

Research Brief

Public Finance and Revenue Mobilization in Union Parishads

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Abstract

Despite the long history of local government in Bangladesh, these institutions, particularly Union Parishads (UPs), are heavily dependent on central government grant allocations rather than local revenue. This makes the UPs rely greatly on central government to perform all developmental and operational activities. UPs have little incentive to mobilize their own resources. UPs do not seem to be financially solvent due to lack of capacity and low quality of local human resources, weak tax assessment capacity, concern of elected representatives about losing local political representation, pervasive tax evasion culture, perceived gap between tax payment and service delivery and narrow revenue base. Very few studies have been undertaken to assess the real context and constraints to local resource mobilization at the UP level. This study aims to analyse system and processes to increase revenue from local sources by assessing their capacity as well as challenges.

In Bangladesh, a central aspect of the local government's weakness, in terms of ability to deliver against its mandated functions, is the lack of capacity to earn and manage local revenues. Currently, an insignificant amount of the total expenditure budget is funded through local taxation, while the great bulk of the resources expended are funded by transfers or grants from the central government. The tax base of the Local Government Institutions (LGIs) remains very narrow as most of the taxes go directly to the central government. Goods and services are produced locally but taxed centrally. Moreover, the transfer of block grants from the central government to UPs is a process marked by delays, irregularities, mistrust and other forms of resistance. All of these limit the capacity and hinder scope of decentralized revenue mobilization at the UP level.

Previous studies (Khan, 2009) showed that at the UP level, there exists a general reluctance among citizens to pay taxes as related

authorities are not only hesitant to collect taxes but also cannot ensure transparency and accountability in fund utilization and service delivery. Other studies found corruption (through mutual understanding between tax assessor and tax payer) in tax assessment, collection, documentation, and use.

This study focuses on UPs' revenue mobilization process, including sources of revenue and its utilization for service delivery and development activities. It also explores the potential of raising revenue from local sources by assessing taxable resources and problems in the tax assessment and collection process as well as citizens' knowledge and perception about the whole process of revenue collection and utilization. The principal objective of the research is to examine the current status and associated challenges regarding UPs' fiscal transfers, including resource ('revenue') collection, mobilization and expenditure.

While there is abundant literature exploring UPs' capacity in terms of service delivery, there is limited research that draws the connection between capacity and revenue generation, untapped resources of UPs and their links to development planning and budgeting. Due to the very limited research on the latter issues, this study intends to draw out policy implications and their relevance for policy makers. This study strived to explore the sources of UP revenues, bottlenecks in raising own revenue and how those could be overcome, awareness of citizen on UP activities, capacity building measures of UPs to collect taxes and raise their own revenue, and the impact of revenue on local development planning and budgeting.

The study applies mixed methods by using both quantitative and qualitative data. Data

comprises 282 face-to-face interviews, 4 group interviews with standing committee members, 46 key informant interviews with elected female and male representatives, UP Chairman and UP Secretary, local elite, local NGOs, staff of Sharique, and central government officials.

The field work was done from September to November 2015 in 4 UPs of Rajshahi and Khulna districts. Among these four UPs, two are highly successful in revenue collection (own revenue >4 lakh Taka) and termed as 'Strong' UPs, (Matikata and Harian in Rajshahi). The other two UPs which are not so successful in revenue collection (own revenue <2 lakh Taka) are termed as 'Weak' UPs (Barakpur and Damodar in Khulna).



KEY MESSAGE 1: LGs' capacity needs to be strengthened

In most cases UPs do not feel any pressure to collect taxes (Sharique, 2007). The study findings show that there are some problems in the tax assessment procedure which hampers overall revenue collection from UPs. Proper assessment of tax needs skilled manpower that is absent at the UP level. For example, in some UPs, researchers found that tax assessment forms were not filled up at all. Findings from interviews with UP elected bodies and other officials confirm that UPs cannot conduct tax assessment and collection properly as they have a shortage of skilled manpower. In addition, UPs do not have adequate resources to conduct activities to encourage people to pay taxes.

Analysis also shows that UPs are getting funds from a number of sources and thus are having difficulty in managing it properly. Sometimes various organizations are giving funds for the same project, and UPs cannot avoid overlapping as they lack a proper

recording and budgeting system as well as manpower. There are also differences in the framework and classification of items in the budget. To avoid these problems, standardization and automation of the budget process for all UPs should be given priority.

Hence, UPs have to be empowered by manpower and technical knowledge so that all taxable resources can be counted properly. In this respect, local governance strengthening programs can take initiatives to create awareness on raising local revenue. For instance, Sharique took various initiatives to improve the local revenue system in its intervention areas including tax assessment training, tax assessment sharing meeting, providing citizens with training on tax, encouraging UP Chairs to make the process of utilization of taxes very visible, and come up with creative ideas and campaigning for non-household taxation.



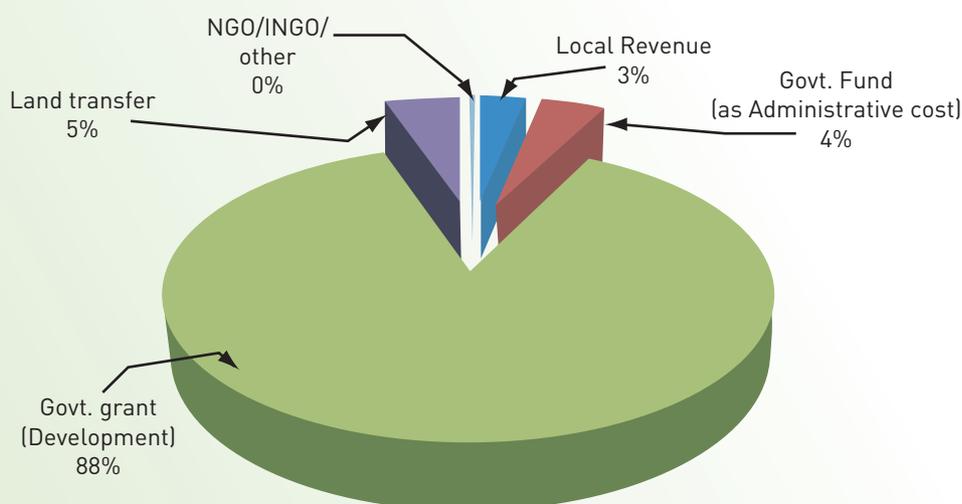
KEY MESSAGE 2:

Revenue varies highly across UPs and potential of raising revenue should be assessed accordingly

Data shows that the major source (88 percent) of financial flow of weak UPs (Damodar and Barakpur of Khulna, where Sharique started their program recently) is the central government transfer of grant for

development activities. Land transfer yielded only 5 percent revenue, followed by Government fund as administrative cost (4 percent), and earnings from local sources amounted to 3 percent only (Figure 1).

Figure 1: Revenue flow in Weak UPs (Damodar and Barakpur in Khulna)



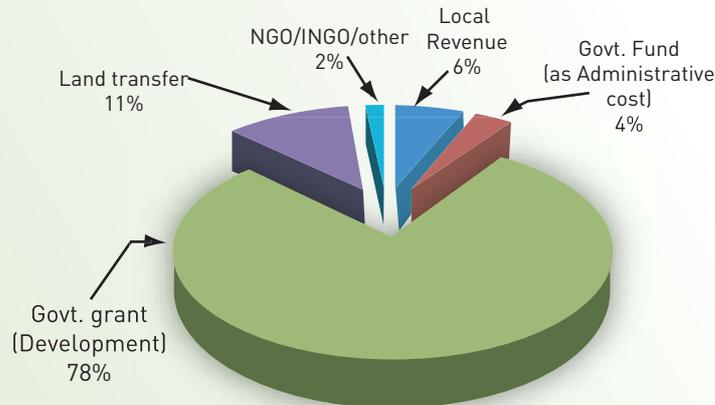
Source: BIGD Survey on Public Finance and Revenue Mobilisation (2015),
Local Governance Programme Sharique

Note: Data were collected from local UP office, Damodar (FY 2013-2014) and Barakpur (FY 2014-2015)

On the other hand, the strong UPs (Matikata and Harian of Rajshahi where Sharique program has been implemented since 2006) shows quite a different picture. These two UPs obtained higher amounts (6 per cent) of revenue from local sources and land transfer (11 percent) (Figure 2) compared to Damodar and Barakpur UPs of Khulna (Figure 1). There is also a difference in the amounts committed by donors and NGOs to these UPs. In this case, the strong

UPs have earned funding amounting to 2 percent of revenue inflow from donors but the weak UPs have failed to attract such funds (Figure 2). This indicates that a healthy local revenue base also earns UPs the eligibility to apply for projects of various donors and NGOs because then they can demonstrate the competence in public service delivery and credibility that donors want to see. This however, is not the case with weak UPs.

Figure 2: Revenue flow in Strong UPs (Matikata and Harian in Rajshahi)



Source: BIGD Survey on Public Finance and Revenue Mobilisation (2015),
Local Governance Programme Sharique

Note: Data were collected from local UP office, Matikata (FY 2013-2014) and Harian (FY 2013-2014)

Based on the above findings it can be said that allocation from the central government is still the main source of funding in UPs. While in the short term, the amount of local revenue collected may appear insignificant, the potential of local revenue sources, nevertheless, remains to be explored. This potential can be harnessed by

strengthening related legislation, opening up business investment opportunities in the local government and raising awareness amongst the public on the importance of paying taxes. For UPs to become strong and empowered there is no alternative to increasing their own earnings and collection of taxes.



KEY MESSAGE 3: Development based on own resources should be encouraged at the local levels

Planning and implementation of different development projects for citizens is the most important functions of UPs. More than 90 percent¹ of funding for these activities comes from the central government grant and fund, NGO/INGO/donor agencies, and land transfer. In this regard, allocation from the central government is still the main source of funding in UPs, and the percentage of local revenue is very insignificant. Central government allocates grants to the UZP, which in turn allocates the designated revenues through block allocation, special grants and land tax transfer.

The limited number of taxable resources is one of the main causes of lower revenue earnings of UPs. Additionally, citizens' lack of knowledge about the taxable resources and complexity of the tax payment system is another reason behind the low rate of revenue collection from the local level. As the UP is one of the oldest tiers of the local government and works as a service provider, citizens are supposed to be aware of the services, activities and functions of UP. However, analysis shows that people are not properly aware about the functions of UPs. The survey result shows that about 88 percent of the total respondents said they were aware about the functions of

1. Damodar and Barakpur UPs, revenue share (central government; government fund, NGO/INGO/donor agencies, and land transfer) is 97 percent. On the other hand, it is 92 percent in Matikata and Harian UPs

UPs. However, when they were further asked about the types of UP functions they were aware of, the highest 77 percent responded that implementing social safety net programs was the key function of UPs. In reality, a UP does not implement any safety net programs and only provides some support to the safety net beneficiary selection process. Collecting local revenue is one of the most important functions of UPs, but only 38.2 percent of respondents regarded tax collection as a function of UPs.

Analysis shows that there is apparently a clear link between citizens' awareness of the importance of tax payments and the subsequent tax collection by UPs. Therefore, there is an urgent need to involve citizens at all levels of local

development planning and budgeting, for example, through the Standing Committees, Ward Shabha and Open Budget Meetings. If local development is inclusive and participatory, there are more chances of revenue earnings from tax collection. Unfortunately, however, that is not the present scenario.

Lack of citizens' awareness of tax payments and UPs' functions, limited taxable resources for UPs and their subsequent dependency on central government funds are all bottlenecks to local revenue collection. These limitations indicate that local development planning and financing are still dominated by the central government. This significantly reduces UPs' autonomy as a decentralized entity.



KEY MESSAGE 4:

Untapped resources at the local level should be recognized and collected properly

Presently, revenue collection at UPs is hindered by legal and operational barriers. For example, in many aspects, the UP Model Tax Schedule seems to be very flexible rather than obligatory or legally binding. Additionally, according to the Schedule, the tax rate of holding and land taxes ranges between 0-7 percent. It is very low compared to that in Municipality, where it ranges between 0 and 27 percent (Rahman and Yunus, 2015). Therefore, the tax rate of holding taxes needs to be revised by adjusting it with the current market demands. Similarly, if there are natural resources like ponds and lakes, they can be used for fish cultivation and taxed accordingly.

In order to increase tax collections, taxable resources need to be expanded as well. In order to do so, UPs need to attract people to invest in different kinds of businesses, for example, construction of community centres, shops or factories. Similarly, emphasis should be given to non-holding taxes as well.

In addition, it is observed that among the 38 functions of UPs mentioned in the Local Government (Union Parishad) Act 2009, only one function is related to local revenue assessment and recovering of tax, toll, fee and levy. Improving these legislative provisions would open up greater opportunities, potentially expand the revenue base for UPs, and give them the required authority to impose taxes.

Furthermore, UPs are lagging behind in ensuring citizens' engagement in the development planning and implementing process. Awareness and participation of citizens in the UP committee, Open Budget Meeting and Ward Shabha was also found to be very low. If the people are involved in the entire development planning and budgeting process of UP, it would allow them to look at how their tax payments are being expended. This experience, in turn, would motivate them to pay taxes.

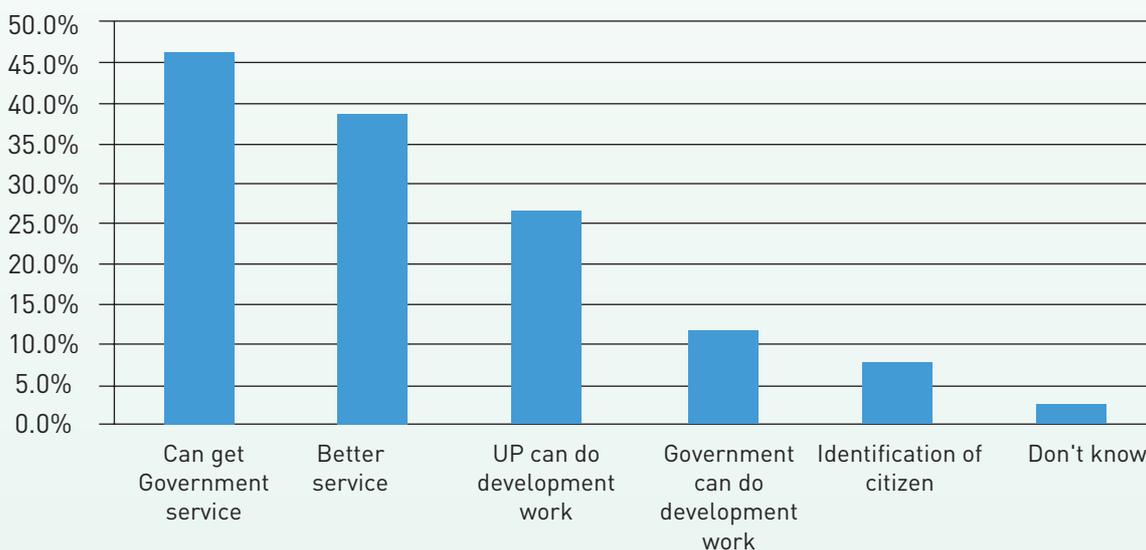


KEY MESSAGE 5: Innovative policy measures and increasing capacity of LGs are essential to manage local level resources

In a majority of the cases in the study, UPs were found to be reluctant to collect taxes because the elected representatives feared losing popularity and votes. As mentioned before, people's lack of knowledge of tax-applicable sources and the tax payment system are barriers to local revenue collection by UPs. Study findings revealed that although UPs are mainly responsible for various development activities, a majority of the people are not aware about their functions. Analysis shows citizens' knowledge about the functions of UPs is strongly related to their level of education. Data shows that the higher the education level, the higher the rate of knowledge about the functions of UPs among the respondents.

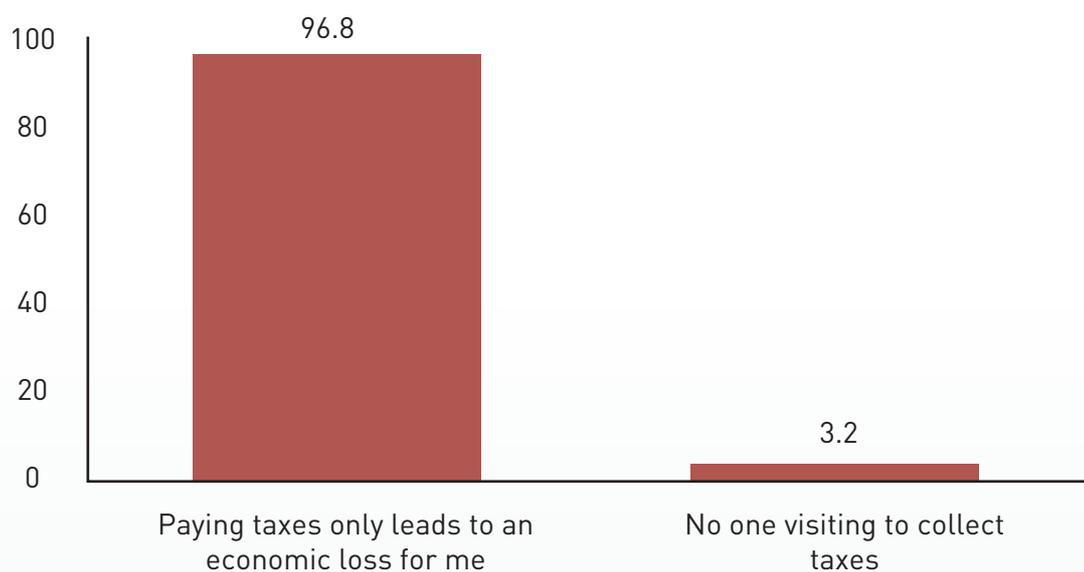
In order to propose recommendations to reverse the scenario, the study analyzed the types of benefits people expect in exchange for paying tax. For instance, tax-paying respondents were asked what type of service they expected in return. In response, 46 percent informed that they expected government service, 39 percent said 'better service', and around 26 percent said that they expected UPs to do 'development work' with the tax revenue (Figure 3). On the other hand, analysis of citizens' unwillingness to pay taxes shows that around 97 percent identified paying taxes as an 'economic loss', as they did not get anything in return (Figure 4).

Figure 3: Types of Benefits People Expect for Paying Taxes to UP



Source: BIGD Survey on Public Finance and Revenue Mobilisation (2015),
Local Governance Programme Sharique
Multiple Responses

Figure 4: Causes of Unwillingness in Paying Taxes (Percentage of responses)



Source: BIGD Survey on Public Finance and Revenue Mobilisation (2015),
Local Governance Programme Sharique
Multiple responses

The study identifies that motivation and amount of tax collection have some positive correlation. Therefore, in this regard there is clearly a need to develop tax collection policy measures addressing people's motivation factor. Such policies should consist of incentives or first-hand benefits for citizens in line with their expectations.

Also, awareness measures should be taken to inform people about their obligations and benefits for paying tax. Tax fairs and other awareness programs should be organized to educate people on the tax system and motivate them to participate.

Tax-paying individuals and organizations could be given incentives, such as a tax payer identity card which they could use for school enrolment, gaining access to healthcare, migration or other services. Likewise, awards for better performing UPs in tax collection as well as disciplinary action for non obligation of tax laws need to be ensured. The tax assessment and payment system needs to be made easier so that people feel comfortable. Government and non-government authorities should take awareness raising measures to bring a behavioural change in people and respective authorities.



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