. <u>Thus, it would seem that the review and audit of local government budgets, to insure conformity among them, should be a function of the central government</u>.

<u>Local Government Capacity</u>

Judging from the experience of the field visits, the issue of local government capacity cannot be simply resolved owing to large expertise differences even among provincial capital districts. In the larger, more populated districts, the local government will include either an accounting or treasurer's office or both, directed by personnel with the requisite qualifications, although the background and training of some staff members may be less desirable. In smaller districts, including capital districts of smaller provinces, the treasury and accounting function are likely to be combined under the direction of a single individual working with a small staff or single aid depending on the size of the district. In the smaller outlying areas, including some small provincial capitals, the functions of bookkeeper, accountant, and treasurer may be the responsibility of a single person who usually operates under the title of Treasurer. While the expertise and background of these people differ, they share the characteristic of a wide variety of responsibilities including tax collection, bookkeeping, budgeting, district recorder and registrar.

In outlying small rural districts, the situation may be even more extreme, as, virtually all clerical operations may be the obligation of the Mayor.

It is our understanding that in these situations, budgetary operations are undertaken in collaboration with budget committees composed of local citizenry. While such committees may provide continuity to ongoing budgetary operations, it is unlikely that they would have the formal training and background desirable.

From this perspective, it would seem that the larger districts, and particularly those which are provincial capitals, have established a workable degree of management capacity which, with sufficient incentive could be responsive to management improvement initiatives. Alternatively, a program of incentives for improved management operations would likely have little effect on smaller, outlying governments with limited, in some cases no, professional staff. The circumstance of the small districts dictate the attachment of an ancillary condition to the above given policy initiative. The policy proposal here is that of the establishment of an ongoing program of technical assistance which would, on a recurrent basis, provide the districts with access to the technical expertise of personnel trained in bookkeeping and accounting.

This access could be provided by various means, including personnel training, use of central or provincial government personnel and the provision of on site technical assistance. While each may have their merits and limitations, it will be argued below that there may be particular advantages associated with the existing expertise in departmental and provincial capitals.

As has been indicated, the basic responsibility for budget preparation lies with the district. However, at least some capital districts play a role in the budget preparation of smaller districts. This is a result of legislation enabling the formulation of integrated budgets by the provinces. Given that a mechanism for the provision of technical assistance--integrated budgets--is operative in at least some areas, it would seem that reasonable policy would reinforce and extend its practice. The basic policy proposal is that the budgetary assistance, review and approval mechanisms inherent in the practice of budget integration be enhanced, expanded and applied to all local governments.

Implementation in this case would seem to depend upon three basic conditions. The first is the establishment of these procedures as a norm of local government operation. This could be accomplished by a revision in budgetary law which converts an enabling provision (Article 55) to a statutory requirement. The second condition is the provision of technical personnel that would undertake the greater workloads and responsibility of budgetary assistance and review. In some departments, this probably could be achieved by the addition of one or two trained accountants working out of the department capital. In the larger departments, perhaps two such specialists would be required. It may be that in some of the larger and more economically active areas, this assistance should be provided by the provincial capital districts. Exactly how and where this assistance should be provided is a matter which would require considerations beyond the scope of this study.

Aside from the expenses associated with the initiation of such a program, the recurrent costs would primarily be the personnel, some small material supplies and travel. Even if an extensive program of assistance in each provincial capital were developed, the cost would seem manageable.[1] While it could be argued that the resources necessary for this undertaking should be provided by the local government, there are a variety of reasons why that may not be appropriate. Perhaps most important is that many, perhaps, most, local governments simply could not shoulder the added financial burden. The alternative, is that the necessary funds be provided by the central government. As the strengthening of local government is a national objective, central government funding is consistent with national policy.

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[1]One could estimate the annual personnel cost at approximately 262,656,000. This estimate is calculated assuming that the program would require 120 full-time personnel receiving a base salary of S120,000 per month (1980) adjusted by other remuneration including family subsidy. The salary figure is slightly higher than that of some chief of departments in Cajamarca provincial governments. Annual salary cost adjusted by S1.520 reflect the other remuneration. All data and calculation based on Cajamarca budget 1980.

Another reason for the central government assuming responsibility for such a program is to insure its consistent and effective operation in all areas. If such a program were left to each of the provinces or even the departments, it would be difficult to insure that all areas would be equally served or that the budgeting practices would be similar in all areas. By housing responsibility for the program in a single unit, it could be more easily assured that all local governments would be served by a standard set of practices applied by equally competent personnel.

Finally, it is crucial to the success of the program that it be established in a framework which would elicit compliance and cooperation. On both accounts, current practices leave much to be desired. For example, in 1979 only 459 of the 1,679 local governments complied with the directives (25-79-EF/76-07 and 26-79-EF/76-07) that they submit copies of their budgets to the Ministerio de Economia y Finanzas. Beyond this, there are cases of local governments which repeatedly fail to comply with the integrated budget procedure practiced in their province. Means to elicit compliance apparently are unavailable to either the MEF or provincial officials. In both cases, officials were of the opinion that their means were limited to frequent re-issue of unanswered requests. Certainly if the technical assistance were to be provided at no cost to the districts, the possibility for improved performance would be enhanced. However, this alone may not be sufficient for it does not alter the incentives which so far have not been strong enough to entice anything like universal compliance. Clearly some incentive mechanism is necessary. There exist a variety of possibilities. However, from the point of view of efficiency and ease of operations, the best would seem to be one built into the structure of the operation, i.e., budgetary procedures, and one which is automatically triggered when the desired outcome is achieved. In this regard, a stipulation that intergovernmental transfers or some part thereof, not be made available to a district government until their budgets had been filed and approved, would have both the above characteristics and the force of a strong incentive. Thus, the policy suggestion is that a system providing budgetary and accounting technical assistance to district governments be established at the department and/or provincial level and that the transfer of central government aid funds to local governments be contingent upon their compliance with regulation governing budget preparation as verified by an accounting audit performed by fiscal officers in and of the central government ministries.

Budgetary Procedures

There are two factors related to budgeting which likely will reduce the possibilities that local districts will enhance or expand their efforts to mobilize local resources. The first is regulatory and precluded local district participation in long-term planning and capital investments. The second is procedural and may account for the apparent lack of initiative to mobilize resources in at least some provinces and districts.

Balance Carryovers

One line item in the revenue side of the current accounts budgets is identified as balance carryover. This is not an unusual entry in revenue accounts. However, it appears that many of the smaller and outlying districts have interpreted it in a particular fashion. To the extent that they have projected unspent funds at the beginning of a budget year, they are entered as a part of revenues they anticipate spending in the coming year. There is nothing inherently inaccurate with this and it is a budgetary law that balances resulting from central government transfers be treated in this manner.[1] The fact that local governments do not feel they can accumulate unspent balances over time simply means that they won't build up reserve funds. Since most capital spending occurs infrequently and requires large sums, district governments without savings will not likely be much concerned with investments. In addition, the field visits indicate that the relation of the districts to the banking community is not conducive to accruing investment funds. As frequently stated, districts receive no interest on the bank deposits they may have. Their lack of concern with saving is no surprise. Indeed, the smart money manager would rather spend his money before its value is eroded by price increases. That the actions of local officials should not conform to those of an aggressive forward-looking planner concerned with augmenting the nation's capital stock, should not be considered in any way perverse. It is likely that their actions are consistent with incentives that not only constrain their ability to build up accounts for investments but also to spend before the value of their funds is eaten up by inflation. Given the circumstances, they may be operating rationally. Whether local officials could be enticed to accommodate those who hope for greater investment in building the nation's infrastructure, cannot be said at this point. What should be noted is that local officials operate in an environment which is not conducive to a long-term perspective.

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[1] Ley del Presupuesto de la Republica, Ley No. 23233 Articulo 61.

Appropriate recommendations must be that the conventions, institutions, regulations and the like which actually govern the behavior of local government officials should be carefully evaluated.

In this regard, it is likely that the relations of local government officials with the banking community will be judged deficient. The recommendation is for a municipal development bank much like those which have been established in many other developing countries. Although it is probably true that municipal banks can be an effective tool for mobilizing district initiatives and resources, there are important questions about the capitalization, operation (e.g., nature of technical) and banking functions (e.g., subsidized loan terms and deposit interest rates) which dictate that the potential of such a bank be based on a careful evaluation of the operating environment of local government. As such an evaluation has yet to be undertaken, immediate efforts to establish such a bank would be premature. The appropriate recommendation is that establishment of a municipal development bank be considered only after the variety of alternatives for capitalization for types of technical assistance, and local government participation be considered in relation to the institutional environment in which Peruvian local government operates. Such consideration must be built upon a detailed evaluation of the fiscal capacity of local governments, their potential to take advantage of technical assistance, the structure of intergovernmental relations; and these must be considered in light of the relation between them and the variety of possible activities of a development bank, loan terms, feasibility studies, project selection criteria, contracting procedures, etc.

Provincial Subsidies

As only a small number of provinces have been visited, and then only briefly, it is difficult to say much about the provincial budgetary processes. However, there was variety among them: one, a departmental capital, one growing, one isolated and rural; two practicing integrated budgets and one not. Moreover, the budgetary officers in the districts as well as government officials in Lima believed that the budgetary procedures in the three areas are representative of most, if not all, provinces. If this is the case, there is an element of budgetary operations which, with the exception of capital districts and some isolated rural districts, stems any inclination that districts may have to raise taxes or user fees. Moreover, this same process may affect the distribution of central government aids.

According to Article 52 of the national budgetary law, district budgets must be approved by the provincial capital. In isolated provinces not practicing integrated budgeting, this oversight function may be minimally operative. Alternatively, in the larger provinces which have implemented integrated budgets, capital districts' review of budgets appears to be regular and systematic. The degree of conformity appears to be related to the size of the districts. Larger districts generally adhere to the use of standard budget forms, while smaller districts are much less compliant with standard procedures, to the extent that letters of petition commonly are submitted in place of budgets. In provinces not employing the integrated budget, districts may exercise a degree of autonomy such that the provincial capital becomes informed of budgetary situations only if the districts submit a request for financial aid.

At least in the areas visited, local governments view the provincial capital as the principal source of outside financial support, particularly in regards to financing of their current operations.[1] On the basis of field visits, it appears that this perception is both accurate and shared by the provincial capital governments. That this is the case would seem consistent with their actual position in the municipal fiscal structure. Provincial capitals have the responsibility of approving district budgets. They may act as the treasury for local governments and through the property tax they have command over a province-wide tax base. These circumstances have importance, for they may, and in some areas do, retard local district initiative to raise revenues and mobilize resources. This follows from the fact that if and when districts anticipate a budget deficit, they turn first to the provincial capital. Having control of the property tax and being the primary recipient of aid from the central governments, the provincial governments view support of the districts as one of their functions. In fact, the majority of the current operating expenditures of some small districts are funded out of subventions from the provincial capitals. The dependence on provincial subsidies of other districts, particularly the larger ones, is not as great, but in many cases it is still substantial. The import of this dependence is that it does not breed initiative in district taxation. To be sure if a district increases the revenues it raises, it could use them to reduce anticipated deficits. But

[1] It should be noted that districts also recognized the role of central government and its agencies and the Departments as sources of financial support. However, they perceived their roles primarily in relation to major construction activities.

raising tax rates and tasas or the increasing of collection efficiency may be of questionable advantage to the district. These activities may just reduce the amount of subsidy it receives from the provincial capital. Moreover, such efforts are costly and, the greater the cost, the greater the tax burden imposed on its residents. The number of district mayors that are willing to increase their tax effort, with little assurance of being able to provide more or better services, must surely be small. But such disincentives are not inherent in the nature of intergovernmental aid to local governments. Indeed, the experience of other countries has shown that intergovernmental aid programs can be structures to increase revenue mobilizing efforts and expand service levels at all levels of local government.[1] That the system of intergovernmental aid in Peru may not do so, could constitute a serious impediment to the country's efforts toward decentralization, to enhance local government operation, and to stimulate the process of economic development.

Regretfully, knowledge about the structure and impact of the existing programs of intergovernmental aids does not provide a sufficient base for the development of specific recommendation. But this can be taken as indicative of a need for serious concern about the newly initiated efforts for decentralized development. Clearly, the possibilities of their success depend on the nature of the environment in which they are to operate. Whether the new efforts will effectively mesh with the operational

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[1]Roy Bahl, "Human Settlement Finance and Management in Less Developed Countries," unpublished manuscript prepared for the United Nations Centre for Human Settlements (HABITAT), December 1979.

circumstance of local government cannot be said. Simply stated there is an urgent need for a serious review of existing intergovernmental aid programs which considers carefully the positive and negative incentives they provide for the mobilization of local revenue.

APPENDIX A

End of Trip Report
Lima-Cajamarca, Peru
March 9-20, 1981

David Greytak
Local Revenue
Administration Project
Syracuse University

The purpose of this trip was to undertake an initial assessment of (a) the availability of local government budgetary data, (in particular-revenue and expenditure data), (b) the budgetary practices and capabilities of district and provincial governments and, (c) the fiscal circumstances of local governments. Originally it was anticipated that this two-week trip would involve on-site visits to district governments and provincial capital district governments in the departments of Cajamarca and Junin, to various central government agencies and offices in Lima. The trip to Junin had to be cancelled because the rains precluded travel to Huancayo.

Travel to and within the Department of Cajamarca was slow and difficult. The roads within the Department, while serviceable, were badly damaged in many places by the rains. As a result, what under normal circumstances are long and uncomfortable trips, became protracted and arduous journeys through rain washed gullies and over pot-holed trails. At one point in mid-trip we experienced a three-hour delay as we waited for the waters to subside at a washed out bridge.

A second factor which hampered the work effort was the summer work schedule. The closing of government offices at 2 p.m. o'clock in conjunction with the extended travel times greatly restricted the opportunities to undertake interviews in Lima and to visit outlying districts and provinces.

Interviews were undertaken and some assorted data were collected from three provincial capital districts (Celendín, Cajabamba and Cajamarca) and three outlying districts (José Galves and Sucre in Celendín, and San Marcos in Cajamarca). Mayors, secretaries, treasurers and/or accountants were asked about budgetary practices and revenue and expenditures performance. They were queried about their districts/provinces and what they knew of other districts/provinces. In every instance we were impressed by the good will and cooperation of all the officials interviewed. The major impressions derived from the interviews are presented in what follows. It must be emphasized that they are based on a selected set of local governments. They should be verified, amplified and/or amended by additional study. However, it should also be noted that the impressions from the work in the province are consistent with information provided by central government officials in Lima.

Marked differences in the level of budgetary technical expertise exist in the areas visited. The background and training of personnel and the overall quality of practices are generally better in the larger Districts. In smaller outlying districts it is often the case that budgets are the responsibility of the mayor or his secretary if he has one. There is an acute awareness of the lack of budget and accounting expertise in these small areas. Larger Districts are often served by an accountant and/or a treasurer although in many instances they may have little formal training for the position. In the largest area visited, the size of the staff is ample and the staff members capable.

Integrated budget practices are in effect in two of the three provinces. Thus, the provincial treasurer's office prepares a single budget for all districts in the province and complies with the accounting and reporting requirements of central government agencies. Where integrated, budgets are not prepared by the provincial capital district. Each district in the province is responsible for developing and filing budget reports with the relevant central government agencies. What seems clear is that there are a variety of practices in effect and the reporting and monitoring of budget practices is uneven and, perhaps in many areas, weak. The Ministry of Economics, Finance and Commerce has verified this. They calculate that depending on the year, only 50 to 70 percent of the districts comply with the requirement of filing budgets with the ministry.

While it appears that the provincial capital districts keep a file of their own or the province's integrated budget, such is not always the case with the smaller Districts. This, in combination with the fact that not all budgets are regularly filed in Lima, implies it is unlikely that a comprehensive set of budgetary information going back beyond a year or two could be obtained. Comprehensive budget data is likely to be obtained by on-site budget collection in combination with the estimation procedure used in the calculation of national accounts data.

All local governments seem to feel that they lack the resources to do much more than their current level of services. With the exception of the district in the province which doesn't practice integrated budgeting, all felt that they had little, if any, autonomy in matters related to raising revenues or service levels.

There is consistent agreement in regards to the property tax. There is the feeling everywhere that there is both underevaluation and low collection. Similarly, it is believed that there is little incentive and little to be done on the part of individual districts to improve the property tax. The causes underlying the poor property tax performance are the reliance on self-assessment of property values and the lack of sanctions which can be imposed on those who do not comply with appropriate property evaluations and/or those who do not pay their tax bills.

These impressions, tentative as they must be, imply that the fiscal circumstances of the districts and provinces could be improved. It seems that the development of accounting expertise, some alterations in the structure of the property tax (provision and application of effective assessment, reporting, and payment mechanisms, and effective sanctions) and more consistent accounting and reporting practices would greatly enhance the operation and evaluation of the local government fiscal structure in Peru.

Finally, the limited data that has been collected will form the basis for a preliminary analysis of the fiscal circumstances of local governments. This report when complete will be submitted to Professor David Robinson, the representative of Syracuse University, Local Revenue Administration Project in Cajamarca.

Appointments and Interviews
Peru
March 9 - March 20, 1981

David Greytak
Local Revenue Administration
Project
Syracuse University

3/9 Lima

Robert Kent, Resident Municipal Advisor, Junín
David Robinson, Resident Planning Advisor, Cajamarca,
Syracuse University, LRAP

3/10 Paul Vitale
David Flood
USAID

Julio Gianella, Resident Planning Advisor, Junín
Nelly Acevedo, Planning Assistant, PRODERIN,
Syracuse University, LRAP

3/11 Fernando Realegín
Gladys León
Instituto Nacional de Planificación

César Lara Garay, Director, Dirección General de
Presupuesto Publico, Ministerio de Economía,
Finanzas y Comercio

3/12 Celendín:

Renan Clodonise Sanchez Izquiedo, Alcalde
Luis Mori Muñoz, Tesorero
Distrito de Celendín, Capital de la Provincia

José Galves:
Temistodes Ladena Diza, Alcalde
Distrito de José Galvez, Celendín

Sucre:
Eugenio Alvarez, Alcalde
Distrito de Sucre, Cajamarca

3/16 Cajamarca:

Letelier Mas Villanueva, Director Ejecutivo,
Proyecto de Desarrollo Regional Integrado

Manuel Noriega Valera, Alcalde
Carlos Rival Davila, Director of Planning and Development
Luis Mendoza Ilaesa, Jefe de Caja,
Distrito de Cajamarca, Capital de la Provincia

3/17 San Marcos:
Alberto Mendoza Garcia, Secretary-Treasurer,
Distrito de San Marcos, Cajamarca

Cajabamba:
Jose Fidencio Gamboa Huanman, Contador, Distrito
de Cajabamba, Capital de la Provincia

3/18 Cajamarca:
Sr. Palacios, Engineer
Proyecto de Desarrollo Regional Integrado
Luis Mendoza Llacsa, Jefe de Caja
Distrito de Cajamarca, Capital de la Provincia

3/20 Lima:
Cesar Lara Garay, Director
Dirección General de Presupuesto Publico, Ministerio
de Economía, Finanzas y Comercio

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**13. Ray Bromley, "Surveys of the Areas of Influence of Markets: Justifications and Methodology."

**14. Robert B. Kent and Aldo Sandoval Ricci, "The Geography of Municipal Finances in the Department of Junin."

**15. Ray Bromley, "Origin - Destination Traffic Surveys: Justifications and Methodology."

*16. Robert B. Kent and Norma Condezo, "Municipal Taxation: Notes on a Tax Collection Campaign in Huancayo, Junin."

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