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INTERGOVERNMENTAL FISCAL RELATIONS IN EGYPT AND MOBILIZATION OF LOCAL REVENUES

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Local resource mobilization decisions are not made in a vacuum, but are one aspect of a system to finance and deliver local services. Properly structured intergovernmental relations between the Central Government and the Local Governments (Governorates, Marakaz, and Villages) are the key to developing a local resource program which can provide the wherewithal to improve operation and maintenance expenditures for services, equipment and infrastructure.

In Egypt, these intergovernmental relations affect the three major parts of the local government budget system: expenditures, revenues, and intergovernmental aids. Each is dependent on the other and the intent of government policy will be weakened unless all three elements are considered as essential parts of an overall central local government finanical system. A change in one component of the system must be evaluated in terms of its impact, positive or negative, on the other two components of the financial system. Thus, it is imperative to see that the three be addressed as a package.

Consider an example affecting each of the three components of the system. Enhanced authority over setting local expenditures could lead to little change in behavior because the central authorities could adjust the subsidy to offset local actions. Greater flexibility in mobilizing local revenues will not generate new revenues unless local people believe they can actually increase expenditures, and improve services in accordance with their own priorities. There is little meaning to a change in the subsidy structure if central officials retain final decisions over local expenditures.

In this paper, the intergovernmental aspects of receipt of local revenues, granting of central transfers, and expenditure of funds are described and the problems the system creates for local resource mobilization are listed. The focus here is on current revenues (Bab I and Bab II) and current expenditures (Bab I and Bab II). A similar analysis for investment expenditures and financing could be undertaken, while realizing that the Ministry of Planning would be the appropriate place for dialogue. This is not the proper context for a detailed analysis of revenues and expenditures, so only the relevant aspects are described. The paper suggests, for the consideration of GOE policy makers, a framework for considering the restructuring of central-local fiscal relationships. Further analysis of the issues discussed below, both during and after the DSS II design effort, is heartily encouraged. The results should led to improved fiscal performance and accountability by local government with corresponding gains for the GOE's overall national development program.

The main conclusions of this report are:

A. GOE policy makers should consider the feasibility of restructuring central - local (i.e. governorate) fiscal relationships to more fully align the GOE fiscal system win the substantial administrative and management responsibility already granted to Governorates under various legislation.

B. The key ministries responsible for addressing and introducing improvements in the fiscal system are Ministry of Finance and Ministry of Planning. The Ministry of Local Government must be supportive of decentralization, but is not the main actor in fiscal decentralization.

C. The components of the local fiscal process, i.e., expenditures, revenues, and intergovernmental aid, should be restructured as a package, not as independent elements.

D. The focus for expenditure decentralization and increased local expenditure responsibility must be greater control over non-wage recurrent expenditure (Bab II).

E. Substantially increased local authority over the use of revenue sources and selection of rates is essential to decentralization.

F. Transfers from the Central Government should be structured so that there is a cost reimbursement transfer to finance wages (Bab I) and revenue sharing to partially finance other recurrent costs (Bab II). A formula should be used to distribute the revenue sharing grant.

EXPENDITURE PATTERNS

The local government budget process begins with submission of a proposed budget to the Ministry of Finance by the sum of all local governments in a governorate. The actual budget which leaves the Ministry of Finance for higher approval is determined by examining requests for all government entities (not just local governments) relative to available resources. Each governor has the opportunity to negotiate with the Minister of Finance on his budget, but the Governor does not have ability to set his budget. Governorates and villages only have direct control over several small funds including their Local Service and Development funds. This indicates that the basis for the intergovernmental fiscal linkages, that is, the setting of expenditure priorities, is outside the direct control of local officials.

Local current expenditure budgets are dominated by the Bab I wage account (see Table 1). More than 85 percent of the total LE 1.89 billion for the FY 84-85 budget is for wages and the remainder is for recurring non-labor expenditures (Bab II). The preponderance of wages in the budget is substantially the result of GOE policies to guarantee employment to all graduates and then to decentralize those hired.* Unless employment policies are changed, the focus of local expenditure options must be Bab II. Note that high Bab II expenditure shares are found in the eight least populated governorates.

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*Actually, it is uncertain what would happen to the wage budget if local governments hired only those people they desired, but paid them market wage rates.

Table 1. Expenditure Budget Share for Babs I & II, by Governorate, 1984/85

	Governorate	Bab I	Bab II	Total Current Budget
1.	Cairo	81.8	18.2	209,836,228
2.	Giza	84.2	15.8	82,522,757
3.	Qaliubia	85.9	14.1	85,376,784
4.	Alexandria	83.6	16.4	122,839,335
5.	Matruh	71.4	28.6	10,514,939
6.	Beheira	88.3	11.7	102,248,913
7.	Gharbiya	88.9	11.1	129,377,258
8.	Menufia	90.9	9.1	100,860,275
9.	Kafr El Sheikh	87.0	13.0	62,251,448
10.	Port Said	69.1	30.9	44,296,513
11.	Ismailia	81.4	18.6	31,045,586
12.	Suez	72.3	27.7	21,915,507
13.	North Sinai	70.3	29.7	18,848,873
14.	South Sinai	59.6	40.4	8,226,485
15.	Red Sea	59.6	40.4	11,704,152
16.	Sharqia	86.5	13.5	139,337,176
17.	Daqahlia	90.2	9.8	133,612,743
18.	Damietta	83.5	16.5	35,138,355
19.	Fayoum	82.8	17.2	58,958,758
20.	Beni Suef	88.5	11.5	64,583,024
21.	Minia	88.4	11.6	89,525,234
22.	Assiut	87.9	12.1	76,723,651
23.	Sohag	88.8	11.2	94,738,321
24.	Qena	85.4	14.6	83,926,448
25.	Aswan	80.9	19.1	53,991,068
26.	New Valley	73.3	26.7	16,263,169
	TOTAL	85.1	14.9	1,888,663,000

*Source: Government of Egypt Budget, 1984-85

REVENUE SOURCES FOR EGYPTIAN LOCAL GOVERNMENTS

Table 2 illustrates the major revenue sources for local governments in the 1984-85 budget. Sovereignty revenues, providing 5.5 percent of local budgets, are taxes levied nationwide at a constant rate for the use of the local governments. Included are the land, building, and vehicle taxes. Shared taxes are the share of joint revenues and the share of the joint fund, both of which are financed with a surtax on imports and exports, and which raise a combined 9.7 percent of local funds. One half of the surtax goes to local governments where the tax is collected (share of joint revenues) and the other half less LE one million is allocated by the Ministry of Local Government (share of the joint fund). A tax shared by the five governorates bordering the Suez Canal (Port Said, Ismailia, Suez, North & South Sinai) is also included here.

Other current revenues and fees include utility user fees, many small taxes and fees on items such as bicycles, dogs and work animals, quarrying taxes, and miscellaneous revenues. Combined, these sources generate 3.8 percent of revenues or LE 71.2 million. Revenues for Cairo and Alexandria Water Companies and other institutions that are set up as Service Authorities or Public Sector Companies, are not in these statistics.

Revenues from other local activities are the Local Service and Development Funds, the Economy Housing Funds, and the Cleansing Fund. These are reported in the budget so that the Ministry of Finance has information on the amounts involved. Despite the rapid growth in these funds, they provide only 3.7 percent of budgeted revenues.

Table 2. Revenue Shares for Selected Categories, by Governorate, 1984-85

Governorate	Sovereignty Revenues Less Shared Taxes(2) %	Shared Taxes(3) %	Other Current Revenues& Fees Less Revenues From Other Local Activities(4) %	Revenues From Other Local Activities(5) %	Central Subsidy %
Cairo	13.5	25.3	5.9	7.7	47.7
Giza(6)	6.9	8.8	3.9	3.3	74.7
Qaliubia	3.6	6.3	5.2	1.9	83.0
Alexandria	10.5	17.3	3.5	6.2	62.6
Matruh	0.9	3.2	4.0	3.3	88.7
Beheira	5.5	7.3	2.9	2.5	81.7
Gharbiya	3.8	5.3	2.9	2.6	85.4
Menufia	3.1	4.9	2.0	1.0	88.9
Kafr El Sheikh	4.3	6.5	2.0	2.7	84.5
Port Said	2.8	17.1	3.2	19.4	57.4
Ismailia	5.5	22.9	1.8	2.3	67.5
Suez	5.4	25.0	2.6	9.6	57.4
North Sinai	2.8	8.2	4.1	9.3	75.5
South Sinai	2.2	18.8	1.4	12.4	65.4
Red Sea	2.0	3.2	7.7	3.2	83.9
Sharqiya	3.5	5.5	7.2	1.5	82.3
Daqahliya	5.1	6.5	2.4	1.0	85.0
Damietta	3.8	5.0	4.3	2.6	84.4
Fayoum	2.8	5.6	8.5	4.1	79.0
Beni Suef	3.7	4.9	2.9	2.6	85.9
Minia	3.9	6.7	2.8	2.4	84.2
Assiut	3.6	6.3	2.5	1.9	85.7
Sohag	3.0	5.8	1.9	2.2	87.2
Qena	3.3	5.7	2.1	2.2	86.7
Aswan	1.9	3.6	3.9	1.9	88.6
New Valley	0.7	1.5	2.4	5.7	89.6
Average:	5.5	9.7	3.8	3.7	77.4

1. Totals may not equal 100%, due to rounding. Total revenue equals total expenditures, from Table 1.
2. Sovereignty revenues minus the share of the joint fund and minus the share of joint revenues.
3. Share of the joint fund plus the share of joint revenues.
4. Bab II revenues include locally levied taxes which are in the central budget. Category 5 of this group has been excluded.
5. This item includes the Local Services and Development Fund, the Economy Housing Fund, and the Planning Fund.
6. Revenue categories do not equal the total in the budget document.

*Source: Government of Egypt Budget, 1984-85

The central subsidy dominates local revenues, providing 77.4 percent of total budget. The column labeled central subsidy includes all items which are technically regarded as a transfer to the local governments, and though it appears in the budget document as a single time, it is more than one transfer. The overall grant-in-aid program can be interpreted more broadly to include other revenue categories listed above. For example, the shared taxes are a type of revenue sharing. Combined with the central subsidy, this means that 87.1 percent of revenues are part of the grants system. Further, the sovereignty revenues are nationally set taxes and are not under direct control of the local governments. Evidence of this is that the local governments can only keep 50 percent of sovereignty revenues collected above the budget. Many local officials also regard these sovereignty revenues as a transfer. This means that local governments actually have, within limits, some direct control over setting the revenue sources for only 7.5 percent of revenues.

Generally, the central subsidy provides a significantly below-average share of revenues in those governorates where the shared taxes (column 2, Table 2) or revenues from other local activities (column 4, Table 2) are significantly above average. Frequently, the same governorates have high percentages for each of these categories (Cairo, Alexandria and four of the five Suez governorates). This is mainly because one-half of the surtax on imports is allocated according to situs (i.e. location) of collection and the tax becomes incident when the goods first land in the country. The special tax for the Suez Canal exacerbates the importance of the shared taxes in the Suez governorates. Also, these appear to be governorates which have chosen to use the Local Service and Development Funds. Cairo's low central subsidy is also the result of significant sovereignty revenue collections for building and vehicle taxes. It should be noted that the more rural governorates generally have relatively large central subsidies.

EVALUATION OF GOE GRANTS

Roy Bahl and Johannes Linn developed a system for categorizing the grant-in-aid programs of developing countries according to a) the method of determining the amount to be granted and b), the method of distributing the total grant amount among local governments.*

The method of determining the total grant amount for all local governments can be use of a shared tax (local governments receive a percentage of central tax revenues), ad hoc (central government decides each year on the total grant amount), or reimbursement for costs imposed. The method of distributing the total grant across local governments can be on the basis of where revenues are collected, ad hoc, formula determined (objective criteria are used to distribute the grant), or cost reimbursement. This categorization is useful for interpreting the system operating in Egypt and is presented in matrix format in Table 3.

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*Roy Bahl and Johannes Linn, Urban Public Finances and Administration in Less Developed Countries, unpublished manuscript, cited in Roy Bahl, "Intergovernmental Grants in Bangladesh", Zilla Roads/Local Finance Project, Interim Report No. 10, November 1983, p. 115.

Table 3: Egyptian Revenue Structure

Method of Distribution	Type of Grant: Cost Reimbursement	Adhoc	Tax Sharing
Cost Reimburesment	Bab I Wages		
Formula			
Ad. Hoc		Bab II	Gasoline tax Joint Fund
Site(location) of collection			Joint Revenue Excess Sovereignty Revenues

Four basic GOE grants will be discussed here: the basic centrally provided subsidy, the shared taxes(joint fund and joint revenues), the excess collections of local sovereignty revenues, and the highway fund(gasoline tax). The total amount of the basic central subsidy is determined partly as a cost reimbursement for some Bab I expenditures and partly ad hoc (particularly those related to Bab II).* The central government's employment policies which lead to massive hirings, and distribution of many employees to local governments, require a large central subsidy for Bab I as a cost reimbursement. The distribution of this grant across governorates is also meant as cost reimbursement for Bab I(Table 3). The basic transfer for Bab II is distributed across governorates in an ad hoc fashion (Table 3).

*The implicit assumption in this discussion is that the subsidy can be separated into two components. This is qualitatively true, but is not quantifiable.

Transfers from the central government which are meant as cost reimbursement bear a relationship to central government revenue growth to the extent that the GOE salary policy is related to revenue growth. But since these cost reimbursement transfers are the result of GOE employment policies, they are outside our current interest and will be discussed no further.

The central subsidy which is oriented towards Bab II bears no fixed relationship to GOE revenues. The result is inadequate revenues to finance Bab II because nonlabor expenditures and particularly those for maintenance are the easiest to cut in a budget crisis. This ad hoc grant system hinders financial and operations planning as the local governments are unable to predict resources for the following year.

The most important basic shared taxes are the joint fund and the joint revenues. The amount of money to be distributed is determined by surtax collections, so in this case, the local governments do share in some central revenue growth. A recent World Bank report indicated that the revenue growth from import duties is slightly inelastic, indicating revenues increased slower than GDP. Thus this sharing is for a slow growing tax. The distribution across governorates is based on origin of collections for joint revenues and is ad hoc for the joint fund (Table 3). Distribution by origin of collection can be inequitable because point of collection presumably bears no relationship to revenue need, but the joint fund is partly allocated to offset this problem. Cairo and Alexandria governorates, for example, are budgeted to receive none of the joint fund, while they are major recipients of joint revenues. These shared revenue sources are likely to be more effective in providing adequate revenues and stimulating financial planning than the central subsidy, because of the better growth and predictability.

All local sovereignty revenues can be thought of as shared taxes where the resources are distributed by location of collection. The sovereignty revenues are collected in the governorates by the Ministry of Finance and are forwarded to the Central Government. The amounts appear in the budget, but are little different from a transfer. Local governments are, however, permitted to retain one-half of any excess collections above the tax estimates included in the Budget. This excess is deposited in the governorates' Local Services and Development Funds. Data reported in the Decentralization Sector Assessment indicate that this excess was the largest revenue source for the funds in Giza and Menufia. Again, this is a shared tax where the share is based on all sovereignty taxes which are defined as local and the distribution is by origin of collection (Table 3). This sharing stimulates local collection of sovereignty revenues and encourages decentralized financial planning, as it provides revenues for the locally controlled fund.

Seventy percent of a two-piaster tax on gasoline is distributed by the Ministry of Local Government for highway construction and maintenance. The total grant to be distributed is determined by the shared tax and the distribution across governorates is ad hoc (Table 3). This grant should be reasonably effective in stimulating financial planning, unless the ad hoc distribution changes radically from year to year.

EVALUATION OF EFFECTS OF INTERGOVERNMENTAL RELATIONSHIPS ON LOCAL FISCAL AUTONOMY

The key question in Egyptian intergovernmental fiscal relationships is; can local governments undertake fiscal planning, and determine their own expenditures? Sufficient data are not available to determine the degree to which local governments control expenditures. As noted above, local governments submit a proposed budget to the Ministry of Finance and the budget sent from the Ministry for further aproval is negotiated between the Governor and the Minister. Clearly, this indicates limited capacity at best for local leaders to determine expenditure levels and specific uses. At the same time, local leaders do have input in the decision process. My judgment is that local leaders (particularly the Governor) probably do influence expenditure decisions, but in a controlled fashion and they are probably unable to achieve expenditures which are more than nominally different from what the Ministry of Finance is planning and what other governorates are doing. The situation is exacerbated as local government employees feel dual allegiance to the governorate, markaz or village and the line ministry.

An equally important and closely related question is, can local governments mobilize additional revenues and transfer these into increased expenditures, or do additonal local revenues result in a lower subsidy from the Central Government? For example, could a local user fee for water be imposed and the revenues used to improve operation and maintenance of a local system? The ad hoc nature of the central subsidy and its dominance of revenues makes this question one without a simple answer. A high official in one Governorate indicated that local taxes are collected on the basis of ability to tax, but bear no relationship with expenditures. The local expenditure budgets are set based on some judgment of expenditure needs. This suggests that, with the exception of the Local Service and Development Fund, local governments are administrators and spenders, but not really revenue generators.

Some information on the linkage between expenditures and revenues can be found in statistical analysis. The correlation between per capita expenditures and per capita local government revenues is generally about 0.7, with a slight difference occurring as different categories of expenditures or revenues are used (based on the 1984-85 Budget and 1983 population). The only real aberration is that Bab II revenues, which are those based on locally imposed rates and bases, have a .88 correlation with per capita Bab II expenditures. Each of the correlations is statistically different from zero.* A correlation which is not statistically different from zero would mean that expenditures are not higher in governorates whose revenues are higher, and vice versa. This provides casual evidence that higher local revenues are related to greater expenditures and limited evidence that these expenditures are more likely to be for Bab II categories. But these results do not prove that expenditures are higher where revenues are higher. Another possibility is that revenues are higher in richer governorates, and the political power to attract higher expenditures is also concentrated in the richer governorates. This would mean that the correlation indicates no causality. Also, increased local revenues could be partly reflected in increased expenditures at the local level, but the priorities for the spending may be different from those anticipated by the local officials.

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*Each correlation is statistically different from zero, but the .88 correlation is not statistically different from most other correlations calculated.

PROPOSED STRUCTURE FOR INTERGOVERNMENTAL FISCAL RELATIONS

The substantial progress made by the GOE to decentralize decision making to local government over the past several years cannot develop furhter until changes occur in the three major components of fiscal relations: expenditures, revenues, and grants-in-aid. Recommendations for changes in each of these three areas are provided separately below, but these three must be addressed as a package. Modification in one, without appropriate changes in the other would be fruitless.

The following goals are suggested for fiscal decentralization:

a) to allow greater local control over expenditure decisions;
b) to improve local fiscal planning;
c) to improve local service delivery, particularly by allowing better operation and maintenance of infrastructure;
d) to increase local accountability for service delivery;
e) to enhance the capacity and desire to mobilize resources locally.

These goals are the basis for the recommendations for restructuring central-local financial relationships. If considered appropriate by GOE policy makers the recommendations which are outlined below would necessitate some modification of the relationships between the Ministry of Finance and the local governments. Support of the Ministry of Local Government is necessary to the success of decentralization, but the next major steps in the decentralization process fall with the domain of central-local financial relationships which is the principal responsiblity of the Ministry of Finance.

Expenditures

Decentralization of decision making and the motivation for local resource mobilization, to be fully effective, must be based on local control of expenditures. The local goverments must have the ability to determine the levels of and priorities for expenditures, particularly for Bab II. Local control over Bab II (nonlabor recurrent costs) is essential to establishing a decentralized and locally accountable service delivery structure. This includes the ability to determine the level of and the priorities for Bab II expenditures. Without this control, local governments will be reticent about mobilizing resources.

As previously noted, the Bab I budget (wages) is substantially the result of GOI employment policies and responsibility for these should not be thrust upon the local governments. The Governors and village leaders only need some control over allocation of workers across sectors in order to target the labor inputs to local priorities. As presently occurs, the local governments should receive a cost reimbursement grant from the GOI to finance the wage budget.

Local priorities are served only when the expenditure decisions are made locally and are not a component of an overall national budget. At the same time, the GOI may have certain national priorities which require cooperation of the local governments, but these can be achieved using carefully selected mandates and categorical grants. Further, central government oversight of service delivery and local resource mobilization must remain in place, but only as oversight.

In sum, local government expenditures for recurrent nonlabor purposes should be, to the greatest extent possible, removed from the central budgeting process and determined locally. Cost reimbursement grants should be provided to local governments if they are to be responsible for labor costs.

An alternative would be for local governments to have the authority to set priorities for certain categories of new expenditures, such as those for operations and maintenance of USAID financed projects. This alternative is much less extreme, but would require some stipulations on the receipt of subsidies. Without careful design of the subsidy, the central government could nominally allow local governments to determine operations and maintenance expenditures for USAID projects and then reduce the subsidy a corresponding amount for the appropriate directorate in that governorate. In this case, no new expenditures take place, but local governments have raised more money. Since the local people are paying more, but getting no better service, they cannot be expected to support the necessary tax increases.

A <u>continuation of support clause</u> that commits the central authority to maintain its subsidy at some previous level can minimize this problem. It is insufficient to say that next year's subsidy cannot be lower than this year's, because the subsidy would probably have increased. Some objective mechanism for taking growth in the subsidy into account (such as the average growth in revenues, etc.) should also be included.

Revenues

Local expenditure control does not constitute substantial decentralization unless revenues can be generated to permit decisions on the level of expenditures. For example, if an increase in new operations and maintenance expenditures are to be financed by mobilization of revenues at the local level, greater revenue raising capacity must be available. Those taxes and fees over which the local governments have control are currently too limited and the rates which can be applied are limited even further, as authority for increases must come from the Cabinet.

Two major advantages would result from an improved legal arrangement and atmosphere for mobilizing local resources. First, service delivery will improve as local governments have adequate resources to operate and maintain the facilities. Second, the necessity for central government transfers will be lessened as local governments generate more of their own resources. This cannot be a complete substitution, but the necessity for central taxes to support local services provision can be lessened.

Consideration of what resources are best for local revenue mobilization must await the results of on going work under the DSS II design. Alternatives include a tax on the property which benefits from new public projects (tax increment financing); increased flexibility over the use of existing tax bases and the setting of rates; greater use of shared taxes with the central government and new sources which are not currently employed. At a minimum, the local governments should have authority to set user fees to provide for the operation and maintenance of water and sanitation systems being financed by DSS II. Ability to set other charges for financing the operation and maintenance of road systems and other infrastructure should also be addressed. Local governments should also have authority to set expenditures based on the revenues which they generate.

Intergovernmental Grants

A properly operating system of intergovernmental grants has three aims. The first is to provide adequate financing for locally produced services. The next is to encourage local expenditure on areas of national interest. The third is to partially offset unequal ability to raise revenues across the Governorates. The recommendations listed below provide for these three, but are not a detailed description of a proposed grant structure.

Grants were categorized in Table 3(page 10) according to the method of determining the overall grant amount and the method of distributing the grant across governorates. This same rubric could be used for the suggested restructuring of the intergovernmental grant system. Consider first the method for determining the overall grant amount. The financing for Bab 1 wages must remain the same, so a cost reimbursement determined grant must still be used, and should also be distributed on the basis of cost reimbursement.

The amount to be allocated for the remaining transfer should be based on a revenue sharing formula rather than being determined ad hoc. Because they are inelastic, local government revenue sources are likely to be inadequate to finance operations and maintenance, making it essential that grants be available. Sharing in the growth of Central Government revenues can insure sufficient revenues to meet local operation and maintenance needs. A second advantage of tax sharing is that local governments would be better able to undertake financial planning. Finally, tax sharing is the most decentralized approach to providing grants, as it maximizes local government control over expenditure priorities. These advantages will only result if the distribution across local governments is also properly designed.

The specific tax to which local government revenues should be linked is more flexible. Total tax revenues, which had an elasticity of 1.13 between 1976 and FY 81/82, are one good option.* Consumption taxes, which are slightly less elastic, are another reasonable option. Some portions of the grant could also be determined by a specific tax, such as the funding for highways from the gasoline tax. The percentage of the revenue source to be shared with local governments should be sufficient to provide at least the same level of Bab II funding that would have occurred in the year revenue sharing begins. A greater share designed to provide better operations and maintenance could be justified, but would be difficult to obtain, given present fiscal realities facing Egypt. In any event, a revenue sharing approach would lead to greater operation and maintenance funding, over time, because the local government Bab II budget would grow at a predetermined rate, rather than being a target for controlling the government deficit.

Distribution of the grant funds across Governorates and villages should be designed to encourage local fiscal planning, support needs for operation and maintenance, and foster local

*This is a total elasticity which includes the effects of tax base grwoth and tax rate changes. The statistic is drawn from Sadiq Ahmed, "Public Finance in Egypt: Its Structure and Trends", _World Bank Staff Working Paper_ No. 639.

taxes,resource mobilization. However, care must be taken to prevent the grant system from becoming too complex. Ideas for achieving these goals are discussed below, but it would probably be desirable to only factor a few of them into a grant program. An unintelligible formula will not motivate the desired effects.

Fiscal planning becomes viable when local governments can reasonably determine the resources which will be available to them. This argues for a formula grant which would allow the local governments to predict the grant amount. A formula grant is one where the distribution of funds is based on a well understood, objective set of criteria. Adequate financing for operations and maintenance can also be provided through a formula grant if the formula includes a measure of need. Population can be used as a proxy for need, but does fail to account for the requirements caused by different levels of infrastructure being in place. Portions of the grant could be based on actual operations and maintenance requirements using kilometers of roads, number of vehicles, families served with water, kilometers of pipelines, or other surrogates for operation and maintenance costs.

Local resource mobilization is encouraged if, at a minimum, the central government grant is not substantially cut when local governments impose taxes or fees. Local resource mobilization is enhanced further if the grant formula is positively linked to tax effort (resources mobilized locally) or if the grant matches local expenditures.

A broad scheme, such as that sketched above, is necessary for truly decentralized decision making. Such a restructuring is impractical for the short term, though it should be considered as a policy goal. In the short term, the grant system should be structured such that it does not counter efforts to mobilize local resources. Ideas on this point were listed above under "Expenditures".

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