

Fiscal Decentralization & Good Local Governance ... and What Does it have to do with Rural Development?

Insights from a study in Bolivia



Rural Sanitation

by Daniel Roduner, LBL

Background

Fiscal decentralisation has been a world wide phenomenon since the 1980ies. It has spread to Latin America amongst other regions and is being introduced – albeit hesitantly – in the former eastern block states, i.e. in states traditionally governed in a centralised way. *Fiscal decentralization* is to be understood as a process in which fiscal authority (public functions, expenditures and revenues) is transferred from a higher (central) level to a subordinate (regional or local) level.

A main cause for this development is certainly the discussion on the role of the public sector and a more efficient allocation of resources within this sector. Decentralization seems to be an instrument to maintain and create internal acceptance of a state in which ethnic, religious, cultural or economic differences weigh heavily – which is certainly the case in Bolivia.

Bolivia's democratic history is - with only around 20 years - still very young. A fundamental step in the process of decentralisation was initiated with the Law of Public Participation (Ley de Participación Popular) in 1994. This law defines the territorial jurisdiction of the

Analytical systems of decentralization

From a conceptual point of view, in the domain of fiscal federalism, we know two analytical models of decentralization:

- a) The system **principal – agent**. The national government (principal) decides on priorities in the public sector, but recognizes the higher implementation efficiency of the sub national governments (agents). In this model the agents are accountable towards the national government, and not to the sub national population.
- b) The system **local public election**. This system presumes a high degree of autocracy of the sub national governments. The greater part of the financing of the sub-national expenditure should be through sub-national tax and non-tax revenues. The expenditure authority is linked with the preferences of the local tax payers, which should be included in the election of the different service levels needed. In such a system the sub national governments' accountability is clearly towards the local population, as the expenditure is financed and the priorities are set by them.

Municipalities (Gobiernos Municipales), and the transfers of national resources (tax money), determines the local responsibilities and establishes the mechanisms for public participation and social control. With the delegation of fiscal responsibilities, the establishment of social control units (members of civil the society integrate so called ‘comités de vigilancia’ / ‘vigilance committees’, that have the authority of controlling the public entities) and mechanisms for active political participation for the society, Bolivia is clearly moving towards a decentralised system, named ‘local public election system’.

An indicator for measuring the progress towards the system of local public election is the level of independency of national funds¹.

As table 1 shows, the largest municipalities manage an income ratio of 1, the medium sized municipalities achieve the generation of barely more then 20 % of the non-conditional transferes and the smaller municipalities don’t even reach to that level. Even when considering only non-conditional transfers we see clearly that fiscal independence of medium and small municipalities isn’t within reach at all.

Table 1: Fiscal Municipal Independency

Municipal revenues vs. non-conditional transfers from the national government

Population	No. of municipalities	1998	1999
Less then 5'000 inhab.	99	13.5 %	17.8 %
5'000 to 14'999 inhab.	128	13.6 %	15.0 %
15'000 to 49'999 inhab.	72	22.9 %	23.3 %
Over 50'000 inhabitants	15	109.5 %	105.8 %

Ministerio de Hacienda, Bolivia

Besides the low capacity for generating local income of most municipalities, we face many other problems in Bolivia: (i) the system of transfers lacks clear policies; (ii) inconsistency between assigned responsibilities and necessary funds for the administration at municipal level; (iii) lack of fiscal discipline and control over municipal debts.

While leaving these major constraints without further analysis and explanation, I’d like to rapidly move towards summarising the prime factors that led to my research:

- a) Historically seen, Bolivia is like a new born baby with respect to (fiscal) decentralisation; and already advancing in the system of local public election.
- b) The sub national governments should allocate their expenditure based on participative local decisions, while local revenues are very low or even nonexistent. Due to lack of confidence, interest and education, among other reasons, the desired accountability isn’t yet developed towards the local population in most municipalities.
- c) Bolivia still suffers from notorious vertical and horizontal fiscal inequality.
- d) Urban municipalities are not too happy to shift revenues to rural municipalities. The lack of clear assignments of functions and responsibilities between national, district and municipal authorities doesn’t help either; the urban population accuses the rural areas of tax evasion.
- e) Infrastructure projects in rural areas have lower costs than in urban areas, due to the participation of local communities in the construction process.

These statements led us to the following ideas and questions: Does the rural population participate in the municipal fiscal system by ‘working for free’? Are they ‘paying’ taxes without knowing it – and without those being recognised? If so, is it possible to measure these contributions and include them in the fiscal regime of the municipalities?

Hypothesis and process

With this background, the hypothesis formulated, and to be confirmed or refuted, was: The communities contributions² in public infrastructure projects are substancial, and can be valued and integrated in the municipal financial accounts in order to (i) recognise the communities’ efforts, (ii) reflect the real situation of municipal incomes and (iii) quantify the real costs of municipal infrastructure projects.

¹In this article we won’t discuss the different kinds of national transferences in general, neither in Bolivia’s specific case; even though we recognize the implicit systemic differences those funds and transferences might comprise.

The research carried out to get a better understanding on this matter included the analysis of information from different ministries, municipal governments and on-the-ground study of over 150 infrastructure projects (in the end only 115 projects were consistent enough for being analysed). Besides these economic studies, two different socio-anthropological investigations were carried out with the intention of getting an 'indigenous' point of view. In the following sections I will always refer to the regions, municipalities and projects included in those studies³. The research does not claim statistically representative significance, but many factors in the sampling process indicate a high relevance of the results for most regions in Bolivia.



Road maintenance

Results of the study and concepts elaborated

The first insights weren't surprising at all: the municipalities heavily depend on external financing (with own finance share between 0,02 and 0,32 %) and those municipalities with highest revenue generation, rely mainly on non-tax revenues; non-tax revenues include fees, charges, contributions (remuneration) and other special non-tax revenues. On the other hand, investment in infrastructure projects remains the bulk of expenditure for all municipalities. Of course, none of the municipalities has measured and/or included the non-financial contributions from communities. Therefore the infrastructure costs are not reflected correctly in their balances.

² Contributions include physical work force and local construction materials, such as stones, sand, wood etc. Many social and ethnological researchers argue that (indigenous) communities also contribute in a high degree with their specific knowledge, forms of traditional coordination and cooperation. A verification of those elements would have surpassed my capabilities and I concentrated my research on work force and materials. Nevertheless, the importance of indigenous knowledge is certainly recognized.

³ The studies were carried out in two different regions: Norte Potosi and Chaco. The economic studies included five municipalities: Uncía, Caripuyo, Lagunillas, Villamontes and Machareti. The socio-anthropological researches were carried out by sub-contractors (NGOs, Universities, and consultants) in the same regions, focusing on two prime indigenous groups: guaraníes and aymaras.

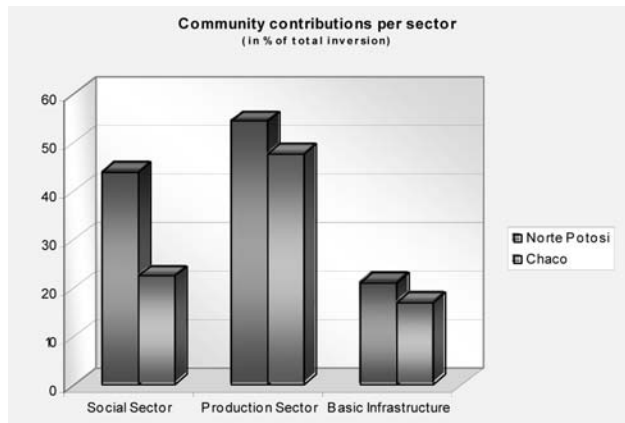
The matters begin to be more interesting, when we analyze local contributions. They differ from project to project and region to region - but with some regularity, based on three fundamental factors:

- Modality of execution: Direct administration of project implementation by the local government involves considerably more community contributions, than does when a private contractor is executing the project.
- Type of project and financing source: Government funds do not need matching funds, cooperation funds usually do. Some infrastructure projects depend on heavy machinery others on low skilled work force.
- Interest of the local population: Projects with immediate individual benefits (i.e. micro-irrigation) count on higher community contributions than common interest projects (i.e. health post).

A fourth important factor would be the traditional way of community work and cooperation patterns in the communities – but that is where sound economic studies are difficult or not possible anymore.

Valuing the community contribution with local-market based prices⁴ shows unexpectedly high results: In one region they add up to between 24 and 28 % of all infrastructure costs; in the other region they reached between 30 and 60 %. As mentioned before, these communities contributions are different in every project, and with analysing the three main infrastructure sectors separately the results become a bit clearer. In the sector of 'Basic Infrastructure' the local contributions are between 3 and 31 % in the 'Production' sector we found community contributions between 25 and 70 % while in the 'Social Sector' the local contributions are between 10 and 54 %.⁵

Figure 1: Community contributions per sector in % of total inversion.



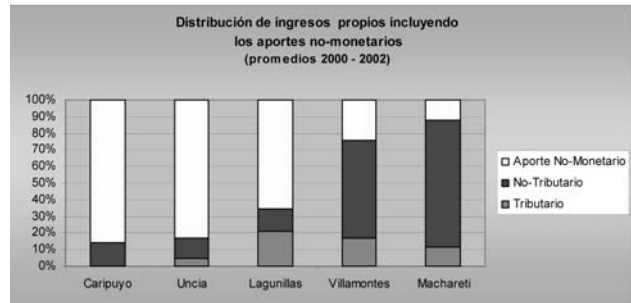
Of bigger interest is the impact that these contributions have on the municipal financial accounts. Extrapolating these figures for the fiscal years 2000-2002 and including them as additional fiscal revenues would increase the municipal revenues between 2 and 13 %, and increment the own revenues (tax and non-tax revenues of the municipality) between 14 and 32 % in one region and between 190 and 600 % in the other region.

⁴ A previous nation wide study delivered local market prices as well as for unskilled and skilled work force, as for all local available materials. The value contributed to the counterparts supposed that the community could have sold their services and materials on the local market and/or that the sub national government would have paid market prices for the services and goods delivered. With other words we valued the community counterparts with (assumed) locally based opportunity costs.

⁵ Basic infrastructure includes: Roads, infrastructure for energy and communication projects; Social infrastructure includes: Sanitary installations, infrastructure in health, education, sports and urbanism; Production includes: Infrastructure for agriculture.

The following chart illustrates the distribution of municipal revenues, including the local non-monetary contributions (aportes no-monetarios).

Figure 2: Revenue distribution in 5 municipalities including community counterparts.



The importance of the non-monetary contributions of the communities for a municipality depends not only on their current revenue structure but also on the modality of execution, type of project and/or sector of implementation and the particular interests of the local population.

The legal and social situation

Under the current fiscal regulations a large part of the rural population is exempted from paying municipal taxes, but is obliged to contribute work force for the execution of municipal infrastructure projects⁶. Thus we encounter some contradictory realities. First, the local population has to contribute with their work force but is not granted any legally regulated compensation. Secondly, even though the majority of the rural population is exempted from fiscal contributions, they are 'paying' taxes with their non-monetary contributions. Thirdly, the traditional social contracts of the indigenous population values the contribution as an important part of community work – 'motiro' in favour of the community; but they reject any intentions of changing their contributions into a 'tax payment', as they are not willing to pay taxes to the municipal authorities. And finally, even though the indigenous population firmly rejects the idea that their contributions could

⁶ The 'Ley de Participación Popular' and 'Ley INRA' does exempt small producers from paying taxes; at the same time it obligates OTBs – Organizaciones Territoriales de Base – in participating and cooperating in the execution and administration of public services.

become something like an ‘obligatory tax’ – which in fact would only improve their situation in comparison to the actual situation – they claim an official recognition of their contributions.

Looking back at the initial hypothesis we can confirm that (i) the contributions of the communities in public infrastructure projects are important, and that (ii) these contributions can be valued. This would (iii) recognise community efforts, (iv) reflect the real situation of municipal incomes and (v) quantify the real costs of municipal infrastructure projects. Nevertheless with the current legal framework, it would not be possible to integrate the contributions into the municipal financial accounts as tax revenue, but it could be registered and therefore be integrated as non-tax revenue!

For now a legal and methodological proposition at municipal level has been created, and is implemented in two pilot projects, where the municipal representatives and the communities agree on each contribution. The community contributions are valued and integrated in the municipal financial accountability as non-tax revenues.

Insights and lessons learned

Apart from the fiscal recognition of the community contributions this study revealed some (more or less) motivating insights:

- In many regions the municipal authorities are not yet recognised as representative for local indigenous communities.
- The indigenous communities claim official recognition of their contributions, but reject any imposed tax obligation (the reasons are broad and are discussed in uncountable ethnological articles).
- The contractual cooperation between municipal authorities and community leaders – as proposed and implemented actually – has a great positive impact on local good governance. Integrating the civil society in the planning, implementing and evaluating process promotes higher transparency, fosters confidence, ownership and accountability of the municipal actors towards the local population.



‘Urban’ electrification

- There is a considerable positive impact on various cornerstones of rural development that might be triggered by a relatively simple measure in fiscal decentralisation – not only in Bolivia, but also in many countries in Latin America, Africa, Asia and Eastern Europe.

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Pictures by D. Roduner