

i

PNAHQ 636

ZILLA ROADS/LOCAL FINANCE PROJECT

A PLAN FOR INCREASED RESOURCE MOBILIZATION
BY LOCAL GOVERNMENTS IN BANGLADESH

VOLUME I: EXECUTIVE SUMMARY

11

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TABLE OF CONTENTS

	<u>Page No.</u>
<u>Volume I: Executive Summary</u>	
Preface	vii
Acknowledgements	x
Rationale and Assumptions	1
Recommendations	4
Land Based Taxes	4
Business Taxes and User Charges	5
Intergovernmental Grants	6
Evaluation and Monitoring	7
Implementation	7
Benefits and Costs of the Reform Package	9
Conclusions	12
Appendix: List of Recommendations	13
<u>Volume II: Final Report</u>	
Scope and Method of Analysis	4
Local Government Structure, Personnel and Financial Administration	12
Land-Based Levies	28
Activity-Based Revenues	57
Intergovernmental Grants	70
Implementation	85
Conclusions: Benefits, Costs and Resources Available	88

TABLE OF CONTENTS (CONT.)

Volume III: Interim Reports Issued Through the
Local Government Finance Project

<u>Interim Report</u>	<u>Author(s), Title, Date¹</u>
1	Larry Schroeder and Maniruzzaman, "Local Government Structure in Bangladesh," November 1982
2	Larry Schroeder, "Toll Roads as a Zilla Parishad Revenue Source: A Case Study," November 1982
3	James Alm, "The Immovable Property Transfer Tax in Bangladesh," April 1983
4	Barbara D. Miller and James A. Wozny, "The Land Development Tax in Bangladesh: Insights From the 1978 Land Occupancy Survey," April 1983
5	Larry Schroeder (with Hasan Murshed and Muin Uddin), "Collecting Local Government Financial Data in Developing Countries: The Bangladesh Experience," June 1983
6	Barbara D. Miller and Showkat Hayat Khan, "Local Voluntarism and Local Government Finance in Rural Bangladesh: Overview and Recommendations," June 1983
7	James Alm and Larry Schroeder, "The Land Development Tax in Bangladesh," June 1983
8	Larry Schroeder, "A Review of Bangladesh Zilla and Union Parishad Finances," June 1983
9	Larry Schroeder, "Upazila Parishads: Their Structure and Revenues," June 1983
10	Roy Bahl, "Intergovernmental Grants in Bangladesh," November 1983
11	Barbara D. Miller, "Possibilities of Benefit Charges for Public Works in Bangladesh," January 1984
12	Showkat Hayat Khan, "Aspects of Public Finance in a Union Parishad: A Sociopolitical Case Study," January, 1984.

¹Each of these papers was revised, some extensively, and was reissued in May 1984.

PREFACE

This Report contains an analysis of local governments in Bangladesh and a set of policy recommendations designed to promote resource mobilization within these jurisdictions. It is based on our study of local public finance in the country conducted since early 1982. Those familiar with the Bangladesh situation will recognize that the past two years saw dramatic changes in domestic policy--many of which have been directed specifically at the rural local government sector. These policy changes, some of which are not yet finalized, constitute both a strength and weakness of this work. On the one hand, the creation of a new level of local government--the upazila parishad--has in some sense made our job easier and means that a strengthening of the financial health of local governments is more feasible now than in the past. On the other hand, the effects of these major institutional changes could not be analyzed in detail, since empirical data are not yet available.

The Local Government Finance Project is a research component of the United States Agency for International Development's Zilla Roads Maintenance and Improvement Project (Project Number 388-0056) which is providing technical assistance to zilla parishads in Faridpur, Rangpur and Sylhet districts. The local finance project has a broader scope: an overall consideration of rural local government finance in Bangladesh. We do not restrict ourselves to zilla parishad finances nor have we focused only on the three districts in our analysis. This broad perspective is fortunate because the upazilas (formerly thanas) have

become the focal point of the BDG's move to decentralize administration. Moreover, the nature of local government finance reform is such that all levels must be considered. The questions of assigning various local tax sources and distributing national grants are as much an intergovernmental matter as a matter for individual local governments. In accord with our terms of reference, we departed from this approach only in the case of urban local governments by minimizing attention paid to the paurashavas and municipal corporations.

The Report is being issued in three volumes. This first volume contains a general summary of our overall effort focusing on the thrust of the recommendations we have made, their rationale and their costs and benefits. Volume II is a lengthier elaboration on these same points and contains the underlying arguments for the recommendations made as well as a discussion of their implementation. Volumes I and II, therefore, together contain the full package of policy reforms drawn from our work. Volume III contains the underlying theoretical and empirical analyses which have been issued in the form of Interim Reports throughout the course of the project. All of the Interim Reports were revised, at least slightly, in response to comments made on the earlier versions of the papers. Several of the reports have been substantially revised to reflect the most current structure of local government in Bangladesh. Taken together these 14 papers represent the most complete study available of the system of local public finance in Bangladesh and options for reform.

The work is supported by the United States Agency for International Development, Washington, D.C., under a Cooperative Agreement (AID/DSAN-CA-0198). The views and interpretations in this publication are our own and should not be attributed to the United States Agency for International Development.

Larry Schroeder
Syracuse, New York
May 1984

ACKNOWLEDGEMENTS

In carrying out this work, the research team spent approximately 65 person months in Bangladesh, including two person years of residency by the three research officers who collected the basic data. Still, we could not have completed this work without the assistance of many others familiar with aspects of local government finance within the Bangladesh setting, including persons outside the government as well as at all levels inside. While the full list of individuals is too long to document here, there are several who, on a continuing basis, provided feedback, comments and assistance far beyond any minimal requirements and should be acknowledged individually.

The National Institute of Local Government (NILG), as our liaison, provided support for our efforts and gave us the opportunity to discuss our preliminary findings in seminar settings. Particularly instrumental in this regard were the NILG Directors and Director General with whom we have worked: Mr. Syed Marghub Murshed, Mr. Mohammad Faizulla and Dr. Kamal Siddique. Director of Research at NILG, Mrs. Bilquis Ara Alam, has been a constant source of substantive, logistic and moral support to the entire team throughout the project. Her efforts are most warmly appreciated.

We wish to recognize explicitly the continuing assistance and support which we obtained from Mr. Mohammad Faizulla who, since completion of his tenure as Director of NILG, has served as Joint Secretary of the Cabinet Division in the Cabinet Ministry. Mr. Faizulla and his colleagues in the Cabinet Division have been particularly

helpful in keeping us informed regarding the numerous changes taking place in the decentralization process.

Mr. Quamrul I. Siddique, Superintending Engineer of the Rural Works Wing of the Ministry of Local Government, Rural Development, Cooperatives and Religious Affairs, has also been instrumental in providing assistance to our team. His wide-ranging interests and knowledge have greatly stimulated our thinking. Likewise, we have benefitted from many enlightening discussions with Dr. Maqsood Ali, formerly Director General of the National Institute of Public Administration and now, Rector, Public Administration Training Center at Savar.

At USAID/Dhaka we have worked with three project officers over the past two years. The idea for a local finance study and the scope of our efforts here were shaped by Dr. Paul O'Farrell. After O'Farrell's departure, Mr. Paul Thorn served as project officer for four months. Ms. Susan Downs and Mr. Gene George, jointly, and subsequently Mr. George alone provided direction and logistic support in the final 18 months of the project. We are especially grateful to Mr. George for seeing us through the period of final drafts, substantive reviews and preliminary presentations.

We wish also to express our heartfelt gratitude to Mr. Maniruzzman, Research Specialist at USAID/Dhaka. Manir was a source of insight, a traveling companion and a "facilitator" throughout the course of the project. His efforts on our behalf, his willingness to tolerate our hectic schedules and his continuing good humor are fully appreciated.

There were, of course, many others who devoted their time and energy to this project both in Bangladesh and the United States. Dr. Robert Firestine, Economist in the Office of Rural and Institutional Development in the Bureau for Science and Technology, USAID/Washington, has monitored the project throughout its history.

We would be remiss not to mention the usual fine preparation of numerous drafts of the Interim and Final Reports accomplished by the professional staff in the Metropolitan Studies Program including Ms. Anne Adams, Ms. Patricia Bradley, Ms. Esther Gray, Ms. Cynthia Lowe, and Ms. Michelle Peterson.

Despite all this good help and advice, we surely have committed errors in these three volumes. The blame for those must be ours alone.

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VOLUME I: EXECUTIVE SUMMARY

This Report is a blueprint for strengthening local government finances in Bangladesh. In it we discuss the rationale for altering the revenue structure of zilla, upazila, and union parishads and present a set of specific recommendations to increase resource mobilization capacity at each of these levels. Finally, we suggest an implementation plan for the reforms over both the shorter and longer runs.

Rationale and Assumptions

Decentralization is a long stated goal of the Government of Bangladesh and, during the course of our research, policies designed to achieve this objective have gone forward. Relatively little has been done, however, about strengthening the financial base of rural local governments. Yet, effective governmental decentralization in Bangladesh cannot be accomplished without increased fiscal autonomy. As long as local bodies are fully dependent upon centrally granted money, local fiscal responsibility and initiative will be lacking.

There are two other compelling reasons for strengthening local government finances. First, it is recognized that one primary constraint to effective development spending in rural areas is mobilizing resources to meet necessary operational and desired maintenance costs of development projects. Second, the central government has identified increased resource mobilization as one major objective in its current Five-Year Plan. Mobilizing greater resources locally is, therefore, in accord with this national goal.

Local fiscal autonomy requires that the central government give local bodies greater independent taxing powers. Successful use of these powers will require a combination of additional training, revision in statutes and rules governing local government taxation and alteration of the intergovernmental grants program to give local bodies the incentives to use the fiscal autonomy provided. Unless all three of these initiatives are acted upon, increased local revenue mobilization is not likely to result.

It is important to recognize that in the unitary government system of Bangladesh, these policies must be initiated from the center. Indeed, we feel that a necessary condition to strengthening local bodies is to improve the ability of the center to monitor, analyze and provide advice regarding local government fiscal actions.

The role of incentives is paramount in the strategy proposed here. Successful redesign of the local government revenue system is possible only by recognizing the incentives and disincentives which the system provides to local taxpayers, elected local government officials and central and local government managers. In keeping with this theme, we recommend a set of local benefit charges which, more or less, link the service provided by the local government to the taxpayer. The expectation is that such links will lay the basis for significant improvements in taxpayer compliance. Moreover, when local services are financed substantially from local resources, elected local government officials will become more accountable to their constituencies and management practices should improve.

Another important possibility for providing incentives is to continue changing the focus of the intergovernmental grants system from relief to promoting development and strengthening the local government institution. The newly issued Guidelines¹ indicate this switch in view, as do the recent reforms in the Food-for-Work Program. What remains is to design the new grant system to provide incentives for local governments to raise more rather than to depend on central revenues. Many of the recommendations made here focus on this redesign.

The Report recognizes the tradeoffs among the competing goals of resource mobilization, economic efficiency, administrative feasibility and equity. The view taken here is that local government fiscal reforms in Bangladesh ought to be aimed primarily at generating more revenues, with acceptable administrative costs. The redistribution of income, in our view, is not the proper role of local governments and to bend local tax reform to emphasize this goal is to risk compromising the revenue raising and administrative improvements. Redistribution is, therefore, a less prominent influence in shaping these recommendations than it would be in the case of national tax policy.

Finally, we should note that all these recommendations depend on a substantially improved local government revenue administration. The design of an appropriate training/technical assistance program is beyond our terms of reference, but it is clear that few of these proposed

¹Planning Commission, Ministry of Finance and Planning, Guidelines for Upazila Parishads for Utilisation of the Development Assistance Provided by the National Government Through the ADP, Government of the People's Republic of Bangladesh (July 1983).

reforms can be put into place before a major training effort is undertaken.

Recommendations¹

The move toward strengthening local government finances can begin immediately. Indeed, the time is perfect to consider local government fiscal reform because the Guidelines have called for a careful reworking of upazila financing arrangements during this year. We propose that these reforms focus on (1) land-based taxes at the local government level; (2) direct business taxes and user charges; and (3) the intergovernmental grant system.

Land Based Taxes

In the rural areas of Bangladesh, land constitutes the most reasonable tax base. Our recommendations are for major changes in three land taxes. The basic rate of the immovable property transfer tax should be increased from its present level of 1 percent to 2 percent nationwide with the local body given the authority to levy up to an additional 1 percent tax on transferred property. Under current plans upazila parishads are not allowed any land-based tax resources. We recommend that this position be rethought and that upazilas receive one-half of the land development tax collected within their boundaries. In addition, upazilas should be given the authority to impose an additional surtax tied to land development tax liabilities. In the

¹The specific recommendations are listed in the Appendix to this volume while the supporting arguments are made in Volume II.

longer run, a change in the method of land taxation using land value rather than land area as the tax base is also advocated.

We do not call for a decentralization in the administration of either the property transfer tax or the land development tax. Nevertheless, we recommend several changes in the administrative procedures used for these taxes so as to improve both their revenue performance and their equity effects by decreasing illegal tax evasion.

With union parishads restricted to the property-based union and chowkidary rates, we feel that reform in this area should focus upon the assessment, record-keeping and collection practices of these local bodies rather than upon statutory changes. Among the recommendations made are the posting of an officer at the upazila level who would be responsible for property valuation in the unions and would provide holdings tax record-keeping assistance to union parishads.

Business Taxes and User Charges

The recent amendments to the Local Government Ordinance direct all taxes on local business activity to the upazila; however, the maximum rates which have been set are extremely low. Furthermore, since no minimum taxes are included and the grant system does not provide any real incentive to mobilize revenues from own sources, upazila business tax revenues are not likely to be stimulated. We recommend that this situation be changed by allowing higher maximum tax rates on businesses, imposing minimum rates and restructuring the grant system to encourage local business taxation.

Zilla parishads have earned revenues from ferries and toll roads and it is anticipated that haats, bazaars and fisheries will be a

principal upazila revenue source. Auction techniques are commonly used for generating these revenues and can be effective. Our fieldwork has enabled us to identify some of the problems associated with the auction technique, and has led us to recommend policies that can be followed to insure that these revenues are maximized and grow over time.

Our investigation into participatory activities at the union level indicates that the community tax and nationwide voluntary contribution programs are not likely to be successful in providing a dependable local government revenue source. On the other hand, spontaneous participatory schemes using voluntary cash contributions can be useful on a localized basis and, while mandating from above is unlikely to be effective, this method of resource mobilization should be encouraged through the grants system.

Intergovernmental Grants

The design of the intergovernmental grant system should be altered to provide incentives for local governments to mobilize additional resources. This should be done in two ways: (a) rewarding, with more grants, local governments which make a greater revenue effort and show a better project completion and maintenance record while penalizing those which do not; (b) using the grant directly to finance improved tax administration at the local level. In addition, the structure of the several grant programs should be rationalized to insure that their goals are mutually supportive rather than being at cross purposes. This is especially the case with what remains of the Rural Works Programme, the Food-for-Work Program and the new Development Assistance Grant to upazilas.

Evaluation and Monitoring

Some additional initiatives are necessary for BDG evaluation of the proposed reforms. Data are an essential ingredient to any monitoring activity, thus we have proposed that the Bangladesh Bureau of Statistics be mandated to carry out an annual Census of Government Finances. This census could concentrate initially on the upazila and zilla levels, but subsequently would be expanded to the union level as well. Our experience with data collection on the project convinces us that such a census is feasible and would be useful. Implementation of such a program could be aided by the experience in other countries and by international donors.

We also recommend the creation of a permanent Local Government Management and Finance Cell within the Local Government Division of the Ministry of Local Government, Rural Development, Cooperatives and Religious Affairs. This cell, staffed by experts in local government finance, would have substantial responsibility for designing and implementing the new revenue-raising system and for analyzing its progress. Coordination of the several training programs pertaining to local finance recommended throughout the course of the Report would also be the responsibility of this cell.

Implementation

The combination of the proposed reforms involves activities currently under the auspices of different ministries, thus a temporary Local Government Finance Reform Implementation Committee should be

formed. This is clearly the first step in the implementation process. The charge to this committee would be to advise on the reform programs and to work out the specific statutory and regulatory details. Membership on this committee should include, but need not be limited to: representatives of the Ministry of Local Government, the Ministry of Finance including a member of the Planning Commission, the Ministry of Law and Land Reforms, the Ministry of Food and Relief and the Cabinet Division.

A subcommittee of the Implementation Committee could also be formed to become a permanent Bangladesh Grants Commission even after the principal components of local finance reform are carried out. The first responsibility of the subcommittee would be to rationalize the grant system by coordinating its component parts and by considering the recommendation made here that total annual grants be tied to some percent of national government revenues. As a permanent body the Grants Commission would have oversight responsibility: determining the indicators to be used in the allocation formulae, working with the Management and Finance Cell of the MLG and the Bureau of Statistics to develop a Census of Government Finances, monitoring the project and tax effort performances of local governments, and recommending changes in the system as they become necessary. This Grants Commission might be headed by a member of the Planning Commission and have seats allocated to the Ministry of Local Government, Ministry of Food and Ministry of Finance. A professional staff would be necessary to carry out the analytical functions of this Commission.

A plan for phasing in local government fiscal reforms is important. Upon appointment of the temporary Local Government Finance Reform Implementation Committee, discussions should begin regarding the recommendations made here. Increasing the flow of land-based tax revenues to local governments including the land development tax, creation of the Local Government Management and Finance Cell within the MLG, altering the grants package and initiating training efforts by training trainers seem to be top priority items. Business tax reforms, further changes in the grants system and subsequent administrative reforms in taxation policies can follow in phases along with increased training efforts.

Benefits and Costs of the Reform Package

The reform program proposed here should provide substantial benefits by enabling the decentralization program currently underway to continue. Among the major benefits that may be derived are an increased overall revenue level, though it is difficult to project even a rough order of magnitude. It should be recognized, however, that the current level of fiscal activity in rural local governments in Bangladesh is minimal. Thus, even small absolute gains in the amount of resources mobilized due to the policies recommended here would constitute large relative increases. Other potential gains are not quantifiable: the movement of government closer to the people, the increased accountability of local government officials, productivity of public works investments and better maintained local public infrastructure. In this

regard, the reforms should assist in "...ushering in a better life for the rural people in the near future."¹

The question facing the BDG is whether such a benefit package, and the probability that it can be attained, justifies incurring the costs. It must be acknowledged that reforms such as those proposed here cannot be carried out without additional spending. The recommendations in this Report call for:

- a. Formulation and staffing a permanent Local Government Management and Finance Cell in the LGD of the Ministry.
- b. Conducting an annual Census of Government Finances.
- c. Posting property valuation officers in each upazila.
- d. Expanded training and financial support for revenue administration at all levels of local government.
- e. Financial support and technical assistance for property tax mapping.
- f. Formation and staffing of a Permanent Grants Commission.

In addition, the recommendations made here would cause some erosion in central government revenues, specifically that associated with transferral of one-half of the land development tax to upazilas.

Associated with these recommendations are some non-fiscal costs that should also be recognized. One is the sacrifice made in moving toward a development-oriented program of fiscal decentralization. By allocating grants among local governments more on a basis of development

¹Guidelines for Utilisation by the Upazila Parishad of the Development Assistance Provided by the National Government Through the ADP, p. 1.

potential and ability to "match" central government taka, and less on a basis of need, some equalization of fiscal capacity will be sacrificed. There would be fewer projects to spread around under a system such as that proposed here, but they should be more productive investments. The projects will have more capital content and will be better maintained. But their construction component will generate fewer jobs than would only earthworks activities. Local taxes will go up to support these activities but will be paid largely by landowners and merchants, possibly creating political costs. Finally, local governments will be more autonomous which means that the BDG will have given up some flexibility in controlling the total amount of government spending in the country. All of these are real costs that accompany this recommended reform package.

While the BDG should carefully coordinate and monitor all aspects of this reform and will have to bear many of its costs, there are areas where donor assistance is appropriate and probably necessary. The recommendations in the Report provide numerous opportunities for technical assistance from other countries:

- a. Technical assistance could be provided to help develop the Local Government Management and Finance Cell in the MLG. Junior personnel might be sent abroad for specialized training.
- b. Financial and technical assistance could be provided to training institutions.
- c. Property tax mapping and technical assistance associated with property tax administration including property identification, record-keeping, valuation and collection could be provided.

- d. In developing specific grants allocation formulae, external assistance could be provided in helping to identify and evaluate the range of possibilities.
- e. Technical assistance in developing the Census of Government Finances could be provided.
- f. The current work has omitted consideration of the treatment of paurashavas and municipal corporations in the overhaul of local government fiscal affairs. The implications on these urban governments of rural local government reform should be fully considered.

Conclusions

There is much to be done in the area of local government finance in Bangladesh. The proposals made here are not the only route to improvement; but at the very least they can provide the basis for discussion of the hard choices that accompany decentralization. We do feel that this package of recommendations can provide the basis for strengthening the role local governments in Bangladesh play in the overall development process. We are even more certain that a comprehensive reform is called for. It is clear that simply altering a few statutes and issuing some circulars will not achieve the goal of increasing resource mobilization at the local government level.

Finally, three components of comprehensive reform should be re-emphasized: incentives to mobilize resources including local tax rate-setting autonomy, strengthening the central government's ability to monitor and assist in promoting these local mobilization efforts, and training to develop financial management skills at the local level.

APPENDIX

LIST OF RECOMMENDATIONS

1. Zilla parishads should be formed in each district with membership consisting of each upazila chairman from within the district. They would elect from among themselves a chairman and secretary. The DC would also be an ex officio member of the zilla parishad. The parishad would have no compulsory or optional service functions assigned to it and, hence, will have no budget or employees. The zilla parishad will serve only as a forum for discussion of the common problems faced by upazila parishads and will reach advisory decisions in cases where actions by one upazila may have spillover effects on other upazilas.
2. If the zilla parishad is abolished or is changed to an advisory body with no direct service responsibilities, revenue sources currently assigned to zilla parishads should be transferred to upazila parishads.
3. Evaluation of upazila officers by line ministry superiors should rely heavily upon the evaluations made by upazila chairmen with upazila nirbahi officers used to mediate disputes in this process.
4. As decentralization proceeds and local governments gain strength in financial affairs and management practices, personnel policies should be deconcentrated with greater power placed in the hands of local officials.
5. The Central Government should allocate sufficient resources to financial auditing activities to insure that locally-raised and grant revenues of local bodies are being used most effectively.
6. A pilot program should be implemented in which a fiscal consultant to local governments posted at the district level would oversee local accounts and would work closely with local government fiscal officers to improve budgeting, financial accounting and record-keeping.
7. Training programs and materials should be developed to increase financial decision-making and analysis skills of local government officers and political leaders. Those involved in financial administration on a day-to-day basis should also be trained more intensively to use financial information for planning purposes.
8. More resources should be allocated to existing training institutes to provide for a larger staff and additional training of trainers.

9. A Census of Local Government Finance should be developed and conducted annually by the Bangladesh Bureau of Statistics. The Census would include detailed information on spending and revenue activities of each local body.
10. A Local Government Management and Finance Cell should be a permanent part of the Local Government Division of the Ministry. This office, headed by an individual trained in local government management and finance, would be given the responsibility to analyze the fiscal and other implications of local government policies and proposals.
11. The immovable property transfer tax rate should be increased from its current level of 1 percent, to 2 percent.
12. Local governments earning IPTT revenues should be given the power to add up to 1 percent to the basic 2 percent rate.
13. The manual of instructions for collection officials should be amended. Officials should be directed to attempt to determine the correct value of the recorded transfer. Evaluation of the job performance of collection officials should include their effectiveness at detecting undervaluation of property.
14. A transfer should not be allowed until the previous deed of ownership, along with evidence of its previous purchase price, is presented.
15. A schedule of approximate property values, broken down by major property characteristics, should be developed and updated annually in all upazilas by the upazila statistical officer.
16. Penalties for undervaluation should be imposed and publicized. These penalties, possibly equal to twice the evaded tax plus interest, would have to be paid in addition to the tax due prior to subsequent transfer of the property.
17. Local bodies deriving funds from the IPTT should regularly inspect and investigate the manner in which the tax is being administered locally to insure that undervaluation is being detected and that the total tax liability due the jurisdiction is properly being credited to its accounts.
18. The BDG tax structure should be altered to provide that 50 percent of land development taxes collected within an upazila parishad should be retained by that upazila parishad. Tax administration should remain the responsibility of the central government.
19. The LDT on agricultural land should be based only on the size of each ownership plot within a khatian.

20. In the longer run the land development tax should be converted to a value-based levy. A schedule of average land values, broken down by major land characteristics, should be developed and updated every 3-5 years in all upazilas. The base of the LDT would be the value of land, equal to the size of the plot times the average value per acre.
21. A proportional tax rate of at least Tk. 20 per acre should be adopted for the land development tax with owners of agricultural plots 1/10 acre or less in size being exempt from the tax.
22. Until a value-based LDT is implemented, the tax rates on agricultural and non-agricultural land should be adjusted every 3 years. The adjustment should be tied to an appropriately chosen price index such as the national income deflator.
23. Upazila parishads should be given the power to set land development tax rates within some bounds. If a nationwide tax rate of Tk. 20 per acre is imposed, localities should be free to impose an additional surcharge of up to Tk. 10 per acre with all such revenues retained by the upazila parishad in which the property lies.
24. Efforts should be made to increase the rate at which mauza maps are being redrawn. This is an especially appropriate area for international donor involvement through the provision of technical assistance and grants or long-term loans.
25. The interest penalty on delinquent taxes should be increased and imposed using compounded rates. In addition, the penalty should be imposed if taxes are not paid within one year.
26. A nationwide training program for tahsildars focusing on record-keeping procedures and changes in the LDT should be implemented. Annual evaluation of tahsildars by revenue officers would emphasize collection efficiency and record-keeping, especially the rate at which transfers of ownership had been recorded.
27. Trained valuation officers should be posted at the upazila level with the responsibility of reassessing properties every five years in each union parishad within the upazila.
28. Formal training programs on holdings tax record-keeping should be provided to union parishad secretaries. In addition, the tasks of the valuation officer should include consultation with these secretaries so as to improve the quality of holdings tax records.

29. The use of private holdings tax collectors should be abandoned and replaced with a system whereby taxpayers must appear at the preannounced site during a specified time period to pay taxes directly to the union parishad secretary. At that time a taxpayer identification card would be issued which would be a necessary qualification for participation in governmental services provided through the union.
30. Training of union parishad chairmen and members should include material on holdings tax collection practices emphasizing the role of legal remedies and tax campaigns designed to improve taxpayer compliance.
31. The maximum tax rates for the vehicles tax and profession, trade and callings tax should be reexamined to ascertain if the rates could not be increased. In any case, minimum rates should be prescribed and the entire schedule should be updated every 3 years to reflect increases in the general price level as measured by the national income deflator.
32. Taxes on the erection and re-erection of buildings should be allowed at the union level. A model tax schedule which reflects current building costs should be devised prior to the imposition of this levy.
33. Duties of upazila officers should include responsibilities that will insure that local public enterprises, e.g., markets and ferries, are operated in a safe and equitable manner. Likewise, to provide for efficient long-term operation of these facilities, accounting procedures should be altered to provide for the costs of their replacement.
34. When auctions are used to issue leases, bidder collusion must be minimized if revenues are to be maximized. Multiple auctions can be used to insure that maximum revenues are extracted from the process. Since the possibility of bidder collusion is lessened by greater numbers of participants in the process, steps should be taken to increase the number of bidders. For example, capital constraints which limit the competitiveness of auctions can be lessened by requiring smaller downpayments and allowing longer time for total payment.
35. Local governments should regularly review rate structures associated with markets, ferries and roads; these rates should be raised periodically to reflect increased maintenance and capital costs associated with inflation. Informational circulars providing data on inflation-induced cost increases should be issued annually.

36. A thorough study of haats and bazaars should be undertaken, probably in the form of a nationwide set of case studies using a common format and carried out under the auspices of a local research group. This study would focus on the operating procedures, including pricing policies, reinvestment issues and potential for establishment of a haat and bazaar "sinking fund" which would allow the locality to insure that resources be available in order for markets to be replaced in a timely fashion.
37. Local governments should be encouraged to investigate the use of tolls on segments of its road system with divisional commissioners made aware of the benefits of this form of resource mobilization.
38. Roads which are primary candidates for politically acceptable and economically feasible imposition of tolls are pucca roads for which there are few, if any, alternative routes available and for which the demand is sufficiently great to allow a franchise holder to bear the administrative costs of collecting tolls. Training of financial managers and administrators should reflect these principles and circulars describing the imposition of tolls on roads should be issued.
39. The community tax should be removed from the statutes as a union parishad revenue source and be replaced with a benefit surcharge tied to holdings tax liabilities when financing projects with high site-specific benefits.
40. Voluntary labor should not be a centrally-mandated form of resource mobilization; all laborers on public works projects should be paid.
41. The BDG should follow up on its proposal to allocate the Development Fund grant by formula in 1984/85.
42. The cash grant for appurtenant structures under FFWP and the Development Fund grant should be integrated in terms of their formula distributions.
43. The Rural Normal grants program should be gradually replaced.
44. A permanent Bangladesh Grants Commission should be established. The Commission could be composed of representatives of various ministries, and would have the responsibility for recommending policies to govern the operation of the intergovernmental grants system. With respect to the coordination of grants, the Commission would: define the allocation formulae for grants; define measures of local government tax effort and project performance; reconcile the distribution formulae for the Development Fund and FFWP grants; and, oversee the statistical measurement of the grant formulae and the monitoring of local government performance.

45. The Grants Commission should develop a coordinated allocation formula and joint guidelines for project design and implementation of the FFWP and Upazila Development Fund grants.
46. If development displaces relief as the principal goal of the Bangladesh grants system, fewer, but larger grants distributed partially on the basis of development potential is an appropriate strategy.
47. A revenue effort measure should be included in the Development Fund grant allocation formula.
48. Allocation of the Development Fund grant to union parishads within an upazila should be based in part on levels and growth of UP resources mobilized within the several union parishads.
49. Voluntary contributions should be included in the determination of local resources mobilized for the purpose of distributing the Development Fund grant to union parishads within an upazila. Any union parishad discovered to have inflated the value of such contributions should be banned from receiving such funds for a period of two years.
50. The BDG should set up a system to monitor the actual distribution of grant monies to all local governments, under all grant programs.
51. The total Development Fund grant should be set for three-year periods as a percentage of some designated central government revenue source. The designated base could be taken as that in the preceding fiscal year, hence local governments could make a reasonable estimate of their grant revenues before they begin their budget cycle. The Grants Commission should recommend the designated base and the percentage.
52. Maintenance of local government projects should be financed from a combination of Development Fund revenues and from a specified percentage to be raised from own sources. Maintenance requirements and standards should be developed and monitored by the central government for all works projects, including FFWP.
53. A Temporary Local Government Finance Reform Implementation Committee should be formed immediately to begin working out the details of implementing a program of local government fiscal reforms.

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ZILLA ROADS/LOCAL FINANCE PROJECT

A PLAN FOR INCREASED RESOURCE MOBILIZATION
BY LOCAL GOVERNMENTS IN BANGLADESH

VOLUME II: FINAL REPORT

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111

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TABLE OF CONTENTS

	<u>Page No.</u>
List of Acronyms	vii
Map of Bangladesh	viii
Bangladesh: Economic and Social Indicators	ix
Scope and Method of Analysis	4
Mobilizing Resources	6
Economic Efficiency	7
Equity	8
Administrative Feasibility	9
Tradeoffs	10
Local Government Structure, Personnel and Financial Administration	12
Government Structure	17
Personnel Administration	20
Financial Administration	22
Summary	27
Land-Based Levies	28
Immovable Property Transfer Tax	29
Tax Rates	31
Tax Base	32
Tax Administration	34
Land Development Tax	37
Reasons for a Local Land Development Tax	38
Tax Base	41
Tax Rate	43
Tax Administration	46
Holdings Tax	49
Tax Base	50
Tax Records	53
Tax Collection	54
Summary	56
Activity-Based Revenues	57
Non-Land Taxes	58
Non-Tax Revenues	61
Leasing Systems	61
Haats and Bazaars	66
Toll Roads	67
Voluntarism	68
Summary	70

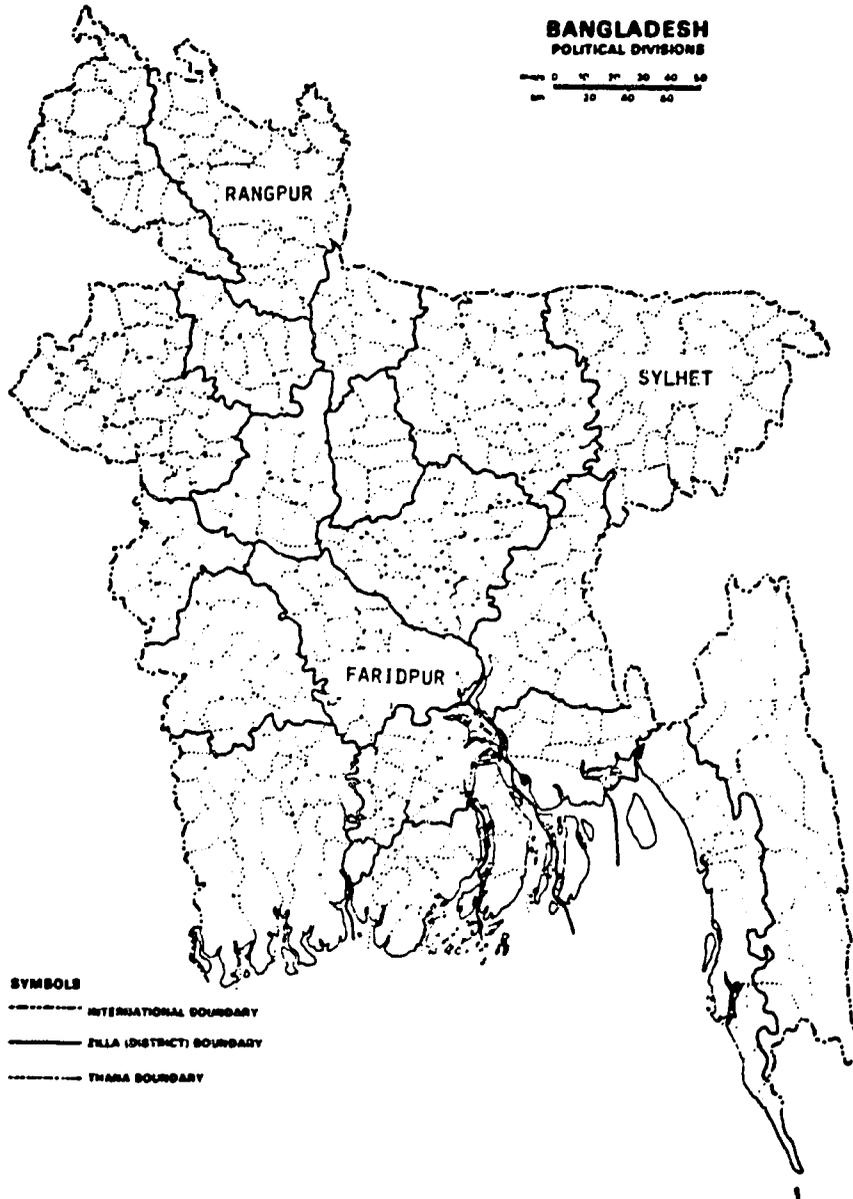
TABLE OF CONTENTS (CONT.)

	<u>Page No.</u>
Intergovernmental Grants	70
Rationalizing the Distribution of Grants	72
Coordinating FFWP and Development Fund Grant	75
Targeting of Grants	77
Building Local Government Institutions	79
Monitoring Project Activities	81
Providing for Maintenance	83
Summary	84
Implementation	85
Conclusions: Benefits, Costs and Resources Available	88
Benefits and Costs	90
Donor Assistance	91
Appendix: Interim Reports Issued Through the Local Government Finance Project	93

LIST OF ACRONYMS

BBS	Bangladesh Bureau of Statistics
BDG	Government of Bangladesh
FFWP	Food-for-Work Program
GDP	Gross Domestic Product
IPTT	Immovable Property Transfer Tax
LDT	Land Development Tax
LGD	Local Government Division
LOS	Land Occupancy Survey
MLG	Ministry of Local Government, Rural Development, Cooperatives and Religious Affairs
NILG	National Institute of Local Government
RWP	Rural Works Programme
SFYP	Second Five Year Plan
UNO	Upazila Nirbahi Officer
UP	Union Parishad
URO	Upazila Revenue Officer
USAID	United States Agency for International Development
UZP	Upazila Parishad
WDB	Water Development Board
WFP	World Food Programme
ZP	Zilla Parishad

**BANGLADESH, POLITICAL DIVISIONS, CIRCA 1982-1983,
SHOWING THREE DISTRICTS OF RESEARCH FOCUS
OF LOCAL GOVERNMENT FINANCE STUDY**



BANGLADESH: ECONOMIC AND SOCIAL INDICATORS

Population (mid-1982):		92.62 million
Area:		55,598 Sq. miles
Population Density (mid-1982):		1660 inhabs./sq. mi.
Per Capita GNP (1981):		US\$ 120 ^a
Life Expectancy (years):	1975	42
	1981	48
Infant Mortality Rate (deaths per thousand):	1975	140
	1981	135
Percent of Population With Access to Safe Water (1975):		53
Per Capita Calorie Supply as a Percent of Requirement:	1974	92
	1980	84
Population Per Physician:	1974	9350
	1980	8775
Adult Literacy Rate (Percent):	1974	23
	1977	26
Average Annual Growth Rate of Per Capita GNP (1973-1982):		21.6%
Average Annual Rate of Inflation (1974-1982):		17.8%
Average Index of Food Production Per Capita (1969-71 = 100) (1979-81):		94
Sectoral Shares of GDP (1981):		
Agriculture		54
Industry		14
Services		32
Sectoral Shares of the Labor Force (1980):		
Agriculture		74
Industry		11
Services		15

BANGLADESH: ECONOMIC AND SOCIAL INDICATORS (CONT.)

National Budget (in million taka):		
<u>1976:</u>	Revenues	17103.3
	Expenditures	13261.0
<u>1981:</u>	Revenues	39899.1
	Expenditures	38262.0
Foreign Aid (in million \$US) (actual disbursements)		
	1972	236
	1973	486
	1981	603
Merchandise Trade (in millions of US dollars):		
<u>1973:</u>	Exports	357.9
	Imports	789.7
<u>1982:</u>	Exports	768.4
	Imports	2241.8
Terms of Trade (1975=100)		
	1976	109
	1981	79
Current Account Balance of Trade (in millions of US dollars):		
	1976	-231
	1981	-1016
External Public Debt as a Percent of GNP		
	1976	39.0
	1981	31.2
Exchange Rate (taka per US dollar)		
	1972	8.078
	1978	14.934
	1983	25.000

BANGLADESH: ECONOMIC AND SOCIAL INDICATORS (CONT.)

^aWorld Development Report (1983) of the World Bank reports US\$ 140.

SOURCES: Population, Merchandise Trade, and Exchange Rate: International Financial Statistics, IMF, 24(10), October 1976, and 37(3), March 1984.

National Budget and Foreign Aid: Statistical Yearbook of Bangladesh, 1980 and 1981; BBS, Ministry of Finance and Planning, Government of Bangladesh.

Per Capita GNP (1981) and Population Per Physician (1980): Bangladesh: Recent Economic Trends and Medium-Term Development Issues, The World Bank, South Asia Programs Department, Report No. 4277-BD, March 4, 1983 (for official use only), p. viii.

All other items: World Development Report, 1978-1983, The World Bank, Washington, D.C.

- 1 -

VOLUME II: A PLAN FOR INCREASED RESOURCE MOBILIZATION
BY LOCAL GOVERNMENTS IN BANGLADESH

The Government of Bangladesh (BDG) is committed to strengthening local government. The intent is probably stated most clearly in the opening paragraph of the recently-issued Guidelines regarding the upazila level of government (those thanas upgraded under the Local Government Ordinance Amendment of 1982).

"Government has decided to delegate authority and devolve administrative and development functions at the grass root level. The main objective is to induce faster and appropriate development at the local level through direct participation of the local people. This will help in identification, planning and implementation of development projects which will benefit local people most, more easily than before. In other words implications of this process of devolution are (a) reduction of dependence of the rural people on the national government for meeting the needs which can be met locally and development of self-reliance in the process; (b) mobilization and utilization of local resources which have hitherto remained untapped; and (c) reducing the direct involvement of the national government in planning and implementation of projects which are purely local in nature. All these are expected to lay the foundation of a solid local government which would be instrumental in ushering in a better life for the rural people in the near future."¹

Local governments have the advantage of being closer to the people than the central government and, therefore, are more likely to perceive the particular strengths and needs of the locality. The statement recognizes another important aspect of decentralization--the role local governments can play in mobilizing resources.

¹Government of the Peoples' Republic of Bangladesh, Guidelines for Upazila Parishads for Utilisation of the Development Assistance Provided by the National Government Through the ADP (Dhaka: Ministry of Finance and Planning, July 1983) p. 1.

There are several arguments in support of additional revenue mobilization through strengthened local governments. First, it is widely recognized that the Bangladesh public sector is small relative to other developing countries. Indeed, our analysis suggests that, when compared to countries with similar income levels and reliance upon agricultural production, tax effort in Bangladesh is 20 percent below the norm for developing countries (I.R. 10).¹ While larger public sectors do not guarantee development, the country's infrastructure needs and maintenance requirements suggest that some increase in the relative size of the public sector is appropriate. Furthermore, increases in local revenues would be in keeping with the stated BDG objective of greater domestic resource mobilization.²

Second, decentralization demands local resource mobilization, because local governments can be accountable for their actions only if they have some fiscal responsibility. Currently, localities tend to turn to the central government whenever resource needs arise. This situation must be changed, especially given the paucity of central funds and the many claims on those resources. Utilizing local revenue-raising powers and restructuring the grant system provide the most effective policies for bringing about such change.

¹Throughout we use the notation, I.R., to refer to our more technical, Interim Reports. A complete list of titles of the reports is contained in the Appendix to this paper.

²This is one of the seven objectives of the Second Five Year Plan (SFYP). See Planning Commission, Ministry of Finance and Planning, Government of the People's Republic of Bangladesh, The Second Five Year Plan 1980-85 (Dhaka: Planning Commission, May 1983), p. 23.

Finally, there are questions of tax administration and compliance. No one, in any country, enjoys paying taxes, fees or charges. But compliance is likely to improve when the payer sees a linkage between payment and benefits received. Hence, there should be an increased willingness to pay when the revenues are kept at the local level to finance local activities rather than sent to Dhaka and returned indirectly via central government expenditures or intergovernmental grants.

There are, therefore, several good reasons to be concerned with resource mobilization powers of local governments in Bangladesh as a crucial ingredient in the move to decentralize administration and political decision-making. This Final Report is designed to indicate how the revenue-raising capacity of Bangladesh local governments can be improved. In general, we feel that there is reason for optimism, because the BDG is committed to this goal and because the necessary local government structure and other institutions already exist. Still, reforms are necessary. The guiding principle behind the reforms suggested here is a better use of incentives to induce greater participation by local governments in the revenue-raising process.

It may seem paradoxical, but reform of local government finances in Bangladesh must begin at the central government level. There are several reasons for this. Foremost is the fact that local governments in Bangladesh are heavily dependent upon central government grants. Changes in the operation or design of these programs must be initiated centrally. Second, the ordinances, rules and regulations under which local governments operate their financial affairs can be altered only at

the central government level. Third, many "local" officials are in reality centrally-posted personnel, which means that the central government must take the lead in directing that responsibilities to local governments be taken seriously. Finally--and perhaps most important of all--trained personnel are scarce and resources are insufficient to permit local bodies to finance training programs. Training must, therefore, be provided centrally. For these reasons most of the recommendations that follow are addressed to the BDG.

Scope and Method of Analysis

The scope of this study of local government finance in Bangladesh encompasses a wide range of issues including (a) the general structure of local government, (b) personnel and financial administration, (c) own resource mobilization instruments and (d) the intergovernmental grant system. Although this study is a part of a project providing technical assistance to zilla parishads on matters of road maintenance, all levels of local government are considered here. There are two reasons for this. One is that local governments constitute a system; therefore to concentrate exclusively on one level while omitting all others is to ignore this interrelatedness. The second is that, while the zilla roads project is concerned with mobilizing resources for purposes of road maintenance, development project maintenance needs are a crucial problem at all governmental levels, especially now that upazila parishads are being given greater autonomy in spending initiatives. While urban governments (both municipal corporations and paurashavas) have not been totally excluded from the analysis, the work has concentrated on local

bodies in rural areas. This focus is especially appropriate in Bangladesh where about 87 percent of the people reside in rural areas.

The analytic techniques used in this work include a study of the underlying statutes, statistical analysis of a broad range of data, structured and unstructured interviews and case studies. No single approach dominates but in all instances the analysis is grounded in well-accepted theories of public economy.

Statutory analysis is a necessary ingredient in any such study since one must ascertain whether problems detected in a local finance system are an outgrowth of poorly designed rules and ordinances or are behavioral in nature. At the same time, we recognize that actual practices may diverge greatly from what is specified by law. For that reason, analysis of facts and opinions is also a necessary ingredient in such a study.

Paucity of data constitutes a severe constraint to any comprehensive study of local government practices in Bangladesh. The BDG does not systematically compile a series of local fiscal statistics. Accordingly, a diverse set of data was used in this analysis: data compiled by central government agencies; data made available by international organizations; and financial and other information collected directly from local governments by site visits and mail questionnaires.

While one can compile empirical data from a variety of sources, a fuller understanding of both data and practices was obtained through personal interviews with the principals involved. Time was spent at all

levels of government discussing various features of the fiscal system using both structured and unstructured interviews.

In evaluating the current system of statutes and practices, we have used criteria thought desirable in any system of public finance: revenue performance, economic efficiency, equity, and administrative feasibility. Since these criteria provide the foundation for all that follows, we briefly elaborate on them here.

Mobilizing Resources

Foremost among the criteria for evaluation is the ability to raise revenues. Of interest are both the potential for mobilizing sufficient resources at any point in time and the potential for revenue growth which is sufficiently stable and adequate to match the increasing demands for public services.

Revenue adequacy depends on the size of the base and the rate applied. An overriding difficulty facing localities in most developing countries is the small size of the available revenue bases. Unfortunately, most revenue sources assigned to local governments do not have a large enough base to produce substantial revenues at low tax rates. The question, then, is whether higher rates can be imposed. Obviously, rates applied to a small base cannot be increased without limit. One constraint may be legal, e.g., central governments often impose strict rate ceilings on local government taxes. In addition, high rates are more likely to produce excess burdens through reactions in behavior by taxpayers attempting to avoid the levy (discussed below) and can increase taxpayer resistance and evasion. Furthermore, inequities inherent in the levy will be exacerbated by higher rates.

A second aspect of this criterion, sufficient growth, has to do with the elasticity of the revenue source (i.e., the percentage change of a revenue yield relative to the percentage change in some variable, usually income). As local government expenditure requirements rise due to population growth, increased service demands or inflation, a "good" revenue source will respond to these same forces. The principle is that the revenue base should be as responsive as is the expenditure base to inflation, real economic expansion or population growth.

Finally, there is the goal of stable revenue growth. While long-term revenue growth is desirable, it is preferable that growth be steady over time rather than fluctuating widely on an annual basis. Fiscal planning is greatly hampered by revenue sources which vary erratically from year to year. If fluctuations are linked to external causes such as natural disasters, little can be done to alleviate the problem; however, if administrative or structural deficiencies in the levy cause fluctuations, additional changes are needed.

Economic Efficiency

Local residents/taxpayers face many economic choices which are affected by local resource-raising techniques. These choices may include whether to live in a high taxing or low taxing jurisdiction, whether to improve a building at the risk of property tax increase, whether to support a proposal for a local capital improvement at the risk of paying a benefit charge or whether to volunteer labor to the public sector in return for a public sector benefit. To the extent a local tax or charge alters choices that otherwise would have been

made, the revenue instrument is said to be economically inefficient or non-neutral in its effects.

Although such nonneutrality can reduce local economic welfare, the distortions may be justifiable in terms of local and national objectives. For example, a business license may raise the cost of doing business in a community but can be justified on the grounds that it is a charge for the proximity to public services which the business enjoys. On the other hand, some revenue sources may have built-in non-neutralities that are undesirable. For example, taxing the value of improvements (buildings and equipment) rather than the value of land discourages investment in improvements. To the extent that investments in these improvements contribute to economic growth, such inefficiencies are undesirable.

Equity

Equity is an overriding concern in evaluating alternative revenue instruments, especially in developing countries where inequality in the distribution of income and wealth is pronounced. A problem is that equity or "fairness" can be interpreted in different ways. One view is that those better able to bear the burden of resource mobilization--the rich--ought to pay more. In practice, this ability-to-pay principle is sometimes translated into revenue policies where those with relatively little income or wealth are exempt from the levy or where progressively higher rates are applied to the rich. While such provisions for vertical equity are desirable, they may give rise to other, undesirable effects. For example, granting exemptions to lower income taxpayers may

erode the tax base, encourage artificial or uneconomic splitting of holdings to avoid the tax or encourage the payment of bribes to administrators to overlook underreporting of income.

The equity criterion can also be interpreted to mean that those who benefit from particular services should pay the cost of those services. This benefits-received version of fairness in taxation is usually associated with special assessments and user charges rather than with general taxation. In the context of developing countries, however, these methods of resource mobilization may be at variance with the ability-to-pay criterion. The principle would lead to an allocation of services weighted heavily toward those with a willingness and ability to pay for those services. Under benefit charge financing, low income groups may well be excluded. Still, in the absence of user charges, highly beneficial services such as water supply and ferry service may not be provided at all, and others, such as wells and irrigation ditches, may deteriorate due to lack of funds for maintenance and operating expenditures. Thus, the ability-to-pay criterion of equity needs to be applied with appropriate concern that it not significantly curtail development activities.

Administrative Feasibility

It is one thing to design an ideal revenue system--one that raises sufficient revenues in a fair way without significantly distorting economic choices--but it is quite another matter to implement such a system. In Bangladesh, as in many developing countries, administration of the revenue system may be the most important constraint to success.

For this reason much of the evaluation and many recommendations of this study focus on the administrative feasibility of alternative reforms.

Several aspects of administration are important including whether the revenue instrument is designed in a manner which will make it administrable given resource, personnel, environmental, political and cultural constraints. Furthermore, it is recognized that to build an entirely new administrative structure would be so costly that any revenue gains could be more than offset by increased administrative costs. For this reason, incremental rather than sweeping structural changes are recommended together with training.

Tradeoffs

These criteria do not always coincide and no single revenue instrument is likely to achieve all goals. For example, a user fee system which is deemed a productive and economically neutral revenue source may also be seen as inequitable. Similarly, an equitable revenue such as a broad-based income tax is unlikely to be administratively feasible within the Bangladesh context. While we have attempted to note the more obvious tradeoffs, it should be emphasized that the ultimate choice is a political decision which will have to be made by the BDG.

In general, our view on these tradeoffs is that local government fiscal reforms in Bangladesh ought to be aimed at generating more revenues, with acceptable administrative costs. Some goals simply are not compatible with local government fiscal reform but are more appropriately pursued directly through national policies. The most important of these is the goal of redistributing income. Local governments should not be expected to act as the principal agent in

income distribution, especially if local fiscal autonomy is given. Income redistribution schemes financed and implemented locally are doomed to failure because recipients of pro-poor services would be drawn to areas where such services are provided while higher income taxpayers, who would bear the burden of these redistributive services, would be driven out. While this does not mean that the ability-to-pay equity criterion is unimportant nor that we ignore it entirely, it does mean that local fiscal policies should not be viewed as major redistributive policy instruments. To do so would be to run the risk of compromising the revenue raising and administrative improvement objectives.

Redistributive policies based on the ability-to-pay principal of equity are, therefore, not stressed in the recommendations. The benefits equity criterion is, however, given considerable emphasis since this goal is compatible with local fiscal reforms. Indeed, benefit-related levies are stressed throughout the discussion of local resource mobilization. There are several good reasons for this. Most important is the incentive effects which underlie such an approach. Where benefits can be tied to payment, there is greater incentive to comply, or at least less incentive to avoid payment. Lack of willingness to pay constitutes a severe constraint to raising resources in Bangladesh. This is especially true at the local level where there is great reluctance to use legal sanctions against non-compliers. Furthermore, a well-administered system of benefit-based levies and user charges tied to marginal costs of operations of projects certainly satisfies the criterion of economic efficiency.

These criteria and analytical techniques are used to derive the recommendations below. We focus initially on the general structure and administration of local bodies in Bangladesh and then turn to locally-generated revenues--first land-based taxes and then those derived from other economic activities. These sections are followed by a discussion of the intergovernmental grant system and how changes in it can buttress the effects of the other recommendations. In the final sections we propose an implementation plan and discuss the benefits and costs of the recommendations made here.

Local Government Structure, Personnel and Financial Administration

At present there are three levels of local government operating in the rural areas of Bangladesh--the zilla parishad (ZP), upazila parishad (UZP) and union parishad (UP).¹ The ZP is responsible for major transportation facilities in the rural areas of the districts (e.g., non-central roads and bridges); the UZP has the major responsibility for local public works (e.g., irrigation facilities); and the UP is responsible for carrying out small development schemes including maintenance of union roads together with settlement of minor disputes among residents within the union. The statutory basis for these bodies is contained in three major ordinances--the Local Government Ordinance, 1976; the Local Government (Thana Parishad and Thana Reorganization)

¹Strictly speaking, the zilla parishad is presently not a local self-government because elections have not been held at this level since the adoption of the Local Government Ordinance in 1976.

Ordinance, 1982; and the Local Government (Union Parishads) Ordinance, 1983.¹ With the creation of upazilas it is obvious that the BDG is focusing its interest in local government on this intermediate level of local government--a policy decision with which we agree fully.

Personnel administration within local governments in Bangladesh is highly centralized. Salary scales are uniform nationally as is the cadre of positions at the UZP level. Some local autonomy is permitted to ZPs in determining staffing levels; however, since most services provided by local governments at the district level are ultimately performed by contractors, the size of the ZP workforce is small compared to the populations they serve, e.g., one employee for every 20-35,000 persons in six of the districts we surveyed.

Financial administration is also quite centralized with common budget forms and financial accounting forms stipulated in the Rules.¹ (It is recognized, however, that many of the local bodies, particularly smaller ones, do not utilize these forms.) Of great significance is the nearly total lack of autonomy accorded to these local governments regarding local revenue-raising powers. There is a prescribed list of revenue-raising instruments available to local governments and the rates and bases for many of these instruments are controlled centrally. Less restriction is placed on the spending side of local government budgets

¹Some discussion of the historical development of local governments in Bangladesh is contained in I.R. 1.

²The bulk of these rules are found in the Rules Under the Basic Democracies Order including those applicable to district councils (ZPs), those applicable to union councils (UPs) and those applicable to two or more types of local councils.

although there is a mandate that 25 percent of total spending be allocated to maintenance activities. Additionally, each Local Government Ordinance contains a budgetary guideline that ranks alternative types of spending.

It should be recognized at the outset that the level of fiscal activity in the local governments of Bangladesh is extremely small. To illustrate this point Table 1 has been constructed from the fiscal data collected as a part of this project. Shown there are the average per capita amounts of revenues and expenditures for jurisdictions at the district, thana and union levels. Since these jurisdictions overlap, it is appropriate to aggregate their spending activity to determine the approximate total amount of local government activity on a per capita basis in rural Bangladesh. Total spending for 1980/81 was Tk. 8.65. If one assumes that per capita income in Bangladesh during that same period was about Tk. 2800, the ratio of local government activity to income was only 0.31 percent.¹ Since spending in thana parishads was nearly entirely supported by central government grants and zilla and union parishads, too, were quite dependent upon grants, local taxes (assuming that the property transfer tax is a local levy) were only Tk. 3.31 per person, on average, or 0.12 percent of income.

This suggests an extremely low level of local government activity in a country which, when compared with other low income developing nations, also has a low central government tax effort (I.R. 10). It is,

¹Using estimated 1981 GNP of US\$ 140 and an exchange rate of about Tk. 19.9 = US\$ 1.

TABLE 1
 MEAN PER CAPITA REVENUES AND EXPENDITURES IN ZILLA,
 THANA AND UNION PARISHADS, 1981/81^a
 (in taka)

<u>Zilla Parishad^b</u>			
<u>Revenues</u>	<u>Amount</u>	<u>Expenditures</u>	<u>Amount</u>
Property Transfer Tax	0.99	Establishment	0.31
Local Rate	0.02	Agriculture	0.01
Rent, Profits & Sales	0.11	Public Health	0.00
Fees	0.01	Educations	0.08
Tolls	0.07	Social Welfare	0.02
Interest	0.03	Public Works	1.23
Miscellaneous	0.11	Miscellaneous	0.10
Contributions	0.02	Works Programme	1.11
Normal Grants	0.10	Total	2.86
Works Programms	1.03		
Total	2.49		
<u>Thana Parishad^c</u>			
Works Programme	2.59	Roads, Bridge, Culvert	0.80
Miscellaneous	0.01	Irrigation	1.10
Total	2.60	TTDC	0.19
		Derelict Tanks	0.12
		Technical & Logistic	0.46
		Miscellaneous	0.01
		Total	2.68
<u>Union Parishads^d</u>			
Holdings Tax	1.14	Establishment	2.14
Local Rate	0.02	Public Works	0.65
Other Taxes	0.07	Miscellaneous	0.13
Property Income	0.09	Works Programme	0.19
Fees	0.60	Total	3.11
Miscellaneous	0.02		
Normal Grants	1.17		
Works Programme	0.19		
Total	3.30		

TABLE 1 (CONT.)

^aThe component entries in this table were computed as unweighted means of the per capita revenues and expenditures of the sampled jurisdictions. Zero per capita amounts were included in the computations. Totals have been computed as the sum of the several entries.

^bIncludes only the 16 zilla parishads which included works programme in their zilla fund. All special grants were excluded from the computation.

^cIncludes 11 thana parishads in the districts of Faridpur, Rangpur and Sylhet. Occasional grants were excluded from the computation.

^dIncludes 31 union parishads in the districts of Faridpur, Rangpur and Sylhet which included the Works Programme in their union fund.

SOURCE: Computed by authors from local government records.

therefore, reasonable to offer a set of recommendations which should produce a greater level of resource mobilization at the local level and, in doing so, will assist in increasing the overall degree of public sector activity in the country. At the same time, it must be stressed that these recommendations are only a start and should not be expected to produce thriving self-sufficient local government bodies overnight. By moving in the directions indicated here, the Government of Bangladesh can, we feel, make a good start at creating a viable and productive local government sector.

Given this background we turn now to a discussion of the recommendations concerning government structure, personnel and financial administration.

Government Structure

Upgrading thana parishads to upazila parishads constitutes a most important policy initiative. Not only does it make plain the intent of the BDG to strengthen local governments, it also targets this policy on a level of local government which, while small enough to respond to localized needs, is sufficiently large to have a resource base which can be tapped effectively. The policy also stipulates that elected officials constitute the decision-making body thereby making the upazila parishad truly a local self-government.

Since union parishads have been and remain local self-governments, the only "local government" unit currently without elected officials is the zilla parishad. Zilla parishads are the local governing body stipulated at the district level. Associated with the creation of upazilas has been a tripling of the number of districts in the

country--from 22 to more than 60. With the creation of so many more, smaller districts and the simultaneous focus on the upazila as the premier local governing body, the question arises as to what role, if any, zilla parishads should take in the future.

Local governments have the advantages of bringing public sector decisionmaking closer to the people and allowing these decisions to be made more rapidly and cheaply. There are, however, costs associated with establishing another tier of government in any environment. These costs can be especially great where there is a lack of skilled personnel available to fill the administrative posts that necessarily accompany another local government organization (I.R. 1).

With a substantially larger number of districts each will be smaller in size and contain only a handful of upazilas. This suggests to us less reason for a fully-functioning local government at the district level. This conclusion is further supported by the fact that zilla parishads have not participated extensively in the full range of activities prescribed to them under the Local Government Ordinance, 1976 (Table 1). If zilla parishads had been actively pursuing a large number of development-oriented activities, it would not be sensible to downgrade them; however, their primary functions have been in the area of transportation (I.R. 8). It appears feasible for upazila parishads to assume these responsibilities.

If upazila parishads assume responsibility for transportation services, there remains the question of the desirability of any sort of local government forum at the district level. We feel there is good reason to retain at least a coordinating body at the district level. It

can still be called a zilla parishad but would consist only of the elected upazila parishad chairmen from all upazilas within the district. The DC could also be an ex officio member of this local body. The ZP could meet periodically, monthly or bimonthly, and discuss problems common to the several jurisdictions. Also discussed would be issues which arise due to the spillover effects of decisions taken in one upazila which might affect other jurisdictions. Decisions of this group would be advisory, in keeping with the notion that decentralized upazila parishads should be independent of higher governmental bodies. Thus, we recommend that

1. Zilla parishads should be formed in each district with membership consisting of each upazila chairman from within the district. They would elect from among themselves a chairman and secretary. The DC would also be an ex officio member of the zilla parishad. The parishad would have no compulsory or optional service functions assigned to it and, hence, will have no budget or employees. The zilla parishad will serve only as a forum for discussion of the common problems faced by upazila parishads and will reach advisory decisions in cases where actions by one upazila may have spillover effects on other upazilas.

This recommendation has the effect of abolishing the need for zilla parishad revenues. If it or any other similar decision downgrading the role of zilla parishads is reached by the Government, the question arises as to what actions should be taken regarding current zilla parishad revenues. These current revenue sources could quite easily be transferred to upazila parishads with no significant changes in the administrative structure of such sources. Furthermore, this would broaden the revenue base of this newest local government body. As such,

we recommend

2. If the zilla parishad is abolished or is changed to an advisory body with no direct service responsibilities, revenue sources currently assigned to zilla parishads should be transferred to upazila parishads.

In the event that zilla parishads are retained and function as in the past, it is important that rules be written which provide for elections at this level of government. Likewise, it would then be even more important that the division of functional responsibilities between the upazila parishad and zilla parishads be determined and specified in the ordinances. Finally, granting revenue autonomy to zilla parishads and restructuring the intergovernmental grants system to provide incentives to use this autonomy are both crucial if zilla parishads are retained.

Personnel Administration

Personnel policy is a central consideration in designing an effective strengthening of local government. In part this is because local self government requires a staff of officers who are responsible to the local electorate. Moreover, personnel policy will dictate the success of new revenue mobilization issues because it is government employees that ultimately carry out the new revenue policies.

One major personnel issue likely to influence the ultimate success of the current decentralization program in Bangladesh concerns the roles of the UZP chairmen and line agencies in guiding efforts of upazila officers. The officers remain employees of the central government and are paid directly from BDG funds but are deputed to the upazilas. While they are to serve their upazila parishad, they are evaluated for

purposes of promotion, transfer, etc., by the district officers within their respective line ministries. This implies that UZP officers must serve two groups--their upazila parishad and their specific line ministry. While the Resolution on Reorganisation of Thana Administration specifies that a UZP officer should follow the dictates of the upazila parishad, it is possible that the officer will decide that it is in his best interest to follow the desires of line ministry since this organization determines his promotions and transfers. This possibility represents an important constraint to decentralization.

For effective decentralization, evaluation of these officers should be based primarily upon the views of the local governments served. Thus, annual evaluations should rely greatly on written reports from the UZP chairman. When a disagreement arises between a line ministry superior and the chairman, the upazila nirbahi officer should mediate to insure that the local government's interests are served without putting the officer's career in jeopardy.

3. Evaluation of upazila officers by line ministry superiors should rely heavily upon the evaluations made by upazila chairmen with upazila nirbahi officers used to mediate disputes in this process.

Given the present state of development of local governments in Bangladesh, it is reasonable to use a highly centralized personnel system with uniform benefits, qualifications, and promotion practices. In the longer run, however, greater local autonomy in these practices should be encouraged.

4. As decentralization proceeds and local governments gain strength in financial affairs and management practices, personnel policies should be deconcentrated with greater power placed in the hands of local officials.

Financial Administration

A theme of many of the recommendations in this Report is the call for greater local government autonomy in financial decision-making. Such autonomy is necessary if local governments are to increase their rate of revenue mobilization. Independent decision-making powers are particularly important with respect to the setting of tax rates.

Nevertheless, financial oversight by independent auditors must remain an integral part of local financial administration. Our on-site survey of jurisdictions indicated two serious weaknesses in the current financial approval and audit system. First, audits of union parishads have not been performed in a systematic and timely manner. This situation should be altered. Even more important is the need to institute a thorough annual financial audit at the upazila level, especially now that greater resources are being funneled through these jurisdictions.

5. The Central Government should allocate sufficient resources to financial auditing activities to insure that locally-raised and grant revenues of local bodies are being used most effectively.

A second weakness of the current system of budget approval and financial audits is that they appear to be perfunctory exercises (I.R. 12). Currently, the primary concern seems to be whether the rules have been followed and if the financial report entries sum to the indicated

totals (even these simple requirements were not met in some financial records we reviewed). While more thorough and timely audits can overcome some of these problems, the financial oversight process itself can be an effective technique to show local financial administrators how budgets and financial reports are useful in analyzing the local fiscal situation and its improvement.

Implementation of this broadened concept of financial review would ideally involve all auditors of local government accounts. This is, however, unlikely to be feasible in the short-run since it would entail considerable training of an increased staff of auditors. Furthermore, the concept of outsiders reviewing financial accounts and practices is experimental in nature; thus, a pilot program instituted in a small number of districts may be the most reasonable strategy. The pilot program, operated through the Ministry of Local Government, would fund a local government "fiscal consultant" to review the financial practices of union parishads and upazila parishads and to recommend changes in fiscal practices. Such a pilot program might be initially financed from donor funds.

6. A pilot program should be implemented in which a fiscal consultant to local governments posted at the district level would oversee local accounts and would work closely with local government fiscal officers to improve budgeting, financial accounting and record-keeping.

The fiscal consultant concept is an on-the-job approach to training. With or without such a program there is an obvious need to strengthen financial administration training at the local government level. Furthermore, this training effort should be multifaceted and

should include different groups involved in local fiscal affairs. For example, veteran upazila officers have not previously participated in the details of budget formulation since, heretofore, they acted as representatives of their line ministries which formulated their budgets. Thus, training in the rudiments of budgeting for all officers at the upazila level is appropriate and necessary. Likewise, local government political leaders must become aware of the rights and responsibilities of local governments regarding financial affairs.

Even more important will be thorough training of upazila finance officers and other local government officials directly involved in financial administration. A portion of their training should focus on the rules of financial administration, i.e., which forms to use, how to balance the financial statement, etc. In addition, good financial administration requires an understanding of how to look for and understand fiscal problems. For example: Are revenues growing in real (deflated) terms and, if not, what are the causes of the slow growth? Is spending on particular activities excessive? Has adequate provision been made for financing the maintenance of new capital projects? These more subtle aspects of financial administration are difficult to teach but they are crucial to using budgets and financial accounts for more than simply a concurrence with the rules.

7. Training programs and materials should be developed to increase financial decision-making and analysis skills of local government officers and political leaders. Those involved in financial administration on a day-to-day basis should also be trained more intensively to use financial information for planning purposes.

Implementation of this recommendation can be conducted through the existing training institutes. One reasonable candidate institution to be given this responsibility is the National Institute of Local Government (NILG) since it already conducts training sessions at the local government level. A large additional training effort will, however, require that resources be made available to the Institute to train an enlarged staff. This initiative would be an especially appropriate project to be undertaken by international donor agencies.

8. More resources should be allocated to existing training institutes to provide for a larger staff and additional training of trainers.

One major problem associated with longer term financial planning has been the uncertainty surrounding intergovernmental grants. The absolute size of government grants, especially the Works Programme grants, often has been unknown to recipient jurisdictions until after the beginning of the fiscal year. Furthermore, shortfalls in actual central government distributions have been common (I.R. 10). In order to reduce this uncertainty, we recommend in the grant section of this Report that a specific formula be developed to tie the size of total grant allocations to collections of some central government revenues (Recommendation 51). In this way the BDG can announce the total amounts to be made available in local government grants prior to the start of a fiscal year and the local bodies can budget accordingly.

The central government must be able to track the financial condition of local governments so as to plot the progress of local fiscal reforms, assist in allocating government grants and monitor

troublesome areas in which further policy reforms might be necessary. At present, the Bangladesh Bureau of Statistics collects and publishes some data concerning local finances, but the coverage is not uniform.¹ Our experience in the field suggests that, given the well-trained cadre of field workers associated with the BBS, a Census of Local Government Finance could be carried out on a regular basis. With consistent nationwide data available, local governments could compare their fiscal situation with that of other localities. Likewise, such a database would be invaluable to an understanding of the workings of local government in Bangladesh.

9. A Census of Local Government Finance should be developed and conducted annually by the Bangladesh Bureau of Statistics. The Census would include detailed information on spending and revenue activities of each local body.

Finally, we feel that local government policy making would be aided if the Local Government Division of the MLG contained specialists in local government management. Expertise in this subject, especially financial management, is not a topic which can be mastered quickly. Furthermore, given the usual rotation of civil officers, it is a matter of chance whether an officer with a deep interest in the more technical aspects of local governments and their finances will be placed in a position where he will have a significant impact on local government policy. A specialist and staff could perform short-term analyses and

¹See Bangladesh Bureau of Statistics, Statistical Yearbook of Bangladesh (Dhaka: BBS) various issues which provides aggregate data for both zilla parishads and union parishads.

provide expert judgment on proposed policies. In addition, the office would work closely with the BBS in the design of the local government finance census and with institutions mandated to train local government managers.

10. A Local Government Management and Finance Cell should be a permanent part of the Local Government Division of the Ministry. This office, headed by an individual trained in local government management and finance, would be given the responsibility to analyze the fiscal and other implications of local government policies and proposals.

Summary

We do not advocate any sweeping changes in the current structure of local governments in Bangladesh, especially in light of the recent upazila initiative. Given this initiative together with the dramatic increase in the number of districts, it is, however, reasonable to revise the role played by zilla parishads by constituting them as advisory bodies without service responsibilities. More important are issues of personnel and financial management. The greatest need in these areas concerns training and placement of fiscal specialists. Under a highly centralized system of government, financial management is principally a matter of control over resources allocated from above. With greater autonomy, fiscal stewardship must also involve planning and greater monitoring and analysis of the local jurisdiction's fiscal condition. Such an initiative should be carried out at all levels from the Ministry down to the union parishad and should be supported both by the central government and international donor agencies who wish to promote this decentralization effort.

Land-Based Levies

The use of land-based levies for local resource mobilization should be an effective strategy in Bangladesh. Most development projects are site-specific, e.g., a roadway, embankment or canal, and in turn some portion of the project benefits are also derived at that site (I.R. 11). While user charges represent the most direct method for imposition of benefit levies, in Bangladesh there is currently little attempt to impose such charges and fees. For example, no charges are currently levied on users of irrigation water taken from public canals.

In the absence of widespread employment of user charges, land-based levies represent a reasonable alternative. Given a functioning land market, benefits of site-specific projects will be capitalized in land value. Capturing some share of these land value increments is one important route to increased revenue mobilization and is in keeping with the benefit charge theme followed here.

There is much to recommend this approach. First, because those to be taxed--landowners--can see direct benefits from the locally-financed projects, they may be more willing to pay the charge than they would be to pay a more general levy. A second advantage of land-based taxes for local governments is the immobility of the tax base. Since legal tax avoidance through mobility is impossible, revenues are more stable. A third advantage is that land-ownership tends to be positively related to income and wealth. Therefore, to the extent that a land-based levy is borne by land-owners, the tax conforms to the ability-to-pay principle of taxation. Fourth is the fact that land-based levies already exist in

Bangladesh. Thus, administrative changes need to be less radical than if new levies were to be imposed.

We consider three land-based taxes--the immovable property transfer tax, the land development tax and the holdings tax. Only the last is now a purely local levy in Bangladesh. The immovable property transfer tax is administered by the central government although the revenues are earmarked for to the zilla parishad or paurashava in which the transferred property lies. The land development tax is administered by and yields revenues exclusively for the central government. The recommendations below propose that these revenue assignments be changed.

Immovable Property Transfer Tax

The immovable property transfer tax (IPTT) is based on the value of the land and buildings bought and sold within a district or paurashava.¹ The levy has generated relatively large revenues for zilla parishads and, to a lesser extent, for paurashavas. Throughout the period 1976/77 through 1980/81 the IPTT accounted for nearly one-half of all revenues available to zilla parishads and grew, on average, more rapidly than did population and inflation. At the same time, when viewed in per capita terms the amounts of revenues generated remain low--a nationwide average per capita collection of only Tk. 1.04 in 1980/81. Furthermore, growth in revenues has not kept pace, on average, with increases in district GDP nor with district value added in agriculture (I.R. 3).² It is,

¹Throughout this discussion we make no presumption concerning any future transfer of IPTT revenues from the ZP to the UZP in spite of recommendations 1 and 2.

²The overall average GDP elasticity for the period 1976/77 through 1980/81 was 0.81 and that for value added in agriculture was 0.96.

therefore, desirable that the elasticity of this revenue source be increased and that the overall yield level be raised.

In what sense can the IPTT be viewed as a benefit charge? On the one hand, the linkage between taxes paid and benefits received is weak because: (1) IPTT is not earmarked for any specific purposes, it applies to all property sold and not just to those with access to good public services, and the tax is paid at the time of transfer (which is a random process). On the other hand, properties which have benefitted from past public investments will have higher land values than those which have not, hence the transfer tax will be higher. In a sense, when a beneficiary sells, he returns a portion of the benefits to the government. If this tax were not levied at the time of transfer, the new owner would fully compensate the old owner for any government-provided benefits and the government would receive nothing. Furthermore, we have shown that the tax on transferred property lowers the market value of all property, even property that is not exchanged (I.R. 3). Thus, to the extent that property ownership is positively related to income and wealth, the tax is in accord with the ability-to-pay principle of equity.

In considering the efficiency effects of the tax and the recommendations below, it must also be kept in mind that the IPTT is only a small component of the total tax or duty due on a transacted parcel. Stamp duties are also imposed at the time of transfer as are several different registration fees, the most important of which is the "A Fee". The stamp duty rates increase progressively with the value of the property and the A Fee is mildly progressive. As shown in I.R. 3,

these rates amount to over 18 percent of property values for parcels selling for Tk. 500,000. Thus, the IPTT, when imposed at its current rate of 1 percent, is small in comparison to these other levies and, therefore, the disincentives associated solely with the IPTT, e.g., discouraging market turnover, are small relative to those of the stamp duties and fees. On the other hand, since the high overall tax rates associated with property transfers may significantly discourage the efficient exchange of land, this central government tax issue is sufficiently important to justify further study.

Tax Rates. Since the current IPTT rate of 1 percent is low--both in the absolute and relative to the total tax rate on property transfers--an increase is likely to generate additional tax revenues with little adverse effect on the exchange of property. If there is no change in reported property values and rates at which properties are transferred, a doubling of the rate would double the revenues currently earned by the local bodies from the IPTT. One might anticipate that the increase in total rate will discourage some transfers. Assuming that the reported value of transferred property would decline proportionately to the percentage increase in the overall (IPTT plus duties) rate, an increase in the IPTT from 1 to 2 percent would have increased 1980/81 ZP revenues from the IPTT from Tk. 1.04 per capita to Tk. 1.91, or by 83.4 percent (I.R. 3). Such an increase would, on average, have increased total ZP revenues by 41.2 percent thereby greatly improving their abilities to meet demands for public services and maintenance needs (I.R. 8).

The following recommendation could be carried out with no alteration in the Local Government Ordinance.

11. The immovable property transfer tax rate should be increased from its current level of 1 percent, to 2 percent.

The IPTT could also be used to strengthen the fiscal autonomy of local governments. If the recommended 2 percent rate is considered a floor, local governments could be given an option to add to the rate up to a specified ceiling rate. Such authority would be a very important step towards decentralization. The principal difficulty associated with such local autonomy concerns administration of the IPTT. Currently, transferred property can be registered and duties, fees and taxes can be paid at any district headquarters, regardless of property location. Interjurisdictional rate differentials would complicate the collection process by requiring the registration officer to determine the appropriate rates for the jurisdiction in which the property is located. If this is seen as overly complicating the tax collection process, registration of property could be restricted to the jurisdiction in which it is located although this would increase tax compliance costs.

Again, a choice must be made: greater local government autonomy versus increased administrative or compliance costs. We feel that the decentralization benefits of autonomy are sufficient to recommend:

12. Local governments earning IPTT revenues should be given the power to add up to 1 percent to the basic 2 percent rate.

Tax Base. Taxes on the transfer of property in developing countries have received much criticism by students of land taxation because of their adverse effects on the rate at which property is exchanged. Nevertheless, given the revenue needs, the scarcity of taxable economic

activity in the rural areas of Bangladesh and the relatively low rates imposed, we feel that the current tax base constitutes a reasonable basis for taxation and we recommend no changes therein. There is, however, some question as to whether the base should be altered given the new larger number of districts or if the levy is transferred to upazila parishads.

The issue is whether the smaller physical size of the taxing units would lead to greater fluctuations in the revenue yield of the IPTT. The tax is levied on the sale of property, which is a random event. With a greater number of taxing jurisdictions, each will be smaller in area with fewer parcels which can be transferred. The randomness in property transfers can, therefore, result in greater annual variability in IPTT yield.¹

Some indication of the potential effect of smaller districts is obtained by contrasting the coefficients of variation in real per capita IPTT collections in 19 districts for the period 1976/77-1980/81 with comparable coefficients of variation for the four divisions in the country. The average coefficient of variation for the 19 districts of is about half again as large as that for the divisional level.

Less stability in tax yields could, therefore, result from the creation of additional taxing units. It may be that this adverse effect does not warrant any additional complication of the tax base and

¹This argument is based on the fact that the variance of the sample distribution of a binomial process declines as the sample size increases. Decreasing district size is tantamount to decreasing the size of a sample since fewer parcels are at risk of being sold in any single year.

administration. On the other hand, large fluctuations in annual revenues can complicate fiscal planning. One approach to this problem, which would create no greater annual variability in yields than currently exists, would be to aggregate the tax yields across the taxing jurisdictions to the level of the original 20-21 districts and distribute the amounts among the ZP or UZP according to a formula. The simplest formula would use only population; another could include both population and miles of roads as a proxy for road maintenance spending needs. The weakness of this aggregation and sharing approach is that it would eliminate the possibility of autonomous rate-setting by the local government. Therefore, we make no recommendations for a change at this time. Instead, the BDG should simply be aware of the IPTT revenue variability problem associated with the creation of new taxing jurisdictions and, if the problem proves to be severe, should consider ways to diminish the difficulty.

Tax Administration. While a rate increase would produce additional revenues from the IPTT, another desirable and productive area of reform concerns tax administration. The single factor most responsible for restraining the yield of the current IPTT is understatement of the value of the transfer. Improving this situation, with or without changing tax rates, will require changes in administration of the tax.

Under current procedures, neither district registrars nor sub-registrars have been instructed to detect and correct undervaluation. Indeed, officials have been instructed to accept the stated value. This should be changed.

The fact that the central government already administers the IPTT in conjunction with the stamp duties provides an advantage in implementing such a change. That is, the Ministry of Law and Land Reforms has an incentive to raise greater revenues. Thus, in conjunction with amending the manual of instructions, the Law and Land Reforms Ministry should make it a policy to reward those registrars and sub-registrars who are successful in detecting undervaluation. Tahsildars, who verify the transfers after registration, are also a part of the compliance process and are also under the control of the Ministry of Law and Land Reforms. Similar incentives should be provided to this group. Thus:

13. The manual of instructions for collection officials should be amended. Officials should be directed to attempt to determine the correct value of the recorded transfer. Evaluation of the job performance of collection officials should include their effectiveness at detecting undervaluation of property.

The detection of undervaluation would be greatly facilitated if additional information were available to registrars, sub-registrars and tahsildars. A reasonable selling price for a parcel of property is likely to be related to its value when previously sold; therefore, if such information is made available, chances will be improved that undervaluation will be detected. Thus:

14. A transfer should not be allowed until the previous deed of ownership, along with evidence of its previous purchase price, is presented.

Property values differ greatly throughout the country. Still, similarly situated properties within a paurashava or upazila are likely to have similar prices with factors such as nearness to roads, access to water and irrigation facilities, and types of structures playing dominant roles in price differentials. It should be possible to construct a table of average property values per decimal for each upazila. The table could then be used as a check on stated values at the time of transfer. The task of constructing such a table could be assigned to the upazila statistical officer who would prepare it after consultation with other upazila officers, members and chairman of the UZP, as well as individuals knowledgeable about the local real estate market.

15. A schedule of approximate property values, broken down by major property characteristics, should be developed and updated annually in all upazilas by the upazila statistical officer.

While detection of undervaluation is a necessary condition for its elimination, it is also important that the individuals participating in such illegal activity be punished. At present there are no penalties on undervaluation. Thus:

16. Penalties for undervaluation should be imposed and publicized. These penalties, possibly equal to twice the evaded tax plus interest, would have to be paid in addition to the tax due prior to subsequent transfer of the property.

Property registration and collection of the IPTT along with other transfer duties and fees are fully the responsibility of the central

government. We would not recommend that this be changed. On the other hand, the zilla parishads and paurashavas seem to take an entirely passive attitude towards the collection of the IPTT. Even though the local bodies have no direct leverage over the registrars and sub-registrars, periodic inspections of the registration process with reports written to supervisors of the personnel involved are in order.

17. Local bodies deriving funds from the IPTT should regularly inspect and investigate the manner in which the tax is being administered locally to insure that undervaluation is being detected and that the total tax liability due the jurisdiction is properly being credited to its accounts.

Land Development Tax

The land development tax (LDT) has, since its inception in 1976, been exclusively a central government revenue. With the push to decentralize and the formation of upazilas, we believe the time is right to allow local bodies, specifically the upazilas, to share in the receipts from this tax (I.R. 9).

The LDT is administered by the Ministry of Law and Land Reforms and is based on the size of land holdings. The Land Development Tax Ordinance, 1976 and its subsequent amendments distinguish between agricultural and non-agricultural land with the latter type of land further subdivided into rural and urban location and land-use types. Agricultural land has always been taxed at progressively higher rates for larger landholders; but the structure of these rates changed dramatically in July 1982 when the number of landholding classes was increased from two to six and the rates were changed. The result of

these rate changes was to increase the effective tax rate per acre on the very smallest (less than one-third acre) landholders as well on larger landholders (those owning more than 2 acres). For extremely large landowners (e.g., those with 30 or more acres) the altered rates amounted to more than a five-fold increase in tax liability (I.R. 7).

Despite the fact that the tax is tied to acreage and land-use rather than value, yields of the LDT increased in nominal and real terms throughout the latter half of the 1970s. Total real collections increased at an average annual rate of 7.5 percent from 1976/77 through 1980/81 (I.R. 7). While the change in tax rates in 1982 should have increased 1982/83 tax yields between one hundred and three hundred percent (I.R. 4), there were widespread administrative problems encountered in implementing the new rate structure. Only after temporarily reverting to the former rates during the final months of the fiscal year did tax collection rates improve so that total nominal revenues for the year exceeded those for 1981/82 (but by only about 10 percent).

In what follows we first indicate how the tax could be structured as a local government (upazila) revenue source. With an eye toward revenue performance, we consider alternative reform policies concerning the base of the tax, its rates and administration.

Reasons for a Local Land Development Tax. The four arguments for local land-based taxes presented above hold for the land development tax. The LDT provides an effective way to tax recipients of benefits of locally-financed projects, cannot be legally avoided by moving, generally conforms to ability-to-pay, and is already levied throughout

the country. With additional administrative and structural changes it could provide an excellent opportunity to tap the most abundant taxable resource available at the upazila level, land, in a manner such that those who benefit from a public investment (e.g., upgrading a road from katcha to pucca) bear a portion of the costs. Furthermore, the link between taxes paid and benefits received should be much more visible when revenues are retained locally.

Any transfer of tax revenues between governments has revenue implications on both public bodies. Thus, changing the LDT from a central government to an upazila parishad revenue source would affect the available resources of each. But as shown in I.R. 9, the total revenue effect of such a change would not be profound at the central government level. In 1979/80, the LDT produced a total of Tk. 138.8 million, or only 1.1 percent of total central government taxes and 0.4 percent of total expenditures. The relative shares were quite similar throughout the period 1980/81-1982/83.

The tax could have substantial revenue effects if transferred to the upazilas. Even one-half of the Tk. 250 million estimated 1981/82 LDT revenues was 215 percent greater than the amounts obtained by thanas that year via Rural Works Programme grants.¹ The relative impact on upazila revenues, given the current Development Fund grant (see below) would, of course, be much less; nevertheless such a transfer of tax revenues would assist these local bodies.

¹This is an upper bound since the LDT is collected in both rural and urban areas while the RWP was distributed only to rural thanas.

Since LDT collections differ across upazilas, the distribution of increased revenues would not be uniform across these local bodies. Revenues would depend on acreage in the upazila and landholding patterns. Additionally, however, upazilas with more effective tax collection efforts would derive greater benefits--an important incentive associated with any initiation of revenue mobilization powers. It would, therefore, be in the interest of the upazila to insure that local taxpayers comply with the levy.

Because of these incentive effects and the need for a productive local revenue source at the upazila level, we recommend that:

18. The BDG tax structure should be altered to provide that 50 percent of land development taxes collected within an upazila parishad should be retained by that upazila parishad. Tax administration should remain the responsibility of the central government.

This recommendation is of a shorter term nature; over the longer run greater responsibility could be undertaken by the local government in administering the levy. Even in the short-run, however, changes could be made to the tax to improve its efficiency and equity implications while improving its yield. Furthermore, as was recommended above (Recommendation 3), job performance evaluations which rely heavily upon the reports submitted by upazila parishad chairmen can provide an incentive to LDT collection officials deputed to the upazila.

Tax Base. The statutory base of the LDT on agricultural land is the total holdings of a household.¹ In theory, each individual's holdings are summed, the individual's holdings are aggregated by family, and the LDT is based on the family's total acreage. This process is to apply to family landholdings located throughout Bangladesh. If this procedure were actually practiced and the current progressive rates applied, then the LDT would be redistributive in nature, and the tax could even be used as an instrument to promote land reform.

Unfortunately, difficulties of record-keeping make it unlikely that tax liability is ever based on total acreage owned throughout the country. Interviews with local officials indicated that ownership in different mauzas within the same upazila--and therefore under the jurisdiction of a single CO-Revenue (now URO)--was seldom checked. The ability to discern ownership in different upazilas or districts is even more limited. Furthermore, if proper procedures are applied in some instances but not in others, inequities are introduced.

Because of the administrative difficulties of aggregation and the inequities which partial aggregation produces, it is more reasonable to base the LDT on a family's holdings within a single khatian. While this change would significantly reduce the potential progressivity of the LDT, we feel that the administrative difficulties in carrying out the aggregation process in an equitable manner are sufficiently burdensome to recommend that:

¹We ignore here any discussion of the non-agricultural LDT under the assumption that the rural upazilas--the local bodies of primary interest here--would be principally affected by LDT policies regarding agricultural land.

19. The LDT on agricultural land should be based only on the size of each ownership plot within a khatian.

The LDT is an area-based tax. It has long been recognized that a tax based on value is better able to promote an efficient use of resources, a more equitable distribution of the tax burden, and greater automatic growth in tax revenues. The development of a value-based LDT will be no easy task in Bangladesh in that a schedule of land values will have to be constructed.

The necessary valuation need not be based on a sophisticated approach, at least at the outset. Similarly situated properties within an upazila are likely to have similar values, with factors such as soil quality, nearness to roads, and access to water and irrigation facilities playing dominant roles in the determination of land prices. While not as accurate as a parcel-by-parcel ocular survey of each plot, reasonably accurate approximations can be made of average land values per decimal in an upazila using these characteristics as the primary determinants of land prices. The values would be based on a survey of transaction prices of land together with information collected from those knowledgeable of local land prices. This task would, as suggested in Recommendation 15 above, be carried out by the upazila statistical officer and would serve two purposes--to improve administration of both the IPTT and the LDT. The use of the upazila statistical officer would also split the tax assessment--tax collection processes. This is an advantage in that it separates the basically political issue of rate-setting from the basically technical issue of land valuation. The result is to increase overall property tax performance.

The upazila land value information can then be used to determine a taxpayer's LDT liability as the product of the acres of land owned in a khatian, the average value per acre for that land type, and the tax rate. Ideally, land values would be updated annually so as to tie tax liabilities more closely to the value-enhancing effects of public sector investments. Altering tax assessments can, however, involve considerable administrative costs. It is, therefore, more reasonable to reestimate these values periodically, for example every three to five years. Thus:

20. In the longer run the land development tax should be converted to a value-based levy. A schedule of average land values, broken down by major land characteristics, should be developed and updated every 3-5 years in all upazilas. The base of the LDT would be the value of land, equal to the size of the plot times the average value per acre.

Tax Rate. Since its inception in 1982, LDT administration officials have expressed dissatisfaction with the highly graduated rate structure for agricultural land. The complexity of the six-slab structure created much confusion among collection officials during 1982/83 and led to a temporary change in rates back to their previous levels.

We feel that a simplification of the rate schedule would aid the collection process keeping the LDT a reasonably equitable tax. For example, a proportional tax rate could easily be designed to generate revenues equal to those of the existing schedule. Using data from the 1978 Land Occupancy Survey (LOS) of Bangladesh we calculated that a tax rate of Tk. 20 per acre would generate potential tax revenues from agricultural land slightly greater than those attainable under the 1982

schedule (I.R. 8). Based on the conservative estimate of Tk. 20,000 per acre land value, a Tk. 20 per acre LDT results in a tax rate of only 0.1 percent of value, certainly not one that could be judged expropriative.

The main advantage of a proportional system is its simplicity. A proportional tax also gives no incentive for artificial, tax-induced break-up of parcels. Moreover, a proportional schedule in Bangladesh will be modestly redistributive given the extreme concentration of land ownership. The estimated distributional effects of a proportional rate system suggest that the per household and per capita potential tax liabilities are higher for small landowners than under the 1982 schedule while the liabilities of a large landowner under a proportional system are lower than before. Nevertheless, the liabilities still rise markedly with holdings size (I.R. 8).

Under a proportional rate structure, the progressivity of the LDT could be improved greatly by exempting the smallest landowners from the tax. This exemption would have little effect on revenues. Again, using the Land Occupancy Survey data, an exemption of plots 1/10 acre or smaller in size would remove 4.2 percent of the sample population owning 0.5 percent of the total land from LDT tax rolls. Under a proportional rate of Tk. 20 per acre, this would decrease revenues by only 0.5 percent. While the exemption introduces an incentive to divide holdings artificially, a 1/10 acre exemption level should effectively eliminate this option for all but the very smallest landowners. Thus:

21. A proportional tax rate of at least Tk. 20 per acre should be adopted for the land development tax with owners of agricultural plots 1/10 acre or less in size being exempt from the tax.

The level of LDT collections is very low, whether measured in per capita, per acre, or per land value terms. As indicated above, the current rates are, on average, no greater than 0.1 percent of land value. The beneficial effects of land taxation depend on the existence of substantive, though not prohibitive, rates.

With a Tk. 20 per acre proportional tax rate and an exemption level of 1/10 acre for agricultural land, the potential yield of the LDT would be about the same as under the 1982 rate schedule. If this were increased to Tk. 25 per acre and if collection efficiency remained constant, potential agricultural land tax revenues would increase by 25 percent.

The level of real LDT collections has fallen over time as prices have increased. In order to maintain or increase revenues, administrative adjustments in the tax base, tax rate, or collection efficiency are necessary. In the absence of a change to a value-based tax, the simplest of these is a rate change. Given a simplified tax rate structure, proportional increases in rates are easy to administer, and avoid the problems such as those associated with the 1982 rate structure changes. Moreover, some regularity should be introduced into the rate changes in order to prevent declines in real LDT collections.

Thus:

22. Until a value-based LDT is implemented, the tax rates on agricultural and non-agricultural land should be adjusted every 3 years. The adjustment should be tied to an appropriately chosen price index such as the national income deflator.

The two previous recommendations could be undertaken whether or not the recommendation to transfer the LDT to upazilas is accepted. If the LDT is, in fact, transferred to these local bodies, they should be given some discretion in the choice of local LDT rates. We do recommend that the central government should continue to derive revenues from the LDT, therefore, some rate floor should be established throughout the country, e.g., the previously recommended Tk. 20 per acre with upazilas sharing in the revenues on a 50-50 basis. Upazilas can then be given the option of imposing an additional surcharge, e.g., up to Tk. 10 per acre, with all revenues flowing to the locality. Again, the fact that these monies would remain in the local area should aid the collection process.

23. Upazila parishads should be given the power to set land development tax rates within some bounds. If a nationwide tax rate of Tk. 20 per acre is imposed, localities should be free to impose an additional surcharge of up to Tk. 10 per acre with all such revenues retained by the upazila parishad in which the property lies.

Tax Administration. As is the case with the IPTT, administrative improvements are crucial to the development of an effective land tax system in Bangladesh. These administrative improvements involve both the determination of the tax base (even under the current area-based levy) and collection of the tax. One obvious requirement for good land tax administration is land-ownership records including land maps. While Bangladesh is more fortunate than many developing countries to have some

tax maps, the mouza maps are outdated and, due to resource constraints, new surveys are being completed very slowly. At the same time, experience in other countries has shown that tax mapping can greatly improve the administration of property tax, leading to improved equity and collection efficiency.

Some central government resources should be diverted to the land survey efforts. In addition, international donors interested in aiding decentralization should seriously consider utilizing grants or long-term loans to help support these mapping efforts. Not only would such efforts aid in LDT administration, they could also play an important role in economic planning.

24. Efforts should be made to increase the rate at which mauza maps are being redrawn. This is an especially appropriate area for international donor involvement through the provision of technical assistance and grants or long-term loans.

Despite reasonable success in collecting the LDT, it is likely that collection efficiency can be further improved. One way to do this is to strengthen the penalty process. At present the penalty for delinquent taxes is small (6.25 percent simple interest) and enforced only after three years. Thus:

25. The interest penalty on delinquent taxes should be increased and imposed using compounded rates. In addition, the penalty should be imposed if taxes are not paid within one year.

Other features of the penalty process need not be changed; however, the timing of these procedures should be altered to reflect the one-year grace period.

The key to successful administration of any tax is in its collection. In the case of the LDT this means that the tahsildar must perform effectively. At least some of the tahsildars with whom we spoke have been in this position for 20 years or more. Several admitted that they have received only minimal training throughout their tenure in office, despite substantial changes over the years in the tax that they are to administer. Some short course training should be implemented for tahsildars, especially those in that position prior to the institution of the LDT in 1976. Training sessions of 2 to 3 days in length could be held at upazila headquarters during September-December when tahsildar work loads are lighter. These training sessions would focus on record-keeping procedures and would instruct tahsildars in any changes that had been made in the LDT.

Experienced personnel can also be used in these training sessions to discuss the major problems associated with tax collections and the procedures they have used to overcome the difficulties. Similarly, these more experienced personnel may have suggestions whereby the currently cumbersome record-keeping procedures might be streamlined while maintaining accounting integrity.

Evaluation of tahsildars' efforts should also be systematic. While, on average, there appears to be a reasonable tax collection efficiency record, there is considerable variation in ratios of collections to demand. Part of this variability may be due to poor record-keeping and slow recording of land transfers by the tahsildars.

Although training may improve job performance, it is also necessary that evaluations of this performance be made and subsequently used in transfer and promotion decisions. Thus:

26. A nationwide training program for tahsildars focusing on record-keeping procedures and changes in the LDT should be implemented. Annual evaluation of tahsildars by revenue officers would emphasize collection efficiency and record-keeping, especially the rate at which transfers of ownership had been recorded.

If the recommended value-based tax is implemented in the longer run, this recommendation becomes even more crucial.

Holdings Tax

The combination of the union rate and chowkidari (village police) rate, termed the holdings tax, is a property tax based on the value of buildings and the land on which they are situated. Revenues from these taxes might be seen as approximating a benefit-based levy since spatially-specific government activities are capitalized in the value of property.

In the past these taxes constituted the major own-source revenue for most union parishads, although some earned substantial revenues from sources such as markets (I.R. 8). But with the institution of the Local Government (Union Parishads) Ordinance, 1983, union parishads will be almost entirely dependent upon these levies since their list of permissible taxes, rates and fees has been shortened. If union parishads are to become fiscally sound, the holdings tax must carry the load.

Analysis of the statutes defining these taxes suggests that they are efficient and reasonably equitable. Thus, we do not recommend any major changes in the laws defining these most important revenue sources for union parishads. On the other hand, our analysis suggests that there is little correspondence between the statutory definition of the taxes and what actually occurs in the unions. This suggests that administration is likely to hold the key to revenue yield improvements from this levy. Only after such improvements are begun would it be reasonable to give additional statutory autonomy to local bodies imposing these taxes.

Each of the three components of a successfully-administered property tax--assessment, record-keeping and collection--contribute to the weaknesses in the UP holdings tax. Assessment tends to be ad hoc; records are poorly kept; and collection is random, at best, and often politically motivated (I.R. 12).

Tax Base. The ad hoc assessment "system" employed in union parishads leads to inequities sufficiently severe to call for a thorough overhaul of the process. Several options might be followed in altering the current union rate/chowkidary tax system.

One approach would be simply to forego any attempt at imposing property-based taxes at the UP level. This, of course, would effectively leave these jurisdictions without own source revenues unless an alternative levy could be devised.

One such alternative would be to institute a personal tax. Personal taxes are levied in many African countries; however, in Bangladesh this interpretation of the tax does not have the weight of

law. In Africa, the tax is paid by all adults (or, in some cases, adult males) either as a flat amount or as a slightly graduated tax with higher income persons paying larger amounts. Since much economic activity is outside the monetized sector in these countries, local chiefs often determine into which income slab a resident falls. If the landless in Bangladesh were exempt from a personal tax levied on all persons including children, a flat tax of Tk. 1.35 per capita would result in UP revenues equal to the average UP holding tax collection found in our sample of 42 UPs in 1980/81.¹ Such a rate could be graduated by allowing UP members to place families into groups ranging from low income or landless to high income/wealthy and then levying a flat tax on each group with the lowest group tax exempt. This is, in fact, the way the tax is administered in some unions. Changing the statutes to reflect these practices would, at least, legitimize the procedure and possibly avoid some inequities inherent in the current more ad hoc system.

The personal tax idea does have some major disadvantages, however. A graduated personal tax would not effectively pick up benefits associated with public sector projects. Of course, the current holdings tax as administered is also not an effective benefit-based levy. The elasticity of a personal tax tends to be low, but probably no lower than the currently-administered tax. Even if progressive slabs were used,

¹This estimate assumes 12 percent landless. This assumption is based on Bangladesh Bureau of Statistics, Statistical Pocket Book of Bangladesh (Dhaka: BBS, 1982), p. 166. Higher estimates of landless persons would, of course, result in larger per capita personal tax rates necessary to achieve constant revenues.

the tax would be regressive within slabs since those near the upper bound of the slab are paying relatively less of their income in taxes than are those near the bottom of each slab. But again, this problem may be no more severe than the current system. With rates kept quite low, inefficiencies associated with a progressive personal tax would not be severe. Indeed, a flat rate head tax without exemptions is economically efficient.

Another alternative, and the one advocated here, is to invest in improvements in the current tax administration system at the UP level. This will, however, take a concerted effort on the part of the BDG.

Our survey of UPs (I.R. 8) and the Sylhet case (I.R. 12) suggest that those carrying out tax assessments do not, for the most part, have any specialized training in valuation practices. Instead, local politicians annually determine total taxes in what appears to be an ad hoc or politically-motivated fashion. Good property tax administration is possible only if politics are removed from the valuation function. Politics should enter only on the ratemaking side.

One method whereby local politics could be removed from the valuation process while increasing the likelihood that the assessor is trained in valuation techniques would be to station an assessor in each upazila. This valuation officer, working under the upazila finance officer, would be responsible for reassessing all properties in each union parishad every five years as directed in the statutes. Local politicians could then "blame" local assessments on this higher level of government thereby reducing some of the local political pressures against this tax. Since assessments require that the valuation officer

be aware of the market values of immovable property, he would also prove useful in helping to construct the table of land values suggested in Recommendations 15 and 20 above.

27. Trained valuation officers should be posted at the upazila level with the responsibility of reassessing properties every five years in each union parishad within the upazila.

Tax Records. It is also clear that there are considerable weaknesses in holdings tax records. We observed that assessment rolls were not up-to-date, the records did not clearly indicate who had or had not paid their tax and procedures for altering records when property was bought and sold were not well-defined. Since reassessment of properties is unlikely to occupy the total time of the valuation officer recommended above, we would suggest that he also be assigned the task of working with the UP secretary to improve bookkeeping procedures so as to increase the accuracy of records on tax payment and non-payment. Additional formal training programs provided directly to the secretaries should also be undertaken under the guidance of the Local Government Division of the Ministry. Without such efforts, accurate assessments are unlikely to be transformed into more equitable and greater yields from the holdings tax.

28. Formal training programs on holdings tax record-keeping should be provided to union parishad secretaries. In addition, the tasks of the valuation officer should include consultation with these secretaries so as to improve the quality of holdings tax records.

Tax Collection. Collection procedures are also woefully inadequate. Most unions rely upon private collectors who are reimbursed some proportion (usually from 15-20 percent) of their collections. While this approach should contain a sufficient incentive to promote successful collection efficiency, it has largely failed to do so. Appointments of tax collectors are often politically motivated and those selected are often not committed to the task or are strongly influenced by political pressures such that relatives of the UP chairman or other powerful persons do not pay their tax at all. The use of roving private collectors also presents greater opportunity for taxpayer-collector collusion and, unless policed very closely, for collector fraud through non-issuance of receipts. It may therefore be helpful to abandon this payment method in favor of personal appearances of taxpayers at the union parishad headquarters or at specific pre-announced sites on particular days throughout the union, e.g., on specific market days.

More important is the need for some direct incentive to be given to local taxpayers to comply with the legal tax liability. One such method that worked in our case study union parishad in Syhlet was to tie benefits from centrally-administered programs such as issuance of ration cards or permission to purchase subsidized rice to documented proof of payment of the holdings tax (I.R. 12). This procedure can be extended to other services provided through the UP as well such as issuance of nationality, character, birth, or death certificates.

29. The use of private holdings tax collectors should be abandoned and replaced with a system whereby taxpayers must appear at the preannounced site during a specified time period to pay taxes directly to the union parishad secretary. At that time a taxpayer identification card would be issued which would be a necessary qualification for participation in governmental services provided through the union.

Education of politicians and taxpayers must go hand-in-hand with these structural changes designed to improve taxpayer compliance. No one likes to pay taxes; but it is less painful if there is a recognition that one derives some benefit from the taxes that are paid. Likewise, political decision makers must be aware of the importance of being willing to collect the taxes levied and to implement techniques for improving tax compliance. The latter is possible both through formal legal methods of collecting delinquent taxes (according to our survey, when these methods are used, people do pay) and informal methods of encouraging compliance. Among the latter are campaigns which build upon a sense of community and the importance of everyone paying his share to support projects undertaken by the local government. Again, the upazila property tax technician could aid in carrying these educational efforts.

30. Training of union parishad chairmen and members should include material on holdings tax collection practices emphasizing the role of legal remedies and tax campaigns designed to improve taxpayer compliance.

Finally, as discussed in the grants section, the intergovernmental grant system should be modified to provide additional incentives for greater property tax collection success by union parishads.

Summary

We recommend three land-based taxes for local governments in rural Bangladesh. The immovable property transfer tax is and should remain one of the principal local government revenue sources. Its growth and elasticity record are not bad, but we feel the absolute level of collections can and should be increased. The two key areas for improvement lie in the level of the tax rate and the collection process. At a minimum, the rate should be doubled; greater local government autonomy would occur if these bodies were allowed to supplement the basic rate with a further surtax of up to 1 percent.

Incentives are the key to improved IPTT collection performance. Penalties and stronger administration of the levy should help overcome evasion of this tax. While local governments have no direct control over the collection process, the stamp duties and registration fees make it in the interest of the central government to insure that these revenues are collected. Some simple changes could aid this effort. Included here are changing the procedures used by registrars, making additional information regarding property values available to those who are to detect undervaluation and basing job performance evaluation on the employee's success in the detection of tax evasion.

We recommend that the LDT become a tax source of the UZP with some autonomous rate-setting powers granted to these local governments. Tax administration should continue to be the responsibility of the central government with it retaining one-half of the collections earned from a nationwide uniform basic tax rate. The tax structure should, in the short-run, be altered to a proportional tax

with the smallest parcels made exempt; in the longer run, the tax should be based upon land values rather than land area. Considerably greater efforts should be made to update mouza maps and train tahsildars so that the tax can be administered more efficiently and fairly.

While the union and village police rates (holdings tax) are currently poorly assessed and administered, we feel changes can be made to improve this situation and provide union parishads with a levy which would generate more revenues in a manner which would be more efficient and equitable. Assigning the assessment function to personnel at the next higher level of government would, we feel, greatly improve the holdings tax by providing more accurate valuations and by diminishing the role local influentials play in the process. More accurate records are also a necessity in the administration process with training providing the key to this objective. Finally, abolishing the current system of private tax collectors, tying tax collections to other services provided at the union level and implementing tax campaigns should improve tax collection efficiency.

Activity-Based Revenues

While real property constitutes the most obvious taxable resource for rural local governments in Bangladesh, both the statutes and actual practice indicate that other economic and non-economic activities can also provide resources to these local bodies. Indeed, under the combination of the Local Government (Thana Parishad and Thana Administration Reorganization) Ordinance, 1982 and the Local Government (Union Parishads) Ordinance, 1983, upazila parishads must rely entirely

upon such non-land based taxes, rates and fees. Since the final taxation rules for upazila parishads were not released until December 1983 it was not possible to observe directly their revenue performance. Still, it appears that these local governments must anticipate most locally-raised revenues to be earned from market and fishery fees with some small additional amounts derived from taxes on businesses, trades and callings. Thus, if the previously-recommended transfer of the LDT to upazilas is not implemented, upazilas must concentrate their efforts in these areas.

Non-Land Taxes

Potential taxes falling under this general heading include those on professions, trades and callings; on births, marriages and feasts; on advertisements; on amusements of various sorts; on animals; and on vehicles other than motor vehicles. Each is a levy on a particular type of economic activity (with the animal and vehicle taxes being equivalent to a personal property tax). In many rural areas of Bangladesh the base of each of these taxes is likely to be small; therefore, tax rates and good administration provide the key to revenue yields.

Two of the taxes listed above deserve particular attention here--the tax on professions, trades and callings and the vehicle tax. Each might be viewed as a kind of benefit-based levy. To the extent that development initiatives undertaken by local governments improve the economic lot of local residents, economic activity will increase. In turn, local businesses and businessmen will benefit, at least indirectly, from a more vigorous local economy. Likewise, vehicles are a good taxation target since a substantial portion of local government

resources are devoted to road maintenance. While some roads may have characteristics lending themselves to the imposition of tolls (discussed below), most do not. Vehicle taxes constitute one method whereby local governments can obtain revenues to support road maintenance.

While one cannot analyze the revenue performance of these taxes at the upazila level, it should be recognized that union parishads were not particularly successful in obtaining significant amounts of revenue from these levies. Fiscal records of union parishads in Faridpur, Rangpur and Sylhet Districts indicated that during the late 1970s and early 1980s less than 3 percent of total UP revenues were earned from these sources, and the yield was only about 10 paisa per person in each union parishad (I.R. 8). From this performance, one could infer that there is some capacity for increasing revenues from these sources. But again, it will require central government action.

The maximum tax rates do not indicate that the revenue productivity of the tax on professions, trades and callings will be great. Few businesses will be required to pay more than Tk. 50 annually with only amusement activities and large employers (more than 100 employees) required to pay as much as Tk. 250 and Tk. 500 per year, respectively (I.R. 1). A five taka tax per employee each year is an extremely low local tax liability.

There are at least two other aspects of the tax schedules which deserve attention and subsequent amendment. One is that the rules are written in terms of maximum rates with no minimum rates specified. While it might be argued that this constitutes "local government fiscal autonomy," it must be recognized that the provision allows jurisdictions

to fail to raise any revenues from this source. This weakness could be alleviated by restructuring the grant system to account for local tax effort (discussed below); in the absence of such a policy minimum rates would be advisable.

A second weakness inherent in flat specific rates not tied to economic activity is that they are income inelastic and respond to neither increases in economic activity nor inflation. While it is currently not feasible to impose business taxes based on a business's gross receipts, revenue elasticity under the current structure will be possible only through periodic rate increases.

31. The maximum tax rates for the vehicles tax and profession, trade and callings tax should be reexamined to ascertain if the rates could not be increased. In any case, minimum rates should be prescribed and the entire schedule should be updated every 3 years to reflect increases in the general price level as measured by the national income deflator.

Taxes on the erection and re-erection of buildings is allowed in the Local Government Ordinance; however, we did not find this tax levied in any of the sampled unions (it is, however, imposed in paurashavas). This one-time tax can be effectively administered at the union level since inspection is easy. Adding even 100 taka to the cost of a new structure would not greatly impede new construction and generally would fall on those with greater ability to pay as evidenced by the fact that they have the resources to construct the building. Finally, imposition at the union level would aid administration of the holdings tax by keeping local tax rolls up-to-date. To do so would, however, require an amendment to the Local Government (Union Parishads) Ordinance, 1983.

32. Taxes on the erection and re-erection of buildings should be allowed at the union level. A model tax schedule which reflects current building costs should be devised prior to the imposition of this levy.

Non-Tax Revenues

The most productive forms of non-tax revenues derived by local governments in Bangladesh are fees placed on markets and tolls on roads, bridges and ferries. Unlike some countries in which these types of activities are operated directly by the local government, the practice in Bangladesh has been to lease facilities to private enterprises. Given the importance of these revenues, it is worthwhile to consider the relative advantages of leasing vis-a-vis directly operating the facility.

Leasing Systems. Probably the most important advantage of the leasing system is that it relieves the local government of the need to staff enterprise facilities on an on-going basis. Under a leasing scheme the day-to-day operational decisions, financial affairs and ordinary personnel problems become the responsibility of the leaseholder. If, as many argue, privately-held organizations are operated more efficiently than are publicly-run facilities, leasing can generate greater local revenues than would governmental operation. This, however, depends on the relative inefficiencies of the two modes of operation and the competitiveness of the leasing process.

Leasing is not without potential disadvantages. In order for the auction method to extract all but normal profits from operators, numerous, non-colluding bidders must participate. Furthermore, so as to protect the health and safety of the general public, the local

government still must insure that sanitary conditions are maintained in the markets and that ferries are kept in safe operating conditions. It is quite possible that local bodies will fail to carry out these inspections when the jurisdiction is not immediately responsible for the service.

Another potential disadvantage of leasing arises when the service in question, e.g., a ferry, is justified as a governmental service due to its redistributive or external benefits.¹ For example, one possible rationale for public markets is that everyone, including those too poor to travel longer distances to larger, more economic markets, should have easy access to these facilities. In such instances, markets need not "make a profit" in order to be justified as a government activity. But if markets are being leased and no profits can be earned, no bidders will be willing to operate the facility. In such an event, the jurisdiction must either subsidize the activity or close it down thereby foregoing any redistributive benefits.

If local government enterprises such as ferries or markets, either self-operated or leased, are to be managed efficiently in the long-run, full costs of enterprise operation must be recognized. In the short-run there may be little need to account for the fact that, while the market is operated, the facility is being "used up" as capital stock depreciates. But over a longer period the facility will have to be replaced, thus full market costs include replacement costs as well as

¹External benefits arise when society as a whole, or segments thereof, derive benefits over and above those enjoyed by the immediate user of the service.

current operating and maintenance costs. In the absence of separate fund accounting which provides for capital stock replacement, the facilities may fall into complete disrepair with no local resources available for reconstruction. While this outcome can arise under either leasing or self-operation, leasing can make it easier for the jurisdiction to ignore these longer term issues and view the annual revenues earned from the facility as truly general fund revenues.

The foregoing discussion of equity goals and externalities of public enterprises suggests that leasing is not always the most efficient nor equitable approach to operation of these facilities. As such, it is not possible to make a general recommendation regarding which mode of operation ought to be used by all local governments throughout the country. On the other hand, it does not appear that these issues have been considered in any depth by policy-makers as they prescribe rules for leasing operations.

It is possible, however, to provide for inspection of facilities and long-term replacement thereof. For example, in the case of markets, the upazila health officer could be designated as the official inspector of markets to insure that the public's health and safety are protected in market facilities. Periodic unannounced inspections of haats and bazaars should be one of his duties. Likewise, upazila finance officers should insure that correct market fees are posted and imposed. Violations in either of these requirements should prompt initiation of proceedings to terminate the lease.

Upon further study of the economics of these facilities, it should be possible to estimate replacement cost needs for public enterprise

facilities such as ferry ghats and markets. From this analysis rules should be written regarding establishment of a "sinking fund" designed to be used to accumulate monies for subsequent use in replacing these facilities. Such self-financing would relieve the central government of demands to provide funds for the provision of these facilities while, simultaneously, encouraging maintenance of the infrastructure.

33. Duties of upazila officers should include responsibilities that will insure that local public enterprises, e.g., markets and ferries are operated in a safe and equitable manner. Likewise, to provide for efficient long-term operation of these facilities, accounting procedures should be altered to provide for the costs of their replacement.

For leased facilities an auction system constitutes an effective way to mobilize resources. In order to maximize these resources it is necessary that bidders do not collude. Increasing the number of bidders decreases the likelihood of successful collusion. If bidder collusion is observed, e.g., only three or four bidders are participating in the auctions or the same persons continuously win the same franchises, steps should be taken to augment the pool of bidders. Potential bidders will participate only if they are aware of possible profits they can earn from the franchise. Widespread publication of the date and time of the auction as well as information regarding potential returns can encourage greater bidder participation. In addition, requiring full payment shortly after the auction may be a constraint on the number of bidders. Installment payments over a period of, perhaps, four or six months can ease this liquidity constraint problem.

While bids lower than the previous year may suggest collusion, it is not sufficient evidence of cooperation among bidders. Local governments should recognize that bidders face uncertainty concerning the gross revenues to be earned from the franchise. In any one year the winning bidder may overestimate revenues. In this case he will lower his bid in the following year (especially if rates have not been increased). In the event a winning bid is below that of the previous year, the locality should investigate the circumstances surrounding the bidding process. It may simply be reaction to a decreased demand for the service provided; on the other hand, it may be due to collusion or an inadequate number of bidders. One technique to overcome the latter situation is to hold a subsequent auction(s) with the stipulation that the highest winning bid in the series will obtain the franchise. In only very special cases should the locality decide to forego leasing entirely.¹

34. When auctions are used to issue leases, bidder collusion must be minimized if revenues are to be maximized. Multiple auctions can be used to insure that maximum revenues are extracted from the process. Since the possibility of bidder collusion is lessened by greater numbers of participants in the process, steps should be taken to increase the number of bidders. For example, capital constraints which limit the competitiveness of auctions can be lessened by requiring smaller downpayments and allowing longer time for total payment.

¹The Sylhet Zilla Parishad foregoes road toll leases when bids fail to equal the previous year's lease under the argument that lease-holders would derive excess and unfair profits from users. This policy ignores the uncertainty associated with the bidding process (I.R. 2).

As currently formulated, local jurisdictions have considerable power over rate setting in public enterprises whether or not they are leased. Fees for upazila parishad markets are set locally while fees on zilla parishad ferries and roads must be approved at the divisional level. A non-standard set of fees is most reasonable since it allows fees to reflect market conditions within the locality. Local government should recognize, however, that with no rate changes, revenues will grow only in response to changes in real incomes and population and will not respond automatically to increases in prices. As a result, revenues will be substantially eroded by inflation unless rates are changed periodically. With local autonomy in rate-setting the central government cannot prescribe a schedule which reflects inflation. The Local Government Division of the Ministry can, however, annually provide informational circulars indicating the degree to which major cost components of public enterprise operation have increased, e.g., fuel cost increases for ferry operators and labor costs for all enterprises.

35. Local governments should regularly review rate structures associated with markets, ferries and roads; these rates should be raised periodically to reflect increased maintenance and capital costs associated with inflation. Informational circulars providing data on inflation-induced cost increases should be issued annually.

Haats and Bazaars. Our work did not focus on the details of operating and financing haats and bazaars; however, the data suggest that these activities can be productive sources of revenue for local bodies. Markets constitute a crucial service provided in rural areas

and are legitimate functions of rural local governments. They do deserve further study.

36. A thorough study of haats and bazaars should be undertaken, probably in the form of a nationwide set of case studies using a common format and carried out under the auspices of a local research group. This study would focus on the operating procedures, including pricing policies, reinvestment issues and potential for establishment of a haat and bazaar "sinking fund" which would allow the locality to insure that resources be available in order for markets to be replaced in a timely fashion.

Toll Roads. The imposition of tolls on haats, bazaars and ferries apparently creates little resistance on the part of users. The same has not been the case with toll roads where considerable opposition has been voiced. Indeed, tolls were previously imposed on roads in, at least, both Dhaka and Faridpur Districts, but in each instance they were subsequently removed due to political pressures. Our analysis has not focused upon citizen attitude formation regarding public services, but it may be that users recognize that operators are incurring out-of-pocket costs when running a ferry or operating a market and that fees are, therefore, justified. On the other hand, users may fail to see that costs are incurred when roads are utilized and conclude that tolls are unfair. Still, zilla parishad expenditures on roads are substantial and due, at least in part, to road usage. Thus, road tolls can be justified on economic grounds, political arguments notwithstanding.

The Sylhet ZP toll road system presents an interesting example of how a local government can raise revenues to aid in the financing of

road transport services (I.K. 2). While one should not expect that tolls will cover all of the costs of maintaining zilla roads (indeed, to do so would likely result in an inefficient toll structure), the revenues from this source can aid in mobilizing zilla parishad resources without requiring changes in the current statutory revenue structure.

37. Local governments should be encouraged to investigate the use of tolls on segments of its road system with divisional commissioners made aware of the benefits of this form of resource mobilization.

Not all roads are equally amenable to imposition of tolls due to political and economic constraints. Experience in Faridpur and Sylhet suggests that tolls are most feasible politically on pucca roads from which benefits can be derived throughout the year. Likewise, economic feasibility requires that road traffic be sufficient to support administrative costs associated with collecting the tolls. It is for this reason that tolls have been most successful on roads used for special purposes such as rock quarry transport and rail connections in Sylhet.

38. Roads which are primary candidates for politically acceptable and economically feasible imposition of tolls are pucca roads for which there are few, if any, alternative routes available and for which the demand is sufficiently great to allow a franchise holder to bear the administrative costs of collecting tolls. Training of financial managers and administrators should reflect these principles and circulars describing the imposition of tolls on roads should be issued.

Voluntarism. As a potential local government resource, voluntary giving of money or labor is statutorily allowed at the UP level through

the "community tax," levied on adult males and based partially on project-specific costs. In form, the community tax is thus a benefit-based levy.

If effectively levied, the community tax could be as significant a source of UP finance as the holdings tax. But in the local governments we studied, there was little employment of the community tax. There is, furthermore, significant overlap in the base of the community tax with the holdings tax and with other benefit charges that might be imposed. With the previously recommended improvements in the administration of the holdings tax, we feel it would be most appropriate simply to remove the community tax from the statutes and rely on the UP holdings tax as the principle benefit-related levy within these jurisdictions. Furthermore, with good record-keeping procedures implemented at the union level, benefit surcharges attached to holdings tax liabilities would be simpler to administer than would a separate community tax.

39. The community tax should be removed from the statutes as a union parishad revenue source and be replaced with a benefit surcharge tied to holdings tax liabilities when financing projects with high site-specific benefits.

Although in some countries voluntary labor is mobilized for public sector projects at the local government level, we do not feel it should be a required part of any BDG grant program because it is generally not able to serve as a benefit-based form of finance. That is, persons who benefit most from public works projects do not participate by giving labor (I.R. 6 and 11).

40. Voluntary labor should not be a centrally-mandated form of resource mobilization; all laborers on public works projects should be paid.

On the other hand, spontaneous, locally-based schemes depending on voluntary cash donations for construction or maintenance should be encouraged. This encouragement is most feasible when incorporated into the grant distribution process (Recommendations 48 and 49).

Summary

Non-land taxes, and government enterprises such as markets and ferries, are both particularly appropriate forms for mobilization of local government revenues in Bangladesh. We feel, however, that the current rate structure for the tax on professions, trades and callings should be reexamined with the view to increasing the maximum allowable rates and by imposing minimum rates. Similarly, reexamination of the auction process used to issue franchises on local government enterprises is called for together with an on-going reassessment of the rates imposed. We do not feel that the community tax nor centrally mandated voluntary labor contributions provide a dependable local government revenue source. Spontaneous, locally-based schemes using voluntary cash contributions should, however, be encouraged through the central government grant system.

Intergovernmental Grants

The above recommendations have focused on reform in terms of revenue raising instruments and budgeting at the local government level. But, for two reasons, the objective of increased fiscal decentralization

cannot be achieved without reform of the intergovernmental grant system. First, local governments receive well over half of their revenues in the form of central grants and are unlikely to require significantly less in the near future. Second, grants can be a powerful incentive to induce local governments to mobilize more revenues from their own sources.

The Bangladesh grant system is in a state of flux. Our view is that many of the recent changes are in a positive direction, toward more of a development orientation and toward improved coordination. However, by its own admission, the BDG has not sorted out all of the details as to how the system will operate, and has left some of the rationalization to be addressed "before 1984/85."¹ It is a good time to review the objectives of the system.

One wants to begin reform of the intergovernmental grant system with a careful consideration of the goals of the program--what is to be accomplished? This must be done in a context of recognizing tradeoffs. In particular, one may have to give up some equity in the system to promote more development activity by local governments. As regards the goals of the system, the most important (and related) issues are how much the Bangladesh grant system will retain its relief orientation and how much will it be used as a tool for strengthening the development activities of local governments. If relief is still to be the primary goal of the system, the present grants structure does a reasonable job

¹Guidelines.

and it is not clear how one would design a "better" system. If infrastructure development and strengthening local governments as a partner in the development process are becoming more important as objectives, further reforms are needed. Such reforms can go far in the direction of promoting fiscal decentralization.

The changes proposed here fall in six general areas: (a) a rationalization of the scheme for the distribution of grants among all local governments, (b) a further coordination of the Food-for-Work and Rural Works Programme grants, (c) the distribution of fewer but larger grants which are targeted on areas with greater development potential, (d) the requirement of a matching local government contribution--drawn from local resources--as a condition of receiving certain grants, (e) the institution of a system for monitoring grant achievements, and (f) the establishment of an effective maintenance plan for all works projects. In fact, changes in the FFWP grant system and the new upazila grant program have already brought important improvements in each of these areas. More, however, remains to be done.

Rationalizing the Distribution of Grants

The BDG now has five major grant programs to rural governments: Upazila Development Fund grant,¹ Rural Normal grants, FFWP-wheat, FFWP appurtenant structures cash grant and the zilla parishad RWP.¹ Each is distributed by a different formula, some are reinforcing but others are offsetting. If the objectives of the programs are similar--relief and

¹At the outset of 1983/84 provision was made for special grants to the rural portions of urban thanas; 63 of these thanas were subsequently upgraded with each provided a one million taka Development Fund grant.

development with an increased emphasis on development--the approach to distribution among upazilas ought to be more similar. It makes little sense to favor larger/smaller local governments under one grant but to discriminate against them under another. At the very least the distribution formulae ought to be better coordinated.

The BDG might begin such a rationalization of the distribution formulae by laying down some basic principles. We would urge that the rules governing a good distribution formulae for Bangladesh grants be as follows. The allocators used should: reflect need; give incentive to better local government fiscal performance; and be as objective as possible. The first suggests that measures such as population, land area, and degree of distress are appropriate for inclusion in the formula; the second would call for measures to stimulate improved local revenue effort, improved project implementation, and better provision for maintenance; and the third calls for the use of indicators that are measurable and can be easily described to recipient governments.

As a first step in this direction,

41. The BDG should follow up on its proposal to allocate the Development Fund grant by formula in 1984/85.

The present equal amount allocations to each upazila reflect neither need nor fiscal capacity. The BDG proposal (Guidelines, p. 4) is to allocate according to population (50 percent), area (10 percent), backwardness (20 percent), and performance (20 percent). We would make the following suggestions in developing this formula:

- (1) Presently, the 'backwardness' measure reflects the low state of development of the upazila whereas the 'distress' indicator under FFWP measures need for relief. These two need not be the same, but they need to be developed and measured in a coordinated way. Moreover, an objective basis for their adjustment, on a year-to-year basis, needs to be worked out. The Bangladesh Bureau of Statistics is currently attempting to develop objective upazila-wise "social indicators" which could be used in this effort to standardize the needs component of the allocation formula.
- (2) The index of performance should include a measure of revenue effort by the upazila parishad. This could be measured as per capita own source revenues (50 percent) plus the percent increase therein over the previous year (50 percent). Both upazila revenues and the revenues of underlying union parishads would count toward the revenue effort of any given thana.
- (3) Provision might be made for a downward adjustment in the resulting formula allocation in the event of inadequate completion of local schemes.

There are two important steps to be taken to help rationalize the grant distribution scheme.

42. The cash grant for appurtenant structures under FFWP and the Development Fund grant should be integrated in terms of their formula distributions.
43. The Rural Normal grants program should be gradually replaced.

Rural normal grants are a collection of mainly compensation grants that seem to exist more because of historical tradition than because of the needs of local governments. The objectives of these programs are unclear in some cases and conflicting in others, and little monitoring of their success has been done.

There are also important horizontal equity issues to be faced in rationalizing the grants distribution system, i.e., eliminating some of

the differential grant treatment of similar UZP. For example, some upazila parishads receive different grant amounts than do others with similar populations and land areas because they are in a "CARE" vs. a "WFP" or "general allocation" district, there are WDB projects in their district, there is/is not a cash grant operating, etc. The overall system needs to be better coordinated so that upazilas are treated differently on more reasoned basis, e.g., because they have larger populations or land areas, or because they are poorer. The integration of the FFWP and Development Fund grant programs should resolve some of this problem.

These reforms would markedly reduce the complexity of the grant system and set the stage for a rationalization of the distribution formulae. At the same time, such reform would require some serious analysis in establishing the initial coordination of the formulae, and overseeing this coordination on a continuing basis. To this end,

44. A permanent Bangladesh Grants Commission should be established. The Commission could be composed of representatives of various ministries, and would have the responsibility for recommending policies to govern the operation of the intergovernmental grants system. With respect to the coordination of grants, the Commission would: define the allocation formulae for grants; define measures of local government tax effort and project performance; reconcile the distribution formulae for the Development Fund and FFWP grants; and, oversee the statistical measurement of the grant formulae and the monitoring of local government performance.

Coordinating FFWP and Development Fund Grant

The independent designs of the Development Fund Programme grant and the Food-For-Work Program are an unnecessary waste of resources. If

past history is any guide, both programs will be put to about the same use in terms of the kinds of projects they support. By treating these as completely separate programs, one foregoes the opportunity to use them in concert to promote development activities. A number of important advantages could be gained by coordination. First, a combined program could be used to provide more cash for materials and equipment while still retaining the public employment orientation of the grants. Second, the distribution of funds under these programs could be coordinated to insure that the desired allocation across local governments could be attained. That is, one could avoid the possibility that FFWP would provide a relatively heavy grant for a UZP while the Development Fund grant would have an offsetting effect by providing relatively less to that same upazila parishad. Third, the FFWP could draw more heavily on the engineering staff if the programs were better coordinated. Finally, the upazila parishad would be in a better position to efficiently allocate the full amount of its resources for development purposes--if the total of the grant amounts were known some time ahead.

The BDG has made the decision that responsibility for FFWP will remain with the Ministry of Food, while the administration and monitoring of the Upazila Development Fund grant will be the responsibility of other Ministries. On the other hand, the BDG has called for a coordination of these programs by assigning upazilas responsibility to see that "...The Food For Work Programme is a complementary effort to the Development Programme undertaken through other means" (Guidelines, page 9). The Guidelines also mandate that

only the FFWP and the Union Parishad Rural Works Programme will carry out any earthworks. We concur with this initiative and think the coordination is an entirely appropriate task to be undertaken by the previously-recommended Grants Commission.

45. The Grants Commission should develop a coordinated allocation formula and joint guidelines for project design and implementation of the FFWP and Upazila Development Fund grants.

Targeting of Grants

There is not great agreement, in any country, on how intergovernmental grants should be allocated among local governments. Some favor "targeting" the grant distribution to those local governments which have the most potential for making effective investments and maintaining these assets. Others favor a targeting on the most needy local governments, and still others favor a "spreading" of grant funds, more or less on a population basis. The Bangladesh grants system has traditionally fallen in the latter category, and this continues to be true under the new Development Fund initiative and the new FFWP formula distribution. So long as the focus of the Bangladesh grant system is on providing relief to the rural poor, the spreading strategy is probably a good one. It distributes money according to where the people are, and if one assumes that rural unemployment is severe throughout the country, the population allocator is as good as any.

If the focus of Bangladesh grant policy were to continue its move from relief to development, however, the spreading approach might be reconsidered.

46. If development displaces relief as the principal goal of the Bangladesh grants system, fewer, but larger grants distributed partially on the basis of development potential is an appropriate strategy.

Under such a scheme, many local governments could still be covered, but they would tend to be those with the best possibilities for constructing and maintaining a viable development project. This would maximize the return which could be earned from each taka of central government grant and it would allow local governments to make maximum use of the limited funds available for materials, equipment, and specialized technical assistance. Such a strategy would also allow the limited number of qualified engineers to play a much greater role in project selection, design, and implementation.

The BDG could take a number of important steps to promote this strategy, and indeed it has already taken some. First, the specification of a maximum number of FFWP schemes in each upazila is a step in this direction, as is the creation of a cash grant to supplement earthworks. Second, the government's proposal to allocate part of the Upazila Development Fund on a basis of performance also reinforces the development goal. Third, the BDG has placed a ceiling on the amount of earthworks under the Development Fund grant for the first year.

On the other hand, some government actions do not reinforce these goals. The Guidelines place emphasis on smaller development schemes, and the rapid creation of upazilas has placed a strain on the availability of scarce manpower. The BDG needs to somehow reconcile these possible contradictions.

The major route to shifting the focus of the grant system toward development is to develop good indicators of project performance, and to use these indicators in the grant distribution process.

Building Local Government Institutions

If the Bangladesh grant system is to promote decentralization, then it must be redesigned to encourage local governments to take more fiscal initiative. What is needed is an incentive to promote the mobilization of local revenues. Such incentives can be built into the grant system and are done so in many countries. Specifically, local governments should be encouraged to think of grants as having a price, or a matching requirement. In this connection, the CARE/USAID grant for appurtenant structures, which carries a matching provision, is a step in the right direction. Yet the match under that program may be drawn from the Development Fund grant, hence there is no stimulation of locally-raised resources. Presently, there are no matching requirements built into the Bangladesh grant system.

47. A revenue effort measure should be included in the Development Fund grant allocation formula.

For example, 20 percent of the Fund might be allocated according to per capita revenues raised in the preceding year, and the percent increase over the penultimate year. In other words, if local governments in an upazila raised more relative to those in other upazilas, and/or increased their rate of revenue mobilization at a relatively faster pace, they would be rewarded with an increased grant amount. For purposes of measuring 'effort,' all revenues raised at the union and upazila levels should be included.

Where will these local matching funds come from? The answer is that the matching contribution may be raised from local taxation, contributions, or user charges as discussed above. This, in turn requires that local governments be given increased local taxing powers. The LDT at the UPZ level and an improved holdings tax at the UP level--as recommended above--would give local governments substantial room to respond to the grant incentives.

These incentives can be further strengthened through the intra-upazila distribution of Development Fund grants to the union parishads. The Guidelines mandate that a portion of the upazila grant be allocated to the constituent unions lying within the upazila. If this sharing, too, is based upon UP revenue collection performance within these union parishads, another stimulus to local government resource mobilization would be inserted into the system.

48. Allocation of the Development Fund grant to union parishads within an upazila should be based in part on levels and growth of UP resources mobilized within the several union parishads.

While we feel that centrally-mandated voluntary labor contributions are not appropriate local resource mobilization techniques (Recommendation 40), the intra-upazila allocation of the Development Fund grant to union parishads does provide an opportunity to encourage local voluntarism. That is, contributions to finance new local schemes or to maintain existing facilities can be included in the determination of total local resources mobilized within a UP and be used to allocate the Development Fund grant among the unions in an upazila. One

difficulty associated with nationwide programs requiring voluntary contributions is monitoring the activities. Localities have incentives to misuse funds by inflating project costs or by failing to follow through on the project. By basing this year's allocation on the amounts actually raised in the past year and by keeping the monitoring activity at the local (upazila) level, these problems should be reduced. Furthermore, penalties imposed on UPs violating the rules can also help minimize such behavior.

49. Voluntary contributions should be included in the determination of local resources mobilized for the purpose of distributing the Development Fund grant to union parishads within an upazila. Any union parishad discovered to have inflated the value of such contributions should be banned from receiving such funds for a period of two years.

Monitoring Project Activities

Regardless of whether the Bangladesh grant system is refocused on development, there is need to track its performance. Until this is done, it will not be possible to determine the extent to which these grant funds are actually being distributed across the country in the desired manner. Indeed, it is safe to say that under present circumstances, even the BDG is not sure how its total assistance package has been distributed.

50. The BDG should set up a system to monitor the actual distribution of grant monies to all local governments, under all grant programs.

As noted previously, the fiscal planning of local governments could be enhanced substantially if there were more certainty as to the amount

of central grants to be received in a given year. One possibility would be that:

51. The total Development Fund grant should be set for three-year periods as a percentage of some designated central government revenue source. The designated base could be taken as that in the preceding fiscal year, hence local governments could make a reasonable estimate of their grant revenues before they begin their budget cycle. The Grants Commission should recommend the designated base and the percentage.

If the percentage is held constant and the designated revenue source is income elastic, such a provision would also ensure growth in these intergovernmental revenues--a feature lacking under previous grants policies.

A second need is for more careful monitoring of the physical accomplishments of the program. The major objective of the program has been relief, providing jobs to the rural poor. Yet there are few records which enable one to know what the job benefits have been, and therefore, it is quite difficult to evaluate the success of the programs. Some progress has been made by CARE-FFWP in this area, but much more needs to be done, especially as regards the other FFWP components and RWP. Likewise, the physical accomplishments of the programs need to be better monitored if the programs are ultimately to be evaluated with grants adjusted based on evaluation. Such monitoring will take on even more importance now that it is planned to include a "performance" indicator directly in the allocation formula.

Third, the use of a revenue effort factor in distributing Development Fund assistance will call for an annual monitoring of local

government fiscal performance. Recommendation 11 for an annual Census of Government Finances would help provide such information. The guidelines for developing such a census need to be carefully worked out with the Grants Commission playing an important role.

Providing for Maintenance

A major problem with the present grant system--to the extent it is meant to promote public works--is a lack of provision for maintenance. The RWP required a contribution of 25 percent of the normal budget for maintenance, but it is not clear that this regulation was effective: there was uncertainty amongst local governments as to the exact meaning of the 25 percent requirement; there was confusion as to what constitutes maintenance activity; and, the 25 percent requirement was not effectively monitored. The Food-For-Work Program makes no provision for maintenance, and it should be noted that many FFWP projects are reconstruction of previously-built schemes that have fallen into disrepair due to a lack of maintenance.

The maintenance problem is a major obstacle to an effective rural infrastructure in Bangladesh. Before construction activities go further, the government needs to establish a firm policy about adequate maintenance of existing facilities. Rather than require a certain percentage of the normal budget to be spent for maintenance, a better approach would be to require that the facilities constructed be maintained at "acceptable" standards. The central government would lay down those standards and would require that they be met as a condition to receiving grant monies for other works projects. This could become a

part of the performance conditions of receiving a full grant share. In fact, the new Guidelines call for a maintenance plan as a precondition to taking up any project.

While the new Guidelines make it clear that maintenance is an important concern, the exact provisions have not been established. There is no explicit mention of the 25 percent provision, only that recurrent costs are to be borne out of the revenue budget. This underlines the need to stimulate the raising of own-source revenues.

52. Maintenance of local government projects should be financed from a combination of Development Fund revenues and from a specified percentage to be raised from own sources. Maintenance requirements and standards should be developed and monitored by the central government for all works projects, including FFWP.

Summary

We call here for the formation of a permanent Grants Commission which would work out the details necessary for ensuring that intergovernmental grants in Bangladesh are allocated and spent in a coordinated fashion while providing incentives to local governments to mobilize their own resources to supplement the grant monies. This incentive can be provided in part through the inclusion of revenue effort measures in the grants allocation formulae as well as by monitoring the performance of local governments in using grant funds. Coordination can be simplified by phasing out the current normal grants while fiscal planning would be aided by tying total grant allocations to some percentage of national revenues.

Implementation

The recommendations made in this Report are not independent of each other. For example, in the absence of local government autonomy regarding tax rates, there is little to be gained from instituting a grant system that rewards greater local tax effort, or without improvements in holding tax record-keeping, the benefits of more accurate assessments will be minimal. Such interrelationships are likely to characterize any alternative comprehensive reform plan. It is, therefore, important that policy changes be coordinated rather than adopted in a piecemeal fashion.

Since the policy changes proposed here involve numerous ministries, coordinating their implementation would be facilitated through the formation of a temporary Local Government Finance Reform Implementation Committee. This committee, which should be formed immediately, would take the lead in formulating the policy changes necessary to carry out the reform package selected. The terms of reference of the Committee would be to debate proposals such as those made here and to work out the needed changes in statutes, rules and circulars.

The committee should involve ministerial personnel at the highest levels and might include those ministries most directly affected by the recommendations: the Ministry of Local Government, Ministry of Finance, the Planning Commission, the Ministry of Law and Land Reforms, the Ministry of Food and Relief, and the Cabinet Division. The permanent Bangladesh Grants Commission (Recommendation 44) might be initially

formulated as a subcommittee of this Local Finance Reform Implementation Committee. Our final recommendation is that:

53. A Temporary Local Government Finance Reform Implementation Committee should be formed immediately to begin working out the details of implementing a program of local government fiscal reforms.

Steps should also be undertaken immediately to create and staff a Local Government Management and Finance Cell within the Ministry of Local Government (Recommendation 10). This office could initially act as staff to the Temporary Implementation Committee and later become a part of the regular local government oversight process.

Assume for the moment that the Government of Bangladesh decided to accept the recommendations made here. In such a case, we feel that there is an ordering in which the reforms should be implemented. Most important in terms of the principal objective being pursued here--resource mobilization--and changes in rules and statutes to provide local governments with a broader revenue base. Thus, increasing the maximum rate of the immovable property transfer tax and transferring one-half of the land development tax to the upazilas and restructuring the taxes as recommended above should be the first changes undertaken. At about the same time, rationalization of the grants system--including greater coordination among its components and the institution of revenue mobilization incentives--take place.

We feel that amendments to the maximum tax rates permissible under the upazila tax on professions, trades and callings should await more

information and some evaluation of their success during the first year of implementation at current levels.

Similarly, the call for posting of upazila finance officers to aid union parishads in valuation and record-keeping will certainly require some initial training of the necessary officers. This step will require the formulation of the training program, recruitment and initiation of the training. It is hoped that trained officers would be in the field in one year.

Preliminary work for a Census of Government Finances could begin almost immediately. The preliminary work, pretesting, final design, etc., could be undertaken in a period of about one year with technical assistance from abroad. The Local Government Management and Finance Cell would play a major role in helping to design the Census, since it is this group (and the Grants Commission) which would use the data most heavily in their oversight and monitoring activities. It should be feasible to undertake such a census, at least in all upazila parishads and zilla parishads, after the close of the 1984/85 fiscal year. Subsequently, the effort would be expanded to the union parishad level.

Finally, there is need to begin planning for a training program in local government finance. Once an institution, such as the NILG, is chosen, training of the trainers should begin immediately. Particularly important is the need to improve skills in areas of accountancy, budgeting, and fiscal planning.

Conclusions: Benefits, Costs and
Resources Available

A new system of local public finance in Bangladesh, as proposed here, would have the following characteristics:

- Zilla or upazila parishads would earn revenues from taxes on the transfer of property but at higher rates than at present and with the option of setting even higher rates.
- The immovable property transfer tax would continue to be administered by the national government in conjunction with collections of the stamp duty and other registration fees, but with revised rules and additional information provided to those collecting this levy and stiffer penalties imposed on tax evaders.
- Upazilas would derive resources from the land development tax, proceeds of which they would share with the national government. Additionally, upazilas would be allowed to impose a local surtax on this levy.
- Administration of the land development tax would remain the responsibility of the central government but with improved information available regarding land ownership, better trained tax administrators and higher penalties attached to noncompliance.
- Upazila revenues would be supplemented via the imposition of taxes on local business activity but at maximum rates greater than those currently allowed and with national minimum rates specified.
- Union parishads would continue to be restricted primarily to the use of the holdings tax as their primary revenue source; improvements in the administration of this tax would be gained through the use of a property valuation and tax administration officer posted at the upazila level.
- The distribution of central grants would be altered to reflect better the development potential of local governments, would be a more coordinated system and would be redesigned to reward those jurisdictions which mobilize more local revenues. This orientation would extend to the union parishad level whereby grant

resources flowing through the upazila would be distributed to unions based, in part, on their success in mobilizing resources through the holdings tax and voluntary contributions.

- Training in local government finance would be emphasized at all levels. Not only would those directly involved in tax administration and government accounting be included in these efforts, but the training would also extend to central government personnel posted at the local government level and local political leaders as well as tax campaigns directed at the taxpaying public at large.
- A permanent Local Government Management and Finance Cell would be established within the Local Government Division of the Ministry of Local Government and would be headed by an expert in local government fiscal affairs. This cell would analyze performance, advise on policies and participate in the framing of new legislation and circulars affecting local government finance in the country, and would have general oversight responsibility.
- An annual Census of Government Finances would be carried out so that tracking fiscal performance and detecting problem areas could be based on a sound analytical footing.

All of the above are viewed as implementable within the near future, e.g., within the next two years. There are, in addition, other changes that should be implemented over the longer run. Among these are:

- A gradual absorption of central government employees currently posted at the local level into the personnel structure of the local body itself. This change would more effectively allow incentives to be provided by local governments for the performance of locally-oriented duties. Particularly useful in this regard would be absorption of employees involved in tax collection, e.g., the land development tax.
- Development of a value-based land development tax to replace the current area-based levy. Such a change would be more efficient and equitable and provide a more elastic revenue source than does the current area-based levy. It would, however, be costly and would require additional technical expertise.

Benefits and Costs

We maintain throughout this Report that the principal benefit of this new system would be to provide incentives to local governments in Bangladesh in order to encourage these local bodies to mobilize resources at a higher level, with greater built-in growth potential, and with reasonable efficiency and equity effects. Such a system would go far in promoting successful decentralization of governmental decision-making within the country while improving local governments' ability to operate and maintain development projects. We cannot put a taka figure on these benefits, but we feel they are substantial.

Other potential gains are similarly not quantifiable. The reforms would help move the government closer to the people and would increase the accountability of local government officials. With greater resources available, public works investments should be more productive, especially as they are better maintained.

These changes will not come without costs. One set of costs of this reform package is the taka drain on the central treasury. These include the revenue loss to the national government due to transferring a portion of the land development tax to local governments; establishing and staffing a temporary Local Government Finance Reform Implementation Committee, a permanent Grants Commission and a Local Government Management and Finance Cell within the LGD of the Ministry of Local Government Finances; instituting a set of training programs; establishing and maintaining a Census of Governments; and covering the costs of the UZP valuation officers. These investments are not

insignificant, but they can buy considerable improvement in local government finance in Bangladesh.

Another type of cost is the sacrifice made in moving toward a more development-oriented program of fiscal decentralization. By allocating grants more on a basis of development potential and ability to match central taka, and less on a basis of need, some equalization of fiscal capacity will be sacrificed. There could be fewer projects to spread around under such a system, but they should be more productive investments. The projects will have more capital content and will be better maintained, but their construction will generate fewer jobs than would pure earthworks activities. Local taxes and fees will go up, but will be levied primarily on politically more powerful landowners and merchants. Local governments will be more autonomous, which means that the national government will have given up some flexibility in controlling the total amount of government spending in the country. All of these are real costs that accompany the reform program recommended here and are necessary costs of fiscal decentralization.

Donor Assistance

While the costs of reform cannot be avoided, some donor financing might be available and appropriate. The Local Government Finance Reform Implementation Committee will want to explore avenues whereby international donors will provide some of the initial costs of the proposed recommendations. Among these are:

1. Technical assistance in the form of one or two local government finance experts could be provided to help develop the local government finance cell in the MLG. A permanent staff assigned to this cell could begin

working with the advisory personnel helping to develop skills in this area. More junior personnel might be sent abroad for specialized training.

2. Financial and technical assistance could be provided to training institutions which will have to be expanded to meet the increased training needs recommended here.
3. Tax mapping and technical assistance associated with property tax administration including property identification, record-keeping, valuation and collection could be provided externally. USAID has a substantial experience in this area.
4. For developing specific grants allocation formulae, external assistance could be provided in evaluating the range of possibilities and their implications as found in comparative settings, e.g., India.
5. Technical assistance in developing the Census of Governments could be provided.
6. A pilot program placing a trained expert in local government finance at the district level to help upazila and union parishads administer their financial affairs could be externally-funded in conjunction with a project limited to a few areas within the country but which required local government participation. This expert could supplement nationwide training efforts by providing more intensive on-the-job training to local financial administrators.
7. The current work has omitted consideration of the treatment of paurashavas and municipal corporations in the reform of local government fiscal affairs. This subject does, however, need to be given serious thought.

With such assistance and with a genuine commitment towards decentralizing resource mobilization opportunities throughout Bangladesh, we feel that the goals stated in the Guidelines and quoted in full at the beginning of this Report can be fulfilled.

APPENDIX

INTERIM REPORTS ISSUED THROUGH THE LOCAL
GOVERNMENT FINANCE PROJECT

<u>Interim Report</u>	<u>Author(s), Title, Date*</u>
1	Larry Schroeder and Maniruzzaman, "Local Government Structure in Bangladesh," November 1982
2	Larry Schroeder, "Toll Roads as a Zilla Parishad Revenue Source: A Case Study," November 1982
3	James Alm, "The Immovable Property Transfer Tax in Bangladesh," April 1983
4	Barbara D. Miller and James A. Wozny, "The Land Development Tax in Bangladesh: Insights From the 1978 Land Occupancy Survey," April 1983
5	Larry Schroeder (with Hasan Murshed and Muin Uddin), "Collecting Local Government Financial Data in Developing Countries: The Bangladesh Experience," June 1983
6	Barbara D. Miller and Showkat Hayat Khan, "Local Voluntarism and Local Government Finance in Rural Bangladesh: Overview and Recommendations," June 1983
7	James Alm and Larry Schroeder, "The Land Development Tax in Bangladesh," June 1983
8	Larry Schroeder, "A Review of Bangladesh Zilla and Union Parishad Finances," June 1983
9	Larry Schroeder, "Upazila Parishads: Their Structure and Revenues," June 1983
10	Roy Bahl, "Intergovernmental Grants in Bangladesh," November 1983
11	Barbara D. Miller, "Possibilities of Benefit Charges for Public Works in Bangladesh," January 1984
12	Showkat Hayat Khan, "Aspects of Public Finance in a Union Parishad: A Sociopolitical Case Study," January 1984

* Each of these papers was revised, some extensively, and was reissued in May, 1984