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RURAL DEVELOPMENT GRANTS TO LOCAL GOVERNMENTS IN ASIA

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FOREWORD

Many countries use some form of intergovernmental transfer from a higher level government to assist in the financing of local government expenditures. The literature in this area, while extensive and growing, has tended to focus primarily upon intergovernmental grants in developed countries. For developing nations the work has tended to be either general in nature or specific to a single country. Hence, this comparative analysis of rural development grant programs in four South and Southeast Asian countries--Bangladesh, Pakistan, Indonesia and the Philippines--is rather unique.

The monograph provides sufficient background on both the governmental and grant system structures to allow the reader unfamiliar with these countries to understand the context in which these grant programs are administered. The focus of the paper is, however, on an evaluation of the transfer programs used in these countries and includes several different evaluation criteria since a grant scheme that performs adequately for some purposes may fail in other areas.

The findings reveal that, indeed, transfers from higher level governments play a very important role in the revenue structure of local governments in each of these countries. At the same time, the grant programs are not particularly designed to strengthen local government's abilities to mobilize and spend effectively their own resources. Furthermore, while decentralization has been promoted as a national policy, particularly in Bangladesh and Indonesia, the granting governments have generally been unwilling to relinquish much control over the allocation of the money transferred to local governments. Finally, while one can consider each of the countries to have a grant "system" in theory, generally the data suggest that allocations are far from systematic, with considerable control over the specific allocation of funds to individual jurisdiction retained by the granting government.

This paper is based, in part, on two in-depth country studies of local government resource mobilization policies (in the Philippines and Bangladesh) conducted previously by the Local Revenue Administration Project of The Maxwell School.[1] The description and evaluation of the grant programs in Indonesia and Pakistan are based on short-term visits I made to each country during June and July, 1986. Due to the differences in the amount of resources devoted to the several countries involved in the study, greater empirical analysis is possible for the Philippines and Bangladesh cases; nevertheless comparable objectives and methods were used

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[1] Roy Bahl and Barbara D. Miller (eds.), Local Government Finance in the Third World: A Case Study of the Philippines (New York: Praeger Publishers, 1983); Local Revenue Administration Project, A Plan for Increased Resource Mobilization by Local Governments in Bangladesh. Volume I: Executive Summary; Volume II: Policy Recommendations. Final Report, Metropolitan Studies Program Monograph No. 14, Local Revenue Administration Project, The Maxwell School (Syracuse, NY: Syracuse University, May 1984).

in each of the four cases. Personal interviews were conducted with knowledgeable central government officials as well as with selected local government personnel. Likewise, local academics familiar with practices regarding intergovernmental fiscal relations in the country were contacted and interviewed. While empirical data were collected in each country from both the central and local government levels, the fact that the case studies were conducted over a series of years means that not all of the data are strictly comparable.

The list of individuals and organizations who assisted in this work is an extremely long one. Most crucial to the efforts were the many government employees who gave me significant amounts of their valuable time to explain how the grants systems were supposed to or actually worked. Many others provided the necessary logistical support to carry out this work. At the risk of omitting names of persons who provided significant assistance, I would like to acknowledge the special efforts made by the following: Mrs. Bilquis Ara Alam, Mohammad Faizulla, Quamrul I. Siddique, Maniruzzaman, Dr. Paul O'Farrell and Gene George in Bangladesh; Shahabuddin Khan and Robert W. Nachtrib in Pakistan; P.A. Salim, Dr. Atar Sibero, William Douglas, Steve Hadley and Michael Morfit in Indonesia; and Raul DeGuzman, Angel Yoingco and Lorinda Carlos in the Philippines.

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RURAL DEVELOPMENT GRANTS TO LOCAL GOVERNMENTS IN ASIA

Larry Schroeder

CHAPTER I

INTRODUCTION AND OVERVIEW

Intergovernmental transfers play important roles in many developed and developing countries. Grants allow central or other higher levels of government to direct the flow of resources into particular regions or activities without requiring the central government to carry out the expenditure process. Furthermore, grants commonly provide an important source of revenue for local governments and can promote decentralization of decision-making.

The governments of developing countries in South and Southeast Asia regularly transfer money to local governments to provide resources necessary to carry out development activities. Central governments from the Indian subcontinent to the islands of the Philippines utilize a wide variety of grant programs. The purpose of this monograph is to explain and evaluate the principal intergovernmental transfer programs currently in use in four countries in this region. While a complete cataloging and evaluation of the grants used in all countries of the region might be

useful and interesting, the breadth of coverage here includes only on Bangladesh, Indonesia, Pakistan and the Philippines.[1]

These four countries provide a geographic, political and stage of development diversity that adds to the richness of this comparative analysis. Bangladesh is one of the poorest countries of the world and is a relative newcomer to the family of nations; Pakistan, from which Bangladesh was formed, is more advanced economically and uses a federal political structure. Indonesia and the Philippines are both composed of numerous islands with considerable cultural diversity; they differ in that Indonesia recently experienced rapid economic growth due to its petroleum reserves, while the Philippines has faced major political and economic problems.

Selected economic indicators of the four countries are shown in Table I-1. The data reveal that each of these countries has experienced an annual population growth rate in excess of 2 percent. In general, Bangladesh is the least developed among these four countries with the Philippines generally displaying the strongest indicators. Indonesia has recently performed much better in food production than have the other three

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[1]Other discussions of grant programs in South and Southeast Asia include M. Alamgir, "The Experience of Public Rural Works Programmes in Bangladesh"; Shoaib Sultan Khan, "The Experience of Public Rural Works Programmes in Pakistan"; and A.S. Kahlon and P.C. Deb, "The Experience of Rural Public Work Programs in India, with Special Reference to the Punjab," all in Planning for Effective Public Rural Works Programmes (Bangkok: United Nations Economic and Social Commission for Asia and the Pacific, undated); Kraiyudht Dhiratayakinant, "Taxing Powers of Local Governments in Thailand," Regional Development Dialogue (Autumn 1986); A. Jameel Siddiqi, "A Review of Rural Development Programmes (1857-1980)" (Islamabad: Government of Pakistan, Local Government and Rural Development Division, 1980).

TABLE I-1

BANGLADESH, PAKISTAN, INDONESIA AND PHILIPPINES:
ECONOMIC AND SOCIAL INDICATORS

		Bangladesh	Pakistan	Indonesia	Philippines
Population (in millions)		98.1	92.4	158.9	53.4
Area (thousands of square kilometers)		144	804	1,919	300
Average Annual Growth of Population (percent)	1965-73	2.6	3.1	2.1	2.9
	1973-84	2.5	2.9	2.3	2.7
Life Expectancy (years)	1975	42	51	48	58
	1984	50	51	55	63
Infant Mortality Rate (deaths per 1,000)	1980	136	126	93	55
	1984	124	116	97	49
Per Capita Calorie Supply as a Percent of Requirement	1974	92	93	98	87
	1983	81	95	110	104
Population per Physician	1976	11,350	3,780	16,430	3,150
	1981	9,010	3,320	11,320	2,150
Adult Literacy Rate (percent)	1974	23	21	62	87
	1980	26	24	62	75
Per Capita GNP (1984, in US$)		130	380	540	660
Average Annual Growth Rate of per Capita GNP (1964-85, percent)		.6	2.5	4.9	2.6
Average Annual Rate of Inflation (1973-84, percent)		9.9	10.8	17.4	12.9
Average Index of Food Production (1982-84: 1974-76=100)		99	104	120	107
Sectoral Shares of GDP (1984)	Agriculture	48	24	26	25
	Industry	12	29	40	34
	Services	39	47	34	41
Sectoral Shares of Labor Force (1980)	Agriculture	75	55	57	52
	Industry	6	16	13	16
	Services	19	30	30	33

TABLE I-1 (CONT.), Page 2

		Bangladesh	Pakistan	Indonesia	Philippin
Official Developmental Assistance (1984, in millions of US$)		1,202	698	673	397
Merchandise Trade (1984, in millions of US$)	Exports	934	2,592	21,888	5,391
	Imports	2,042	5,873	13,882	6,365
Terms of Trade (1980=100)	1982	105	93	105	89
	1984	106	88	101	101
Current Account Balance of Payments (in millions of US$)	1970	—	667	- 310	- 48
	1984	521	1,118	-2,113	-1,241
External Public Debt as Percent of GNP	1970	—	30.6	32.2	21.1
	1984	40	29.7	35.2	43.9
Exchange Rate (per US$)	1980	16.251	9.9	626.8	7.6
	1984	26	15.36	1,074	19.76
		(Takas)	(Rupees)	(Rupiahs)	(Pesos)

SOURCES: Exchange Rates: International Financial Statistics Yearbook 1986 (Washington, DC: IMF); all oti items: World Development Report, 1978-1986 (Washington, DC: The World Bank).

countries. The economy of Bangladesh is dominated by agriculture, both i terms of GDP shares and in terms of employment, whereas the other thre countries have more balanced economic bases. Each of the countries has experienced current account balance of payments deficits although, in terms of merchandise, Indonesia has experienced trade surpluses due to its petroleum reserves.

Subnational governments in each of these four countries are expected to play a role in the development process. Likewise, in each country, transfers of money from higher to lower governments are used as a development tool. It is, therefore, interesting to analyze the attributes of the grants programs and to evaluate their success. Such analysis, however, requires an understanding of the general goals of grant programs. Hence, a brief outline of criteria against which grant programs can be evaluated is presented below. This is followed, in turn, by chapters devoted to evaluations of rural development grant programs in Bangladesh, Pakistan, Indonesia and the Philippines. The final chapter presents the comparative findings of the analyses and suggests how policies might be implemented so as to improve the effectiveness of government grants in the development process.

Theory of Intergovernmental Grants

There is no intent to provide a full elaboration of government grants theory here. It is useful, nevertheless, to review the purposes of intergovernmental transfer programs and the major criteria against which

such programs might be evaluated.[2]

Objectives of Rural Development Grants

Evaluation of intergovernmental transfers is made more difficult by the fact that granting and recipient governments commonly have different objectives or goals. Consider first the goals of the granting government--usually the central government in the unitary government case or the state (provincial) government in the case of a federal system. One major objective of most higher level governments is to encourage specific expenditures by recipient governments. For example, grants to provide for particular capital expenditures by local governments, or grants for certain recurrent expenditures, e.g., salaries of teachers or maintenance of roads, are used when granting governments feel that local governments would be unwilling or unable to construct the facilities on their own or would underallocate their spending on these activities.

Encouraging specific expenditures is certainly justified when positive spillovers or externalities are expected to accrue from such spending. Providing grants to localities to treat effluents which would otherwise be dumped directly into a stream and thereby affect downstream communities is an example of a spillover effect that might be addressed using

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[2]For several general discussions of grants in developing countries see Ursula Hicks, "Intergovernmental Fiscal Relations in Less Developed Countries," Metropolitan Studies Program Occasional Paper No. 32, The Maxwell School (Syracuse, NY: Syracuse University, 1977); Richard Bird, Intergovernmental Fiscal Relations in Developing Countries (Washington, DC: The World Bank, 1977); Kenneth Davey, "The Development Impact of Fiscal Transfers to Local and Regional Governments," paper presented to the International Workshop on Financing Local and Regional Development, United Nations Centre for Regional Development, Nagoya, Japan, December 1984.

intergovernmental transfers. Rural development grants that encourage specific types of spending which are expected to increase overall productivity and, hence, economic growth of the country also have effects beyond the localities themselves.

A second justification for intergovernmental transfers is to redistribute resources spatially. Spatially targeted grants may be based on several different goals. Preferential treatment of regions with greater development potential may speed overall economic growth of the country. Targeting grants to poor areas ensures that jurisdictions in such areas will have the ability to provide some minimum necessary level of public services. Grants to particular regions or areas may also be used for specific political reasons, e.g., to calm a rebellious region.

Grants are also sometimes used by higher governments to encourage greater resource mobilization efforts by lower level jurisdictions. Grants which are allocated on the basis of revenues mobilized locally or which provide for only a portion of the total costs of a capital investment are examples of such transfers. If greater resources are mobilized, recurrent costs associated with the grant-financed development expenditure can more likely be met from local sources.

While these three objectives are probably the most common goals articulated by granting governments in developing countries, other objectives are also sometimes given. For example, some rural development grant programs are designed to increase employment. Others are designed to encourage maintenance of capital projects.

Objectives are likely to differ from the above when viewed from the standpoint of local governments. While recipient governments commonly want to receive funds from above, the recipients' preferences would be for grants that can be used for any purpose desired locally. That is, grants without any strings attached are likely to be preferred to those arriving with numerous restrictions. Redistributional grants will be preferred by those localities treated preferentially and will be opposed by those receiving relatively smaller allocations. Certainty of grant flows is likely to be viewed by all localities as preferable to grants that are determined in an apparently random manner and which may or may not ultimately be transferred to the local governments. Related to certainty of the grant flow is revenue growth from the grant system over time. Obviously, in the face of increased demands for public services due to increased population and prices, local governments find themselves in the position of having to spend more money, hence grant revenue growth is desired.

From this brief discussion of preferred attributes of grant systems it is also obvious that grant programs cannot simultaneously achieve all these objectives. Instead, trade-offs are necessary. In fact, even when viewed only from the grantor perspective, there are likely to be trade-offs. Grants which redistribute resources from more to less prosperous areas may have the effect of lowering the overall growth rate of the economy if the productivity of spending in the less prosperous region is less than in the more prosperous area. Grants designed to encourage labor intensive

projects likewise may result in lower overall growth than more capital intensive projects. And grants meant to encourage local resource mobilization may result in greater revenues flowing to wealthier jurisdictions, thereby conflicting with redistributional goals. All these objectives and their conflicts must be kept in mind in the evaluation below.

Types of Grant Programs

There is a wide variety of methods which higher level governments use to transfer resources to lower level jurisdictions. Yet three characteristics of such programs can be used to summarize the primary differences among these transfer methods. These characteristics include: (1) how the size of the grant pool is determined; (2) how the share allocated to a particular locality is determined; and (3) whether the grant can be used for general purposes or is restricted to specific purposes. Following Bahl and Linn, these characteristics can be arrayed in a simple two-dimensional matrix as shown in Table I-2.[3]

Type A grants are tax sharing arrangements with some portion of tax revenues collected locally retained by the local government. The total amounts for type B, C and D grants are based upon some fraction of revenues derived at the higher level of government, but are distributed in different ways. Type B grants are allocated according to some set formula; type C grants are cost reimbursement grants with the amounts distributed to a

[3] Roy Bahl and Johannes Linn, Urban Public Finance and Administration in Less Developed Countries (Washington, DC: The World Bank, forthcoming).

TABLE I-2

ALTERNATIVE FORMS OF INTERGOVERNMENTAL GRANT PROGRAMS

Method of Allocating the Divisible Pool Among Eligible Units	Method of Determining the Total Divisible Pool: Specified Share of a National Government Tax	Ad Hoc Decision	Reimbursement of Approved Expenditures
Origin of Collection of the Tax	A	--	--
Formula	B	F	J
Total or Partial Cost Reimbursement	C	G	--
Ad Hoc Decision	D	H	K

SOURCE: Roy Bahl and Johannes Linn, Urban Public Finance and Administration in Less Developed Countries (Washington,

locality dependent upon the total amount spent locally; type D grants are distributed in whatever manner the higher level of government sees fit.

More common are grant pools which are determined annually on an ad hoc, often political, basis. Grants of type F are also distributed according to some known formula, even though the grant pool is not determined in any predetermined manner. Type G grants are distributed on a cost reimbursement basis while type H grants are distributed in the same way the grant pool is determined--in an ad hoc manner. Type H grants give the granting government the most discretion in changing priorities and, therefore, are most prone to be manipulated primarily for political purposes.

Type J and K grants provide the granting government considerable discretion in approving expenditures. Type J grants are commonly open-ended, with all or some fraction of approved spending undertaken by the recipient governments reimbursed via the grant.

Grant types C, G and J tend to be categorical grants; that is, the money must be spent on particular services or projects. As noted above, type J grants usually are not limited in size whereas both C and G grants have fixed limits. All other grants tend to be general purpose in nature, such that the money can be used as the local body sees fit (subject to other expenditure mandates imposed by higher level governments).

In the comparative review below it will be shown that governments in South and Southeast Asia use nearly all of these different grant types when distributing resources to rural local governments. Still, we will see that

central governments have tended to avoid grants which limit their discretion in making budgets: with the exception of tax sharing (Type A grants), central governments have preferred determining grant pools on an annual and ad hoc basis rather than basing the pool on some preset formula (grant types F, G, H, J, K). This has created considerable uncertainty on the part of the recipient governments regarding the size of the transfer they might anticipate in any given year and, in turn, has tended to limit local fiscal planning.

Evaluative Framework

The approach taken here is to describe briefly how the grant program is supposed to operate and how it fits into the overall financial structure of local governments. We then turn to a review of the actual operation of the grant program(s) noting how it has changed over time. Among the features of interest are how the grant pool is determined; how grants to individual jurisdictions are determined, and whether the allocated funds are, in fact, distributed to the localities; how the funds may be and, in fact, are spent; and how local governments are held accountable, if at all, by the granting government to spend the funds according to the intent of the grant program.

Based on this description of the programs and the supporting data, we attempt to evaluate the rural development grant programs from a variety of perspectives. These include:

1. Size and growth of the grants
2. Local government fiscal planning effects of the programs
3. Spending implications of the distribution system

4. Local fiscal effort implications of the grant schemes
5. Redistributional implications of the grant schemes
6. Fiscal accountability, especially maintenance spending implications
7. Overall fiscal decentralization implications of the programs

This analysis is carried out first for Bangladesh, then Pakistan, followe by Indonesia and closing with the Philippines.

CHAPTER II

INTERGOVERNMENTAL GRANTS IN BANGLADESH

The system of local governments in Bangladesh has recently undergone considerable change with the expressed intent of the Government of Bangladesh (BDG) to decentralize decision-making power to local authorities. Interestingly, the grants system is playing a central role in this decentralization process. In what follows, we first outline this decentralization plan and note how it is altering the general structure of local governments within the country. We then turn to a description of the grants system--both prior and subsequent to the alteration in the structure. Finally, we provide a general evaluation of the rural development components of the intergovernmental grants system.[1]

Local Government Structure

One cannot fully understand the local government structure and the role of intergovernmental grants without simultaneously considering the linkage between local bodies and the central government administrative structure. As is the case in many countries, local governments in Bangladesh are greatly influenced by personnel of the central government posted at the local level. In these cases, grants are essentially an

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[1]For additional discussion of local government finance in Bangladesh see Local Revenue Administration Project, A Plan for Increased Mobilization by Local Governments in Bangladesh, Vol. I: Executive Summary; Vol. II: Final Report, Metropolitan Studies Program Monograph No. 14, The Maxwell School (Syracuse, NY: Syracuse University, May 1984).

alternative method of financing exactly the identical set of services that could otherwise be financed by direct budgetary allocations to central government ministries.

In Bangladesh, there are three layers of administration: division, district, and upazila (see Figure II-1). These units exist throughout the country, except for the most highly urbanized cities where there are no upazilas. Overlapping local governments also operate throughout the country. Zilla parishads (district councils) are to operate at the district level, although no rules governing these local bodies have ever been written; instead central government personnel operate these governments. Nevertheless, zilla parishads do exist on paper and receive intergovernmental grants. Upazila parishads constitute the local governments of upazilas and are governed by locally-elected leaders. The final layer of local government consists of union parishads in the rural areas, with paurashavas in smaller urban areas and municipal corporations in the large, highly urbanized localities.

Below, we consider intergovernmental flows prior to the creation of this new local government structure; hence, it is necessary to outline how the structure looked prior to its change in 1982. While local governments have had a long history on the Indian subcontinent, their history within Bangladesh as an independent nation extends only to 1976 when the Local Government Ordinance was promulgated. Even then there were three layers of local government contemplated--zilla parishads, thana parishads and union parishads; but it was only at the union level where direct representation

FIGURE II-1

ADMINISTRATIVE AND LOCAL GOVERNMENT HIERARCHY

Administrative Units	Local Government	
Division (4)	No local governments at the divisional level	
District (64)	Zilla Parishad[a]	
Upazila (460)	Upazila Parishad (460)	
	Rural	Urban
	Union Parishads (approximately 4,400)	Paurashavas (78) Municipal Corporations (2)

[a]Rules to create self-governments at the district level have never been written. The future of these local governments is uncertain given the recent increase in the number of districts from 21 to 64.

SOURCE: Various government publications.

of locally elected officials was used. Thana parishads included elected chairmen of the constituent union parishads but were led by a central government official. As noted above, zilla parishads have never enjoyed leadership from elected representatives.

It was the upazila parishad upon which most attention was focused during the restructuring process that occurred during the 1982-1984 period. All thana parishads in the country were upgraded to upazila parishad with elections of chairmen finally held in 1984. The upgrading process also involved posting more senior central government officials in these rural governments to oversee the activities of the line ministry personnel.

In summary, the structure of local governments in Bangladesh has, until recently, been characterized by dominant roles being played by central government personnel and only slight concern for local self government. Furthermore, as is made clear in the review below, central government revenues flowing through the grants system dominated the available resource base of these local governments.

Intergovernmental Grants System

Given the major structural change that occurred subsequent to 1982, it is necessary to distinguish between the pre- and post-1982 grants systems.

Pre-1982 Grants

Prior to the creation of upazilas (late 1982) there were 21 zilla parishads, 478 thanas and 4,472 unions.[2] Each was entitled to receive a

[2]Bangladesh Bureau of Statistics, 1981 Statistical Yearbook of Bangladesh (Dacca: Bangladesh Bureau of Statistics, 1982), p. 36.

grant for development projects, called Rural Works Programme grants, and certain "normal" grants[3] which were used primarily for employee compensation.

Urban local governments receive four types of grants: (a) a grant to compensate for the loss of the octroi tax (octroi was abolished by the government in 1981); (b) Urban Works Programme grants for development projects; (c) Normal Grants, which are primarily for compensation of employees; and (d) special project grants.

The previous typology of grant programs (Table I-2) included shared taxes as a form of resource transfer from higher to lower levels of government. As such, the immovable property transfer tax (IPPT) imposed in Bangladesh is a part of the grant system.[4] The tax is imposed at 1 percent of the reported value of all immovable real property, i.e., land and permanent buildings, bought and sold within a zilla parishad. For property located within urban areas, the tax accrues to the paurashava or municipal corporation; rural property transactions provide tax revenues to the zilla parishad in which the property is located. Historically, this has been the most important revenue source obtained by zilla parishads, commonly accounting for approximately one-half of the available revenues. No constraints are placed on the spending of this tax revenue.

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[3]"Normal grants" is a term used in Bangladesh to refer to those grant programs which do not fall under the heading of public works.

[4]James Alm, "The Immovable Property Transfer Tax in Bangladesh," Metropolitan Studies Program Occasional Paper No. 68, The Maxwell School (Syracuse, NY: Syracuse University, April 1983 [revised May 1984]).

Since we are primarily interested in grants to rural governments, particularly for development purposes, we focus in this discussion on the Rural Works Programme (RWP). The RWP was designed with four objectives in mind:

1. The development of rural infrastructure for transportation, irrigation, flood control, community development;

2. The creation of off-season employment opportunities for the poor and for landless farmers;

3. Nation-building goals which are achieved through local participation in development projects and through local leadership in carrying out these projects;

4. Strengthening the capacity of rural local government institutions to lead rural development.[5]

The type of works carried out under the RWP in 1982/83, the amounts actually allocated and which tier of local government was to implement the schemes are shown in Table II-1. Rural roads and irrigation projects dominate the RWP--not an unreasonable allocation given the climate and physical attributes of the country and the needs for these types of infrastructure investments.

While individual local government projects or schemes were to be decided upon by the jurisdictions themselves, the process was not fully decentralized. One reason for this stems from the structure of local governments themselves--central government personnel dominated both the

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[5] A.B. Chowdhury, Performance Report on Works Programme, 1977-78 (Dacca: Ministry of Local Government), p. 3.

TABLE II-1

REVISED BUDGET ALLOCATION OF RURAL WORKS PROGRAMME
GRANT COMPONENTS FOR 1982/83
(in millions of takas)[a]

	Zilla	Thana	Union	Total
Rural Roads	24.12 (45)	13.40 (25)	16.08 (30)	53.60
Infrastructure for Rural Irrigation, Planning, Training, etc.		41.90 (100)		41.90
Drainage, Flood Control and Water Conservancy		13.03 (50)	13.03 (50)	26.06
Thana Training and Development Center (TTDC)		19.00 (100)		19.00
Technical and Logistical Support				40.00
TOTAL	24.12 (17.16)	87.33 (62.13)	29.11 (20.71)	180.56

[a]Amounts in parentheses indicate percentage allocation across the three tiers of local government.

[b]Not allocated.

SOURCE: Ministry of Local Government, Government of Bangladesh, May 1983.

zilla and thana parishads. Furthermore, projects chosen at one level had to be approved by the next higher level of government; hence, even at the union parishad level, approval by central government personnel was required. In addition, the BDG required that maintenance of completed schemes had highest priority; completion of ongoing schemes had second priority; and initiation of new schemes had third priority. Finally, due to the assignment of functions, zilla parishads were restricted to road projects; thana parishad money was earmarked for five categories of projects: rural roads, irrigation, drainage, training center (TTDC) and union community centers. Thus, the allocation system underlying the Rural Works Programme was far from decentralized.

Allocations to individual localities were made at the center. By convention, and without explicit rationale, rural roads money was allocated to zilla, thana and unions according to the ratio 45:25:30 percent. Drainage funds were split equally between the thana and union levels. All other funds were earmarked for the thana level. Distribution of these funds to the zilla parishads, thana parishads and unions was supposedly also done on a formula basis. Distributions to zilla parishads for road projects were to be based two-thirds according to population and one-third according to land area. The full amount of the thana and union allocations for roads, irrigation and drainage schemes were to be made according to the same formula. The union portion of this allocation was to be passed through the thana parishad and also was to be distributed on the basis of population and land area of the constituent unions. Hence, in theory, every local government was to receive a RWP allocation annually.

While the RWP constituted the largest grant flow to rural local governments, another set of 10 "normal" grant programs provided additional funds to these governments (Table II-2). Normal grants were designed to provide additional recurrent revenues to local governments and, while the grant titles suggest an earmarking of funds, in fact the funds were fungible.[6] Given the paucity of own-source revenues, particularly among union parishads, the normal grant revenues were commonly used to provide salaries to the few local government officials and to maintain the local offices of the unions.

It should be noted that the Food-For-Work Program (FFW) in Bangladesh also transfers resources to rural areas although the funds do not formally flow through local government treasuries. The rationale behind the FFW is to use surplus labor in rural areas to carry out public works projects and compensate the labor with wheat so as to achieve the multiple objectives of providing jobs for the rural poor, distributing food throughout the nation and improving the infrastructure. During the early 1980s the FFW was considerably larger than the RWP and the public works projects chosen under the two programs were quite similar; in fact, there was good evidence that the two sources were seen by local governments to be alternative means for financing the same kinds of infrastructure projects--reconstruction and resurfacing of rural roads and re-excavation of canals for irrigation and drainage.

[6]The recurrent nature of these grants is made more explicit by the fact that the funds are allocated as a part of the recurrent budget of the BDG whereas the RWP allocations are made from the Annual Development Budget.

TABLE II-2

NORMAL GRANTS

1. Augmentation grants to zilla parishads
2. Special salary (subvention) grants for local government employees
3. Compensatory grants for special purposes: grants to zilla parishads in lieu of landlord share of cesses
4. Grants to zilla parishads for increased development activities
5. Grants to union parishads
6. Grants to union parishads for chairmen's honorariums
7. Grants to union parishads for members' honorariums
8. Grants to union parishads for salaries of the secretaries
9. Grants to union parishads for salaries of the rural police force
10. Grants for union parishad seminars

SOURCE: Compiled from various Government of Bangladesh sources.

Post-1982 Grants

With the creation of the upazila, there was a concurrent restructuring of the rural development grant system. The RWP was maintained as a source of revenue to the zilla parishads (which increased in number to 64). For upazila parishads (which replaced the thanas) and union parishads, the RWP was terminated as a source of revenue. Replacing it was the "Development Assistance Fund" grant as well as a "Special Infrastructure Fund" grant. The first of these is a block grant to each upazila parishad in the country. During its initial year the amounts distributed were based only on the date when the former thana was upgraded to upazila status. During 1983/84 each of the original 212 upazilas received Tk. 5 million; another 185 upazilas obtained Tk. 3 million; the remaining 63 upazilas were allocated Tk. 1 million. This distribution "formula," which disregards all other need factors such as population or land area differences, was originally planned to be altered for FY 1985; however, equal shares (Tk. 5 million) were again used rather than using a more complex distribution scheme.

Although designed as a block grant, upazila parishads were not given total freedom in determining sectoral allocations of the Development Assistance Fund money. The Government issued Guidelines regarding the minimum and maximum percentages of the total that could flow to agriculture, irrigation and industry; physical infrastructure; socio-economic infrastructure; sports and culture; and miscellaneous purposes. The Guidelines also charged the upazilas to allocate funds "which in

character and magnitude should be, as far as possible, similar to the Rural Works Programme carried out so long by the national government" (p. 8 of the Guidelines). Furthermore, one-third of the amount earmarked for Rural Works were to be allocated to the union parishads which no longer were direct recipients of RWP funds. Beyond these Guidelines, no other intervention in the allocation of this grant was made by the Government. There was, however, a monitoring cell established within the Ministry of Local Government, Rural Development and Cooperatives to ensure that the Guidelines were being followed by local jurisdictions.

The Special Infrastructure Fund grant was used as a special allocation of money to upazilas to allow them to upgrade the local government facilities in the upazila center. Thus this money was not spent for pure development purposes, but rather was used to improve government buildings, to provide improved housing for locally-posted personnel and to improve other services in the more urbanized portions of the upazila. Once facilities had been improved, the intent was to abolish this grant flow.

Evaluation

The previous review suggests that one must distinguish between the pre- and post-1982 (actually FY1984 when the first allocations were finally made) systems of local government in such evaluation.

Size and Growth of Grant Programs

The size of a grant program can be expressed in various ways. Table II-3 shows the long-term trends in rural government grants for the period

TABLE II-3

RURAL GOVERNMENT GRANTS
(in millions of takas)

Year	Property Transfer Tax	Rural Works Programme	Development Assistance[a]	Special Infrastructure[a]	Normal Grants
1976-77	45.1	205.0	--	--	n.a.
1977-78	58.2	176.6	--	--	n.a.
1978-79	72.0	226.3	--	--	n.a.
1979-80	99.9	319.4	--	--	98.3
1980-81	85.5	324.5	--	--	96.0
1981-82	n.a.	373.6[b]	--	--	130.5
1982-83	n.a.	434.9[b]	--	--	114.3[b]
1983-84	n.a.	28.0[b]	1,709.5[b]	1,723.0[b]	114.1[b]
1984-85	n.a.	36.5[c]	2,300.0[c]	1,930.0[c]	114.0[c]

[a]Grants began in 1983-84.

[b]Revised budget estimated.

[c]Budgeted amounts.

SOURCE: Compiled from Ministry of Finance and Planning, Budget Estimate (various years); Demands for Grants and Appropriations (Non-Development) (various years); Demands for Grants and Appropriations (Development) (various years); and from data supplied by the Ministry of Local Government.

1976/77-1984/85. The immovable property transfer tax is seen to have experienced rapid growth during the late 1970s. The formal grants to rural local governments are seen to have grown slowly in nominal terms during the latter half of the 1970s and into the 1980s. Normal grants were nearly constant in nominal terms throughout the period. It was the creation of the upazila and the special block grant allocation which dramatically changed the size of grant flows within the country. Development assistance grants in 1983/84 were more than four times the total amounts allocated in 1982/83.

The relative size of both the rural and urban components of the grant system are seen in Table II-4. The first three columns of that table show that until 1983/84 the total grant system (excluding shared taxes) constituted less than 0.3 percent of gross domestic product (GDP) but that this ratio more than doubled with the new upazila grant scheme. One would also have to conclude that, until the decentralization effort, the grant system in Bangladesh was "pro-urban" since, on a per capita basis, urban areas commonly received greater allocations than did their rural counterparts. This changed dramatically with the creation of the upazila. Finally, the role played by grants within the overall government fisc is seen to be relatively minor, at least until 1983/84.

From the standpoint of the local governments, grants have always played an important role in Bangladesh. With the property transfer tax included, zilla parishads can be said to be almost wholly dependent upon the grant system (Table II-5). Thana parishads had no revenue-raising

TABLE II-4

TRENDS IN GRANTS TO LOCAL GOVERNMENTS

Fiscal Year	Grants as Percent of GDP			Grants in Real Per Capita Terms (in Takas, 1976/77=100)[a]			Grants as Percent of Central Government		Central Government Taxes as Percent of G
	Urban[b]	Rural[b]	Total	Urban	Rural	Total	Taxes	Expenditures	
1972/73	0.146	0.339	0.485	22.21	4.60	6.03	12.26	2.59	3.95
1973/74	0.029	0.215	0.244	4.70	3.34	3.46	5.83	1.61	4.19
1974/75	0.014	0.106	0.120	2.31	1.77	1.82	2.95	0.95	4.09
1975/76	0.036	0.210	0.246	5.20	3.14	3.33	3.29	1.19	7.49
1976/77	0.039	0.238	0.277	5.20	3.38	3.55	3.86	0.91	7.15
1977/78	0.020	0.189	0.209	2.70	2.84	2.82	2.63	1.23	8.95
1978/79	0.019	0.208	0.227	2.47	3.09	3.03	2.66	1.25	8.54
1979/80	0.024	0.242	0.266	3.05	3.63	3.57	3.75	1.31	7.10
1980/81	0.020	0.216	0.236	2.44	3.20	2.13	3.36	0.96	7.02
1981/82	0.036	0.103	0.134	4.89	1.74	2.09	1.71	0.83	8.09
1982/83	0.037	0.104	0.141	5.09	1.82	2.12	1.71	0.79	8.28
1983/84[c,d]	0.050	0.586	0.635	6.56	10.12	9.71	8.23	2.25	7.72
1984/85[e]	----	----	----	----	----	----	9.43	2.78	----

[a]The deflator used in the calculation is the CPI for Dhaka Government Employees/Middle Income Class.

[b]Urban grants are Works Program/Urban Development, Normal and Octroi Compensation which began in 1981/82. Special Projects grants which accrue exclusively to Dhaka and Chittagong are excluded. Rural grants include Works Program/Development Assistance and Normal grants.

[c]Revised budget estimates.

[d]1983/84 GDP is provisional.

[e]Budget estimates

SOURCES: Financial data compiled from Ministry of Finance and Planning, Budget Estimate (various years); Demands for Grants and Appropriations (Non-Development) (various years); Demands for Grants and Appropriations (Development) (various years); and from data supplied by the Ministry of Local government. Population, GDP and CPI data compiled from Bangladesh Bureau of Statistics, Monthly Statistical Bulletins of Bangladesh, Economic Indicators of Bangladesh, and Statistical Yearbook of Bangladesh (various issues).

TABLE II-5

PERCENTAGE DISTRIBUTION OF ZILLA PARISHAD REVENUES, BY SOURCE, 1976/77-1980/81
(in percentages)

Revenue Source	Fiscal Year 1976/77	1977/78	1978/79	1979/80	1980/81
Property Transfer Tax	40.7	45.5	48.3	50.7	49.4
Local Rate	4.9	0.1	1.4	0.6	0.5
Rent, Profit and Sales Proceeds	9.4	10.0	7.5	6.7	5.3
Fees and Rates	0.2	0.2	0.2	0.2	0.2
Tolls on Roads, Ferries and Bridges	2.8	2.7	2.8	2.3	3.3
Interest	0.5	1.0	1.4	1.2	1.6
Miscellaneous Revenue	1.8	2.7	2.5	3.9	3.6
Voluntary Contribution	0.0	0.0	0.6	0.1	1.3
Normal Grants	6.2	6.5	5.1	4.2	4.5
Works Programme Grants	33.5	31.3	30.0	29.9	29.6
Total[b]	100.0	100.0	100.0	100.0	100.0
Grants as Percent of Total[c]	80.4	83.3	83.4	84.8	83.5

[a]Only the 14 zilla parishads for which data were available for the entire period and which reported RWP grants in the District Fund were used for this table.

[b]May not sum to total due to rounding.

[c]Property transfer tax, normal grants and works programme grants.

SOURCE: Computed by the author from zilla parishad records.

powers of their own so were fully dependent upon central government allocations; their successor bodies, the upazila parishads, have revenue-raising powers, but with the massive flows from the center are unlikely to use them greatly. As might be anticipated, union parishads, too, are extremely dependent upon the flow of resources from above. In general, then, while grants do not dominate central government activity, local governments would probably not be able to survive without these transfers.

Local Government Fiscal Planning Effects

Even though their dependence upon grants has always been great, local governments in Bangladesh have not been encouraged by the grant system to engage in longer term fiscal planning. This is due to the fact that the system often falls victim to revenue shortfalls experienced at the center. While annual budgeted amounts are announced soon after the start of the fiscal year, total actual allocations commonly fall below the initially-announced levels. The problem was particularly severe for the Rural Works Programme. Table II-6 shows the experience during the period 1974/75 through 1982/83. Except for 1975/76, 1977/78 and 1979/80, amounts allocated as a percent of the amounts initially budgeted fell significantly short of 100 percent. Local government officials indicated that in such instances they would simply delay the implementation of infrastructure projects until the following fiscal year. While the nature of most of the schemes financed under the RWP were conducive to these actions (or inactions), such fiscal uncertainty causes frustrations and delays in adequately carrying projects. Furthermore, there were also delays in

TABLE II-6

RURAL WORKS PROGRAMME ALLOCATIONS AND SPENDING
AS PERCENT OF AMOUNTS BUDGETED,
1974/75-1982/83

Fiscal Years	Total Budgeted Amounts (in millions of takas)	Allocation as Percent of Budgeted Amounts	Spending as Percent of Budgeted Amounts
1974/75	173.700	66.17	59.47
1975/76	192.830	107.43	140.32
1976/77	237.150	86.44	91.46
1977/78	172.360	102.45	104.01
1978/79	251.150	90.12	90.12
1979/80	321.086	99.48	99.31
1980/81	335.697	96.67	96.44
1981/82	404.335	92.40	n.a.
1982/83	498.341	87.26	n.a.

SOURCE: 1979-1983 data supplied by the Min
Government (September 1982 and May 1983). 1974-1978 data from Details of Demand for Grants and Appropriations (Development), Ministry of Finance and Planning, The People's Republic of Bangladesh, 1975/76-1982/83.

transferring money from the center to local jurisdictions, with some government personnel being paid late.

Apparently, during its first two years of operation, the upazila development assistance grant did not encounter the same problems, probably due to BDG concern that this centerpiece of its domestic program not fail due to delays and revenue shortfalls. Whether, in the face of national resource constraints, this improved performance can be maintained remains to be seen.

Spending Implications

Budgetary choices at the local level are constrained to some extent by the intergovernmental grant system in Bangladesh. Under the RWP the types of projects permitted were decided upon centrally as was the allocation of money across the various types of infrastructure investments, e.g., roads, canals, etc. Since RWP personnel at the zilla parishad level and all thana parishad employees were compensated directly from central government funds (these amounts were not a part of the overall allocation), there was no temptation to use these development-oriented grant monies for recurrent expenditures.

Normal grants are, in fact, fungible despite the earmarked implication of the grant titles. In fact, given the narrow revenue base of union parishads, the bulk of these funds are actually spent on salaries of the few union employees and officials. This has occurred in spite of a provision contained in the rules governing the RWP that 25 percent of

normal budget revenues were to be spent on maintenance of previously-constructed RWP schemes. Even then, 25 percent of a small revenue base is small and cannot result in substantial maintenance spending. Furthermore, there has never been extensive monitoring of this requirement nor has the problem of distinguishing between maintenance and "reconstruction" ever been fully resolved.

Under the upazila development assistance program, local governments are given greater discretion in their spending choices, although within centrally-mandated guidelines. The nature of the guidelines are sufficiently broad, however, not to place severe constraints on the budgetary flexibility of upazila parishads. For example, the original guidelines stated that from 25 to 35 percent of the grant was to be spent for infrastructure purposes and 30-40 percent could be allocated to agriculture, irrigation and industry. Since employees of the upazila parishad, except for the upazila chairman, retained their central government employee status, there again would be little pressure for upazila parishads to reallocate these monies from development-oriented to employee compensation purposes.

Fiscal Effort Implications

There is little reason to think that the current grant system of Bangladesh does much to encourage local governments to mobilize resources on their own. Even the administration of shared property transfer tax is such that zilla parishads are passive actors in the tax collection process. Allocations of the RWP as well as the normal grants were supposedly made on

a formula basis, but no attempt was made to build revenue effort into that formula.

The one area in which one might expect some small incentive effect is from the normal grants, which, under the grant design, were intended to provide only some fraction of the total amounts spent on compensation of particular employees. For example, one-third of the chairman's salary, one-half of the council members' pay and one-half of the secretary's compensation were to be reimbursed from this grant. Likewise, one-half of the rural police force salaries were to be paid from normal grant funds. In fact, however, the local governments are not required to show a matching amount. Some local government officials indicated that during periods of revenue shortfalls, they would remain unpaid; union parishads generally made few attempts to mobilize more resources. Furthermore, other normal grants, particularly the special purpose grant, is often viewed by recipient local governments as being provided to cover any deficits incurred; hence, little additional revenue effort can be expected from this long list of recurrent grant programs.

The upazila development assistance grant could, conceivably, be used to stimulate local revenue effort since, under its original formulation, it was suggested that future grant allocation formulae include some measure of "fiscal performance." During its first two years of operation, however, the grant did nothing to stimulate local tax effort. Whether the fiscal

performance factor, which was to constitute 20 percent of the total allocation formula, encourages revenue effort remains to be seen.[7]

Redistributional Implications

Tax sharing grants cannot be expected to redistribute resources from poorer to wealthier jurisdictions; indeed, the expectation is that such arrangements will exacerbate fiscal differences, with this commonly used as the primary argument against such grant schemes. In fact, under an analysis of the IPTT in Bangladesh, it was not possible to find a strong statistical relationship between local economic activity and the amount of IPTT derived by zilla parishads.[8]

The RWP was supposedly distributed on the basis of population and land area (with the proviso that in some 'special cases' additional allocations were made). Using a sample of zilla, thana, and union parishads, grant distributions (measured in both total and per capita terms) have been correlated with population (Table II-7). On a per capita basis there is a negative relationship between grant distributions and population. If distributed purely on the basis of population, one would expect these correlations to be zero. The "bias" of the distribution system, therefore, appears to favor smaller (in population) rural governments. Unfortunately,

[7]Furthermore, there is also the need for revenue instruments to be placed at the disposal of these local governments if any fiscal effort improvement could ever result.

[8]James Alm, "The Immovable Property Transfer Tax in Bangladesh," Metropolitan Studies Program Occasional Paper No. 68, The Maxwell School (Syracuse, NY: Syracuse University, April 1983 [revised May 1984]).

TABLE II-7

SIMPLE CORRELATIONS OF GRANTS AND POPULATION SIZE: BY TYPE OF LOCAL GOVERNMENT AND TYPE OF GRANT, 1980/81

	Per Capita Grants			Total Grants		
	Works Programme	Normal	Combined	Works Programme	Normal	Combined
Zilla (16)[a]	-0.49	-0.43	-0.49*	-0.10	0.88*	-0.03
Thana (11)	-0.68*	---[b]	-0.57[c]	0.12	---[b]	0.35
Union (27)	0.26	-0.43*	-0.38*	0.76*	0.25	0.47*

*Denotes significance at .05 level.

[a]Excludes Chittagong Hill Tracts, which does not receive any property transfer tax.

[b]Not applicable because thana parishads do not receive any Normal grants.

[c]This correlation coefficient is for the Rural Works Programme grants combined with other occasional special project grants. This category includes grants received for such purposes as haats and bazaars, food godowns, workshops, farmers' training, etc.

SOURCE: Roy Bahl, "Intergovernmental Grants in Bangladesh," Metropolitan Studies Program Occasional Paper No. 87, The Maxwell School (Syracuse, NY: Syracuse University, November 1983 [revised May 1984]).

without any income data it is impossible to test for wealth-based redistribution effects of the grant schemes.

The upazila development assistance grant was originally distributed with equal shares going to each upazila parishad. Under such a "formula" small jurisdictions are treated preferentially, at least on a per capita basis. One must question the wisdom of using such an allocation device across 464 upazilas with widely differing populations and where local conditions would be expected to vary greatly.

Fiscal Accountability

Little monitoring of grant spending was ever attempted under the RWP; furthermore, local government fiscal auditing by a centralized audit authority has never been a major initiative of the BDG. While numerous forms had to be completed by local governments and RWP projects were to be taken from Plan Books prepared at the local government level, ex post auditing of the schemes was minimal at best. In great part this probably stems from the lack of trained personnel to carry out the enormous task of monitoring such a large number of individual schemes.

With the introduction of the upazila development fund, a monitoring cell has been established within the Ministry of Local Government. During its initial year of operation, reporting forms were developed and processing of data was computerized. Again, however, such monitoring is done at the center with little in the way of on-site evaluation of the overall soundness of the schemes undertaken. Nevertheless, it is a start at ensuring that the funds distributed to local governments are being put to economical use.

There was a maintenance requirement written into the RWP. Again, the lack of monitoring and insufficient knowledge regarding what constitutes maintenance resulted in this requirement essentially being ignored. Indeed, we observed that local level leaders had great uncertainty as to what the maintenance requirement actually meant. Some jurisdictions interpreted the requirement to mean 25 percent of total local government income, some as 25 percent of budgeted works (capital) expenditures and some as 25 percent of average works expenditures during the previous two years. In fact, the BDG meant the requirement to be 25 percent of recurrent budget revenues, excluding RWP grants.

Fiscal Decentralization

Prior to the creation of the upazilas in 1982 one would have concluded that there was minimal fiscal decentralization in Bangladesh. In rural areas only the union parishad could be considered a local self government and it was so weak fiscally that its role in the development process was almost nonexistent.

The upazilas have greatly altered this situation with the grants system playing a major role in the decentralization process. Even though guidelines somewhat restrict the fiscal freedom of upazila parishads, these governments enjoy considerable autonomy relative to the past and to other levels of rural local government in Bangladesh. At the same time, one cannot conclude that these local governments are fully decentralized. Employees are still central government personnel and can be transferred and promoted at the discretion of the center. The chief administrative

officer, the upazila nirbahi officer, is second only to the chairman in terms of power and is also posted at the discretion of the center. But maybe even more importantly is the lack of incentives and good revenue instruments available to the upazila parishads to mobilize and spend resources of their own. In part, the problem can be traced to the assignment of revenues. Land or property-based taxes remain under the control of the BDG with no sharing of revenues with the locality; business-based taxes cannot yield much revenue in many of the rural-dominated upazilas; and other revenues, including local market revenues, depend greatly on the location of market centers. The grant system, too, is a culprit in slowing the fiscal decentralization process. Unless the allocation formula is altered in a manner to encourage such local resource mobilization with appropriate instruments assigned locally, the future of fiscal decentralization in Bangladesh remains bleak.

Summary

Until 1982 local governments played an extremely minor role in the development efforts of rural Bangladesh. At the same time, the small role that was played was dominated by the center with grants constituting the primary source of revenues. With the creation of the upazila parishads along with the initiative to decentralize governmental decision-making, this situation has changed considerably. About 10 percent of total central government taxes are now budgeted for transfer to local governments and nearly all rural development efforts have been aimed at the upazila level.

Nevertheless, the system still must be altered further if grants are to be used as the stimulus to encourage local governments to mobilize resources of their own and to spend these resources on productive development projects and to maintain the facilities that already are in place.

CHAPTER III

INTERGOVERNMENTAL GRANTS IN PAKISTAN

Pakistan offers the opportunity to observe intergovernmental grants within the setting of a federal system. In such a system local governments are given their official status by the second tier of government--in the case of Pakistan, provinces. As students of local government in the United States, Canada or Australia know, this can greatly complicate analysis, since each second-tier government may treat its localities somewhat differently. This is the case in Pakistan. Unfortunately, due to the short amount of time spent in the country, this analysis will not be able to discuss fully and adequately the rich amount of detail that a longer term analysis might be able to show. Nevertheless, some of the local government diversity across the provinces is noted here.

Local Government Structure

The country is politically subdivided into four provinces--Baluchistan, North West Frontier Province (NWFP), Punjab and Sind. The 1973 constitution divided the functions between the federal and provincial governments, reserving for the former the usual national level functions of national defense; external affairs; foreign aid; regulation of banking; air, sea and rail transport; national highways and strategic roads; communications and fuel supply. Maintenance of law and order, labor legislation and population planning were listed as being "concurrent" responsibilities of both levels.

Provinces, therefore, are expected to carry out such functions as education, health, agricultural support (including irrigation) and roads. The constitution does allow, however, for provinces to entrust their responsibilities to the federal government and they have done so, primarily due to the lack of sufficient provincial ability to pay. For example, universities have been funded directly by the central government since 1980 when provinces were found to be unable to support them adequately.

Current revenues of provinces are derived from a combination of own-source revenues and taxes imposed by the federal government, but shared with the provinces; hence, even at the provincial level the role of intergovernmental transfers is great. Indeed, provinces derive over one-half of their current revenues from shared taxes. The income tax, sales tax, export duty on cotton, excise and royalty on natural gas and the gift tax are all collected by the federal government and shared according to a formula with the provinces. The shares are based on formulae derived by a National Finance Commission which, according to the 1973 constitution, is to meet every five years. The current sharing allocation is based upon recommendations made by the commission meeting in 1974 and, although another commission was appointed in 1979, its recommendations were never made public. The current formula calls for 80 percent of income and corporate taxes as well as the federal sales tax to be shared with provinces on the basis of population. From the 1981 census of population, this means that Punjab receives 57.97 percent of the total to be allocated; Sind, 23.34 percent; NWFP, 13.39 percent; and Baluchistan, 5.30 percent.

In addition, provinces obtain the revenues earned from the gift tax and surcharge on natural gas on the basis of the point of collection.

Development revenues available at the provincial level are determined at the national level, with 90 percent of the total amount shared among the provinces on the basis of population. The remaining 10 percent is shared equally between the two less developed provinces, NWFP and Baluchistan. Because of their poor financial conditions, provinces recently have been unable to supplement these monies from their own revenue sources.

There are essentially four different periods that are useful in describing local government developments in Pakistan.[1] The first, basically from independence in 1947 through 1958, was a period of nation-building during which little attention was given to local government.[2] Hence, during that period the structure of local government was quite similar to that found during the pre-independence period.

The second period ran from 1959 through the end of the 1960s. It was guided by the Basic Democracies Act of 1959 under which four tiers of local government were created--union councils, tehsil councils (thana councils in East Pakistan), district councils and divisional councils. As was the case

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[1]See, for example, G. Shabbir Cheema, "The Performance of Local Councils in Pakistan: Some Policy Implications." Paper prepared for United Nations Development Programme (Islamabad: UNDP, undated), pp. 7-11. This same partitioning of the history of the country into four main periods holds for more than just local governments. See Chapters 5-7 of Viquar Ahmed and Rashid Ahmed, The Management of Pakistan's Economy, 1947-1982 (Karachi: Oxford University Press, 1984).

[2]It is useful to recognize the parallel here with Bangladesh, which during its first decade or so was unable to focus much on local governments since its attentions were consumed with nation-building.

during the early history of Bangladesh, the central government played an important role in all but the lowest level of these local governments. It was also during this period that the Rural Works Programme, which had its genesis in the work of Akhter Hameed Khan at the Comilla Academy, was used to lead the rural development efforts in both West and East Pakistan.

The Basic Democracies Act was abolished by the Martial Law government in 1971 meaning that local governments were also essentially dismantled. Central government officials took over all functions and powers of the local bodies, even though each province adopted a local ordinance during the period 1972-1975. Since elections were never held, these ordinances were moot.

The current system of local government, introduced in 1979, gave considerable power to local councils. Each province adopted a new local government ordinance in 1979 (1980 in Baluchistan) and elections were held. Second elections were held in 1983, with plans currently underway for the next round to be held in 1987.

Generally speaking, the structure of local governments is similar in the four provinces, although some of the details differ. For rural areas, each provincial local government ordinance provides for both district and union councils, although in Sind and Baluchistan there is also provision for tehsil/taluka councils as an intermediate layer; markaz councils were provided for in Punjab. Urban local governments include town committees, municipal committees and municipal corporations. As noted in Table III-1 the primary difference in detail regards the number of members constituting each local body.

TABLE III-1

STRUCTURE OF LOCAL COUNCILS (1979/80 ORDINANCES)

Province	District Council	Union Council	Town Committee	Municipal Committee	Municipal Corporation
Punjab	Zilla Council in each district; 50 thousand population per ward	Up to 15 members; 1-2 thousand population per ward	9-15 members; 5-20 thousand population	15-35 members; 20 to 500 thousand population	50-100 members; 500,000 and above population
Sind	20-65 members	1500 population per ward	5-18 members; 5-25 thousand population	20-65 members; 25 to 500 thousand population	20-65 members; above 500,000 population; KMC = 150 members
NWFP	32 members	15-20 thousand population per ward	8 members	11-15 members	35 members
Baluchistan	One member from each union	7-15 members; 10-15 thousand population	5-13 members; 5-10 thousand population	9-35 members; 10 to 100 thousand population	40-60 members; population as determined by Government

SOURCE: Md. Afzal, Local Government in Pakistan (Islamabad: Ministry of Local Government and Rural Development, 1985), p. 18.

Service functions of the union and district councils include the traditional activities of providing roads, lighting, health and sanitation, water supply, etc. As is so often the case in developing countries, however, lack of adequate resources limit the extent to which all of the activities are carried out. While we were unable to collect detailed information on the extent to which these activities are carried out in a set of individual jurisdictions, Table III-2 shows the relative proportion of total expenditures that is devoted to development spending. In general up to 75 percent of total district council spending is shown to have been spent for developmental purposes in 1983-84. The considerably smaller percentage for urban areas is probably attributable to the fact that these more general purpose jurisdictions are expected to produce a wider range of services than are the rural bodies where provincial departments provide services directly to the residents.

Table III-3 shows per capita local government revenues in each of the four provinces for 1983-84. As one might anticipate, on a per capita basis district councils derive considerably more revenues than do their union counterparts. Urban governments, with their considerably broader tax bases, greatly outstripped the rural local governments in terms of revenues. Across the four provinces, 1983-84 revenues at the district level were largest in the NWFP with Punjab and Sind revenues somewhat smaller. Baluchistan, on the other hand, had per capita district revenues only a fraction of the level found in the other three provinces. A comparison of union revenues shows Sind far in front of the other three

TABLE III-2

DEVELOPMENT SPENDING AS PERCENT OF TOTAL SPENDING BY PROVINCE AND LEVEL OF LOCAL GOVERNMENT, 1983/84

Local Government	Province			
	Baluchistan	NWFP	Punjab	Sind
District Councils	48.92	75.53	52.93	46.76
Union Councils	23.98	80.99	72.83	50.03
Urban Local Governments	39.92	48.85	33.35	32.0

SOURCE: Date supplied by Government of Pakistan, Ministry of Local Government.

TABLE III-3

PROVINCIAL PER CAPITA REVENUES, 1983/84
(in rupees)

	Provinces			
	Baluchistan	NWFP	Punjab	Sind
District Council				
Taxes	2.33	12.26	10.54	9.87
Projects	0.13	0.13	0.05	0.17
Grants	1.87	4.38	0.14	2.03
Other	0.29	0.34	1.56	2.34
Total	4.62	17.11	12.30	14.41
Union Council				
Taxes	1.15	0.29	0.91	4.11
Projects	0.04	---	0.05	0.04
Grants	1.83	1.59	0.74	1.98
Other	0.49	0.12	0.17	1.08
Total	3.51	1.97	1.87	7.20
Municipal, Town Committees and Corporations				
Taxes	154.10	117.43	99.18	151.71
Projects	1.80	2.29	1.44	0.71
Grants	7.94	6.89	0.63	3.85
Other	2.25	6.74	9.91	12.88
Total	166.08	133.35	111.16	169.15

SOURCE: Total revenue data supplied by Government of Pakistan, Ministry of Local Government. Population data from 1981 Census Reports of Baluchistan, NWFP, Punjab and Sind Provinces. 1981 Population Census Organisation, Statistics Division, GOP, (Islamabad, December 1984)

provinces. In each of these provinces, for each of the levels of local government, some grant revenues are seen to supplement locally-raised resources.

Intergovernmental Grants System

Since the grant programs differ across the provinces, this section has been subdivided on a provincial basis.

Baluchistan

Both recurrent and development grants are provided to rural local governments in this province. Recurrent grants essentially take the form of "deficit" grants since the Department of Local Government reviews the local governments' budgets and attempts to ascertain from these budgets whether or not own-source revenues will be sufficient to meet local employee salaries and provide for maintenance.

Developmental grants flow from the provincial Annual Development Programme. These grants are in the form of block grants to unions and to districts. In 1985-86 each union council was to receive Rs. 70,000 without regard to population or any other characteristic of the union. District council allocations were to be based on both population and an equal allocation across all jurisdictions.

One feature of the grant system in Baluchistan (as well as in the other provinces) which greatly complicates and, possibly, creates unintended results in the overall allocation of funds is a grant allocation to each member of the provincial assembly (MPA). Each Baluchistan MPA has

been asked to identify projects, costing less than Rs. 1.5 million each, but totalling Rs. 8 million. These projects will be implemented by provincial or district or union governments but may or may not be in accord with the views of the local government. Hence, the addition of this new "grant layer," which circumvents the local government system, may result in a set of uncoordinated projects.

Per capita 1983-84 district council grants in the province are shown in Table III-4, as are the relative importance of these grants. The data suggest a wide range in the per capita amounts (possibly due to the equal distribution portion of the overall grant formula) with Pishin receiving only Rs. 0.09 per capita, whereas Sibi received Rs. 12.13 per person. In a similar vein, there are considerable differences in the relative importance of grants in these districts. Grants constituted only slightly more than 6 percent of total revenues in Loralai, whereas in Chagai over 92 percent of total income was derived via transfers from the province.

Interestingly, there is somewhat greater uniformity in the per capita grants to union councils (Table III-5). This is surprising if grants were allocated to unions on an equal jurisdictional basis. But the data in the second column of the table suggest that, at least in 1983-84, equal allocations were not made to each union council. At this level of local government there is, again, considerable difference in the relative importance grants play in the overall financial scheme. In Gwadar, for example, only 9 percent of total revenues were derived via transfers from the province, whereas in Pishin all revenues were obtained via this route.

TABLE III-4

REVENUES OF DISTRICT COUNCILS, BALUCHISTAN, 1983/84

District Council	Per Capita Grants	Per Capita Total Income	Per Capita Grants as Percent of Total Income
Chagai	4.722	5.153	92.613
Dera Bugti	a	a	84.672
Gwadar	4.049	4.844	83.576
Kachhi	0.917	1.602	57.224
Kalat	1.205	1.374	87.692
Kharan	2.071	2.520	82.177
Khuzdar	1.769	3.439	51.426
Kohlu	1.487	1.487	100.000
Lasbela	1.772	14.688	12.062
Loralai	0.712	1.168	6.094
Nasirabad	0.678	1.035	65.575
Panjgur	3.341	25.678	13.011
Pishin	0.090	1.331	6.728
Quetta	0.503	2.709	18.555
Sibi	12.128	20.595	58.886
Turbat	0.427	0.699	61.130
Zhob	0.991	1.109	89.362

[a]Population data not available.

SOURCE: Per capita figures computed from population figures in 1981 Census Report of Baluchistan Province, Population Census Organisation, Statistics Division, GOP, Islamabad, December 1984. Revenue data supplied by Baluchistan Local Government Department.

TABLE III-5

REVENUES OF UNION COUNCILS,
BALUCHISTAN, 1983/84

Union Councils by District	Number of Unions	Mean Grant Per Union	Per Capita Grants	Per Capita Total Income	Grants as Percent of Total Income
Chagai	12	18,635.58	1.857	7.165	25.91
Dera Bugti	10	17,400.00	a	a	84.67
Gwadar	6	7,468.17	0.399	4.134	9.65
Kachhi	28	9,994.96	0.917	1.586	57.82
Kalat	19	27,859.21	1.551	2.640	58.77
Kharan	10	25,348.90	1.980	3.306	59.88
Khuzdar	22	16,387.55	0.932	3.295	28.29
Kohlu	9	---	---	0.093	0
Lasbela	--	---	0.468	1.769	26.44
Loralai	35	54,176.06	4.888	8.172	59.81
Nasirabad	37	17,953.68	1.684	1.810	93.06
Panjgur	11	16,878.00	1.155	1.648	70.09
Pishin	31	27,753.74	2.273	2.273	100.00
Quetta	--	---	0.414	0.836	49.51
Sibi	15	11,180.13	1.283	7.473	17.17
Turbat	21	16,387.24	0.907	1.252	72.44
Zhob	28	16,186.39	1.253	2.964	42.28

[a]Population data not available.

SOURCE: Per capita figures computed from population figures in 1981 Census Report of Baluchistan Province, Population Census Organisation, Statistics Division, GOP, Islamabad, December 1984. Revenue data supplied by Baluchistan Local Government Department.

NWFP

Apparently no recurrent grants are provided to union and district councils in this province; all grants from the provincial treasury flow from the Annual Development Programme. Again, both levels of local government derive money from development grants. Unions are provided block allocations with equal amounts (Rs. 69,000) given to each union council. District councils receive two different block grants--a district council block grant and a rural roads grant. The plans for 1986-87 (still incomplete when this information was collected) called for the district council grant to be allocated on a "matching" basis. No specific procedures, however, had been determined as to how this matching was to be accomplished, e.g., whether plans would have to be submitted to the province before money was distributed or whether the match would occur after projects had been completed. The rural roads grant was to be distributed using a two-factor formula--60 percent based on an equal allocation across all jurisdictions and 40 percent based on population.

The amounts budgeted for 1986-87 across the several districts are shown in Table III-6. As shown there, the per capita amounts distributed under the Rural Roads Programme are far greater than the total of the other two block grant schemes. The fact that the district council grants are budgeted even prior to the fiscal year in spite of the fact that the funds were to be distributed on a matching basis suggest a "closed-end" matching grant program that would have to be monitored closely to insure that matching funds were, in fact, generated at the local level. Indeed, it is

TABLE III-6

BUDGETED 1986/87 PER CAPITA RURAL DEVELOPMENT GRANTS AND 1984/85 PER CAPITA REVENUES, NORTHWEST FRONTIER PROVINCE

District Council	Grant Program: Rural Roads Programme	Grant Program: Union Council	Grant Program: District Council	1984/85 District Council Revenues
Abottabad	4.508	4.130	1.558	14.107
Bannu	6.117	3.592	2.115	9.644
Chitral	15.545	3.639	5.375	44.178
D.I. Khan	6.326	3.366	2.187	13.916
Dir	6.053	3.147	2.093	13.147
Karak[a]				
Kohat	4.863	2.182	1.682	21.030
Kohistan	8.353	4.598	2.887	1.745
Malakand	13.053	4.550	4.511	9.586
Mansehra	4.969	4.076	1.718	28.623
Mardan	3.939	3.527	1.361	10.354
Peshawar	2.767	2.540	0.957	10.766
Swat	4.535	3.693	1.568	17.882
Total Local Program	5.327	3.512	1.841	15.057

[a]No population data available.

SOURCE: Per capita figures computed from population figures in 1981 Census Report of NWFP Province, Population Census Organisation, Statistics Division, GOP, Islamabad, December 1984. Revenue data supplied by NWFP Local Government Department.

difficult to imagine how a single matching formula will be workable in all districts. As is shown in the table, there was a considerable difference in 1984-85 in the amounts of district per capita revenues. Assuming the same per capita amounts were to be raised in 1986-87, no single matching percentage, e.g., 10 percent, would result in the different sized allocations across these districts as shown in the budget.

It is also unclear whether the two-factor formula was actually used to allocate the rural roads funds given the amounts allocated to Chitral and Malakand district councils, which greatly exceed the per capita amounts in the remaining districts. It very well may be the case that all of the grant allocations are made on an ad hoc, rather than a formula, basis.

Punjab

Of all provinces in Pakistan, the grant programs in the Punjab are most complex in the sense that rather than use one or two simple block grant schemes there are six different programs utilized. There is no recurrent grant program; all grants are a part of the provincial Annual Development Programme. Also, no money is provided directly to union councils. Instead, the funds all flow through the district council with some allocated at that level to the unions.

The largest of the grant schemes is the matching grant program. The funds are first allocated to districts using a formula that includes population, area, available infrastructure and arable land. In Rawlpindi District the District Council chairman allocates these funds to those unions capable of matching one-half of the total costs of a project.

Cheema reports that in 1981/82, contributions from communities under this grant program amounted to 30 percent of total expenditures; and in 1982/83, the matching percentage had risen to 46 percent.[3] The local match can be monetary or in-kind (labor, land, tractors, etc.). Apparently, the schemes have included numerous types of infrastructure development, including schools, paving streets, building roads and water supply systems.

The focal point grant program allocates funds to semi-urbanized areas (with populations less than 10,000) with the express objective of slowing migration to the larger cities. The grant is used to provide a package of services including a basic health unit, high school, water supply, sewer services, link roads, electricity and a public hall. The program is only three years old; however, the data in Table III-7 suggest that the objective of this grant program is seen by the province to be particularly important since it is second most important in size and has been increased greatly over the past three years.

The small village scheme grant is allocated across the districts using the same formula as the matching grant program. Cheema provides data indicating that from 20-30 percent of total spending on projects under the program were derived from self-help contributions mobilized at the local level.[4] In Rawlpindi the money is distributed among union councils on a two-factor formula basis: one-half equally divided among all unions and

[3]G. Shabbir Cheema, "The Performance of Local Councils in Pakistan: Some Policy Implications," A Report prepared under the auspices of UNDP (Islamabad: United Nations Development Programme, undated), p. 40.

[4]Ibid., p. 40.

TABLE III-7

PUNJAB RURAL DEVELOPMENT GRANT PROGRAMS,
1984/85 TO 1986/87
(in thousands of rupees)

Grant Program	1984/85	1985/86	1986/87	Percentage Change 1984/85 to 1986/87
Rural Roads	18,116	20,000	15,000	-17.20
Special Directive	11,223	10,000	10,000	-10.90
Focal Point	9,114	55,400	50,000	448.61
Matching	128,411	124,400	148,800	15.88
Village Level	33,376	32,000	32,000	- 4.12
Model Village	6,250	8,200	8,600	37.60
Total	206,490	250,000	264,400	28.05

	Per Capita		
Grant Program	1984/85	1985/86	1986/87
Rural Roads	0.529	0.584	0.438
Special Directive	0.328	0.292	0.292
Focal Point	0.266	1.618	1.460
Matching	3.750	3.633	4.346
Village Level	0.975	0.935	0.935
Model Village	0.183	0.239	0.251
Total	6.031	7.301	7.722

SOURCE: Per capita figures computed from population figures in 1981 Census Report of Punjab Province, Population Census Organisation, Statistics Division, GOP, Islamabad, December 1984.

one-half based on population. Union councils can allocate these funds as they see fit; but most commonly the funds are spent on activities such as drains, streets, culverts, schools and water supply schemes.

Rural roads grants are allocated across all districts on an ad hoc basis as are the special directive grants. The final grant program is the model villages grant. Fifty villages have been selected by the province to receive these grant funds. Again, however, the money is directed through the district councils who oversee the allocation of the funds.

Sind

Both recurrent and development grants are utilized in Sind (Table III-8). The former are directed only to union councils, specifically to the 333 union councils in the province which have no incomes of their own. Thus, the grant is essentially a deficit grant with the amounts based on the approved budgets of the unions. No information was received regarding how the new road repair grant would be distributed across the union councils.

Development grants in this province are made to both union and district councils, with approximately the same amount of funds distributed to each level. The distribution formula used at each level is based 60 percent on population, with the remaining 40 percent inversely related to the amount of own-source revenues collected at the local level. It is unclear, however, how this latter portion of the formula is actually implemented, given that many of the unions derive no revenues of their own. Apparently, the district councils are expected to match the funds allocated to them under this program, with the matching ratio being 50:50.

TABLE III-8

GRANTS TO RURAL LOCAL GOVERNMENTS IN SIND, 1985/86 AND 1986/87
(in thousands of rupees)

	1985/86 Budget	Revised	1986/87
Revenue Budget			
Grants to Union Councils		13,620	5,000
Grants for Road Repairs by Union Councils		---	22,650
Total Revenue Budget		13,795,681	12,747,802
Annual Development Programme			
Block Grants to Union Councils			11,500
Block Grants to District Councils			11,510
Total ADP			2,776,250

SOURCE: Data supplied by Sind Local Government Department.

Evaluation

It is not possible to analyze in depth these different grant programs given the lack of detailed data. Nevertheless, there are some rather obvious implications of the grant schemes described above.

Size and Growth of the Grant Programs

Given the federal structure, it is most reasonable to discuss this aspect of the Pakistan rural development grant programs on a province-by-province basis. Table III-9 shows, for district and union councils by province, the relative importance of grants in the overall revenue structure as well as the percentage increase in grant revenues experienced over the period 1979/80 through 1983/84. The data indicate that there is considerable difference across provinces regarding the extent to which local governments are dependent upon grant finance and the growth in grant revenues during the early 1980s. As one might anticipate, union councils with their narrower tax bases are generally more heavily dependent upon grants than are district councils. While unions in NWFP were until 1982/83 totally dependent upon intergovernmental transfers, union councils in the economically more prosperous provinces of the Punjab and Sind have experienced decreasing dependency upon grant revenues. District councils in the very poor province of Baluchistan are also quite heavily dependent upon grants whereas grants as a percentage of district council revenues in Punjab are extremely small.

While grants constitute a most important source of revenue for local governments in Pakistan, they still do not represent a significant portion

TABLE III-9

RELATIVE IMPORTANCE AND GROWTH OF DISTRICT COUNCIL AND UNION COUNCIL GRANTS, BY PROVINCE, 1979/80 - 1983/84

Province	1979/80	1980/81	1981/82	1982/83	1983/84	Percentage Growth 1979/80 - 1983/84 Total Revenue	Percentage Growth 1979/80 - 1983/84 Grant Revenue
Baluchistan							
District Council	23.2	34.6	65.6	54.7	40.6	273.8	553.0
Union Council	100.0	26.9	51.5	93.6	52.1	2,750.4	1,385.4
NWFP							
District Council	2.4	0.4	3.9	21.6	25.6	373.9	4,991.9
Union Council	100.0	100.0	100.0	100.0	80.8	69.5	36.9
Punjab							
District Council	1.3	1.5	0.5	4.8	1.2	135.9	104.3
Union Council	45.9	60.3	40.2	20.0	39.5	281.2	227.6
Sind							
District Council	25.7	37.2	23.8	23.5	14.1	136.2	29.6
Union Council	75.1	52.9	37.7	22.3	27.5	93.8	-29.1

SOURCE: Data supplied by the Government of Pakistan, Ministry of Local Government (Islamabad).

of total spending on the part of provinces. For 1986/87, aid to rural local bodies constitute the following proportions of total Annual Development Programmes (ADP) for the four provinces:

Baluchistan	5.13%
NWFP	5.54
Punjab	3.86
Sind	0.88

It is, therefore, difficult to conclude that local governments are seen as primary recipients of development funds in any of these provinces.

Local Government Fiscal Planning Effects

Apparently there have been no major problems which subsequently result in grant flow shortfalls to rural local governments in Pakistan. At the same time, there is also little advance knowledge given to local jurisdictions regarding the amount of money they can expect to flow from the provinces. Furthermore, grants to local governments have increased and subsequently decreased over the years, thereby adding to revenue instability and hindering fiscal planning.

While not directly related to longer term fiscal planning effects of the several grant schemes, the empirical data displayed above suggests that there is probably some difference between the way grant funds are supposed to be allocated and the way they are actually distributed. That is, in Table III-5, there are considerable disparities in the average grants per union council in Baluchistan even though, supposedly, these grants are distributed equally to all unions. Likewise, in NWFP it is difficult to see how matching grants were utilized on any consistent basis. The data

indicate that, rather than well-defined grant "systems," the methods actually used to allocate funds across districts and unions are generally ad hoc in nature rather than formula based. While this is not necessarily a weakness in the grant schemes utilized, it does suggest that perhaps local governments cannot easily plan what their allocations might be in the upcoming fiscal years with any confidence.

Spending Implications

Each of the provinces uses block grant allocations when transferring money to lower level governments. As such there is potentially a great deal of autonomy available to the local bodies in the allocation of funds. Unfortunately, the lack of an in-depth analysis of local decision-making and allocation of grant funds at the local level make it impossible to know or analyze in any detail what the actual spending implications of these grant schemes are.

The focal point grant program in the Punjab raises a longer term spending issue which apparently has not been addressed as yet. This issue concerns how the various infrastructure facilities being financed by this grant, e.g., health centers, schools, water systems, etc., will be financed when put into operation.

Fiscal Effort Implications

The fiscal effort implications of the different provincial grant programs differ considerably. In both Baluchistan and Sind deficit grants are used; as such, they would have negative effects on fiscal effort. Interestingly, in NWFP, Punjab and Sind (for development grants), matching

requirements are built into the grant system (at least theoretically). In such cases there should be encouragement of greater fiscal effort on the part of local governments. Furthermore, at least in Punjab, union councils are allowed to use nonmonetary resources in meeting the matching requirements. More detailed research into the actual effects of these matching grants schemes is necessary, however, since it is unclear exactly how the accounting for the matches is carried out and if, in fact, the matches are ultimately made.

Redistributional Implications

Given that there is no information regarding incomes at the local level (indeed, there are no data even at the provincial level), it is not possible to ascertain whether the grant schemes used in these four provinces tend to assist poorer local governments or enhance the resources of more prosperous areas. For the deficit grants it is likely that the distributions are pro-poor, although it is also possible that wealthier jurisdictions simply are not mobilizing the resources at their disposal.

We can, however, determine whether per capita grants tend to favor smaller or larger jurisdictions. Table III-10 shows simple correlations between per capita grants and population of union councils and district councils in the provinces of Baluchistan and NWFP. For district councils in both provinces and union councils in NWFP, larger jurisdictions generally received smaller per capita grants even though in NWFP there was a strong positive correlation between population and total grant allocations. If smaller jurisdictions are also poorer, then such grant

TABLE III-10

CORRELATIONS BETWEEN GRANTS AND LOCAL GOVERNMENT POPULATION AND OWN-SOURCE REVENUE, BALUCHISTAN (1983/84) AND NWFP (1986/87) BUDGET

	Correlation between Population and Grants:	
	Total Grants	Per Capita Grants
Baluchistan		
District Councils	-0.435	-0.638
Union Council	0.560	0.282
NWFP		
District Councils	0.935	-0.781
Union Councils	0.921	-0.431

	Correlation between Per Capita Grants and Per Capita Nongrant Revenue
Baluchistan	
District Councils	0.334
Union Councils	0.230

SOURCES: Tables III-4 to III-6.

allocations tend to be income equalizing; however, the premise of this argument cannot be tested. Positive coefficients were obtained when 1983/84 per capita grants were correlated with per capita nongrant revenues in Baluchistan suggesting that those jurisdictions raising greater amounts of own resources were also rewarded with larger grants.

Fiscal Accountability

The block grants used in the various provinces are not structured to require preapproval of projects. Likewise, there does not appear to be significant auditing of the uses of funds, primarily because of the lack of qualified personnel at the provincial level to conduct such audits. In Punjab the deputy commissioner at the district level is responsible for the utilization of funds by union councils.

Concern for maintenance of projects was never mentioned in the personal interviews carried out at the provinces; nevertheless, as was noted above, certainly the model villages and focal point grant programs used in the Punjab are likely to bring with them longer term needs for maintenance. None of the block grant allocations apparently carry with them any mandate that a certain portion be used for maintenance.

Fiscal Decentralization

The use of block grants is certainly in keeping with decentralization principles; hence, from this review of the grant system used in Pakistan one can conclude that there is considerable decentralization of decision-making associated with the grant programs. It is important to note, however, that a recent development in the country could greatly diminish

the role of self-governing local bodies. With the relaxation of martial law and the popular elections of provincial assembly members (MPAs), allocations have been given to these members of the assembly to carry out projects of their own choice within their districts. There is no requirement for the schemes to be coordinated with district or union projects. This means that it is possible for an MPA to proceed with a pet project that does not necessarily fit into the overall development scheme already planned at the district or union level. Interestingly, in some provinces this could result in a considerable disruption of the rural development process since the amount allocated to MPAs is considerably greater than that granted to local governments. For example, the 1986/87 Baluchistan ADP calls for MPA allocations nine times greater than the total allocated to rural local governments; in NWFP the ratio of MPA allocation to rural local government grants is only 1.4. While possibly too much can be made of this change in the allocation system and the erosion of decentralized decision-making it could bring, the phenomenon deserves closer study. For example, an indepth analysis of the types of projects undertaken over the next 2-3 years and their coordination with district and union schemes would seem to be useful.

Summary

The federal structure of local governments in Pakistan means that there are differences in the intergovernmental grant processes used across provinces. Provincial allocations to local governments have generally

avoided recurrent grant programs; instead they have concentrated on block allocations for infrastructure projects. Some progress has been made in the creation of grant schemes that should have positive fiscal effort implications although the exact extent of the stimulative effects are not known as yet. Finally, it may be that after a short period of emphasis on local governments (which was the first level allowed to hold popular elections), provincial and possibly even national assembly members will begin to overwhelm the powers of local leaders, thereby moving the country away from a decentralized decision-making state.

CHAPTER IV

INTERGOVERNMENTAL GRANTS IN INDONESIA

As noted in the introductory overview of this monograph, Indonesia's petroleum reserves have provided it with income and wealth not found in the other three countries reviewed here. Given an environment in which the direct revenues from oil sales have accrued to the central government, it is particularly interesting to observe how local governments have fared. It will be seen below that the Government of Indonesia has relied even more heavily upon transfers to lower levels of government than have the other three Asian countries reviewed here. At the same time, it will become clear that, even though these transfers have the characteristics of grants to local governments, the center retains considerable control over the ultimate allocation of funds.

The retention of centralized control is not particularly surprising given the political and cultural setting of Indonesia. Early in its history, a primary concern of the Indonesians was to create a strong central government to overcome regional separatism pressures as well as political extremism from factions opposing the government in power. Furthermore, it has been argued that the Javanese cultural tradition emphasizes centralized power and authority.

[1]These arguments are summarized in Michael Morfit, "Strengthening the Capacities of Local Government: Policies and Constraints," unpublished manuscript (Jakarta: 1986).

Local Government Structure

Indonesia is an archipelago of more than 13,000 islands containing a population of about 160 million which makes the country the fifth most populous in the world. This population is unequally divided across the numerous islands with more than 60 percent of the population residing on Java Island which constitutes only about 7 percent of the total land area of the country. Furthermore, the cultural history of this country is quite heterogeneous. Since heterogeneity often constitutes a good rationale for local government institutions which can differentially respond to particular local needs, it is particularly interesting to observe the structural characteristics of the local governments used in this country.

Indonesia is subdivided into 27 provinces (propinsi) containing 246 rural dominated regencies (kabupaten) and 55 municipalities (kotamadya) in major urbanized areas.[2] The regencies are subdivided into 3,539 subdistricts (kecamatan). Finally, at the lowest level are the villages (desas) of which there are over 67,500. This lowest level of "government" is really more of a traditional organization than a formal government; it does not play an important direct role in the administrative and intergovernmental structure of the country.

While these lower levels of the governmental hierarchy are considered autonomous, they are closely linked with the central government, both

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[2]The data reported here are all taken from the 1984 Statistical Yearbook of Indonesia (Jakarta: Biro Pusat Statistic, 1985), and refer to the situation in 1983.

politically and administratively. For example, the Governor of a province is actually appointed by the President although the President's choice is limited to three names which have been put forward by the provincial parliament. Both the central government and regional governments are responsible for service provision. Central government tasks are performed by "vertical agencies" which are subordinate to the technical ministries while local agencies (dinas) perform regional government services. As will be seen below, financing of many of the regional services is heavily dependent upon central government money; furthermore, many decisions regarding the extent and nature of local services are actually made from above.

The underlying philosophy of central-local relations in Indonesia has been characterized as a combination of deconcentration, decentralization, cooperation and "vrijbestuur". Deconcentration occurs when the central government plans and funds activities to be implemented by its officials at the regional level. Decentralization arises through the revenue-raising powers granted to the local governments themselves, the funds from which are spent locally as the local governments see fit. Cooperation involves regional governments implementing programs funded by the central government with the primary allocation decisions being made centrally but with input from the local bodies. Finally, "vrijbestuur" is a principle which essentially states that local political leaders (governors, mayors) are to carry out some development efforts on their own initiative.[3]

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[3]See Government of Indonesia, Department of Home Affairs, "INPRES: A Case Study of Financing Local Level Development," paper presented to the United Nations Centre for Regional Development, Nagoya, Japan (Jakarta, 1982).

Local government accounts differentiate between routine and development spending; however, this differentiation does not mean that routine spending is necessarily all recurrent expenditures nor that development spending consists purely of expenditures on capital. Indeed, it appears that there are several reasons why local governments have incentives to budget spending in the development category rather than in the routine category. Development spending, even if no different than services provided under the heading of routine spending, is favored in nearly all developing countries since it is more popular politically. In addition, while spending for labor under the routine side of the budget is highly controlled from the central level (since it is the central government that provides funding for permanent employees), labor employed for development purposes can be temporary.[4] Hence, there is greater local flexibility for development spending than for routine expenditures.

To gain some idea of the size of local government revenues and spending for routine and development purposes and the growth in these expenditures, see Table IV-1. The results show that, in nominal terms, total expenditures by these local bodies increased approximately four-fold over the six years, 1976/77-1982/83. Of course, it should also be noted that, during the same period, GDP of Indonesia grew by 376.4 percent and population increased 17.2 percent. Furthermore, the increase in spending when measured in real terms was only about 50 percent.

[4]For a good discussion of local government personnel policies see Brian Binder, Financial Management in Local Government, Development Administration Group, Institute of Local Government (Birmingham: University of Birmingham, 1982), pp. 106-108.

TABLE IV-1

GROWTH IN INDONESIAN LOCAL GOVERNMENT SPENDING
1976/77-1982/83
in millions of rupiah)

Level of Local Government	1976/77	1982/83	Percentage Change
Provinces:			
Routine	Rps.358,243.0	s.1,548,883.0	332.4
Development	138,426.0	461,690.0	233.5
Total	496,669.0	2,010,573.0	304.8
Regencies and Municipalities			
Routine	149,500.0	560,918.0	275.2
Development	78,708.0	435,015.0	452.7
Total	228,208.0	995,933.0	336.4
	Total Spending in Real Terms 1976/77 - 1982/83		
Provinces	Rps.944,237.6	Rps.1,425,938.3	51.0
Regencies and Municipalities	433,855.5	706,335.5	62.8

SOURCE: GDP Deflator (1980=100) figures from International Financial Statistics Yearbook 1986 (Washington, DC: International Monetary Fund, 1986).

Differentials in spending levels across the 27 provinces can be observed in Table IV-2 where both provincial and second-level local government (regencies and municipalities combined) spending per capita amounts are shown for 1982/83. The results suggest that provinces generally spend approximately 2-3 times the per capita amounts spent by the second tier of local governments in Indonesia. The range in per capita spending by provincial governments was from about Rps. 9,000 - Rps. 39,000, while in the second tier localities the range was from about Rps. 4,000 to near Rps. 18,000 (other than Irian Jaya where per capita spending by regencies and municipalities was over Rps. 30,000). It should be noted that the amounts for the second tier of local governments may be skewed by the fact that in some provinces there is little urbanization; whereas in others, considerably more of the population lives in urban areas which tend to have more productive local revenue bases and, as well, greater demands for local government public services.

Financing these routine and development expenditures at both the provincial and second-tier levels is accomplished through a combination of own-source revenues and grants from higher level governments. As is shown in Tables IV-3 and IV-4, local taxes do not account for a large proportion of the revenues available to either provinces or second tier local governments. This is despite the fact that at least 12 different tax sources are available to provinces and 14 different levies can be used by

TABLE IV-2

PER CAPITA TOTAL SPENDING BY LOCAL GOVERNMENTS
BY PROVINCE, 1982/83

Province	Provincial Spending	Regency and Municipal Spending
1. Aceh	Rps.16,121.3	Rps. 7,861.7
2. North Sumatera	14,348.2	7,651.8
3. West Sumatera	16,018.8	7,175.8
4. Riau	17,998.2	13,511.3
5. Jambi	23,897.0	17,991.7
6. South Sumatera	12,115.3	10,846.2
7. Bengkulu	27,253.9	9,378.9
8. Lampung	10,496.6	4,269.6
9. Jakarta	30,418.6	---
10. West Java	9,385.7	4,771.1
11. Central Java	10,612.1	4,702.3
12. Yogyakarta	16,938.9	6,672.5
13. East Java	9,387.7	5,183.8
14. Bali	17,625.9	7,577.3
15. West Nusa Tenggara	13,203.3	5,941.7
16. East Nusa Tenggara	15,638.3	10,436.6
17. West Kalimantan	15,487.5	11,590.9
18. South Kalimantan	20,689.6	12,741.4
19. Central Kalimantan	34,788.3	9,136.3
20. East Kalimantan	38,203.6	16,766.0
21. North Sulawesi	25,416.1	10,306.4
22. Central Sulawesi	23,710.1	7,999.2
23. Southeast Sulawesi	26,733.6	16,323.8
24. South Sulawesi	12,569.5	15,355.5
25. Maluku	21,809.4	7,618.7
26. West Irian	39,773.4	30,277.7

SOURCE: Statistik Indonesia 1984 - Statistical Year Book of Indonesia (Jakarta, Indonesia, Central Bureau of Statistics).

TABLE IV-3

MAJOR SOURCES OF PROVINCIAL REVENUES, 1982/83
(in millions of rupiah)

Source	Routine Revenues	
	Amount	As Percent of Total[a]
Previous Year Surplus	Rps. 71,624	4.2
Local Taxes	259,803	15.2
Intergovernmental Transfers	1,282,188	74.8
All Other	101,514	5.9
Total	Rps. 1,715,129	100.0
	Development Revenues	
Previous Year Surplus	Rps. 120,478	26.8
Intergovernmental Transfers	294,737	65.5
Local Funds	5,159	1.2
Development Loans	10,386	2.3
All Other	19,476	4.3
Total	Rps. 450,236	100.0

[a]May not sum to total due to rounding.

SOURCE: Ministry of Finance.

TABLE IV-4

MAJOR SOURCES OF REGENCY AND MUNICIPAL REVENUES, 1982/83
(in millions of rupiah)

Source	Routine Revenues	
	Amount	As Percent of Total[a]
Previous Year Surplus	Rps. 10,344	1.8
Local Taxes	35,867	6.1
Intergovernmental Transfers	393,309	66.8
(Central Government)	(218,133)	(37.0)
(Provincial Government)	(175,176)	(29.7)
All Other	149,521	25.4
Total	Rps. 589,041	100.0
	Development Revenues	
Previous Year Surplus	Rps. 23,334	4.9
Central Government	234,936	49.2
Provincial Government	20,126	4.2
Loans	22,337	4.8
Local Funds	86,818	18.1
All Other	90,236	19.0
	Rps. 477,787	100.0

[a]May not sum to total due to rounding.

SOURCE: Ministry of Finance.

districts and municipalities.[5] Only in the case of development revenues for districts and municipalities are local revenues very important. This is primarily because of a shared tax (hence, actually another form of intergovernmental aid) on property called the IPEDA, the revenues from which local governments share. As of January 1 1986, this revenue source was abolished and replaced with another national tax on property values--the Pajak Bumidan Bangunan (PBB), which was to take the form of a capital-value based property tax. The transition to this new form of taxation has, however, been slow and has probably decreased the amount of funds available to local governments since there was considerable confusion in implementing the levy.

Intergovernmental transfers dominate the finances of both the provincial and second-tier local governments. Provinces rely very heavily upon the central government for both routine and development funds with the total flow from the central government accounting for more than 72 percent of provincial revenues. Likewise, transfers from the central and provincial levels of government constitute about one-third of all routine revenues of second tier local governments and slightly over one-half of all development revenues.

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[5]This lack of productivity of local taxes has been emphasized by Nick Devas, Local Taxation and Related Issues of Central-Local Financial Relations, Development Administration Group, Institute of Local Government Studies (Birmingham: University of Birmingham, 1986). Devas has recommended that the list of local taxes be shortened significantly so that local governments can concentrate their efforts on the more productive sources.

The inescapable conclusion from this rather cursory look at local government finances in Indonesia is that local bodies are heavily dependent upon the center for both development and recurrent spending.

Intergovernmental Grants System

There are several major types of grant programs used in Indonesia with only a portion of the total flow of funds from the center accounted for in the data above. Again, we are primarily interested in the flow of development grants; nevertheless, it is important to review at least briefly the overall flows of money from the center to local governments.

Subsidi Daerah Otonom (SDO)

This is the largest of the grant programs to local governments and essentially pays for the salaries and allowances of all local government employees, including primary school teachers. Over 84 percent of the grant to provincial governments for routine spending was accounted for in 1982/83 from this source. A portion of the revenues are then passed on from the provinces to the second tier local governments in the form of a transfer (thus accounting for the relatively large amount of intergovernmental revenues from provinces to districts and municipalities).

Since this is simply a way to finance labor expenditures, determination of the overall grant size is based upon allocation of approved personnel across local governments and the nationally uniform level of salaries. Little or no autonomy is provided to local governments in the determination of the size of these grants since personnel decisions

must be approved from above. Because local governments everywhere tend to be labor intensive, the use of this financing mechanism places considerable control over local governments in the hand of central authorities. While this aspect of the subsidy may be viewed negatively by local governments, it does have the advantage of providing for a sure source of income. From a national perspective it insures that relatively uniform levels of labor services will be available in all locations.

Subsidi Pembiayaan Penyelenggaraan Sekolah Dasar (SPP/SD)

This grant subsidizes the operation of primary schools located in the provinces. Again the money is first transferred to the provinces which, in turn, pass the funds on to lower level governments (hence the data in Tables IV-3 and IV-4 regarding intergovernmental transfers actually include some double counting).[6]

Ganjaran

This grant is intended to help local governments pay for costs of administration over and above direct personnel expenditures which are covered by the SDO. It, too, is distributed directly to provinces which then pass a portion of the funds on to lower level governments. The grant is formula based: a predetermined constant amount for each of the lower level governments within a province (which is to be passed on), with the amount retained by the province depending upon the number of lower level

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[6]For more information regarding this grant see, Kenneth Davey, Central-Local Financial Relations, Development Administration Group, Institute of Local Government Studies (Birmingham: University of Birmingham, 1979), Chapter III.

bodies within the province as well as its population growth rate. Essentially, then, this grant is another recurrent grant to local governments but with few strings attached.

Inpres

This intergovernmental grant program actually consists of eight different sub-programs; taken together, these subprograms represent the bulk of development-oriented grants to local governments in Indonesia. The specific subprograms include:

a. Village development subsidy
b. District/municipality development subsidy
c. Provincial development subsidy
d. Village school development subsidy
e. Health development subsidy
f. Re-greening subsidy
g. Road construction subsidy
h. Market place subsidy

The first three of these are block allocations to different levels of local government while the other five are sectoral allocations, although implemented by local governments. All of these grants are based on "Instructions from the President", hence the title Inpres.

The village development subsidy (bantuan desa) is the oldest of the Inpres grants, initiated in 1969/70. The allocations are made on a simple formula basis--an equal amount allocated to each village (1.35 million rupiah in 1985/86). This grant subprogram has remained relatively small but does permit villages to undertake small infrastructure projects such as village roads and bridges.

The regency/municipality development subsidy (bantuan DATI II) was first distributed in 1970/71 and is seen by most observers as being the centerpiece of the block grant allocation to local governments in Indonesia. Again the allocations are made on a simple formula basis, in this case a specified amount per capita with a minimum amount per jurisdiction. The time series of allocations under this program are shown in Table IV-5 which shows that in 1985/86 the per capita allocations were Rp.1,250, with a minimum jurisdictional allocation of Rp.165 million. In real terms, the per capita allocations have increased 157.6 percent over the one and a half decades the program has been operating.

While the DATI II subsidy was designed in accord with decentralization principles, one main aim of the program was to create employment opportunities at the district level "to absorb underutilized labor force so as to minimize rural-urban migration." In keeping with this goal, the grant is used to finance numerous, rather small, but labor intensive infrastructure projects within a district. In rural districts nearly all of the Inpres funds are used for road construction and reconstruction.

While this Inpres grant is a block grant, it is not made without input from higher level governments. The governor of the province approves the proposed use of the funds. Furthermore, contractors are paid directly by the central government rather than having the money pass through the local treasuries, hence the reason for noninclusion of these Inpres grant funds from local government budgets.

The provincial development subsidy (bantuan DATI I) has existed since 1974/75 when it replaced a tax sharing scheme which was deemed both

TABLE IV-5

PER CAPITA INPRES GRANTS TO REGENCIES AND MUNICIPALITIES, 1970/71-1986/87

Fiscal Year	Grant Per Capita	Minimum Grant Per Jurisdiction (in millions)
1970/71	Rps. 50	Rps. 5.0
1971/72	75	7.5
1972/73	100	10.0
1973/74	150	12.0
1974/75	300	16.0
1975/76	400	20.0
1976/77	400	30.0
1977/78	450	40.5
1978/79	450	50.0
1979/80	550	65.0
1980/81	750	100.0
1981/82	1,000	150.0
1982/83	1,150	160.0
1983/84	1,150	160.0
1984/85	1,150	160.0
1985/86	1,250	165.0
1986/87	1,250	170.0

SOURCE: Information supplied by the Department of Home Affairs, Government of Indonesia.

inefficient and inequitable. Prior to 1974/75 provinces were to receive a percentage of all foreign exchange or export earnings produced from within the province. Since not all provinces were equally endowed with exportable products, particularly petroleum, and since this scheme created the incentive to build ports even if not economically efficient, a formula grant allocation was devised. The formula used is quite ad hoc with the amounts allocated to provinces depending only partially on the population of the jurisdiction. For example, in 1985/86 only two different sized allocations were made--Rp.10 billion to smaller provinces and Rp.12 billion to the five most populous provinces (North Sumatera, South Sumatera, West Java, Central Java, and East Java).

While provincial governments have considerable say over the use of this block grant, local discretion is not complete. According to Binder, each province receives a guidebook which specifies how much the province is to allocate to roads and bridges, and irrigation development and maintenance and is provided some guidance as to how the remainder of the money is to be allocated.[7] Furthermore, the central government has final approval over ratification of the provincial budget.

The village school development subsidy (Inpres sekolah dasar) was first implemented in 1973/74 and by 1977/78 was the largest of all of the Inpres programs. This, of course, reflects the goals of the Government of Indonesia and is a good example of how a granting government can use a sectoral block grant allocation to help achieve national priorities.

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[7]See Binder, Financial Management in Local Government, p. 54.

In this and the other sectoral Inpres grants there is considerable central control over the allocation of funds. The approach taken relies upon central decisions regarding how many schools can be built within a locality during one year. The central government has already designed the schools to be built and has also estimated the construction cost per school, with some regional cost differentials factored into the determination of grant size. Thus determining the allocation of the village school development subsidy to a district simply involves multiplying the number of schools to be built times the local cost factor. The only truly local decision concerns the exact geographic location of the school. While this decision certainly is an important one, it falls far short of true decentralized decision-making where the locality would not only decide upon the number of schools but would also decide whether resources should be used for schools or for roads or other infrastructure investments.

The health development subsidy (Inpres kesehatan) was first employed in 1974/75 and is used to construct local health centers. Under central government plans, each district is ultimately to have at least one health center. The allocation system is similar to that used for the village schools, i.e., central determination of the number of health centers to be built each year, the jurisdictions which are to be allocated these centers, the design of the centers and their unit costs. Only the choice of actual site is left to the district government.

The re-greening subsidy (Inpres penghi jauan dan reboisasi) is intended to be used for improving the quality of soil and environment by

providing local governments with resources necessary to replant forests or to plant grassland. This grant program began in 1976/77. The specific allocation of funds across jurisdictions is determined by the Ministry of Forestry.

The road construction subsidy (Inpres penunjangan jalan) is the youngest of the Inpres programs; it was initiated in 1979/80. Even though the bulk of the block grants to districts are used for rural roads, the Government apparently felt that even more resources should be specifically directed into this activity. Again, the allocation is made centrally, apparently on an ad hoc basis.

The market place subsidy (Inpres pasar) is a bit different from the previous grant programs. It is used to provide credit to local governments to build markets and shopping centers. The program began in 1976/77 but remains the smallest of all the Inpres programs.

Tax Sharing

The well-developed system of block and sectoral grant programs to local governments in Indonesia has been supplemented by one additional grant program which takes the form of tax sharing. While the national government retained the right to impose a tax on property, the bulk of the funds raised (90 percent) have been allowed to remain in the jurisdiction (regency or municipality) in which the property is located. The remaining 10 percent are to be passed on to the province. Until 1986 this tax (Ipeda) was levied on the rental value of property at a rate of 5 percent. (Vacant land was taxed at 200 percent of the normal rate.) In 1986 the

Ipeda was replaced with a capital value based property tax (PBB) levied at 0.5 percent of 20 percent of the assessed capital value of the property with the first Rp 2 million exempt. The sharing arrangements were altered slightly with the national government continuing to get 10 percent of total revenues; the remaining 90 percent were to be shared with 80 percent remaining at the district/municipality level and 20 percent passed to the province. This change in the allocation scheme will actually lower the share to remain at the lowest level from 90 percent to only 72 percent (80 percent of 90 percent). While the change to a capital value-based tax and improved administration of the tax could enhance revenues and should result in a more rational tax system, during the current transition period there are likely to be (and, in fact, have been) considerable problems in administering the tax. Hence, in the short run, local governments may find this source of revenue declining in size rather than increasing. A great part of the problem stems from the lack of assessed values for the millions of parcels of property in Indonesia.

Evaluation

This review indicates that the grants system in Indonesia may be the most fully developed of the four countries reviewed here. Yet, an evaluation of the system suggests that it does little to strengthen local governments in the country. We concentrate here on the major rural development grants--the Inpres grants.

Size and Growth of Grant Programs

Table IV-6 shows the absolute sizes of the total Inpres grant spending

TABLE IV-6

INPRES GRANTS AS PERCENT OF GDP, TOTAL DEVELOPMENT AND TOTAL CENTRAL GOVERNMENT SPENDING, 1977/78 - 1986/87

	Inpres Grants		Inpres Grants as a Percent of:		
Fiscal Year	Total[a]	Percent Change	GDP	Central Government Expenditures[b]	Development Spending
1977/78	Rps. 304.7	---	1.34	7.1	14.1
1978/79	357.6	17.4	1.12	6.7	14.0
1979/80	470.8	31.7	1.04	5.8	11.7
1980/81	714.0	51.7	1.32	6.1	12.1
1981/82	1,032.6	44.6	1.73	7.4	14.9
1982/83	979.5	- 5.1	1.33	6.8	13.3
1983/84	1,310.0	33.7	1.50	7.2	13.2
1984/85	1,364.8	4.2	1.42	7.0	13.7
1985/86[c]	1,467.3	7.5	d	6.4	13.8
1986/87[c]	1,315.3	-10.4	d	6.1	15.9

[a]In billions of Rupiahs.

[b]Includes both Routine and Development Spending.

[c]Budgeted amounts.

[d]GDP amounts for these years not available.

SOURCE: GDP figures are from International Financial Statistics (Washington, DC: International Monetary Fund, January 1987). Other figures are from the Ministry of Finance.

for the years 1977/78-1986/87 as well as their rates of annual increases over the years. In general, the Inpres program grew rapidly during the late 1970s and early 1980s only to slow more recently as the petroleum revenues of the country have diminished. In fact, the 1986/87 budget called for an absolute cut in the size of Inpres grants.

The table also reveals the size of Inpres grants relative to GDP, total national government spending and to total development spending. The data suggest that the Government of Indonesia has consistently budgeted for and distributed Inpres grants to maintain their relative importance in the overall activities of the Government. In general, Inpres grants have constituted 6-7 percent of total government expenditures and about 14 percent of development spending. One major feature of the table is that, even when Inpres grants were scheduled to be cut back in 1986/87, they were not reduced as much as were other development-oriented expenditures. This suggests that the central government feels that Inpres should continue to play a key role in the economic development of Indonesia.

Not all of the Inpres programs have grown uniformly over time. Table IV-7 shows the composition of the various sub-programs of Inpres for the same time period, 1977/78-1986/87. These data suggest that over the years there was a slight decline in the proportion of Inpres funds channeled directly to lower level governments in favor of the sectoral programs. The one sectoral program which was obviously given most prominence was the village school building program. The program which grew most in importance was the rural road program. These trends seem to have been altered in the

TABLE IV-7

RELATIVE SIZE OF INDIVIDUAL INPRES PROGRAMS: 1977/78 - 1986/87

Program	1977/78	1978/79	1979/80	1980/81	1981/82
Subsidy to Provinces	24.7	24.3	21.4	23.4	20.8
Subsidy to Districts	22.7	19.8	18.5	16.7	15.8
Subsidy to Villages	7.6	6.7	6.6	7.1	6.8
(General Programs)	(55.0)	(50.8)	(46.5)	(47.2)	(43.4)
Primary Schools	27.9	31.3	33.1	35.0	36.3
Health	8.6	7.5	6.4	7.1	7.6
Markets	0.4	0.4	2.6	0.4	0.6
Replanting/ Reforestation	8.0	10.1	8.7	6.8	6.8
Roads	---	---	2.8	3.6	5.3
(Sectoral Programs)	(45.0)	(49.2)	(53.5)	(52.8)	(56.6)
Total[b]	100.0	100.0	100.0	100.0	100.0
Total Amount[c]	304.7	357.6	470.8	714.0	1,032.6

	1982/83	1983/84	1984/85	1985/86[a]	1986/87[a]
Subsidy to Provinces	25.8	19.3	18.5	19.1	21.3
Subsidy to Districts	19.8	14.8	14.3	14.7	16.8
Subsidy to Villages	9.0	7.0	6.8	6.7	7.5
(General Programs)	(54.7)	(41.1)	(39.6)	(40.5)	(45.6)
Primary Schools	27.3	42.0	41.9	42.1	31.7
Health	8.2	6.7	4.7	7.8	8.7
Markets	0.5	0.8	1.9	0.8	0.9
Replanting/ Reforestation	5.1	4.5	4.5	2.9	3.2
Roads	4.3	4.9	7.4	6.0	9.9
(Sectoral Programs)	(45.4)	(58.9)	(60.4)	(59.5)	(54.4)
Total[b]	100.0	100.0	100.0	100.0	100.0
Total Amount[c]	979.5	1,310.0	1,364.8	1,467.3	1,315.3

[a]Budgeted

[b]May not sum to total due to rounding.

[c]In billions of Rupiahs.

SOURCE: Ministry of Finance.

most recent budget. The general programs to provinces, districts and villages increased from 40 to 45 percent of the total with the school program taking the brunt of the overall decrease in sectoral grant funding.

Local Government Fiscal Planning Effects

Unlike the other countries reviewed here, the generally favorable economic and fiscal conditions of Indonesia, at least through the early 1980s, have not created problems of shortfalls in the transfer of funds to lower level governments. At the same time, the centralized determination of the flow of sectoral Inpres grants does little to encourage local government planning. Furthermore, the sectoral Inpres funds do not flow through the regular local government fiscal channels.

Another planning-related issue that does not arise in the other countries examined here (although it could become an issue in Bangladesh) is absorption capacity of local governments. Numerous observers of local governments in Indonesia have commented on the fact that funds often are not spent during the fiscal year in which they are transferred to local bodies. For example, Kristiadi shows data which suggest that less than one-third of the rural roads and village school grants were absorbed in 1983/84 and that only about one-half of the public health and reforestation grants were used that year.[8] In an effort to overcome this problem and to ease fiscal pressures at the central government level, the Government has recently changed the rules such that any money not spent during the fiscal

[8]Kristiadi, "Financing Local and Regional Development: The Case of Indonesia," p. 30.

year will not be allowed to be carried over into the next fiscal year. Success of this policy will, of course, depend upon why the previous delays in projects occurred. If it was simply due to the lack of absorptive capacity at the local level, the policy is reasonable. On the other hand, if the delays were due to overly centralized rules, the new procedures may harm local areas even though it was not due to improper planning by local governments.

Spending Implications

The unique feature of the grant program in Indonesia (at least the Inpres program) is the use of the sectoral allocations which greatly limit the spending flexibility of local governments. Furthermore, it is apparent that the fiscal health of the local governments will depend almost entirely on the willingness of the Government to transfer funds. Davey notes the concern of provincial and kabupatan leaders regarding the fragility of their financial situation and the fact that there were considerable strings associated with the money being received from the center.[9] Similarly, as long as payments of wages and salaries remain the responsibility of the central government through the Subsidi Daerah Otonom, the central government is likely to retain considerable control over the activities of local bodies. On the other hand, this arrangement helps to insure that the local government employees will, in fact, be paid and that services will continue to be provided at the local level.

[9]Davey, Central-Local Financial Relations, pp. 79-81.

Fiscal Effort Implications

There is very little reason to believe that local governments in Indonesia are encouraged through the grants system to mobilize resources. The salary grants insure that local employees will be paid regardless of local fiscal efforts, and the capital grants have been substantial and without any revenue effort encouragement.

Only the Ipeda, or tax on local property, had any real local tax effort implications. Since 90 percent of total local collections were retained locally, there was some incentive for local governments to encourage compliance with this tax. The recent change in the property tax levy has actually diminished this incentive since now only 72 percent of local collections are to be retain locally. While the overall yield of the tax may result in significantly greater total revenues and, hence, greater shares flowing to the local governments, the change in the share retained locally will lower the local tax effort incentives. The fact that both the Ipeda and its replacement are central government levies with no local autonomy regarding tax rates means, again, little fiscal decentralization and, hence, little willingness to expand revenue efforts can result from this tax.

Redistributional Implications

Inpres grant monies are distributed in different ways depending upon the specific program. The sectoral grants are distributed in an ad hoc manner by central government personnel; unfortunately we do not have detailed data regarding the allocations used recently, hence it is not

possible to evaluate the redistributive effects of these programs. For the general allocations to villages, districts and provinces, different distribution formula are used. Under the village program, which is allocated on an equal basis to each village, there would naturally be an inverse relationship between size of village and the amount of per capita grant funds. If allocated correctly, no such size bias would appear in the grants to districts and urban areas since these allocations are to be made on an equal per capita basis. Such an allocation method will, however, do nothing to redistribute resources from wealthier to poorer jurisdictions.

The one grant program which is likely to lead to more significant redistribution of resources is the Inpres grant to provinces since the grant does not depend upon the income level or population of the provinces. As is shown in Table IV-8, per capita Inpres grants differ quite substantially across the 27 provinces, ranging from only Rp. 395 to Rp. 11,001 per capita. This difference would be even greater if the five largest provinces would not receive Rp. 2 billion more in grants.

Shown in the same table are the levels of per capita 1981 GDP (the latest data available) of the several provinces. The simple correlation between the per capita grants and per capita GDP is -0.24. The results suggest that there is some minor income equalizing effects of the Inpres grant allocations, with poorer provinces receiving generally larger allocations.

Fiscal Accountability

There is a maintenance requirement associated with the grant monies

TABLE IV-8

PER CAPITA INPRES GRANTS TO PROVINCES AND PER CAPITA GROSS PROVINCIAL PRODUCT, 1981

Province	Per Capita Grants	Per Capita 1981 Gross Provincial Product (Rps. 1,000)
Aceh	3,425	288
North Sumatra	1,300	347
West Sumatra	2,699	214
Riau	4,093	300
Jambi	5,917	233
South Sumatra	4,912	366
Bengkulu	11,001	176
Lampung	1,733	197
Jakarta	1,318	739
West Java	395	247
Central Java	444	171
Yogyakarta	3,490	182
East Java	389	238
Bali	3,798	217
West Nusa Tenggara	3,354	365
East Nusa Tenggara	3,392	247
West Kalimantan	3,684	1,006[a]
South Kalimantan	9,183	275
Central Kalimantan	4,460	196
East Kalimantan	6,583	221
North Sulawesi	4,331	193
Central Sulawesi	6,689	240
Southeast Sulawesi	1,544	134
South Sulawesi	9,425	126
Maluku	6,349	277
West Irian	7,692	617
Timor Timur	16,722	---

[a]Estimated from 1980 estimates of gross provincial product times rate of growth in national GDP 1980 to 1981.

SOURCE: 1984 Population Estimates and 1981 Provincial Product figures from Statistik Indonesia 1984 (Statistical Yearbook of Indonesia), Central Bureau of Statistics, Jakarta, Indonesia.

transferred to local governments. As is the case in the other countries reviewed here, however, this maintenance requirement has little effect. For example, during one interview of kabupatan officials, it was stated that one of their projects funded under Inpres grant monies was a maintenance project. In fact, it was admitted that this project did not differ substantially from any of the other projects similarly funded and that, instead, the naming of the project as maintenance was primarily to satisfy the imposed constraints.

Fiscal Decentralization

There is little doubt that the system of local governments in Indonesia is far from being decentralized. While the block grant Inpres programs do allow local governments autonomy in spending, they are only about one-half of the total flow of Inpres funds to local levels. Furthermore, the grants to pay salaries of local employees means that the central government maintains considerable control over activities at the local level. Indeed, for a local government to add permanent personnel requires the approval of the central government. Thus, while the level of transfers of money from the center to local governments appears considerable, one must conclude that the system of local governments in Indonesia is highly centralized.

Summary

Local governments in Indonesia have benefited from the combination of economic health of the national economy and the fact that the Government of

Indonesia has promoted the role of local governments in the overall development plans of the country. The grants system has played a key role in this process. At the same time, the center has maintained a firm hold on the activities of local bodies through the use of sectoral grants to local governments and control over personnel policies at the local level. The grants system has not been used to redistribute money in any systematic manner across the local bodies nor has it been used to encourage local governments to do more for themselves through greater local resource mobilization.

CHAPTER V

INTERGOVERNMENTAL GRANTS IN THE PHILIPPINES

While there has recently been considerable political and economic change experienced in the Philippines, the structure of local governments and the intergovernmental grants system have not changed dramatically since the analysis reported upon here was carried out.[1] As importantly, the analysis reported upon here demonstrates how research on intergovernmental grants systems can be quite extensive when sufficient data are available at the local level.

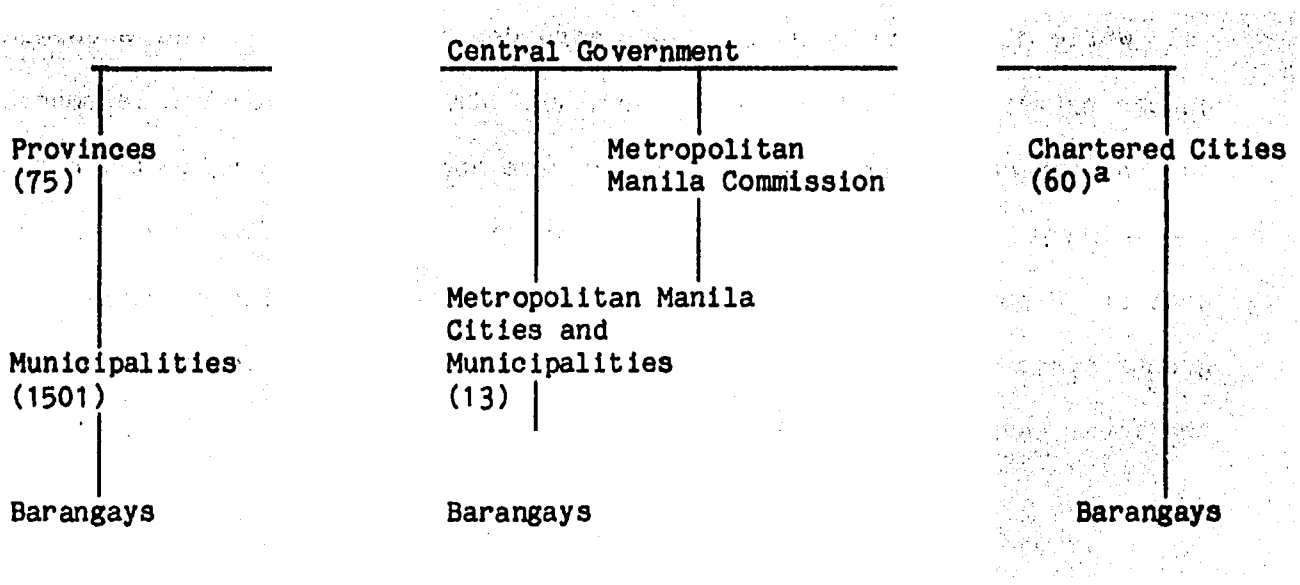
Local Government Structure

Local governments in the Philippines include provinces and municipalities in rural areas; chartered cities; and Metropolitan Manila, which includes both the City of Manila and 13 municipalities. All of the governmental units throughout the country are further subdivided into barangays (Figure V-1). In general, the structure is highly centralized even though popularly elected representatives act as political leaders of the local governments. The centralization is most profound in the area of financial administration since both treasurers and property tax assessors are considered employees of the Ministry of Finance although deputed to the local bodies.

[1]Roy Bahl and Barbara D. Miller, eds., Local Government Finance in the Third World: A Case Study of the Philippines (New York: Praeger Publishers, 1983).

FIGURE V-1

THE STRUCTURE OF LOCAL GOVERNMENTS IN THE PHILIPPINES



[a]Including cities in Metropolitan Manila.

SOURCE: Various government publications.

Each of the 75 provinces is fully subdivided into municipalities which are usually rural in character, containing only a small, semi-urbanized market area. Municipalities are expected to provide local roads, a market and to take the lead in promoting local development. The barangay (or barrio) has existed as a neighborhood unit of local government since the Colonial Spanish era. During the late 1970s the government expressed considerable interest in making more use of the barangays and provided increased grants, increased powers for raising revenues and increased service provision authority.

In general, much of the activity of the local public sector, even if not financed centrally, is influenced in great part by Central Government policies and directives. The barangay movement may be a move towards "taking the government to the people;" yet even its development has been largely directed from above.

Presidential decree (PD) 477 in 1974 established a common fund structure for all local governments in the Philippines. Each jurisdiction has two funds--the General Fund and the Infrastructure Fund. Expenditures from the latter are to be used exclusively for providing, maintaining, improving or constructing roads, bridges, wharves, piers or other water transport as well as other infrastructure projects such as parks, irrigation systems, sewage systems, etc.

The General Fund is the source of all other spending within the local jurisdictions (other than for education). It should be emphasized that the distinction between the General and Infrastructure Funds is not identical

to a separation into current and capital expenditures, as might be implied from these descriptions. Indeed, the General Fund may contain capital construction expenditures and the Infrastructure Fund obviously contains current spending for maintenance activities on roads, bridges, etc. Moreover, though expenditures in the Infrastructure Fund are generally developmental in nature, there are also economic development oriented expenditures in the General Fund. This means that a full accounting of local government development activities cannot be obtained by concentrating solely on Infrastructure Fund activities. There are also substantial interfund transfers which complicate matters further.

Considerable control is placed over the financial affairs of municipalities with this centralized orientation of local financial management no more strongly evident than in the various restrictions placed upon localities in terms of what they can or must budget for certain, specified functions. While this practice, in theory, enhances the direction which the Central Government can give, it markedly reduces the discretion which local governments have in determining the size and makeup of their budgets.

The budgets of local governments in the Philippines are substantially affected by Central Government mandates. In fact, up to 37 percent of General Fund revenues are earmarked for statutory reserves, Infrastructure Fund transfer, aid to hospitals, and the integrated national police. Additional reserves for elections increase this percentage slightly, as

does the decision determining how much to transfer to the Barangay Development Fund.

Intergovernmental Grants System

During the latter half of the 1970s the intergovernmental grant system in the Philippines consisted of four different grant programs. This analysis focuses on the two predominant rural development-oriented grant schemes--the general Bureau of Internal Revenue (BIR) Allotment and the Specific Tax Allotment (STA).

The BIR Allotment

Prior to 1973, 17 percent of national internal revenue collections were distributed to local governments. The basis for the distribution was BIR collections in the preceding year, with 13 percent of total collections allocated to provinces and cities and 4 percent of collections were allocated to municipalities. These total amounts were then distributed on the basis of population (70 percent) and land area (30 percent). In addition, local governments received an amount equivalent to about 6 percent of the preceding year's national internal revenue tax collections in the form of local shares from the withholding tax and from "excess" income tax collections.[3] As in the case of tax sharing in Indonesia, this component biased the distribution of central assistance toward a small

[2]Bahl and Miller, Local Government Finance in the Third World: A Case Study of the Philippines.

[3]Local units received 30 percent of the income taxes collected (in a jurisdiction) above the 1959 level.

number of relatively wealthy provinces.

This bias, and the desire to make the grant system more equalizing, brought on another major reform in 1973. Its major features included: (1) 20 percent of national internal revenue taxes (not assigned to special funds and accounts) should be transferred to local governments, with the computation based on BIR collections during the third year prior to the current fiscal year; (2) the allocation would be divided among local government levels with 30 percent to provinces, 45 percent to municipalities, and 25 percent to cities; (3) the funds would be shared according to a weighted three-factor formula[4] based on population (70 percent), land area (20 percent) and equal shares (10 percent); (4) for FY 1974-FY 1976, the annual allotment for any local government would not increase by more than 15 percent nor decrease by more than 50 percent of the locality's FY 1971 allotment; (5) 20 percent of a jurisdiction's Allotment was to be earmarked for developmental projects approved by the Ministry of Local Government and Community Development (MLGCD); and (6) each barangay was to receive 10 percent of property taxes collected within the barangay and, in addition, each jurisdiction was to contribute up to P500 to each barangay within its boundaries.[5]

[4]Apparently the 1970 Census results were to be used in computing the allocation, thus no jurisdiction-level changes would be made in the allocation formula until the 1975 census results were processed.

[5]Barangays do have annual budgets, although given the limited nature of their activities, these budgets are not very complex. Their funds are held in trust, with the local treasurer acting as agent.

The BIR Allotment was amended in 1974 specifying barangays as co-recipients of the Allotment. Through FY 1976 barangays were to receive P56 million that had previously been earmarked for division among provinces, municipalities and cities. After FY 1976, the split among local governments was to be:

a. 25 percent to provinces
b. 40 percent to municipalities
c. 25 percent to cities
d. 10 percent to barangays

The amount set aside for barangays was to be distributed in the form of community development project grants, with the distribution administered by the President. Thus there was an alteration in the BIR grant system away from general grants towards project grants.

The BIR Allotment system was changed again in 1976. This amendment was made, at least in part, to address the grant distribution during the six month transition from a July 1 - June 30 fiscal year to a January 1 - December 31 fiscal year, effective January 1, 1977. In addition, it specified that in FY 1977 a "hold-harmless" provision (no decreases in the annual Allotment) replaced the 50 percent maximum decrease in annual Allotments with Allotment increases restricted to 25 percent of the FY 1976 amount.

The system was further altered in 1977. Allocations for the fiscal years 1978 through 1980 would be equal to those determined for 1977. In fact, this temporary measure may be the most important change in the grant system since it has held constant the peso level of the grant to be

distributed and brought on a drastic decline in the real distribution. By 1980, only about one-third of the actual grant entitlement was being distributed.

Specific Tax Allotment

The second major program of intergovernmental assistance to local governments is funded from a designated portion of specific taxes on a variety of petroleum products collected in the second preceding year, e.g., the basis for the Allotment in 1979 was the designated tax collection in 1977. The grants are provided to provinces (20 percent), municipalities (30 percent) and cities (50 percent), with the allocations based on the same weighted three-factor formula as used for the BIR Allotment. The entire allocation is to the Infrastructure Fund.

As in the case of the BIR Allotment, barangays were included in the allocation scheme in 1974. One-fourth (25 percent) of the total specific tax was to be retained in a special fund allocated by the President to barangays for road and bridge construction, improvement and maintenance. The specific tax rates were increased substantially in 1977 and again in 1979. These changes result in a marked increase in the size of the Specific Tax Allotment Fund.

National Tax Allotment

In addition to the establishment of the General and Specific Tax Allotments, PD 144 also created an additional Local Government Fund consisting of 5 percent of the BIR revenues (over and above the 20 percent set aside for General Allotment). This was to be used for project grants,

with projects approved by a committee consisting of the Minister of Finance, the Minister of the Budget and the Minister of Local Government and Community Development.

This fund amounts to earmarking an additional share of BIR for local governments but leaving the distribution--amount and the discretion of the Office of the President. In amount, the Allotment to the Local Government Fund is not insignificant approaches half the size of the BIR General Allotment in some in the two years for which we have sufficient data it appears small proportion of the total amount due was actually released.

Barangay Grants

Increasing amounts of resources were made available to the barangay unit of local government during the mid-1970s. PD 144 designated 10 percent of real property tax collections for barangays and provided for a contribution by local governments of up to P500 to each barangay within its boundaries; PD 549 required that 10 percent of the BIR General Allotment go to the barangay unit; and PD 558 allocated 25 percent of the Specific Tax Allotment to the Barangay Fund.

The property tax shares are distributed for barangay use with no major restrictions on the use of these funds. Use of the P500 contribution to the Barangay Development Fund requires approval of the MLGCD. In the case of the barangay share under both the Specific and General Allotment, the distribution is administered by the Office of the President. The purpose of the BIR General Allotment distribution is community development projects

and the Specific Tax Allotment distribution is for infrastructure construction, improvement, and maintenance.

Evaluation

We concentrate in this evaluation on the BIR and STA Allotment programs.

Size and Growth of Grant Programs

Table V-1 displays the amounts that were to have been distributed during the period 1975-1981 under the BIR, STA and NTA grant programs (but see discussion below concerning certainty of actual distributions). From the entries in the table it is apparent that there were considerable increases in the total amounts that were, statutorily, to have been distributed to local governments in the Philippines. Indeed, the growth was more rapid than that experienced by GNP during the same period. The overall growth from 1975 to 1981 in the amounts to be distributed are quite great: 312 percent for both the BIR and NTA; 517 percent for the STA. This increase is attributable to the fact that, unlike in the other countries examined in this comparative case study, the size of the grant pool is statutorially linked directly to revenues collected by the central government. Furthermore, the revenues to which the grant pools were attached were relatively elastic or buoyant sources: in the case of the BIR, primarily income taxes, and in the case of the STA, petroleum taxes, the rates of which were increased substantially during the late 1970s.

When viewed from the standpoint of the recipient rural local governments, grants are seen to contribute significantly to the amount of

TABLE V-1

SIZE AND GROWTH IN POTENTIAL GRANTS TO PHILIPPINE LOCAL GOVERNMENTS, 1975 TO 1981
(in millions of pesos)

Year	BIR		STA		NTA	
	Total Due	As Percent of GNP	Total Due	As Percent of GNP	Total Due	As Percent of GNP
1975	599.8	0.52	142.8	0.12	150.0	0.13
1976	878.2	0.67	118.2	0.09	219.6	0.17
1976[a]	422.6		54.7		120.4	
1977	1,140.6	0.74	115.3	0.07	324.9	0.21
1978	1,117.3	0.63	115.3	0.06	318.3	0.18
1979	1,332.6	0.60	525.1	0.24	379.7	0.17
1980	1,853.0	0.68	767.0	0.28	475.1	0.17
1981[b]	2,472.6		881.8		618.2	
Percentage Increase 1975-81	312.24		517.51		312.13	

[a]Six month transition when fiscal year changed.

[b]Budgeted.

NOTE: GNP figures used are
(i) not final estimate for 1976;
(ii) preliminary for 1979;
(iii) projected for 1980; and
(iv) budgeted for 1981.

SOURCE: BIR figures from Accounting Divisions, BIR, MOF and NEDA; STA figures computed by author; NTA figures from Bureau of the Treasury, Final Cash Operations Statements (annual).

resource available. For a sample of 98 municipalities in the Provinces of Albay, Bulacan, Iloilo and Sorsogon, grants are seen to have contributed, on average, about 35 percent of total revenues available (Table V-2). Of course, whether or not these amounts are in any sense "adequate" cannot be gauged from such data. It is interesting to note that, in our detailed exploration of the accounts of several local governments, we found that cash balances were being accumulated in a variety of the localities.[6]

Local Government Fiscal Planning Effects

On a statutory basis both the BIR and STA are type B grants suggesting a highly structured flow of money from the central to local governments. Grant flows in one year are to be tied to actual central government tax collections two years previous. This arrangement has the highly desirable feature of promoting financial planning since not only is the distribution formula supposedly known by all but, in addition, the amounts to be distributed in a single year are known well in advance of the budgeting process. Unfortunately, in the Philippines, this is not the case in practice.

Actual distribution of money under the BIR and STA for the period 1975-1980 is shown in Table V-3. The BIR amounts are shown to have fallen considerably short of what the statutes would imply. Whereas nearly all of the BIR allotment was distributed in 1975, only about one-third of the amounts due in 1980 were actually distributed. The result of this

[6]Bahl and Miller, Local Government Finance in the Third World: A Case Study of the Philippines.

TABLE V-2

PER CAPITA AND PERCENTAGE IMPORTANCE OF BIR ALLOTMENT, SELECTED JURISDICTIONS, 1977

	Municipality by Province				
	Albay	Bulacan	Iloilo	Sorsogon	Pooled Municipal Sample
Per Capita:					
BIR Allotment	5.24	6.71	6.50	5.90	6.24
Business Tax	1.50	3.95	1.32	1.55	2.00
Property Tax	0.85	4.99	2.28	1.12	2.49
Total[a]	10.45	24.81	18.77	12.30	17.75
BIR as Percent of Total Revenue	50.10	27.10	35.40	48.20	35.20
Number of Observations	17	23	43	15	98

[a]Includes sales of assets, borrowing, etc.

SOURCE: Annual Report of the Commission on Audit on Local Governments, 1977; figures for BIR as percent of total revenue computed by author.

TABLE V-3

ACTUAL DISTRIBUTION OF PHILIPPINE GRANTS TO LOCAL GOVERNMENTS, 1975 TO 1980

	BIR			STA		
Year	Actual Distribution	As Percent of Amount Due	Percentage Increase/ Decrease	Actual Distribution	As Percent of Amount Due	Percentage Increase/ Decrease
1975	505.4	84.26	——	n.a.	——	——
1976	547.8	62.38	8.39	——	——	——
1976[a]	315.1	74.56	-42.48	144.6	264.35	——
1977	658.9	57.77	109.11	124.8	108.24	-13.69
1978	658.9	58.97	0.00	94.6	82.05	-92.42
1979	658.9	49.44	0.00	528.9	100.72	459.09
1980	658.9	35.56	0.00	n.a.	——	——

[a]Six month transition.

SOURCE: BIR actual distribution figures from Accounting Divisions, BIR, MOF and NEDA; STA actual distribution figures and all other figures computed by author.

shortfall in amounts distributed is that actual growth in the BIR was totally stagnant from 1977 through 1980. The record (incomplete) for the STA is considerably better--with amounts distributed sometimes even exceeding the amounts statutorily due.

There are good macroeconomic reasons for this observed shortfall in the actual distribution of funds via the BIR. The Government of the Philippines faced severe fiscal difficulties during the late 1970s, particularly as the country had to cope with an international petroleum shortage and rapidly increasing price levels. One spillover effect of these difficulties was that growth in intergovernmental transfers was considerably less than that implied above. Unfortunately, this also meant that local governments could not realistically plan their activities based upon the statutory structure of the grant programs.

Spending Implications

Lump-sum grants of the BIR type do not mandate any particular action on the part of local governments and, as such, cannot be expected to have significant effects on specific types of spending. At the same time, it was noted above that local governments in the Philippines are mandated to allocate a significant portion of their revenues in specific ways. Thus, even though the BIR Allotments are not earmarked, one would anticipate that functional spending would be quite uniform across jurisdictions.

Of interest is whether the grant system has significant effects on rural development spending. Analyzing this effect is, unfortunately, not straightforward due to the complex fund structure used in the Philippines.

As noted above, municipalities have both a General Fund and an Infrastructure Fund at their disposal. While the BIR flows directly into the former and the STA flows fully into the latter fund, not all development spending is derived from the Infrastructure Fund. Furthermore, there are interfund transfers from the General to the Infrastructure Fund.

In order to capture these intricacies in financial management and to estimate the grant impact on development expenditures among municipalities, a theoretical model was constructed and tested on the nonrandom sample of 96 municipalities in the four provinces of Albay, Bulacan, Iloilo and Sorsogon. The statistical results suggest that each additional peso of BIR is associated with a P1 increase in development spending, i.e., that the BIR is spent entirely for development purposes.[7] On the other hand, the STA was found to be insignificantly related to development spending.

Fiscal Effort Implications

Given the nature of the grant system used in the Philippines there is little reason to expect that increased tax effort would result from the BIR and STA Allotments. No tax effort measure is included in the allocation formula nor are the grants of a cost-sharing type. In order to investigate the total spending effects of grants, another statistical model was constructed to estimate the differential levels of spending associated with different levels of grant amounts across jurisdictions. The model

[7]The full theoretical model and statistical estimates can be found in Roy Bahl, Larry Schroeder and Michael Wasylenko, "The Stimulative Effects of Intergovernmental Grants in Developing Countries: The Case of the Philippines," Metropolitan Studies Program, The Maxwell School (Syracuse, NY: Syracuse University, unpublished).

explicitly allows for interfund transfers while recognizing that the BIR flows to the general fund and while the STA is directed to the infrastructure fund. Because of the possibility for interfund transfers, simultaneous equation statistical techniques were necessary to test the model, again on the same sample of 96 municipalities in four provinces.[8]

The regression results bear out the hypothesis that per capita general fund expenditures are higher where per capita infrastructure fund expenditures are higher, even when income level, population size, etc., are taken into account. This leads us to expect that the cross-effects of grants (e.g., the indirect impact of the Specific Tax Allotment on general fund spending) will be important. The results from three-stage least squares estimates suggest that the BIR Allotment is stimulative. A P1 increase in BIR is associated with a P1.34 increase in general fund spending. As is expected, per capita general fund expenditures are higher where per capita nonagricultural income and per capita assessed valuation are higher.

The indirect impact of the BIR Allotment on Infrastructure Fund expenditures is small, meaning that larger BIR grants do not free up substantially more resources to be transferred to the Infrastructure Fund. Nevertheless, this indirect effect on total spending is positive (0.22) and leads to the conclusion that a P1 higher level of BIR Allotment per capita would result in P1.56 additional total spending per capita from the two funds (P1.34 in the general fund and P0.22 in the infrastructure fund).

[8]Ibid.

The results also suggest that higher STA allotments are associated with smaller per capita spending from the infrastructure fund--an unanticipated result; however, there is a very high standard error associated with this estimated coefficient. With the negative coefficient, the resulting total effect (direct and indirect) of higher per capita specific tax allotments on both general fund and infrastructure fund spending is found to be negative. There is, therefore, no basis for arguing that the STA is stimulative of local government expenditures, and certainly it is not more stimulative than is the BIR Allotment.

Redistributional Implications

It is not clear whether the Government of the Philippines is attempting to use the BIR and STA to equalize per capita personal income, local government fiscal capacity, local government spending or according to needs. By including population and land area in the distribution formulae, one might argue that there is an attempt to equalize according to spending needs. However, this will equalize incomes only if more populous areas tend also to be poorer.

In order to measure the redistributive effects of the actual allowances, we determined the simple correlations between per capita BIR and STA allotments in 1977 and per capita personal income, per capita assessed value, per capita expenditures and population size (Table V-4). The correlations were computed for the same sample of 96 municipalities in Albay, Bulacan, Iloilo and Sorsogon provinces.

The per capita BIR distribution is significantly related (at the 0.05 level) to assessed valuation, spending and population size. The

TABLE V-4

SIMPLE CORRELATIONS BETWEEN PER CAPITA BIR AND STA ALLOTMENTS AND SELECTED INDEPENDENT VARIABLES, SELECTED MUNICIPALITIES, 1977

Independent Variable	BIR	STA
Per Capita Personal Inco	0.09	-0.14
Per Capita Assessed Valu	0.27**	-0.10
Per Capita Expenditures	0.52**	-0.14
Population Size	-0.34**	-0.26*
Number of Observations	96	

* denotes significantly different from zero at the 0.10 level.

**denotes significantly different from zero at the 0.05 level.

SOURCE: Computed by author.

implications of the findings are that greater amounts of BIR are allocated to those jurisdictions with greater fiscal capacity (property tax base) and those localities already spending more. On the other hand, more populous jurisdictions are seen to obtain significantly less in the form of BIR allotment. The results suggest the statutory formulation of the grant program is not being followed.

On the other hand, the STA allocation appears to be equalizing (although the size of the correlation coefficients are, admittedly, small). Lower income municipalities, those spending less and those with smaller populations tend to receive greater per capita STA grants.

Fiscal Decentralization

At first blush the grant system in the Philippines does seem to encourage local autonomy since few strings are directly tied to the grant allocations other than the requirement that all STA funds flow directly to the infrastructure fund. At the same time, it must be recognized that local governments in the country are highly regulated in terms of their overall management of funds. Hence, it is difficult to conclude that any significant level of fiscal decentralization has been accomplished.

One aspect of the grant system that must also be noted here is the role of the barangay and the flow of funds to this lowest level of "local government." As seen in Table V-5 there was an apparent attempt during the later 1970s to emphasize these local bodies by allocating considerable amounts of money in their direction. However, the final two columns in the table also show that the intentions were not necessarily followed. In 1980

TABLE V-5

BARANGAY SHARES AND ACTUAL DISTRIBUTION OF BIR AND SPECIFIC TAX ALLOTMENT PROGRAMS: 1975-1981
(in millions of pesos)

Period	BIR General Allotment[a] Amount Due[c]	Specific Tax Allotment[b] Amount Due[c]	Amount of Actual Release[d]	Actual as Percent of Total Due
1981	241.1	293.9	NA	----
1980	185.3	225.7	42.5	10.3
1979	148.1	175.0	25.2[e]	7.8
1978	124.1	38.4	27.0[f]	16.6
1977	126.7	38.4	30.0	18.2
1976[g]	65.0	39.4	80.0	76.6
1976	46.9	18.3	NA	----
1975	65.0	33.0	NA	

[a]10 percent Barangay Development Fund (PD 559).

[b]25 percent Barangay Development Fund (PD 558).

[c]Appropriated but not cash supported.

[d]These are the combined actual releases for Barangay Development Fund from BIR General and Specific Tax Allotment.

[e]₱25.2 (2.6 not yet released plus 22.6 with advice of allotment for actual release).

[f]₱27.0 (26.1 not yet released plus 0.9 with advice of allotment for actual release)

[g]Six month transition.

SOURCE: Budget Operation Division, Ministry of the Budget, Tax Statistics Staff, NTRC, January 23, 1981.

only about 10 percent of the total amounts due were actually released to the barangays. One reason for these shortfalls may have been due to the overall financial situation in the country at that time and the fact that distribution of the money is discretionary rather than in accord with a full allocation system. A second reason may be that there is simply insufficient capacity at the barangay level to absorb large amounts of money in an economical manner. If decentralization is to proceed at this disaggregated level, the absorption question must be addressed.

Summary

This brief review of intergovernmental grants in the Philippines (as of the late 1970s) suggests that, at least on paper, the grant system is highly developed with good potential for built-in revenue growth and considerable discretion provided to local governments. In fact, actual data show that discretionary central government alterations to the system slowed the growth in allocation of funds to local governments. Furthermore, it is not clear that the allocations have actually been made in accord with the statutory guidelines. While development spending may be stimulated by the grant schemes being used, there is no explicit encouragement of local resource mobilization within the grant structure. Finally, significant controls are retained by the central government, leading one to question whether local governments have considerable decentralized decision-making powers in the Philippines.

CHAPTER VI

COMPARATIVE ANALYSIS AND SUMMARY

These four countries of South and Southeast Asia present an interesting picture of the role intergovernmental transfers play both in terms of national economic development and in terms of supporting activities of local governments. In this concluding section we compare the four different systems of rural development grant programs reviewed here, emphasizing the same set of seven evaluation criteria focused on in each case.

Alternative Grant Systems

In the introductory section it was noted that grant systems can be classified according to two characteristics--how the grant pool is determined and how the distributions are made among the participating local governments (see Table I-2). Nearly all of nine different types of grants systems are used (at least theoretically) in the four countries examined here.

Type A grants (sharing of taxes at the point of collection) are used in both Bangladesh (the property transfer tax) and Indonesia (Ipeda). Type B grants (a predetermined share of national taxes distributed according to some formula) constitute the statutory basis for the BIR Allotment system in the Philippines (although it was seen that, in fact, the statutory share has seldom been distributed). Neither Type C grants nor D grants

(predetermined proportions of higher level tax collections distributed on a cost sharing or ad hoc basis) were observed in these cases.

Much more common are grant systems under which the granting government determines the total grant pool on an ad hoc basis. Indeed, each of the four countries uses some form of Type F or H grants. It is interesting that granting governments often suggest that they are using Type F grants (ad hoc determination of the grant pool with distribution done via a formula) whereas an examination of the data suggest that, in fact, the distribution is also ad hoc in nature (Type H grants). The grants to upazilas in Bangladesh, the general Inpres grants in Indonesia, the several different grants made to district and union councils in Pakistan and both the Bureau of Internal Revenue and Specific Tax allotments in the Philippines are considered Type F grants. In fact, it appears that only the first two of these show actual allocations being made according to the formula.

One may wonder why the formulae are not always followed. In great part it is probably due to special, probably political, reasons that the granting government may find it in its own best interest to distribute funds in a manner different from the formula. It is also probably the case that such "special" distributions are workable because commonly little information is made available to local governments regarding how the money was ultimately allocated. For example, seldom is there a single report available which shows the actual allocations made to each of the eligible local governments. Instead, special tabulations have to be made.

Furthermore, when local officials are queried about how the grant allocations are made and how much their localities should receive, the local leaders seldom seem to know many of the facts underlying the system nor do they seem particularly concerned that their jurisdictions are getting their "fair share." Only with additional information and genuine interest on the part of local officials will this situation likely be changed.

The sectoral Inpres grants used in Indonesia are a combination of G (ad hoc determination of the grant pool but with cost reimbursement) and H Type (ad hoc determination of the pool and of the distribution) grants. They have the characteristics of G Type grants in that the amounts allocated to jurisdictions are based upon the standard costs of constructing such facilities as elementary schools or health centers. At the same time, the fact that the central government retains the freedom to reallocate funds across the sectors however it sees fit suggests that the grants are Type H allocations. Furthermore, allocations to each local government appears to rely heavily upon decisions made by central decision-makers.

The grant schemes currently being used in the Punjab Province of Pakistan to construct model villages and the focal point grant also have some characteristics of G Type grants since standard costs are used in determining the amounts allocated. At the same time, there is probably a great deal of provincial discretion used in determining which unions or districts are to receive these allocations.

Cost reimbursement grants (Type J) characterize the routine grants used in Indonesia to cover salary costs of local government personnel. At the same time, the central government retains almost total control over the actual amounts to be distributed under this grant since it controls local government personnel decisions. The deficit grants to union councils in at least two provinces of Pakistan constitute cost reimbursement grants, but made on an ad hoc basis (since there is no guarantee of such funding). This therefore qualifies as a Type K grant scheme.

In general, then, a wide variety of different grant funding and distribution schemes are used in the four countries examined here. This makes it harder to generalize about the overall state of intergovernmental grants in South and Southeast Asia. Nevertheless, there are some general conclusions we can reach regarding the implications of these several different systems.

Size and Growth of Grant Programs

There is some difference in the relative importance of grants to local governments when the measure of this importance is viewed from the standpoint of percentages of GDP or granting government spending. For example, in Indonesia Inpres grants alone constituted 1.42 percent of GDP in 1984/85; in Bangladesh the analogous percentage for all grants (rural and urban; normal and development oriented) was 0.64 percent in 1983/84; in the Philippines in 1979 the BIR and STA Allotments constituted 0.62 percent

or gross national product (see Tables II-4, IV-6, V-1, and V-3).[1] While such a comparison involves different factors and time periods, the similarity of the ratios between Bangladesh and the Philippines is striking. At the same time, it should be recalled that the 1983/84 ratio for Bangladesh is considerably greater than during the late 1970s and early 1980s, prior to the initiation of the decentralization program.

With the exception of Bangladesh since 1983/84, the review of the evidence here does not suggest that there has been a significant increase in the role grants play in the overall allocation of funds by granting governments. Indeed, until 1983/84, in Bangladesh the trend was moving slowly downward; in the Philippines a similar downward trend was noted; and in Indonesia there was near constancy in the share of total spending going into local government grants.

This is not to suggest that grants are unimportant, at least to the recipient governments. Rural localities in Bangladesh are heavily dependent upon grant revenues (nearly 100 percent at the upazila level and in excess of 80 percent in zilla parishads); the reliance on grants by unions in Pakistan ranges from 27.5 to 80.8 percent (Table III-9), and in districts, the analogous percentages are from 1.2 to 40.6 percent. Indonesian local governments are almost entirely dependent upon revenues generated centrally and redistributed locally, particularly since the central government retains responsibility for local employee compensation.

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[1]Given the nature of data obtained from Pakistan and its federal system, it is not possible to compute a similar ratio.

Philippines municipalities were slightly less dependent upon flows of funds from the central government, with the BIR Allotment constituting from 27-50 percent of general fund revenues in a sample drawn from four provinces in 1977.

Implications of Intergovernmental Grant Programs

With grants playing such an important role in the revenue structures of local governments in these four countries, it is important to consider the various implications these programs have on local government behavior.

Fiscal Planning

Considerable improvement would seem feasible with regard to the local fiscal planning implications of the grant systems used in the four countries reviewed here. Revenue shortfalls have characterized the grant systems in both Bangladesh and the Philippines; little is known at the local level regarding what money they might anticipate during the upcoming fiscal year in both Indonesia and Pakistan.

The statutory grant system in the Philippines would seem to be a model that would aid greatly in local fiscal planning. Implementing such a model would, however, remove considerable power from the granting government and would mean that ad hoc decision-making at the center would no longer be possible. To tie the grant pool to some proportion of one or more central (provincial) revenue sources collected during a previous year would allow local governments to have a much better idea of what kind of revenue increase (decrease) they might expect and to plan accordingly.

This issue cannot be overemphasized in nations characterized by rainy seasons during which construction activities are nearly impossible as is the case throughout much of the Third World. It is far too common to find that local governments do not learn of their allocations until one to two months into the fiscal year. If the fiscal year begins near to the start of the dry season, this lack of knowledge can cause significant delays in the start of grant-funded projects and, hence, has a deleterious effect on the overall results.

Spending Implications

Block grants with few strings attached are used in each of the countries examined here. Yet one should not necessarily conclude that the granting governments do not retain considerable power over the manner in which the funds are spent. The upazila development grant in Bangladesh contains general guidelines regarding the sectoral allocation of money. Likewise, in the Philippines there are numerous mandates regarding the overall spending of total revenues, including grant funds. The empirical analysis of the spending implications of Philippine grants suggests that there is stimulation of development expenditures.

The sectoral Inpres grants used in Indonesia give the central government absolute power to determine the allocation of those funds; on the other hand, the general Inpres grants allow localities to choose those functional areas of spending most desired locally. In Pakistan there are some provincial differences regarding the allocation decisions that can be made locally although, in general, considerable latitude is allowed in

determining the use of grant funds (except for the several highly specific rural development grant schemes in the Punjab).

Fiscal Effort Implications

There are a few minor instances of grant schemes which have potentially positive effects on local fiscal effort. The matching grants apparently being implemented in some provinces in Pakistan could provide an incentive for local revenue effort; likewise, the upazila grant program in Bangladesh may evolve into a system where the flow of grant money is partially determined by local tax effort. The sharing of property tax revenues with Indonesian localities can also have a significant effect on tax collection effort; however, the extent of that incentive has recently been reduced. Furthermore, since this is a Type A grant, the effects of such an arrangement are not directly comparable with grant schemes that involve a formula or cost reimbursement distribution method.

One attribute of all the local government fiscal systems reviewed here will always tend to dampen any fiscal effort effects of grant systems. This is the fact that generally little autonomy is given to local governments in setting local tax rates. In such an environment, a local government can respond to grant-based incentives only by increasing tax collection rates on current and delinquent taxes or by using other nontax revenue sources. But even then the use of alternative revenues is limited greatly by the higher level of government. Hence, unless greater autonomy is provided to localities in terms of raising their own revenues, little should be expected from revisions in grant programs to encourage local fiscal effort by altering the allocation formula.

It should also be recognized that there are seldom sufficient data available to devise a particularly good grant allocation formula that includes local fiscal effort. It is preferable that such an effort indicator be stated relative to the fiscal capacity of a locality. While there may be alternative measures of capacity that are acceptable to both granting and grantee governments, local income probably most accurately reflects taxpaying ability. Yet, of the four countries examined here, only in the Philippines are there any estimates made of local income. Until such measures become available (and it must be recognized that collecting accurate data as a part of the census is costly), less appropriate proxy measures would have to be used.

Redistributional Implications

None of the formula-based rural development grant schemes reviewed here has necessarily been designed to direct funds to localities based upon the level of local economic conditions (although there were plans to include "backwardness" in the upazila grant program in Bangladesh). Generally, population is the primary determinant of grant allocations, although such factors as land area, miles of road, etc., are sometimes also included. There are also instances in which a constant amount is guaranteed to all recipient governments, regardless of local conditions.

Since in the Philippines local level income data are available, we could examine the apparent redistributional consequences of the grant program. Our findings suggest that local income is not statistically related to either BIR or STA Allotments, hence there are no obvious income

redistributional effects of these programs (although the analysis suggested that municipalities with greater per capita assessed property values received significantly greater BIR grants per capita).

It has been possible to determine if there is any relationship between per capita grants to localities and the total population of these jurisdictions. If only population is used in the allocation formula, there should be no statistical relationship found. In fact, in the Philippines, Bangladesh, and in Pakistan, we observed that larger jurisdictions receive lower per capita intergovernmental transfers. This might indicate that the granting governments feel larger (in population) localities have greater revenue raising capacity and, hence, are less "in need" of grant funds. (Of course, if other factors are used in the distribution formulae, they may account for this finding.) Indonesian Inpres grants to provinces are distributed in a manner which yields greater per capita grants to those areas with lower per capita GDP. In general, then, it appears that there is an attempt to use rural development grant programs to "equalize" across jurisdictions, at least on the basis of population size.

Accountability for Maintenance

One interesting finding from this review is that granting governments are cognizant of the need for maintenance spending on capital infrastructure located at the local level, and some have attempted to devise grant-based strategies to insure that maintenance spending is accomplished. At the same time, it does not appear that these efforts have worked well.

In Indonesia, at least 25 percent of the general Inpres grants are to be used for maintenance and the sectoral Inpres may be so used. An identical 25 percent floor was used under the Rural Works Programme in Bangladesh; however, the new upazila development grant apparently does not contain a similar mandate. No maintenance requirements are written into the rules governing grant fund allocation in the Philippines or in Pakistan, although the Philippines does require an interfund transfer into the Development Fund which is to be used for both maintenance and construction efforts.

While there is an obvious need for greater maintenance of capital facilities at the local level of government in developing (and developed) countries, accomplishing such maintenance is difficult for several reasons. One reason why mandated spending on maintenance is unlikely to work well is that defining such spending is extremely difficult. While an engineer can probably discern the difference between maintenance and reconstruction efforts, mandating such a distinction for a large number of local governments is difficult. As was noted above, the local response to the mandated maintenance requirement in Indonesia was simply to "title" one project as maintenance, even though that project was not substantially different from the others in the local government's portfolio. Furthermore, while rules can be written, unless there is a monitoring of these expenditures, little will be accomplished. For example, in a discussion with individuals responsible for auditing local governments in Bangladesh, it was stated that there was no attempt to determine if, in

fact, maintenance efforts were actually undertaken. This can effectively neutralize the maintenance rule.

If neutral observers so easily recognize the need for additional maintenance spending, why does it not occur? In part, the answer may be attributed to politics. Political leaders everywhere (including in developed countries) recognize that a new road, bridge, building or other infrastructure attracts considerably more attention than does maintenance. Thus, from a political point of view, construction or reconstruction of projects are likely to be preferred to maintenance. In part, the grant system itself also may be to blame for lack of maintenance spending. When grant systems are structured so that flows of grant funds are essentially guaranteed to allow a local government to reconstruct run-down facilities, the incentives will be overwhelmingly in favor of foregoing maintenance efforts. What is needed is additional information on how grant systems might be restructured to provide the correct set of incentives to encourage maintenance. This set of cases has, unfortunately, not discovered a workable technique to put such incentives in place.

Fiscal Decentralization

The grants schemes examined here do have implications regarding the extent of decentralization of decision-making powers in the four countries. The local government system in Bangladesh has become considerably more decentralized with the wherewithall to implement local decisions based on a significant flow of money to upazilas through the grant system. Nevertheless, considerable powers are still retained centrally; hence,

while there is greater decentralization than in the past, the system cannot be said to be fully decentralized.

Commonly, empirical studies of decentralization conclude that federal systems are more decentralized than are unitary systems.[2] While it is true that provinces in Pakistan enjoy considerable autonomy, the local governments in the country remain relatively unimportant. As noted above, grants constitute a significant part of local government total revenues, it is also the case that these grants are relatively insignificant portions of provincial resource allocation. The grants that are provided, however, generally contain few strings; therefore, one might say that there is considerable local autonomy allowed. A recent development may, however, alter this situation as elected members of provincial and national assemblies are provided with significant resources which they can allocate as they see fit. This could undermine the role played by local governments and lead to a greater centralization of power in the country

Indonesia is a prime example of a country where empirical data may suggest that there is considerable local decision-making power whereas, in fact, the bulk of the resource allocation questions are answered centrally. While the general Inpres block grants come without strings, they are only about one-half of total Inpres grant funds. Furthermore, as long as

[2]See Roy Bahl and Shyam Nath, "Public Expenditure Decentralization in Developing Countries," Environment and Planning (1986), pp. 405-418; or Michael Wasylenko, "Fiscal Decentralization and Economic Development," unpublished manuscript, Metropolitan Studies Program, The Maxwell School (Syracuse, NY: Syracuse University, 1987).

personnel decisions and compensation are made centrally, one cannot cite Indonesia as a good example of a highly decentralized system.

It is hard to conclude that during the 1970s Philippine local governments enjoyed significant autonomy. The national government retained considerable control over the allocation of those resources which local governments received via grants, as well as the resources mobilized locally. Furthermore, the empirical indicators suggested that the central government was growing relative to subnational governments.[3] Finally, as has been noted before as true in each of the countries examined here, local revenue-raising opportunities were limited by central government regulations. Indeed, until such autonomy is granted, full decentralization is unlikely to occur.

Thus, while decentralization has been espoused as national policy in each of the countries examined here, this review would indicate that it may be more wishful thinking than reality. The grant systems may promote some decentralized decision-making; nevertheless, local governments remain highly dependent upon their higher level counterparts.

Other Considerations

There are several other items that should be noted in this summary review of grant systems in South and Southeast Asia. One of those is whether or not any of the grant "systems" examined is really a system in the sense that it has a well-defined set of objectives which it attempts to

[3]Roy Bahl and Barbara D. Miller (eds.), Local Government Finance in the Third World: A Case Study of the Philippines (New York: Praeger Publishers, 1983).

achieve. In general, the set of grants used in Bangladesh appears to have been put into place over time without considerable thought or analysis given to its consequences. Likewise, first impressions of the grant schemes used in the several provinces of Pakistan suggest that they, too, were not developed in any highly systematic manner. While much thought is given to allocations of national government funds to provinces in the country, no similar effort appears to have been made regarding transfers to the lowest levels of government. The Philippines grant structure appears quite systematic on paper; in reality, however, there have been sufficiently major adjustments in the various allotment schemes to conclude that it has lost its systematic characteristics. More in-depth analysis of actual allocation and uses of funds in Indonesia is necessary before one can conclude whether the systematic-looking system of grants used there really accomplishes what it was meant to do.

As noted in the first section of this paper, objectives other than the ones examined here are sometimes sought for grants to local governments. One such objective which was given in both Bangladesh and Indonesia is creation of rural employment opportunities. Somewhat analogous to the employment creation goal is the objective stated explicitly in Pakistan to decrease migration from rural to urban areas. It is difficult to assess whether these objectives have been accomplished by the grant programs, but assessments of the Rural Works Programme in Bangladesh have estimated that it created from about 30,000 to 70,000 per year, during the period 1971/72

through 1976/77.[4] This is not an unimportant number of employment opportunities; but whether alternative grant schemes or policies could have done better remains an open issue. At the same time, it is hard to conclude that the grant programs being implemented in Pakistan will have the effect of significantly reducing urban migration in the country. While rural infrastructure and public services may play a role in the migration decision, employment opportunities are still likely to be more important than the level of services available locally.

Finally, it is useful to at least mention an issue that was not addressed extensively here, nor has it been analyzed to any significant degree in any situation. This is the issue of absorptive capacity of rural local governments in developing countries. Large flows of grant funds to small local governments may simply exceed the capacity of the recipient government to administer and spend the money effectively, particularly if the system also requires that each project must be a small one. The issue has been raised with regards to the upazila development program in Bangladesh, as well as the barangay grants used in the Philippines. Likewise, the slow rate of spending grant funds observed in Indonesia may be an indicator of lack of absorptive capacity. While we cannot answer this question here, we feel it is sufficiently important to raise it and suggest that it be added to the research agenda whenever grant programs in South or Southeast Asia (as well as throughout the Third World) are

[4]Roy Bahl, "Intergovernmental Grants in Bangladesh," Metropolitan Studies Program Occasional Paper No. 87, The Maxwell School (Syracuse, NY: Syracuse University, May 1984), pp. 41-42.

analyzed. While grants may play crucial roles in the development process, if they are inefficiently utilized, greater benefits might result from alternative spending mechanisms.[5]

In conclusion, the intergovernmental grant programs used in four countries of South and Southeast Asia are diverse and fairly extensive. Furthermore, it is unlikely that this situation will change in the near future.

[5]We are not arguing that local governments are incapable of spending money; everyone knows that the funds can be spent. The issue is one of effective utilization of funds. Unfortunately, researching this issue--since it involves an assessment of expenditure effectiveness--is particularly difficult.