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Local resource mobilisation

Key principles and options for reform

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Local Resource Mobilization
Key Principles and Options for Reform

Decentralization, fiscal, administrative and political, is one of the pillars of Myanmar's transition. The 2008 Constitution established 14 subnational governments in an effort to make public expenditure more responsive, foster revenue collection and encourage national reconciliation. Below the State and Region level, municipal authorities – often referred to as Development Affairs Organizations (DAOs) – play a very important role. They are responsible for a broad range of public services which are fully self-funded through independent revenue mobilisation. Other levels of governance exist, for example the village tracts, but the institutions at these levels have a mostly consultative role, conveying the preferences of communities to higher levels of governance.

State and Regions' governments have been in operation since 2010 and their constitutional mandate includes both expenditure responsibilities and revenue raising powers. Self-raised revenues, however, represent only a minor entry in the budget of State and Regions, making them over-reliant on transfers from the Union. Subnational taxation appears to be particularly below potential, hovering at a yearly level below USD 1 per capita (Dickenson-Jones et al., 2015).

The incoming Government of Myanmar has acknowledged the important role that State and Regions can play and emphasised the need to boost subnational revenue collection. From this perspective, the international experience shows that delegating the power to raise revenues might not be sufficient if States and Regions do not face a coherent set of incentives that pushes them to collect, enforce and increase tax liabilities. Such incentives are often the product of effective reforms within the political and administrative sphere.

This note draws on previous analysis by the IGC and the Asia Foundation on State and Regions public finances and administration in Myanmar,[1] as well as research on the role and structure of DAOs.[2] The note builds upon the presentations and discussion that took place during a training session with a number of departments in the Ministry of Planning and Finance in June 2016. The recommendations are also informed by the authors own research[3], projects carried out by the IGC in other partner countries and reviews of international experience.[4] Finally, the author and the IGC team carried out field visits in Shan State and Yangon Region. The note first summarizes key principles and recommendations regarding fiscal decentralization in Myanmar. It then develops a few ideas for initiatives which respond to the themes that emerged during the discussion with government officials and which the IGC could help with by providing technical support. The note

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[1] Dickenson-Jones G, Kanay De S, Smurra A, 2015, "State and Region Public Finances in Myanmar";
Nixon N, Joelene C, Kyi Pyar Chit Saw, Thet Augn Lynn, Arnold M, 2013, "State and Region Governments in Myanmar".
[2] Arnold M, Ye Thu Aung, Kempel S, Kyi Pyar Chit Saw, 2015, "Municipal Governance in Myanmar".
[3] For example: Gadenne L, (2016) "Tax Me, But Spend Wisely? Sources of Public Finance and Government Accountability".
[4] Gadenne L, Singhal M, 2014, "Decentralization in Developing Economies", Annual Review of Economics.

focuses on subnational revenue collection (both self-raised revenues and transfers), but this represents only one element of a successful decentralisation strategy. The design of policies in this field will have to take into account the assignment, regulation and possible reform of expenditure responsibilities to States and Regions. The IGC is committed to helping the Government of Myanmar on both sets of reforms, working closely with the Asia Foundation and the World Bank.

1. Key principles of fiscal decentralization

1.1 Clear allocation of responsibilities

Myanmar is in the process of re-defining the responsibilities – both in terms of provision of public good and services, and in raising revenues – of different levels of government: Union, States and Regions, and township level administrations. A key overriding principle for successful fiscal decentralization is the clear allocation of responsibilities: this implies defining in a precise and transparent way the role of each level of government in, for example, providing education, and explaining this new allocation of roles to citizens and civil society. Knowing which level of government should be held accountable will improve public participation in the decision-making process and foster government's effectiveness. There are currently overlapping responsibilities at the local (township) level across several decentralized government departments as well as the DAOs, making it difficult for citizens to understand which department is in charge of what. This issue, discussed in details by previous work published by the IGC and the Asia Foundation,[5] suggests that local authorities may not be willing to take a clear leadership in providing local public goods and services.

1.2 Clear allocation of incentives in line with responsibility

To put it simply, the level of government responsible for one particular public policy aim should also have incentives to allocate resources in the most efficient way to achieve this objective. When local bureaucrats are in charge of the allocation of resources at the local level their incentives are often to comply with directions coming from the Union, which are not necessarily in line with the needs of each specific local community. As acknowledged by officials from the Budget Department of the Ministry of Planning and Finance, Myanmar is a large country and each State and Region has different development priorities. If we think that the local population is well informed about their need for public goods and services, the most straightforward way to align incentives is to decentralize decision-making power to elected officials, who are accountable to the local population and have to respond to their demands.

This principle of alignment of incentives to responsibilities should also apply when thinking about the rules governing the allocation of revenue-raising responsibilities to different levels of government. The current system in Myanmar prevents local governments from keeping any surplus revenues at the end of the fiscal year. This mechanism gives subnational agencies the responsibility to collect taxes, but it does not provide them with the incentives to raise extra revenues beyond their set quota, for example by modifying tax rates or by increasing collection efforts. Allowing local governments to keep the extra tax revenues they raise is a good way forward if the Union of

[5] Nixon et al., 2013; Dickenson-Jones et al., 2015.

Myanmar wishes to see more local tax collection. This could positively affect revenue collection at all levels, from the State and Region all the way down to the municipal authorities.

1.3 Systematic collection of data on what different levels of government do, made publicly available

One of the oft-stated advantages of decentralization is that it allows for experimentation and comparison: different state/regions can attempt different policies to achieve a given policy objective; comparing across these state/regions can help both the Union and citizens decide which policy works best and whether it should be adopted by other states. For this advantage to materialize in practice the country needs to systematically collect information on spending, revenues and policy choices at all layers of government; only with such information can citizens hold their elected politicians accountable and attempt to learn from the different policies undertaken at the local or state/region level. International evidence suggests the development of an efficient statistical institute often goes hand in hand with decentralization reforms.

2. Key principles of revenue decentralization

The above principles apply to all decisions regarding fiscal decentralization. During the training session in June, the discussion focused on issues relating to the allocation of revenue-raising powers (whether from taxation or the exploitation of natural resources) to different levels of government. The following key principles emerged from the session.

2.1 Subnational governments need their own sources of revenues

Decentralizing only *expenditure* responsibilities whilst financing the expenditure from tax revenues collected at the Union level is unlikely to reap all the benefits of decentralization. International evidence suggests that subnational governments are more efficient and accountable when they spend revenues that they levy themselves through subnational taxes, than when they spend revenues they receive from the Union level. This may be because citizens are more likely to watch carefully how subnational revenues are spent if they have to pay subnational taxes. Research carried out on Brazilian municipalities shows that when governments collect more revenues from taxes, they spend more on improving and expanding local education infrastructure, while no such effect is present when municipalities receive higher transfers from the central government (Gadenne, 2016).

Myanmar is currently discussing which revenues to allocate to subnational government. The 2015 constitutional amendments that provide State and Regions with a share of income tax, commercial tax and stamp duties is a promising reform. This policy, in fact, achieves the dual goal of increasing the volume of resources available to State and Regions while also providing tax-payers with an additional incentive to pay taxes. If part of the citizens' contribution is bound to remain within their own constituencies, they will be more willing to pay. However, from the perspective of State and Region's governments, these funds represent fiscal transfers form the Union and not self-raised taxes. If the Myanmar decentralisation process is to keep its momentum and be successful, State and Regions will need their own, self-raised sources of revenues as well as a coherent set of incentives to encourage collection.

International practice suggests that property taxes (in Myanmar both the land tax and the building tax are forms of property taxes) are good candidates for decentralization to local governments, commodity taxes are often decentralized to the state/region level, with the Union government keeping the income tax, trade taxes and some excise taxes. One of the key principles to follow when thinking about revenue decentralisation is the *mobility of the tax base*. If the asset being taxed is immovable, for example a building, then subnational governments are well-placed to levy taxes on said asset due to their proximity (it is will be easy for to assess and monitor the value of the asset) and the fact that the asset cannot be relocated to avoid taxation.

From this perspective, Myanmar has closely followed well-established principles of good governance.[6] Going forward, the implementation of a modern property tax will be a natural step to increase revenues and increase the equity of the overall revenue system. This process, however, will pose numerous challenges. If State and Reons are to succeed in this task, the Union will have to provide support, technical capacity and financial resources. The IGC is committed to supporting GoM in this effort and helping design a system that reflects international best practices as well as Myanmar's context.

2.2 Transfers must be allocated in a transparent way that preserves incentives

Decentralizing taxation powers to subnational governments is a necessary feature of successful decentralization but no country in the world has been able to avoid the need for inter-governmental fiscal transfers – transfers of revenues from the Union level to subnational governments. This is because the Union often wishes to redistribute revenues across States and Regions to ensure that the poorest areas, which cannot levy as much taxes as the richer ones, are not left behind (redistribution motive). In addition, the Union government is usually more efficient at raising taxes, suggesting that some of the tax-revenues should be collected by a Union level agency and then shared with subnational government through fiscal transfers (efficiency motive). The best practice is to define a transfer allocation rule that determines how much each subnational government receives through transparent and objective criteria (such as a state/region's GDP). Importantly, the formula must be 'set in stone' – detached from the political process – to make transfers predictable and allow subnational governments to plan their budget a couple of years ahead (see below). One way to ensure the formula is detached from the political process is to enshrine it in the constitution.

Currently Myanmar allocates transfers to States and Regions based on a battery of indices, which balance different policy objectives and strive to enforce a system that is both fair and equitable. One of the indices used is each State and Region's tax revenues. The motivation for this inclusion is to ensure that states with the least tax revenues receive enough transfer revenues to finance their expenditures. Unfortunately, this creates perverse incentives at the subnational level. If a State or Region knows that for each extra Kyat of taxes it raises it will get less in transfers from the Union, it has little incentives to raise more tax revenues. Revenue collection, in fact, incurs both financial and political costs, while transfers from the Union (or automatic deficit financing) are a cheaper and easier alternative. In a context such as Myanmar's in which encouraging subnational governments to collect more taxes is a priority, giving more transfers to governments that levy less revenues seems counter-productive. In addition, it should be noted that by including GDP in the formula, the budget department takes into account not only the level of welfare of a State and Region, but also its *potential* revenue-raising power, making the inclusion of tax-revenues raised redundant.

International experience suggests that allocating transfers on the basis of GDP (so that poorer regions receive more) and population (so that more populated regions receive more) is the best way to meet States and Regions different needs without depressing their incentive to self-raise revenues. From this perspective, the best practice is to follow the traditional principle of 'more is less': having

[6] World Bank, 2015, "Public Expenditure Review"

too many criteria entering the formula will complicate the system and not necessarily lead to better outcomes. The more criteria there are, the harder and more costly it is for the Central Statistical Office to measure these variables in a timely fashion. A complicated formula will also make it more difficult for the general public to understand the rule and hence know how many resources their subnational governments can spend.

Finally, one form of transfer often used internationally, on top of transfers allocated on the basis of a formula, is 'matching transfers'. These transfers are useful if the Union government wishes to push States and Regions towards implementing specific policies or achieve certain development objectives: matching transfers are revenues that subnational governments receive if they commit to spending some of their own revenues (from taxes for example) on predetermined policies or projects. Since the amount of support received from the Union is proportional to the amount committed by the subnational government, this mechanism actually encourages not only virtuous spending, but also increased revenue collection.

While the primary objective of these transfers is to incentivise local governments to raise revenues and channel them towards specific growth objectives, they can also play an equalising role. For example, matching transfers could be designed with different rates for different States and Regions, providing more resources to the poorer ones.

A good example of successful implementation of this policy is provided by Indonesia. A matching capital grant was provided to communities that invested in education infrastructure in order to ensure that schools where within walking distance from each constituency. This program is thought to have delivered significant improvements in literacy and enabled a minimum standard of access to education.[7] Similar policies are implemented not only by developing countries throughout the world, but also by OECD countries.

2.3 Subnational governments need to be in charge of their budgets

Subnational governments need to be able to plan their expenditures ahead, and must be responsible for the budgetary consequences of their decisions. This enables them to allocate resources efficiently to the policy priorities of their constituencies and promotes good fiscal management. As mentioned above, this implies that if the subnational governments make efforts to increase their tax revenues, they must be able to keep those funds. A DAO, for example, is a lot more likely to re-organize its building tax department and raise more revenues if it can plan to spend the extra revenues next year to meet citizens' demands. If the extra revenue is appropriated by the State or Region government, or by the Union, township-level policymakers and bureaucrats have no incentive to implement new policies to increase revenue yields. If actions are not taken to amend this mechanism, the status quo will prevail and the agencies tasked with collecting revenues will stick to their currently very low revenue quotas.

Similarly, one of the pitfalls of decentralization is 'soft budget constraints', which is the use of the Union government as a last resort funder of subnational policies. If subnational governments believe that any budget deficit will be financed by the Union, they will likely overspend without thinking of the fiscal consequences of their decisions. These perverse incentives are thought to have precipitated the public debt crisis of Latin American countries and are a concern in all decentralized

[7] Shah A, 2006, "A Practitioner's Guide to Intergovernmental Fiscal Transfers", The World Bank

countries. The Union should make it very clear that subnational governments are in charge of their budget, and commit not to help with additional funds at the end of the budget year except in extraordinary circumstances, such as natural disasters. The implementation of this approach will have to be gradual and supported by adequate training of subnational policymakers, coupled with enhanced transparency and accountability.

2.4 Subnational governments need support to increase their capacity to tax

Finally, it should be noted that subnational governments in recently decentralized countries like Myanmar are often not initially capable of raising taxes efficiently. Raising taxes requires the existence of a logistical, administrative and judicial framework that enables governments to both observe economic transactions or assets and collect some of the value of these transactions and assets to finance public goods and services. To take a concrete example, local governments cannot levy property taxes unless they know the value of all properties in their constituency. Even with that knowledge, they cannot raise taxes without threatening credible legal consequences for those who refuse to pay. Finally, if tax inspectors do not have tools to track payments over time, or concrete incentives to exert effort in their work, the amount of revenues collected is bound to be below its potential level. Decentralization reforms throughout the world are often accompanied by programs that help subnational governments build modern tax administration, for example through transfers of technical skills from Union-level tax authorities.

In Myanmar, the cost of enforcing tax liabilities through the involvement of the police or courts of justice is very high compared to the value of the tax to be collected. For this reasons, it is worth thinking about alternative enforcement mechanisms that are both effective and low cost (see below). In addition, tax collectors are not rewarded for increased efforts, and any additional revenue does not remain within their department or their constituency. For this reason, there is no incentive for them to collect any amount beyond their quota.

3 Suggestions for policy initiatives the IGC could help with

Several questions arose during the conversation with members of the Budget Department and the Internal Revenue Department regarding international best practices in improving tax collection. In this context there are several initiatives the IGC could help the government design, test and, if successful, implement. These could be implemented at the State/Region or Township level in partnership with decentralized governments, but could also be tested at the Union level to determine what works in Myanmar. The Union could then offer subnational governments help with implementing those policies that are most effective. These initiatives could be designed to help with any aspects of tax collection: they could of course help governments raise more taxes from the citizens but also, and equally importantly, make sure that taxes are paid on time (a crucial element as late payments are in effect revenues losses for the government) or limit the number of times the tax authorities have to remind citizens to pay taxes, lowering the costs of tax collection.

3.1 Incentives for taxpayers: leveraging community level mechanisms

One particularity of the Myanmar context is the extent to which citizens contribute revenues to local projects outside of the formal tax system. There is substantial evidence, some of which collected by IGC staff on the field, that local communities are able to raise revenues from their members to invest in public goods or services without the mediation of official tax authorities. Unlike governments, these communities cannot rely on the law to force citizens to pay taxes (or even make them understand that they are actually paying taxes) but they use two other powerful mechanisms which governments, especially at the local level, could try to leverage in their own process of tax collection.

First, they use what economists call 'social incentives': citizens see it as their duty to their community to contribute, and everyone in the community knows what everyone else has contributed. With this system, households that decide not to contribute, or contribute less than what their wealth would allow, could feel shame or lose their social status – increasing the 'social cost' of not contributing. The Union level does something similar in Myanmar, by publishing the name of the biggest taxpayers every year. Subnational governments could also increase the visibility of tax payments or provide citizens with a symbolic 'reward' for paying their taxes on time - something they could show others as proof of their contribution to local public goods.

Similar mechanisms have been established in other countries. For examples, in some Indian states, tax evaders are publicly shamed by sending marching bands to their shops. In Myanmar, however, an approach that rewards taxpayers, rather than shaming evaders, might be more effective. A fruitful and inexpensive avenue could be, at least in urban areas, using Facebook: tax authorities could for example post a 'thank you for paying taxes' message on citizens' Facebook page (or a special Facebook groups created for each community – like a virtual billboard), or give citizens the option to send messages to their friends reminding them to pay taxes on time. Such innovative use of Facebook has been very efficient in nudging citizens towards taking pro-social behaviour (such as paying taxes or voting) in other countries.

Second, communities seem to rely on the 'reciprocity' element of the contributions they collect: they point out the use of the contributions for a specific project, making the link between a contribution and a particular type of spending very clear. Governments everywhere struggle to make citizens understand that the taxes they pay are used to finance very specific public policies that improve citizens' everyday lives; Myanmar is no exception. For examples, communities that receive tarmac from the municipal office as a contribution to a community road project seldom know the exact value of this contribution and struggle to establish a link between the tarmac received and taxes paid each year. One way to increase citizens' willingness to pay taxes could be to make the link with expenditures very clear at the time of tax collection. Here again Facebook (or, if unavailable, text messages) could be a useful and cheap tool. For example, authorities could send messages (potentially with info-graphics and pictures) explaining what local governments do with the revenues collected the day before tax inspectors come to collect taxes in a particular area, or tax notices are sent. One could also think of combining reciprocity and social incentives by putting billboards with the name of taxpayers next to public works financed by the local governments.

It should be noted that this type of initiatives are very cheap for the government – using Facebook or text messages to communicate with citizens is something government ministries everywhere are starting to do and costs close to nothing. The IGC is currently implementing a similar program in Bangladesh, where firms are provided with different types of social incentives: some are given a *compliance card*s or publicly recognised by their peers. What works best in each context will depend on a country's specific socio-economic and cultural landscape. A wide number of interventions and technologies could be piloted. The IGC is ready to support GoM in identifying, designing and monitoring the impact of any such policies.

3.2 Incentives for tax collectors: alternative payment mechanisms

Officials at the IRD, Medium Taxpayers Office, mentioned that their department was looking into different options to motivate tax collectors to exert more effort in collecting taxes. This is an area in which the IGC has hands-on expertise, as it has already worked with other Asian countries to understand how to get tax collectors to perform better. One striking result from a previous IGC project is that financial incentives work: when tax inspectors' pay is linked to the amount of taxes they collect, they collect more taxes. Importantly, however, this project was run in a context in which tax inspectors often take bribes and there is some evidence that in some cases tax inspectors also collected more bribes when given financial incentives. This is a cause for concern as bribe-taking undermines citizens' trust in the tax authorities and may erode their willingness to pay taxes in the long run. If the authorities in Myanmar are worried about the possibility that tax inspectors are taking bribes the IGC can help think about reforms to the way tax inspectors are paid combined with a system of audit that would lead to better revenue collection and less bribe taking.

Other forms of incentives might also be effective. A follow up experiment to the above-mentioned project, for example, is now testing whether the opportunity to be transferred to an office closer to the tax collector's hometown/family can be an effective incentive. The specific characteristics of each country's culture and public sector will determine which type of incentives is more likely to be effective. For this reason, we look forward to explore this potential area of reform and continue the conversation with the IRD.

3.3 Digitizing DAO tax collection records

The IGC, together with the Asia Foundation, is currently working on the development of data management systems in 4 townships. The project is aimed at digitising DAOs tax collection records and fee payments receipts, as well as providing tax collectors with a mobile app to help them in their daily operations and switch to a more efficient paper-less system. As part of the process, we are also establishing a digital taxpayers registry in order to streamline the calculation of liabilities and better monitor compliance. We expect this project to improve the efficiency of the target agencies, but also generate a wealth of useful data that municipal governments can use to better understand fiscal issue within each constituencies and design evidence based-policies. The system will be piloted over the next 12-18 months and the IGC is keen on ensuring that the lessons learnt from this project are leveraged to foster similar developments in other States and Regions. Moreover, the IGC could also offer support with the development of better monitoring systems for revenues and help the Budget Department improving and analysing the large stream of data they receive form subnational governments.

3.4 Complementary Policies

Taxpayers and tax collectors are not the only individuals that need to be provided with the appropriate set of incentives. As briefly mentioned above, subnational institutions – both at the State and Region, and Municipal level – need to be provided with solid incentives to collect taxes and increase fiscal revenues. Three key elements need particular attention in the Myanmar context.

First, State and Regions need to be entitled to keep any fiscal surplus materialised over the fiscal year. In Myanmar, budgets are often designed using previous years as guidelines, leading to mere compliance with relatively stable targets inherited from the past. In this context, policy-makers do not have the incentive to increase their revenue targets as they might fear they will fall short, and any effort to boost collection does not lead to additional funds being available to the State and Region, or municipality.

Second, the transfer mechanism should not act as a disincentive to self-raised revenue mobilization. As noted earlier, the inclusion of a States and Regions tax revenues in the current transfer allocation formula acts as a disincentive to raising more revenues locally.

Third, the expenditure responsibilities assigned to State and Regions might be too narrow. From this perspective, subnational governments might not have the incentive to mobilise additional revenues because of the perception that there aren't sufficient expenditure or investment opportunities available to them. In this context, elected officials do not have the incentive to levy more taxes from their voters.

From this perspective, as GoM investigates policies to foster subnational revenue mobilisation (both through reforms of the administrative and incentives system as well as through specific tax reforms, including property tax reform), it will be paramount to reform the regulation on management of fiscal surpluses, reform the inter-governmental fiscal transfer formula and develop a framework for the decentralisation of additional expenditure assignments. The IGC remains committed to supporting GoM in all of these processes, working closely with the Asia Foundation and the World Bank.

In conclusion it should be noted that there is no 'one size fits all' approach to increasing tax revenues at any level of government. International experience suggests the above policies could help in the Myanmar context, but careful design of, and experimentation with, policy reforms is necessary to understand which reforms are more cost-effective in this context. The IGC has substantial expertise in *policy experimentation*: the piloting of policies in a randomized way in some regions to 'test' whether the policy works and rigorously evaluate its costs and benefits. This experimentation approach enables the government to try out different policies before deciding which one should be implemented at the national or state/region level.

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