Municipal Finances in Latin America: Features, Issues, and Prospects

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ANDREW YOUNG SCHOOL OF POLICY STUDIES

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Municipal Finances in Latin America: Features, Issues, and Prospects[1]

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Abstract

This paper takes an in-depth look at the current state of the local public finances in the Latin America region, identifies and analyzes some of the main challenges for improving efficiency, equity and effectiveness in the delivery of public services and it closes by offering a set of recommendations for policy reform

[1] This paper was prepared as background material for the *2nd Global Observatory on Decentralization and Local Democracy* (GOLD II) of United Cities and Local Governments. I am thankful to Gustavo Canavire-Bacarreza and Gabriel Leonardo for very able assistance and Harold Vasquez-Ruiz and Mark Curtis for conducting additional background research. I am also grateful to Edgardo Bilsky, Claire Frost, Andrew Nickson, Paul Smoke, Eduardo Stranz, the FLACMA technical team and attendees at the UCLG regional workshop in San Salvador in Ferbruary 2010 for helpful comments on previous drafts.

Local governance and the municipality have a long history and tradition in Latin America going back to colonial times.[2] But it has been only after the 1980s, and for many countries only in the last decade, that genuine decentralization reform efforts have come to invigorate and enhance the role of local governments. However, despite some significant progress to date many challenges still remain for municipalities to play a vibrant and meaningful role in the delivery of public services and to contribute to improve the daily lives of Latin American citizens.[3]

The general trend has been an increasing level of fiscal decentralization in the Latin American region over the last two decades when we measure fiscal decentralization as sub-national expenditures as percent of national expenditures (from on average 13 percent in 1985 to 19 percent in 2005), or as sub-national revenues and expenditures as percent of GDP (from 5.5 percent in 2000 to 6.6 percent in 2007). However, there are significant variations in these trends across countries in the region.[4] Overall, increased decentralization can be detected in the devolution of new responsibilities including the environment and the fight against poverty and in the increase in decentralized expenditures in education, health, etc. Less progress can be detected in the devolution of autonomous revenue sources.

Fiscal decentralization continues to be a dynamic process in Latin America. Recent times have seen a variety of innovations in the region that have attracted interest from all corners of the world, for example raking systems local performance in Brazil and Colombia, per client based transfers for health and education in Chile, or fighting poverty with direct transfers to families administered by municipalities in Brazil. A good number of countries are embarked or considering significant reforms that that will further deepen and strengthen municipal autonomy. For example, Bolivia has recently approved a new Constitution to allow for better representation at the sub-national level of different ethnic groups; Uruguay recently has introduced a third tier of government with 89 new

[2] See United Cities and Local Governments 2008 GOLD I report.
[3] The effectiveness of decentralization efforts has varied considerably across countries of the Latin America region. In the last decade, decentralization has moved at a fast pace in countries such as Colombia and Peru but it continues to be stagnant after several decades of planning and legal measures in countries such as the Dominican Republic and Haiti. Besides Brazil and all the Spanish-speaking countries of Latin America, this paper covers also Haiti, Jamaica, and Trinidad and Tobago. As shorthand, all the countries will be addressed in this paper as Latin America.
[4] See, for example, Daughters and Harper (2007).

municipalities; Costa Rica has approved also very recently the "Ley General de Transferencia de Competencias y Recursos a los Municipios" which provides the possibility to transfer 10 percent of the national budget resources to the municipalities clearing the way for these local government to assume new competencies and improve the quality of services and infrastructure; or in El Salvador the association of municipalities (COMURES) is maintaining an active dialog with the central authorities to increase the funding and general stability of the general transfer system. On the other hand, there are countries in the region where some trends have been in the opposite direction and could go toward some forms of re-centralization. For example, in Argentina the Law of Economic Emergency of 2002 and the Budget Law of 2006 have given central authorities increased discretion to assign federal funds or unilaterally interrupt their disbursement. In the Dominican Republic there have also been elements of recentralization with new Municipal Law of 2007 establishing fixed budget shares for different types of expenditures on personnel, services, public infrastructure, etc ; it is also feared that the new country constitution will lead to the general transfer fund of 10 percent of the state budget. Similarly, in Peru recent legislation has revoked the municipalities' prerogative to issue building licenses and rezoning of land use and the regular transfer funds allocated to municipalities have been significantly reduced for 2009 to 2011. In Colombia, the central government has recently decided to directly allocate resources for water and sanitation that until then had been assigned to municipal governments (through a fiduciary fund administrated by Central Government). Finally, in Venezuela the municipal authorities have been denouncing the continuous curtailment of competencies and resources and the increasing encroachment of the central authorities in local matters.

This paper takes an in-depth look at the current state of the local public finances in the Latin America region, identifies and analyzes some of the main challenges for improving efficiency, equity and effectiveness in the delivery of public services and for promoting development and it closes by offering a set of recommendations for policy reform.[5]

[5] The focus of this report is on fiscal decentralization. Issues of political and administrative decentralization for the most part are not covered in the report.

I. Overview of the Structure and Performance of Local Government Finances in the Region

Countries in the region are highly diverse along a number of dimensions: federal versus unitary, size, colonial tradition, etc.. This diversity is found first among the four federal countries in the region: Argentina, Brazil, Mexico and Venezuela. Among the countries with a unitary system we can identify clusters of countries with more similar institutions and current challenges, including the Andean countries (Colombia, Ecuador, Peru and Bolivia), the generally smaller countries of Central America, the Island States with non-Iberian traditions,[6] and what we could call the southern cone exceptions (Paraguay, Uruguay and especially Chile) because of their approach to fiscal decentralization. The diversity is also found in population size (from the 196 million of Brazil to the one million of Trinidad and Tobago), in real GDP per capita (from $9,357 in Argentina in 2007 in constant 2000 US dollars to $884 in Nicaragua and only $411 in Haiti), and in other dimensions.

However, there are also many common features in the way that municipalities are structured and work, which enables us to treat all municipal governments in the region from a common perspective. An important common feature is that, for those countries with more than one tier of sub-national government, the relationship between the central government and the municipalities are for the most part directly between these two levels as opposed to the central government dealing exclusively with the regional and local governments and then these latter dealing exclusively with the municipalities.[7] In most cases, the legal status of the municipalities clearly stated in the constitution or specialized laws, such as municipal codes. The most important exception to this rule is Argentina where the constitution gives the intermediate level government, the provinces, discretion to structure the fiscal arrangements with the municipalities.[8] To a lesser extent the same

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[6] Naturally, these countries are not usually classified as “Latin” America.

[7] In the technical parlance the vertical relationships between different levels of government are bifurcated (central to local and central to regional, separately) as opposed to hierarchical (central to regional to local, all linked)..

[8] In contrast, for example, the Brazilian Constitution defines its political system as the union of the central government, the states, and the municipalities, thus giving local governments an autonomous standing vis-à-vis the intermediate level governments.

story is repeated in Mexico.[9] Thus, the key difference explaining the different approaches to central-local relations is that between 'federal' and 'unitary' nations. But even in the federal cases, despite the variety of provincial-local arrangements that exist in Argentina and to a lesser extent in Mexico, [10] the issues currently facing municipal governments are not essentially different from those being faced by the rest of the municipalities in the region. For this reason, in this the report we will not make a point of identifying the different groups of country experiences but instead we will use a common framework for all countries, identifying throughout particular country experiences as lessons of what needs to be avoided or what may be desirable to imitate and replicate.

The Structure of Local Governments

As a rule the vertical structure of government in Latin America is organized in three tiers of government (Table1), with the exceptions of Peru, that has four levels, and Jamaica and Trinidad and Tobago that have two levels[11] The focus of this paper will be almost exclusively on the lowest tier of government: the municipalities. The intermediate levels (States, provinces, regions and departments) will be referred to only in issues relevant to the municipalities.

[9] Brazilian states also have some limited role in managing the municipalities.
[10] Note also that the status of the capital city of Buenos Aires is defined separately in the Constitution.

[11] In the case of Bolivia, the provincial level may not be interpreted as an additional autonomous level.

Table 1: Decentralization in Latin America: Political and Territorial Organization (2007)

Country	Levels of gov. (#)	Govt. level names	Intermediate Level (level 2)	Local level (Level 3)	Level 4	Average Population Level 2	Average Population Level 3	Population in the largest city (% of urban population)	Population in urban agglomerations > 1 million (% of total population)	GDP per capita (current US$)
Argentina	3	federal, provincial, municipality/department	24	1638		1,686,750	24,714	35	39	6644
Bolivia	4	national, department, municipality/canton	9	327	*	1,027,535	28,280*	26	32	1379
Brazil	3	federal, state, municipal	27	5564		7,271,948	35,288	12	38	6855
Chile	3	national, region, municipality	(15)	345		1,096,943	47,555*	39	34	9878
Colombia	3	national, department, municipality	32	1102		1,422,401	39,927	25	28.8	4724
Costa Rica	3	national, canton	(7)	81		599,416	51,801	..	35	10800
Dominican Republic	3	national, province, municipality	(32)	229		297,098	61,237	32	22	3772
Ecuador	3	national, province, canton	22	215		633,075	64,780	29	32	3335
El Salvador	3	national, department, municipality	(14)	262		504,743	26,971	35	21	2973
Guatemala	3	national, department, municipality	(22)	333		591,009	39,046	16	8	2536
Haiti	3	national, department, commune	10	140		892,455	----	46	21	699
Honduras	3	national, department, municipality	(18)	298		424,407	25,635	..	..	1722
Jamaica	2	national, parish		14		200,309		..	..	4272
Mexico	3	national, state, municipality	32	2454		3,436,106	44,807	10		14400
Nicaragua	3	national, department, municipality (+ 2 special regions)	(17)	153		340,344	37,816	..	..	1022
Panama	3	national, province/comarca, district	14	75		236,406	44,129	53	38	5833
Paraguay	3	national, department, canton	18	227		379,517	30,094	51	31	1997
Peru	3	national, region/special province, province/district	26	1834		1,122,342	15,911	40	29	3846
Trinidad and Tobago	2	national, region/borough/city		16		65,460		..	..	15668
Uruguay	2	national, department (municipality)	19	89**		183,041	39,076	49	45	6960
Venezuela	3	national, state, municipality	24	335		1,100,617	78,850	12	32	8299

Note: #computed using the number of jurisdictions in level. Between brackets when the authorities are not elected. In Peru are two kinds of municipalities: provincials and districts.
*In Bolivia there are departments, provinces (not elected authorities: 112), municipalities and territories of traditional peoples “territorios indígneas originarios campesinos” (incorporated in the new constitution)
** In Uruguay, the municipalities that have been in the constitution were last year.

As of 2010, there were over 16,000 municipal governments in Latin America. Their number by country obviously varies with population size and territory, with Brazil counting 5,564 municipalities and at the other extreme and Trinidad and Tobago with 16 municipalities. Local governments vary quite considerably in size in each country (Table 1).

Even though a significant share of the population of Latin American countries live in the largest city in the country (for example, 53% in Panama, 49% in Uruguay, 40 % in Peru, and 35 % in Argentina), the majority of municipalities in the region remain, for the most part, small in size and of a rural nature. For example, in Peru over 200 municipalities have populations under 1,000 inhabitants, and over 50 percent of the all municipalities have fewer than 5,000 inhabitants. Thus the region faces challenges at the two extremes: massive metropolises with high levels of population density, congestion and rings of urban poverty; and very small municipalities in rural areas with low density, with low administrative capacity and lacking an appropriate scale for the provision of many basic public services.[12]

In many Latin American countries the structure of local governments continues to be work in progress.[13] For example, for the case of Bolivia, the new 2009 Constitution declares autonomous governments at the regional, municipal and indigenous community level, with the characteristic that the indigenous communities may fit in one or more municipalities or regions. The legal norms regulating this structure have not been enacted yet. The proliferation of new local governments, almost always through the fragmentation of existing ones, continues to be quite common in the region. For example in the Dominican Republic, between 1995 and 2006 the number of municipalities rose from 108 to 154.[14]

[12] An additional complication is that many municipalities in the region are a mix of urban and rural (and peri-urban) areas that have very different service needs.

[13] This progress has not been lineal either, but rather characterized in many cases by politically driven episodes of de-centralization and re-centralization. See, for example, Smoke et al. (2006).

[14] A recent law in that country has imposed stricter requirements for new potential municipalities requiring that they have 15,000 residents and be able to generate at least 10 percent of the revenue that their previous municipality was raising.

Local Expenditures and the Assignment of Competencies

The scope of local government expenditures: The local government share in total public expenditures and in GDP differs significantly by country but they are generally lower than those observed in other regions of the world. However, as shown in Table 2, the share of the public sector in GDP as measured by total expenditures of the general government is rather high, and at levels above those of other countries in the world at similar levels of per capita income. This contrast of relatively smaller local government sectors in otherwise relatively larger overall public sectors may be explained first, by fewer functional expenditure responsibilities being assigned to local governments in comparison with other regions of the world, and second, by relatively lower levels of expenditure and service provision in those expenditure responsibilities actually assigned to local governments, as discussed below.

As shown in Table 2, there are large differences in the share of local governments in total public expenditures and their relative importance in GDP. Among the most decentralized countries, as measured by the municipal share in total public expenditures are: Ecuador, , Brazil and Colombia around 20 percent, follow by Peru and Bolivia around 16 percent. Two large federal countries, Argentina and Mexico stand at 6.8 percent and 5.7 percent, respectively. At the low end we find unitary countries that are still highly centralized such as many Centro-American and Caribbean countries (from 7% in Salvador, to 1,7% in Panama and Jamaica and between them Dominican Republic, Nicaragua, Honduras, Costa Rica)).

Perhaps a more meaningful measure of the role of local governments as providers of public services is the share of local expenditures in overall GDP (Table 2). This variable measures the percentage of national resources channelled through local governments. From this perspective, Brazil at 7.7 percent and Bolivia at 7.0 percent and Ecuador at 5.1 percent are currently the most municipally decentralized countries in the region, while Peru, Colombia, and Argentina account for between 2 and 3 percent of GDP. At the bottom stand more centralized countries: Dominican Republic, Panama, El Salvador and Jamaica, with less than 0.9 percent of GDP.

Table 2: Public Finance Indicators

Country	Total Expenditure in general govt. (Mill USD)	Total Expenditure in general govt. (% of GDP)	Local Expenditure (Mill USD)	Local Expenditure (% of GDP)	Local Expenditure % of General Government
Argentina(2006)	44,390.00	30.8	3,107.30	2.2	6.8
Bolivia(2008)	5,503.00	42	880.48	7	16
Brazil(2007)	601,405.00	34.9	112,331.59	7.7	18.7
Chile(2007)	25,995.00	15.2	3,119.40	2	12.8
Colombia(2006)	48,406.00	14.2	10,165.26	2.7	18.7
Costa Rica(2008)	58,982.30	38	na	na	na
Dominican Republic(2006)	7,612.00	16	403.00	0.9	5.3
Ecuador(2007)	10,357.00	21.6	2,423.00	5.1	23.3
El Salvador(2007)	3,710.00	18.2	107.90	0.5	3
Guatemala(2002)[1]	5,174.00	14.5	na	na	na
Haiti(2004)	802	15	na	na	na
Honduras(2004)	1,982.80	22.4	195.00	2.2	9.8
Jamaica(2008)	4,261.00	38	73.00	0.7	1.7
Mexico(2007)	327,973.00	28.7	19,678.38	1.6	5.7
Nicaragua(2002)	1,304.50	23.3	na	na	na
Panama(2005)	6,855.20	44.9	137.10	0.8	1.7
Paraguay(2006)[2]	5,290.80	37.1	423.26	0.3	8
Peru(2007)	16,904.00	16	2,774.00	2.6	16.4
Trinidad and Tobago(1995)	8,600.00	34.8	0.00	5.2	14.8
Uruguay(2007)	8,611.00	30.8	0.00	na	na
Venezuela(2007)	58,888.00	25.7	na	na	na

Notes:
[1] central government only
[2] Data from financial statements. Local data partial (only 33% of all Municipalities included)

The assignment of expenditure competencies: Several features characterize expenditure assignments in Latin American countries. First, with the exception of Argentina, [15] all countries have explicit assignments for municipalities in the national laws. In most countries, as shown in Table 3, the expenditure assignments are defined in the country's Constitution; otherwise, the assignments are specified in special laws, most commonly some form of municipal code.[16] Often, in these formal assignments, municipalities are allowed to provide any services not specifically assigned to any other level of government.[17] The use of the constitution for determining expenditure assignments can be understood as a sign of status and guarantee for municipal governments, but generally using the constitution for these purposes can also create problems because of the difficulty of adding sufficient detail on assignments and the difficulties of changing and updating assignments in response to frequently evolving conditions.

Second, there are enormous variations in the assignment of responsibilities to municipalities; the assignments represent a mosaic of approaches, which as shown in Annex 1 defy generalization. Most countries provide for a set of obligatory functions, often exclusively assigned to municipalities (as opposed to shared responsibilities with other levels of government). These range from basic urban services such as garbage collection, road maintenance, parks, market stalls and slaughter houses, and so on, as well as some administrative functions such as, civil registry, land planning and housing permits. In addition, most countries also provide for voluntary functions, which often are co-shared with other levels of government. These may include some social services, such as basic education and primary health services, and public utilities, such as water and

[15] In Argentina, each province regulates the expenditure responsibilities of municipalities differently. The provinces, in general, tend to enumerate a set of general functions accompanied by a clause that may be used to expand local competencies. Much less frequently the provinces explicitly enumerate the functions that municipalities must fulfil or functions exclusively assigned to them.

[16] There are some qualified exceptions to the rule. For example, in the case of Colombia there is no special law assigning expenditure responsibilities at different levels of government, but there are several laws (60 of 1993 and 715 of 2001) that specify certain norms regarding the assignment of competencies.

[17] A clear exception to this rule is Chile, where municipalities are circumscribed to a closed list of functions. But unlike the behavior of sub-national governments in other regions of the world showing eagerness to expand their functional responsibilities, the norm in Latin American countries appears to be that of little venturing beyond those responsibilities listed in the laws, with perhaps the exception in some countries (for example Brazil and Mexico) in the area of local economic development.

sewerage services. But as can be seen in Table 3, in some countries (Colombia, Guatemala, Jamaica) basic education and primary health can also be designated as obligatory and exclusive responsibilities of local governments[18].

Third, fundamental redistributive social welfare services (such as social security, unemployment compensation, and welfare payments) must be the responsibility of the central level. However, in some countries (for example, Bolivia and Chile) the central governments, while retaining the obligation of financing those services, have delegated to local governments the implementation and management of several important social welfare programs (e.g., family welfare services) in order to exploit the advantage of proximity and better information local governments that have.[19] Municipal governments in many Latin American countries play a large role in public investment in infrastructure at the sub-national level often as equal partners with upper level governments in patterns similar to those observed in European countries.[20] For example, in Brazil local governments in recent years have undertaken close to 45 percent of all public sector investment.

Finally, many countries in Latin America have concurrent or shared expenditure responsibilities, which generally result in less clarity and more potential conflict than exclusive assignments. There is, however, no clear correlation between the dominance of concurrent responsibilities and the degree of municipal decentralization. Bolivia, Brazil, Mexico and Venezuela have considerable co-shared responsibilities, but the first two have a relatively high degree of municipal decentralization, while the latter two (especially Venezuela), have among the lowest degree of municipal decentralization. Nor is there a correlation between the prevalence of exclusive functional assignments and the level of municipal decentralization. Of course, in some cases, such as the Dominican Republic, Honduras, and Uruguay, most functional responsibilities are still assigned exclusively to the central government. In other countries, such as Colombia, Peru, El Salvador, Guatemala and Jamaica, there is a nontrivial degree of exclusive

[18] In El Salvador basic education and primary health are assigned to the local level, but actual service delivery works through special local mechanisms administrated jointly by the State, the communities and the private sector.

[19] On the whole these experiences appear to have been positive (Bolivia, Brazil, Mexico and Peru).In the case of Mexico some programs have been critiqued because of partisan interference by central authorities in the deployment of funds.

[20] The budget figures are discussed further below.

responsibilities. In the first two, however, there is a relatively high level of municipal decentralization, while the latter three have relatively low levels.

Revenue Assignments

Practically all countries of Latin America assign certain taxes to local governments; some exceptions are El Salvador, Jamaica, and Trinidad and Tobago. As shown in Table 3, the most commonly assigned tax is the property tax, although it is named differently and varies somewhat in scope across countries.[21] Other local taxes include betterment levies, car registration and car permits, real estate and land transfers, different forms of business licences,[22] taxes on gambling and, in a few some form of sales taxes or business tax based on sales countries).[23] Practically all local governments are allowed to charge fees and charges for particular public services such as building licenses, refuse collection, public utilities, slaughter houses, and public markets and others.

Table 3: Assignment of Taxes and Fees to Local Governments in Latin America

Country	Type of tax		Type of Fees
	Property	Others	
Argentina	urban/rural property (and its increased value b/c of public investment)	car registration, turnover tax	public utilities, fines
Bolivia	urban/rural property	car registration, car/property transfers, slaughterhouse, construction	
Brazil	urban property (including increased value due to infrastructure improvement)	tax on service sector (ISS), registered goods tax, real estate transaction tax	fines, public utilities
Chile	urban property	car registration, alcohol	public utilities, fines, permits

[21] Of significant importance is that just a handful of countries allow for the taxation of both urban and rural property. Those countries allowing only the taxation of urban property leave rural municipalities in a relative disadvantage. Note also that the property tax is still assigned to the central government in El Salvador and that there appears to be no property tax in the Dominican Republic, only a property transfer tax.

[22] A good example is the "patente municipal" in Chile which is paid annually at rate based on the declared own capital assets. This tax is further discussed in the next section.

[23] In the cases of Brazil's ISS (tax on services) and Colombia's ICA (tax on trade and industry) municipal collections exceed those from the property tax (IBI, impuesto sobre bienes inmuebles). The two country experiences with these taxes are also further discussed in the next section.

Colombia	urban property (and its increased value b/c of public investment)	surtax on gasoline, tax on industry/commerce, mineral extraction, slaughterhouse, gambling	public utilities, fines
Costa Rica	urban property		public utilities
Dominican Republic			
Ecuador	urban/rural (and its increased value b/c of public infrastructure investment)	car tags, permits (business, construction),	fines, utilities
El Salvador		Specific taxes for each municipality based on congress approval such as business taxes on industrial, trade, and financial activities	fines, public utilities, fees for services rendered
Guatemala	urban property[1]	tax on wages, advertising (banners), extraction of products/economic activity, alcohol	
Haiti			
Honduras	urban/rural property (and its increased value b/c of public investment)	turnover tax on industry and trade, extraction of natural resources (fishing, minerals, oil), cattle slaughter	public utilities, firefighters, fines
Jamaica		Parochial revenue fund	
Mexico	Urban property	Car registration (all other taxes are centralized)	Varies by state
Nicaragua	Urban/Rural property	Sales tax (recently eliminated); patents and business licenses	fines, public utilities
Panama	tax on unused land (urban/rural)	tax on alcohol, economic activity and vehicles	fines, fees (cattle slaughter)
Paraguay	urban property (and its increased value b/c of public investment)	car registration, games/gambling, wealth tax (corporate), land transfers/subdivision	public utilities
Peru	urban/rural property	car registration, car/property transfers, construction	public utilities, fees, fines
Trinidad and Tobago			
Uruguay	urban property (and its increased value b/c of public investment)	car registration, gambling, shows	fines, fees for services
Venezuela	urban/rural property	car tags, gambling, economic activity,	fines, fees for permits

Notes:
[1] Tax collection authority is only given to local governments that prove to have the capacity to collect the tax
[2] Argentina: Not all provinces have delegated property taxes to their municipalities

3 Brazil: The ISS is assessed and collected by the municipality at rates set by the municipality but subject to a maximum fixed by federal law

Revenue assignments are formalized in different ways. In many cases, the assignments are specified in the general tax laws or in the special municipal laws. In other cases, they are established in the national constitution, as for example in Brazil. In some other cases, the constitution delegates to the intermediate level of government, provinces or states, discretion to determine local revenue assignments, such as in the case of Argentina and Mexico, which results in a variety of *de facto* assignments.[24]

The level of autonomy granted to local governments also varies. As summarized in Table 4 most countries use a "closed list" approach and do not allow the introduction of new taxes to local governments; some exceptions include Ecuador and Uruguay.[25] On the other hand, about two-thirds of the countries in the region allow local governments the ability to set the rates of some taxes; this practice is widely accepted as the most desirable form of tax autonomy that can be granted to local governments.[26] It is interesting that countries such as Bolivia and Peru, where decentralization reforms have advanced rapidly in recent years, still grant no discretion to set tax rates. A reduced number of countries in the region grant local discretion to modify tax base.[27] Most countries in the region allow local government discretion in fixing the levels of fees and user charges for local government services. Nevertheless, an important restriction on the revenue autonomy of local governments is the practice followed in several countries of requiring local government revenue budgets ("plan de arbitrios") to be previously approved by a higher tier of government prior to the beginning of the fiscal year.[28] As can

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[24] In the case of Mexico, the constitution assigns the real estate taxes (and only the real state tax) to the municipalities. This is the only tax explicitly assigned to the municipalities..

[25] In Argentina, some provinces may also allow their local governments to introduce new taxes but under quite restrictive guidelines.

[26] There is not a lot of information available on how this autonomy is actually used, but it would appear that it is quite common for local governments to adopt the lower rates authorized in the law.

[27] Generally, this form of tax autonomy is also considered less desirable, although there may be less of a problem in changes in the bases of taxes with rather immobile bases such as land and buildings. But even in these cases the use of different bases may make more difficult the measurement of fiscal capacity across jurisdictions.

[28] There are two versions of this prior approval. In one version the approval works as simple legality where the higher level cannot change resource allocation decisions. In the second version, the higher level can change decisions of the lower level. The practice in the regions seems to be more in the nature of the first version where approval by the higher level works more as a check that the regulatory framework is being followed.

be seen in Table4 this is still a practice in Costa Rica, Nicaragua, Panama, and Paraguay; in Mexico this approval comes at the intermediate level from the state governments. In terms of fiscal administration (Table 4), the general rule is local responsibility for the administration of local taxes, fees and charges, although in some cases tax administration responsibility is shared with the central authorities.[29]

Table 4: Autonomy Granted in Revenue Assignments to Local Governments and Responsibility for the Collection and Administration of Local Taxes and Fees

Country	Ability to introduce new taxes	Ability to set tax rates within legal limits	Ability to change tax base	Control or veto over local govt. budgets by Central/Regional govt.	Responsibility for the collection of:	
					Fees	taxes
Argentina	Yes	yes	Yes	No	L	L
Bolivia	No	no	No	Central	C/R	C
Brazil	Yes	yes	Yes	No	L	L
Chile	No	yes	Yes	No	L	L
Colombia	No	yes	No	No	L	L
Costa Rica	No	No	No	Central	PS*	PS*
Dominican Republic	No	no	No	No	C	C
Ecuador	Yes	yes	No	No	L	L
El Salvador	Yes	yes	No	No	L	L
Guatemala	No	yes	No	No	L	C/L
Haiti	n.a.	n.a.	n.a.	Na	na	C
Honduras	No	yes	No	No	L	L
Jamaica	No	yes	Yes	Central	L	C/L
Mexico	No	no	No	Regional	L	L
Nicaragua	No	yes	Yes	Central	L	L
Panama	No	yes	No	Central	L	C/L
Paraguay	No	no	No	Central	L	C/L
Peru	No	no	No	No	L	L
Trinidad and Tobago	no	no	No	No	L	C/L
Uruguay	yes	Yes	No	Central	L	L
Venezuela	yes	Yes	Yes	No	L	L

*Note *:* Costa Rica collects through the private sector

Property taxes remain the great unrealized promise for local tax autonomy in Latin America, a problem that is shared with other regions of the world. In most countries

[29] As an exception, it appears that in Bolivia all local taxes are collected and administered by the central authorities.

in the region, the yield from property tax remains far below its potential. While the property tax on average in recent years raises revenues of 2.12 percent of GDP in OECD countries, 0.68 percent in transition countries, and 0.60 percent in developing countries, the average in Latin America is only 0.37 percent of GDP. The reasons for low performance are multiple, including low political will –from the national government as well as from the Parliament and the local governments themselves- and the disincentive effects of revenue sharing and inter-governmental fiscal transfers (IGFTs), as well as outdated and poorly equipped tax administrations. These factors translate into generous exemptions and low tax rates, obsolete and infrequent property value assessments, incomplete registries and cadastres and a lack of willingness and means of enforcing collections. This lacklustre performance varies little with the different arrangements in the region for discretion on rate setting or administration of the property tax.[30]

More generally, the whole range of local raised revenues from own taxes and fees in Latin America represent a relatively small share of total consolidated revenues in the public sector, although in terms of the share in local budgets these revenues are relatively large.[31] Of course, there is a large variation in experience from country to country. Table 5 shows that as percent of consolidated government revenues, local governments in Colombia raise 22 percent, Brazil and Peru 18 percent and Bolivia, 16 percent. At the lower end stand Panama with 2 percent.[32] For Mexico this figure is 6 percent.

However, on average, municipalities raise a higher percentage of their budgets from own revenues that is the case in some other regions of the world, including Africa, Asia and a good portion of European countries. As shown in Table 5, the percent of local budgets financed out of own taxes and fees is quite high, between one quarter and over half for many countries. [33]However, in Bolivia this share is only 11 percent, in Brazil 20 percent and in Mexico, 16 percent.

[30] For a discussion of the issues, see Sepulveda and Martinez-Vazquez (2009) and De Cesare and Lazo Marín (2008).
[31] These two effects are compatible if we recall our discussion in the previous section that local government budgets represent a relatively small share of the general government budget.
[32] See Annex 2 for the breakdown of revenues collected by each tier of government. In Venezuela the figures seems to be extremely low probably due to reporting issues; some large municipalities in Venezuela appear to collect property taxes and fees.
[33] See Annexe3 in the Appendix for the breakdown of sources of revenues for local governments.

Table 5: Shares of Local Own Revenues (in percentages)

Country (Most recent year)	Local government revenues as % of total govt. revenues	Own taxes and fees as % of local revenues	Local own taxes and fees as % of GDP
Argentina(2006)	7.0%	49.8%	1.2%
Bolivia(2008)	16.0%	11.4%	2.7%
Brazil(2007)	17.6%	20.1%	1.8%
Chile(2007)	9.0%	63.0%	0.7%
Colombia(2006)	22.0%	41.2%	2.1%
Dominican Republic(2006)		58.4%	0.7%
Ecuador(2007)	12.0%	34.6%	1.6%
El Salvador(2007)		69.9%	0.0%
Haiti(2004)		25.0%	0.5%
Honduras(2004)	8.0%	58.1%	0.9%
Jamaica(2008)	0.0%	100.0%	0.2%
Mexico(2007)	6.0%	15.6%	2.4%
Nicaragua(2002)		44.0%	0.6%
Panama(2005)	2.0%	49.0%	0.3%
Paraguay(2006)	8.0%	34.1%	1.2%
Peru(2007)	18.0%	43.2%	2.6%
Trinidad and Tobago(1995)		52.9%	0.1%
Uruguay(2007)			0.0%
Venezuela(2007)	0.0%	94.9%	0.1%

Intergovernmental Transfers

Because of the limited extent of fiscal autonomy, practically all local governments suffer from vertical imbalances, i.e. the expenditure needs arising from their functional competences exceed their ability to self finance them. Although the existence of vertical imbalance is not in dispute, their actual extent is generally a polemical issue because practically no country in the region has introduced explicit methodologies to measure the expenditure needs of local governments in a transparent and objective manner. In order to address the existing vertical imbalances, practically all countries in the region implement a range of fiscal transfers, often consisting of different forms of revenue sharing, an array of specific or conditional grants, and in some cases, equalization grants.

In addition to vertical imbalances, in practically all countries in the region there are also significant horizontal imbalances between local governments. These imbalances are the result of the different tax capacities and economic bases of local governments and also of different expenditure needs arising from differences in the costs of service delivery and differences in the profiles and needs of the resident populations. Horizontal imbalances are most pronounced between urban and rural municipalities and between smaller and larger urban centers. As we see below, different approaches are used in the region to address these horizontal imbalances.

The emphasis throughout the region has been on addressing the problem of vertical imbalances through different forms of revenue sharing with central government tax collections. There has been less emphasis on the design of explicit equalization grants, although quite often revenue sharing formulas contain equalization features. Conditional grants are less common in Latin America than in other regions of the world, but here again there are important exceptions.

The large variety of country approaches followed, as shown in Table A.5 in the Appendix, makes it hard to synthesize them in a brief space.

Nevertheless, most countries in the region use some form of <u>general revenue sharing</u>. The pool of funds is most frequently defined on the basis of central government general revenues or their most important sources; this is the case, for example, of Bolivia, Colombia, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua. In other cases, the pool is based on specific central government taxes; for example, 20 percent of the fees on oil production derived by the Mexican states must be passed on to their municipalities; Nicaragua's additional tax sharing with the municipalities is based on revenues from natural resources; and in Peru, some of the tax sharing is from a share of the sales taxes and from gas and oil extraction proceeds (*canon*, *sobrecanon*, and *canon petrolero*). In these latter cases, actual transfers can be subject to considerable fluctuations, for example, depending on international price levels for natural resources.

In some cases, shared revenues are distributed on a derivation (i.e. origin) basis, for example, the *canon*, *sobrecanon*, and *canon petrolero* in Peru. This approach (sharing revenues from natural resources on a derivation basis) has become a significant factor adding up to regional horizontal fiscal imbalances. Most often some sort of formula is used for the distribution of resources that includes several variables, some of which, as noted above, may have equalizing features.[34] For example, in Bolivia revenue sharing is based solely on population; in Ecuador it is according to population and relative poverty levels; in El Salvador it is according to population, 'equity' (a fixed amount for each municipality), poverty, and land surface area; in Guatemala it is distributed according to a formula that includes equal shares (fixed amounts), population, number of settlements, and per capita income; in Honduras it is according to population and equal amounts for all municipalities; in Nicaragua it is according to population and several other criteria; and in Peru it is according to population and infant mortality rates. Frequently, the formulas are also employed by central governments to pursue several objectives other than equalization. For example, in Ecuador the sharing formula includes elements for rewarding administrative effort and achieving goals in the national development plan, while in Nicaragua the formula provides incentives for increasing revenues from property tax and for achieving more effective budget execution.

Some countries allow unconditional use of shared revenue, including Bolivia, Ecuador, El Salvador, and Honduras. But in other cases the use of funds is conditional. For example, in Colombia the use of revenue sharing funds is earmarked for basic education, health, and water and sewerage; in Guatemala, for education, health and infrastructure; in Nicaragua and Paraguay, a share of the funds --80 percent in the latter case-- must be spent on infrastructure investment.

Revenue sharing practices in the federal countries have some similarities with those of unitary countries, but there are also some different features. In Argentina, tax sharing with local governments is carried out exclusively by the provincial governments, which can decide how to distribute their share of federal VAT and income taxes. The Brazilian states also have a tax sharing system funded with 25 percent of their regional VAT revenues, which is distributed 75 percent on a derivation basis according to value added in the municipalities and 25 percent by a formula based on population, land area and others. This same formula is used to distribute federal tax sharing with the states

[34] In some cases, like in Paraguay, the allocation of funds is still ad-hoc at the discretion of the central authorities. In this context it is worth mentioning that there used to be more widespread *ad hoc* allocation of funds in the region, but now most countries, with limited exceptions, have moved to the better practice of formula based determination of the pool of funds.

(cooperation funds) to the municipalities. In Mexico, the states are required to distribute to their municipalities at least 20 percent of the income that they receive from revenue sharing in the federal funds (*Fondo de Fiscalización and Fondo General de participaciones*). Mexico also has a federal grant, amounting to 1 percent of federal collections (*Fondo de Fomento Municipal*) that is (distributed on the basis of municipal revenue collections. In Venezuela, 25 percent of tax revenues from hydrocarbons and mining are earmarked for use in health, education and housing and distributed to municipalities largely on a mix of the derivation principle and population size; in addition, in Venezuela 15 percent of VAT revenues are distributed to municipalities on the basis of population, poverty, and land area and earmarked for local infrastructure.

Conditional or specific transfers are less extensively used in Latin American than in other regions of the world.[35] Nevertheless their use is increasing, especially in those countries where central governments count on being associated with local governments as partners for the delivery of certain services and the implementation of national programs.[36] For example, Bolivia has introduced a conditional health transfer for a national program in support of infants and mothers (*seguro materno infantil*). In Brazil, several conditional grants have been introduced for public transport (funded by the sharing of federal fuel levies), for basic education, and for health services, including hospitals from the national health system. In Chile several highly conditional grants have for many years funded local governments' activities in education, health, and other social programs. Some conditional grants are earmarked for certain geographical areas that are deemed to be lagging behind. For example, in Ecuador there is a conditional capital investment grant for the Amazon region.[37]

[35] Here we are referring in a conventional way to specific funds assigned to particular objectives and administered separately by central government agencies. This is interpreted as being different from the conditioning or earmarking of revenue sharing funds. As we have seen above, a number of countries in the region condition the use of revenue sharing funds to investment in infrastructure and so on. If the restrictions in the use of revenue sharing funds were included in the general category of conditional transfers then the practices in the regions would not be that different from those in other regions of the world.

[36] In a traditional way experienced in other regions of the world, the rise of conditional transfers has been more to assist the center in better implementing its programs and less in providing incentives to local governments to improve local functions.

[37] This is a specific instance of larger developmental goals that can be addressed by conditional transfers, such as arid areas, poor areas, unexploited high potential areas, etc.

A particular subgroup of conditional grants is earmarked for investment in local infrastructure. For example, El Salvador offers grants for municipal capital infrastructure based on the presentation of project proposals. In Guatemala one-eighth of VAT revenues are earmarked for infrastructure in social and basic services while a share of vehicle taxes is earmarked for maintenance and improvements of roads and drainage. In Mexico, at least 20% of the investment grants (*Fondo de Compensación*) from the federal government must be assigned to the poorest ten states in the country and used by the municipalities of those states.

The practice of explicitly addressing horizontal disparities among local governments through equalization transfers is still not common but it is taking hold in the region. One reason for the slow introduction of explicit equalization grants is that quite often revenue sharing schemes do incorporate some equalization elements in their allocation formulas. Several examples of existing equalization grants (above and beyond revenue sharing schemes with some equalizing elements in their formulas) are worth mentioning. One is Bolivia's HIPC (Heavily Indebted Poor Countries Initiative) transfers started in 1997 with funds from international organizations (the World Bank and the IMF) and distributed by the central government to local governments using a formula based on the poverty level and population of municipalities. In Brazil, there is a federal equalization transfer to the municipalities funded with a share of federal VAT and income tax revenues; the fund is split into two parts, with 10 percent going to state capital municipalities (distributed according to population and the inverse of per capita income) and the other 90 percent to the rest of the municipalities (distributed according to an index that favours municipalities with smaller populations). An interesting approach is that of Chile, where the formula driven equalization grant (the Common Municipal Fund) is funded by the municipalities' own revenues from different sources in what is known in the technical parlance as a "fraternal" (or Robin Hood) system, in which the relatively richer municipalities finance the transferred amounts to the poorer municipalities. The allocation formula includes population size, poverty levels, exempted real estate property, and past revenue collections. One key positive feature in all these examples is the recognition of the need to introduce a separate instrument (equalization grants) to address the separate objective of horizontal inequalities arising from different expenditure needs and fiscal capacity.[38] A key common challenge ahead is the need to improve the methodologies used to quantify the expenditures needs and fiscal capacity of the different local governments. [39]

Borrowing

Given their expenditure responsibilities, most municipalities have a need for long-term finance for capital infrastructure. Local borrowing can be considered a legitimate, efficient, and equitable source for financing this local infrastructure. However, it is also widely accepted that the process of local borrowing must be subject to explicit rules and limitations in order to ensure fiscally responsible behavior by local officials and to guarantee macroeconomic stability in the country.[40] Commonly applied rules include those about expected behavior, such as the "golden rule" that long-term borrowed funds must be used for capital infrastructure only, and not for recurrent expenditures, and different quantitative budgetary limits on borrowing. Among the latter, there are rules on non-negative current budget balances, limits on the level of total debt and debt-service payments as a percent of budget revenues, as well as restrictions on borrowing abroad.

[38] The use of a fraternal system to fund the equalization transfers in Chile is also a promising innovation. This is a system common to a good number of European countries but it is uncertain how easily it will be adopted by other countries in the region.

[39] For the available methodologies used in other regions of the world see, for example, Martinez-Vazquez and Searle (2007).

[40] Historically this was not always widely accepted in some countries in the region, which in past decades saw an accumulation of macroeconomic difficulties associated with unfettered sub-national borrowing in some of the federations and politicized government-run municipal development banks.

Table 6: Authority to Borrow by Local Governments in Latin America

Country	Access to Financial Markets	Municipal Bank	Limitations
Argentina	Y	Y	Y
Bolivia	Y	N	Y
Brazil	Y	N	Y
Chile	N	N	n.a
Colombia	Y	n.a	Y
Costa Rica	Y	n.a	n.a
Dominican Republic	N	Y	Y
Ecuador	N	N	Y
El Salvador	N	Y	Y
Guatemala	Y	n.a	Y
Haiti	n.a	n.a	n.a
Honduras	Y	Y	Y
Jamaica	N	N	Y
Mexico	Y	N	Y
Nicaragua	Y	n.a	Y
Panama	n.a	n.a	n.a
Paraguay	Y	N	n.a
Peru	Y	N	Y
Trinidad and Tobago	N	N	n.a
Uruguay	Y	N	Y
Venezuela	Y	Y	na

For a variety of reasons, ranging from fiscal conservatism to negative past experience, not all countries in the world allow their local governments to borrow. Yet in the case of Latin America, as shown in Table 6, most countries do allow local governments to borrow.[41] Practically all countries allow such borrowing even though they impose rules and limitations on local borrowing similar to the above-mentioned international 'good practice' guidelines. In most cases, foreign borrowing is not allowed, in some cases it is allowed with permission of the higher authorities, and in other cases even domestic borrowing requires administrative approval by higher level authorities.[42] Over time, national systems have adapted to particular idiosyncrasies and approaches.

[41] The exceptions include Chile, Dominican Republic, El Salvador, Ecuador, Jamaica and Trinidad and Tobago.

[42] For example, foreign borrowing by the municipalities in Argentina requires administrative approval at the provincial level and by the Ministry of Economy at the national level, which it has been argued has been subject to political criteria beyond technical aspects. .

For example, in Nicaragua, municipalities are able to contract short or medium term loans from public and private banks for public works, with long-term loans for large-scale public works approved by the National Assembly. Loans must be repaid within the term of the elected officials, as mayors and municipal councils may not leave debts to their successors, except for long-term loans approved by the National Assembly. In the case of Colombia, law 358 of 1997 introduced a system of "semáforos" (streetlights) restricting the level of local debt according to the ability to pay by the local units; if interest payments are below 40 percent of the operational surplus and if the debt level is under 80 percent of current revenues, local governments are free to borrow according to the law; however, they require permission to borrow from the Ministry of Finance if any of those limits is exceeded. With law 819, which came into effect in 2003, the necessity to have a primary surplus sufficient to cover the repayments and interest was added to the existing indicators. The three indicators must be positive in every year of the loan, and this must be reflected in the medium term fiscal framework of the municipality or department. In El Salvador, municipalities are able to borrow from commercial banks once they receive the proper quality ranking from the Ministry of Finance and the semi-official organization charged with the physical distribution of the general transfer funds to the municipalities establishes an intercept agreement for those transfers to work as collateral for the loans from the commercial banks. As in other countries around the world, it is common to impose limits on annual debt service as percent of revenues (for example 20 percent in Argentina and Bolivia or 40 percent in Ecuador) and/or the total stock of debt as percent of total revenues (120 percent in Brazil or under 100 percent in Ecuador and Peru.)

The actual amount of sub-national debt, which includes local and provincial/state debt, is quite low in most countries, with the exception of Brazil and Argentina, where sub-national debt represents in recent times between 10 and 15 percent of GDP; Mexico, Colombia and Bolivia come behind with sub-national government debt representing less than 2 percent of GDP as of 2007. However, for municipal governments alone in recent years, Bolivia is first in debt service (interest and repayment of principal) as percent of total municipal expenditures at around 9 percent, followed by Ecuador at around 8 percent. For Argentinean and Brazilian municipalities, debt service as percent of total municipal expenditures is round 4 percent.[43]

Budgeting

The budgeting process at the local level in most Latin American countries is still carried out along traditional lines with heavy emphasis on incremental budgeting and ex-ante and financial audit controls for the disbursement of funds. Much less attention is given to the planning of expenditure programs and ex-post evaluation of the effectiveness of funds disbursed on programmatic goals.[44] One positive aspect is that almost without exception, local budgets need to be approved by democratically elected local councils. However, as we have seen above, in a significant number of countries (Bolivia, Costa Rica, Dominican Republic, Jamaica, Mexico, Nicaragua, Panama, Paraguay) at least some components of the local budgets need to be approved ex-ante by some higher level authorities at the central or regional levels. It is questionable whether or not these approvals are really needed; international best practice is to rely on horizontal accountability mechanisms ex-ante, and on the ex-post audit and to grant full budgetary autonomy to local governments.[45]

"Participatory budgeting" is an area of innovation in several countries in the region that has attracted much international attention. The specific meaning of this term varies among those countries that have introduced this type of reform, but it generally means additional mechanisms for citizens to influence local budgetary decisions beyond the conventional vehicle of representative democracy through the democratic elections of municipal councilors.[46] For example, in Bolivia a 1994 law established a mechanism of citizen participation in the local budget process through citizen committees (*comités de vigilancia*) and community-based organizations (OTBs—*organizaciones de base*), that

[43] See Porto (2009).

[44] The strong emphasis on ex-ante treasury controls has not, on the other hand, reduced corruption, which, with some exceptions, still appears to be extensive among local governments (and the rest of the public sector) in the region. The difficulties lie more in poor execution of the ex-ante controls than in a deficient design.

[45] In some cases controls for checking the legality of actions, as opposed to changing budget allocation decisions, can be justified when horizontal accountability and audit mechanisms are deficient or not present at all.

[46] Somewhat related, citizen participation mechanisms such as referendums, "popular initiatives," and elected representative recalls have been operating in other regions of the world.

are social organizations of peasant communities, indigenous population, and neighbourhood groups. Citizen participation at the local level is also important in Brazil, but what participation actually entails varies considerably across states and even municipalities. In Brazil the participatory budgeting process has been accompanied by a great variety of experiments; in some cases groups of citizens are empowered to address social and political inequalities by influencing the allocation of budget resources through neighbourhood meetings.[47] Other countries in the region, including some provinces in Argentina, have formally adopted participatory budgeting. So far there are accounts of specific local government successes in Brazil and elsewhere of increasing ordinary citizen input and preferences in budget decisions.[48] On the other hand, participatory budgeting is appropriate for certain elements of the budget; thus, even in Porto Alegre (Brazil) the share of the budget subject to this process is limited. Other countries in the region have formally adopted participative budgeting. Nevertheless, the implementation of participative budgeting often depends on the will of the Mayor and the City Council as it is not a compulsory or permanent tool.

As for the composition of municipal budgets, data availability varies significantly across countries and our discussion is based on a small number of countries. In terms of the economic classification of local expenditures, the high share of capital infrastructure expenditures in the municipal budgets of a significant number of countries is notable (Table 7). For example, in both Chile and Ecuador, local governments spend 55 percent of their budgets on capital expenditures; in Guatemala this figure is 64 percent and in Peru, 58 percent. Of course, there are large variations for these figures across countries, and these variations have a lot to do with the assignment of expenditure responsibilities—what tier of government is responsible for capital infrastructure in the different areas of responsibility: schools, roads, etc –, and also with the legal restrictions imposed on local governments for how they can spend revenue sharing and other types of funds—for example, in Peru, local governments only can spend funds from the *canon* and *sobrecanon* from natural resources on capital investments. There is also the possibility

[47] See Afonso (2006).
[48] For a positive assessment in the case of Bolivia, see Faguet (2004). See also Goldfrank (2006) and Shah (2007) for general assessments.

that capital expenditures are over reported.[49] But whatever the explanation, it is clear that many local governments in Latin America have been given an important role to play in the task of providing much needed infrastructure. This highlights the importance of finding more stable and potent instruments for infrastructure finance.

Table 7: Budget Expenditure by Economic Classification of Local Governments

Country (Most recent year)	Wages and Salaries/ Pension funds (% of total)	Current expenditure other than wages and salaries (% of total)	Capital Expenditure/ debt/equipment (% of total)
Argentina(2006)	47.40%	29.27%	23.33%
Bolivia(2008)	65.80%	26.90%	7.30%
Brazil(2007)	46.74%	53.05%	0.21%
Chile(2007)	29.11%	15.66%	55.23%
Colombia(2006)	74.05%	1.96%	23.98%
Ecuador(2007)	23.60%	20.80%	55.60%
El Salvador(2007)	45.61%	39.78%	14.60%
Guatemala(2002)	0.00%	36.00%	64.00%
Honduras(2004)	30.42%	19.03%	50.55%
Mexico(2007)	82.83%	12.29%	4.88%
Nicaragua(2002)	23.08%	38.46%	38.46%
Panama(2005)	41.68%	55.24%	3.08%
Paraguay(2006)	71.99%	10.94%	17.07%
Peru(2007)	11.73%	30.31%	57.95%
Venezuela(2007)	33.22%	33.31%	33.47%

As we have seen, the movement toward open and participatory budgeting is spreading in the region increasing budget efficiency and accountability in general. Although participatory budgeting is not directly about decentralization itself, the movement toward participatory budgeting has tended to reinforce decentralized institutions. There are, however, exceptions; for example, in the Dominican Republic,

[49] There are incentives in many countries in the region to report some current expenditure as capital expenditure. For example, in some cases central legislation restricts the share of budgets that can go to recurrent purposes. In other cases, practically all kinds of current expenditures have been demonized as being inefficient so local authorities actually report some current expenditure as actually being some form of capital expenditure. But, fortunately there does not appear to be a problem in Latin America with the off-budget programs and expenditures that are common in other regions of the world, for example Africa and Asia.

Law 176 of 2007 goes a long way to introduce participatory budgeting but the actual level of decentralization to local governments in that country remains quite weak.

Even less data is available to obtain a panoramic view of the functional classification of local budgets in the region; even for those countries for which data are available for individual municipalities, comparisons are hard because of the different classification methods used in each country, and, of course, because of different assignments of responsibilities, different needs and cost levels, and so on. As shown in Table 8, education expenditures, deriving from the assignment of expenditure competencies, are an important item in the local budgets of Bolivia, Brazil, Chile and Colombia; in all these countries, education expenditures represent between 22 and 37 percent of the local budgets. For the same reason, expenditures on health services are relatively important in the local budgets of Brazil, Colombia, and Peru, with budget shares here ranging between 16 and 22 percent. It is noteworthy that in most of these countries for which disaggregated data are available, not surprisingly the most important expenditure item in terms of budget shares is "general administration."[50]

Table 8: Shares of Local Government Expenditure by Functional Classification

Country (Most recent year)	General administration (% of total)	Education (% of total)	Health (% of total)	Sanitation (% of total)	Transport (% of total)	Others (% of total)
Argentina(2006)	28.69%	4.31%	9.93%	0.00%	7.35%	49.72%
Bolivia(2008)	4.77%	22.15%	7.20%	1.41%	n.a.	64.47%
Brazil(2007)	17.86%	25.99%	21.94%	2.97%	3.05%	28.20%
Chile(2007)	42.84%	36.86%	11.89%	0.00%	0.00%	8.42%
Colombia(2006)	18.56%	26.51%	19.58%	3.76%	0.00%	31.58%
Peru(2007)	30.72%	9.79%	16.06%	0.00%	20.08%	23.35%
Venezuela(2007)	26.27%	3.04%	9.31%	n.a.	11.37%	50.00%

II. Special Issues, Constraints and Opportunities for Local and Intergovernmental Finance in the Region

As shown in Section 1, the Latin American region offers a vast array of different experiences and approaches to local finance. The kinds of issues facing local

[50] Expenditures in U.S. dollars and the share of the different local sectoral expenditures in GDP are shown in Table A.7 in the Appendix.

governments in large federal countries such as Argentina, Brazil, and Mexico are often very different from those affecting local governments in small countries such as El Salvador, Nicaragua, or Paraguay. Furthermore, there is also significant diversity among the large federal countries as well as among the unitary countries. Hence, the attempt to generalize in the analysis of local problems and their solutions is neither always possible nor desirable. The analysis is intended to help policymakers develop a better understanding of the issues and explore potential remedies in a particular case—not to prescribe general solutions to problems that, even if at one level are similar, are happening in different contexts Nevertheless, some themes common to a significant number of countries in the region—even if in somewhat different ways and degrees—clearly emerge from the description of the local finance system presented in Section 1. In this section we identify some of the special issues, constraints and opportunities for the development of local finance in Latin America. The section is organized around four major themes: (a) Organizational Structure; (b) Intergovernmental Fiscal System Design; (c) Budget Process and Transparency; and (d) Short Terms and Long Term Structural Challenges.

II.a Issues on Organizational Structure

Fragmentation and sub-optimal scale[51]

Many countries in the region have numerous local governments that are too small to take advantage of economies of scales in the delivery of public services. Often this problem is aggravated by the incentives provided for further fragmentation by transfer formulas that ensure fixed amounts of funds to each municipality, regardless of size.[52] In response to this problem some countries have introduced legislation requiring minimum population size in order to ensure the future fiscal viability of any new local government. This action can be effective in slowing down the process of further fragmentation but it does not help to address the inadequate scale of the already existing municipalities. Even

[51] The issues of local fragmentation and administrative capacity have a significant political component and from that perspective they were reviewed in GOLD I. Our main perspective here is on how fragmentation and administrative capacity may affect the fiscal sustainability of local governments.

[52] For example, in El Salvador, the Fund for Economic and Social Development (FODES), which is the main source of local revenues, is distributed according to a formula that distributes 25 percent of the funds evenly to all municipalities.

though many countries offer voluntary consolidation or amalgamation programs, these measures, as is the experience in other regions of the world afflicted with the same problem, tend to be quite ineffective even when accompanied by financial incentives for the municipalities involved; in fact voluntary amalgamation of local governments has been very rare in the region. One solution is the forced amalgamation by central mandate. But even though this approach has been used by some countries outside the Latin America region, the approach can be quite disruptive and politically difficult to implement, which explains why it has never been used in the region. Perhaps a more attractive and potentially equally effective approach is the promotion and creation of associations of municipalities into *mancomunidades* for the delivery of certain public services requiring certain minimum scale.[53] This is an approach still largely unexploited but it is currently being developed in some countries, especially in southern Brazil, Ecuador or Peru.[54]

The trade-off between economies of scale and representation[55]

The issue of an optimal scale of local governments presents an inherent tradeoff between the (potential) better political connection in terms of representation and accountability of smaller jurisdictions with the (potential) greater fiscal viability of larger jurisdictions. Thus, the issue of jurisdiction size is not only or primarily a technical issue, but also one that involves political considerations.[56] Economies of scale allow greater

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[53] However, these programs can be difficult to implement. For example, in El Salvador, the National Plan for Territorial Development and Organization (PNODT) was supposed to promote *mancomunidades* and general cooperation among local governments which would allow them to lower administrative costs by working together to print jointly needed forms and gathering regularly to share ideas. However, local governments remain uncoordinated and have for the most part failed to work together and take advantage of economies of scale where applicable.

[54] Other approaches to dealing with the problem of inadequate scale include the contracting out to private companies of some services, so that private companies can benefit from sufficient scale by supplying different municipalities, or the creation of ‘sector specific’ service governments or districts. The privatization of services is being used in several Latin American countries quite successfully; the creation of special districts or single purpose jurisdictional arrangements, quite common in North America, has been adopted at some level in some countries in Central America (El Salvador, Nicaragua) for the administration of health and education (SILOS-SILAIS, etc). Special districts do the same thing as *mancomunidades*, but these latter are purely voluntary. See Martinez-Vazquez and Gomez (2008) for a discussion of the issues and solutions.

[55] See Martinez-Vazquez and Gomez (2008) and Imansyah and Martinez-Vazquez (2009) for a more extensive discussion of this issue.

[56] From this perspective, it is interesting to note how some larger local governments organize themselves; for example, in the case of Bogotá, the sub-mayoralities receive modest grants for community participatory

efficiency in services production thanks to the greater size of service areas covered with the union of local governments. Nevertheless, the responsiveness to the needs and preferences of residents and accountability of public officials tend to deteriorate with size or scale. to the local government.

The essence of this trade-off between the greater efficiency of smaller governments that can better match local preferences and desires of local residents in their expenditure allocation and economies of scale in production with lower costs associated with larger governments implies a compromise solution between the two objectives. In particular, it implies that lower cost effectiveness in the delivery of public services may be offset by greater efficiency in responding to the needs and preferences of local residents.

Local administrative capacity

Closely associated with the problem of small size is the lack of administrative capacity of local governments in many countries. Interestingly, one effect of decentralization reforms in the region has been the distancing between central government agencies and municipalities. Central governments (or state or provincial governments in the case of federal countries) spend too little time and resources in developing the capacity of local governments.[57] Some of the slack has been taken up by municipal government associations, which, for example in some of the Andean countries and in Central America, provide their members with assistance and training. However, these associations often lack the resources necessary to address this issue. Central (or provincial–state) governments can do much more. Some best practices do exist in the region (see Box 1) and could be imitated in other countries.

Summarizing, there are no exact answers or methodologies to address the issues of optimal size for municipalities. Several goals need to be pursued including cost

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decision making, while larger metropolitan/network infrastructure decisions are made and implemented by the city government.

[57] The Latin America region shows a lower prevalence of Ministries of Local Government/Interior/Home Affairs that are more prevalent in other regions of the world and higher presence of special agencies designed to exclusively address the needs of local governments, such as ISEDM y FISDL in El Salvador or INIFOM in Nicaragua. In general, it is easier for these types of specialized agencies to play a supporting and capacity development role than it is for sectoral ministries; the downside is that the specialized agencies tend pull a lower rank within the government administrations in the bargain for additional resources.

efficiency and representation and accountability and several constraints need to be met regarding fiscal viability and administrative capacity. See Box 2.

Box 1: Developing Local Administrative Capacity in Chile

Although Chile is not by any means a highly decentralized country in the Latin America region, it has had several successful programs dedicated to strengthening the administrative capacity that could serve as a best practice for the region. An important ingredient of this success is that municipal governments maintain a stable number of employees –with the support of the law- and that they can pay relatively competitive wages, comparable with private sector levels, so that municipalities are able to better retain professional and technical staff.[58] Chile's municipal institutions have been strengthened through new municipal development initiatives such as: the Municipal Development Program (PROFIM), the Program of Innovation and Best Local Government Practices, the Program for Regional and Institutional Development, the Program for Information Technology and Communications and the National System of Municipal Information. Each of these programs has been designed to strengthen a specific aspect of municipal administrative capacity and have been in operation for the past fifteen years, often funded by foreign governments and multilateral agencies.

PROFIM was designed to improve the management capacity of local governments in planning, productive development, financial management, human resources, and management of social services. The program was implemented in two phases. The first, between 1993 and 1999, included only 24 municipalities, and the second, between 1999 and 2004, was extended to include a further 100 municipalities.

The Program of Innovation and Best Local Government Practices encourages municipal officials who wish to innovate in both technological and social programs through a competition that invites all municipal officials in the country to submit their best initiatives and innovative projects. Those selected participate in exchange programs to learn about good practices in other national or foreign municipalities.

The Program for Information Technology and Communications for municipal management and citizen control promotes the creation of electronic portals open to the public for information on municipal procedures and the delivery of municipal services.

The National System for Municipal Information (SINIM), allows access via Internet to different indicators –by municipality, region or for the whole of the country's local governments- on management, finance, staff, public services, education, health and other key aspects of the Chilean municipal functioning. (see: www.sinim.cl).

A few years ago, a National System of Municipal Training was established by request from the Chilean Association of Municipalities, which operates it jointly with the Sub-Secretariat of Regional and Administrative Development of the central government.

Box 2: Four Possible Criteria to Consider for the Minimum Size of Municipalities

Although the desirable minimum size of municipalities is a complex issue that must be addressed in the historical and political contexts of each country, there are four basic criteria that can be followed as guideline for policy decisions:

(1) *The production/cost efficiency/population criterion.* The international experience shows that although

[58] See Castañeda (1992) for a discussion of these issues. Adequate salaries and employee turnover are still major problems for local governments in many countries in Latin America. For example, in the Dominican Republic, 75% of local government employees earn less than 3,000 Dominican pesos ($??), a salary which places them in the bottom quintile of the country's earnings distribution.

unit costs for some public services are not much affected by the scale or size of the local government, in the case of other services (such as water, brown fields or public transportation) unit costs can be much affected by scale. Thus, given the existence of economies of scale for some specific services, depending on the assignment of expenditure responsibilities, in order to arrive at the lowest cost of production it is required to reach a minimum size in terms of population. Depending on the type of services, the minimum population size can range between 10 thousand and 100 thousand. Yet we must note that there are other ways to provide services in a cost efficient manner than by imposing a minimum absolute size on all local governments, including buying the services from a larger local government, creating an association between several smaller local governments and join forces to produce the service, or even buying the services from a large privatized producer. What this means is that this criterion of a minimum population size should be administered intelligently with flexibility to allow for these other service delivery possibilities.

(2) *The representation/political responsiveness/accountability criterion.* The general presumption is that smaller local governments will generally tend to be more representative and accountable to the residing population. But consideration must also be given to ethnic diversity or fractionalization of the population and adequate representation of the interest of minority groups. Consideration may also be given to population density. From an accountability and representation focus it would seem that a simple but useful rule of thumb will be the time required to travel to the location of the municipality building.

(3) *The financial/fiscal capacity criterion.* It does seem reasonable to require that any new local government have a minimum level of economic capacity to self finance some of its service needs. How to measure this capacity is not always an easy matter, but it should involve some approximation to the “expenditure needs” and the “fiscal capacity” of each potential municipality and the setting of some threshold for the difference between needs and capacity.

(4) *The administrative capacity criterion.* This can be measured in a number of different ways, but fundamentally what is required is that there be qualified personnel available for running efficiently the business of the local government.

II.b Issues on Intergovernmental Fiscal System Design

Lack of clarity in the assignment of expenditure responsibilities to local governments

One of the weakest points of many decentralization programs in Latin America has been the scant attention given to a clear assignment of expenditure responsibilities of sub-national governments, thus ignoring this crucial first step in the design of any system of intergovernmental fiscal relations. Instead, the focus often has been almost exclusively on putting in place some form of financing scheme.[59] At present, there continues to be too much emphasis in many countries of the region on decentralization processes simply understood “as the provision of some of revenue sharing and transfers” to local governments, ignoring the fundamental rule that “finance should follow function.” To be sure, in most countries in the region it is possible to extract from different pieces of legislation (including the constitution, municipal codes) an explicit statement or an

[59] See Bahl and Martinez-Vazquez (2006) for a discussion of the proper sequencing of decentralization reforms.

approximation of what expenditure assignments may be, but this is generally misleading in that in those assignments there is still a high level of imprecision regarding what local governments are responsible for vis-à-vis central agencies (or provincial- state agencies) and regarding national transfers and grants. On closer analysis, the assignment of functional responsibilities remains in many cases too general and vague. For example in El Salvador, the municipal code gives authority to municipalities to perform a list of duties or responsibilities that clearly overlaps with those also assigned to central government; the same is true in Uruguay. In other cases, the vagueness and confusion lie in the way that legislation is implemented (or not implemented). For example, Law 66 of 1997 in the Dominican Republic added primary and secondary education to the responsibilities of local governments; yet real power and decision-making remain with the regional Education and Culture committees, which may be considered a deconcentrated tier of the central government.[60]

Beyond the operational inefficiencies associated with the unclear assignments of functions, an important consequence of unclear responsibilities are the ambiguities in political accountability this situation introduces—how do people know which level of government to hold accountable for what? The governance implications and what this means for attaining the purported benefits of decentralization are quite considerable.

Another problem is that the assignment of expenditure responsibilities in practically all Latin American countries is uniform for all local governments, regardless of their size and administrative capacity. As we saw above, a good way to address these shortcomings is the creation of associations of local governments into *mancomunidades*. Alternatively, there may be room for asymmetric assignments for municipalities of different size and administrative capacity

Nevertheless, highly asymmetric assignment of expenditure responsibilities can itself lead to confusion. For example, in Ecuador, the Constitution (Article 226) establishes the obligation of central government to transfer functional competencies at the

[60] Although the trend in the region has been toward more devolution of responsibilities to local governments, there are exceptions. For example, Jamaica has been recentralizing functions previously assigned to the local governments (Parish Councils) through the creation of national entities under the tutelage of the Ministry of Local Government, which is in charge of fire protection services, parks and markets.

discretion (by voluntary request) of sub-national governments. This means that any sub-national government can request a full or partial competence in a particular area at their discretion, leading to great heterogeneity in central-local relations, thereby compromising the overall effectiveness of intergovernmental coordination. A better practice could be to design two or at most three different packages of expenditure responsibilities that can be devolved to local governments depending on their administrative capacity. However, an important issue with asymmetric approaches is the need for using verifiable criteria—that is, differential assignments must be grounded in something other than political connections.

Another factor contributing to confusion in the assignment of expenditure responsibilities is the common practice of unfunded mandates. Frequently, line ministries may partially decentralize certain competencies to local governments without providing the required resources to implement them properly. There may also be increasing reporting requirements on local governments without adequate coordination among central government agencies or the provision of the technical and financial means to make that reporting possible.

A workable system of expenditure assignments, no matter how specific, is developed in the laws and regulations, always requires institutions of coordination and effective dialog between the different levels of governments. Because of the larger number of municipalities, it is important that the voice and interests of these local governments be represented by associations of municipalities. On this front there has been considerable progress since practically all countries in the regions have developed effective municipal associations that have taken on the representation of municipal interests.[61] However, central authorities have not always recognized and accepted these associations as strategic partners in improving policy design in expenditure assignments and in strengthening all other components of fiscal decentralization systems.

One final issue in the practice of expenditure assignments is the practically universal lack of effective and transparent methodologies to translate the assignment of functional responsibilities into expenditure needs. Sometimes, historical costs (or levels of expenditures prior to decentralization) are used as a guide. Different methodologies

[61] See, for example, the discussion in Porto (2009).

are used in other countries around the world that could be successfully implemented in the region. The advantage of having some effective method to calculate expenditure needs is that the discussions on, and ultimate design of, revenue assignments, whether through own revenue or fiscal transfers, becomes more informed and rational.

Insufficient revenue autonomy

The level of tax revenue autonomy of local governments differs quite significantly across Latin American countries. Countries such as Brazil and Chile have relatively high autonomy and countries such as El Salvador, Mexico and Peru have significantly less autonomy. But, in general, as in some other regions of the world (Africa, Asia and many European countries), local revenue autonomy in Latin America remains below what is desirable. There is a debate in the fiscal decentralization literature as to what the "desirable" level of local revenue autonomy would be. According to one view, all that is needed is that local governments have revenue autonomy "at the margin." This means that they should have to either raise or lower their own taxes in order to expand or contract their budgets, even when the rest of the financing is done through government transfers and revenue sharing. From this point of view, autonomy at the margin should thus allow local authorities to adjust their resources while showing flexibility, accountability and transparency towards residents. According to a second view, more accountability and especially more fiscally responsible behavior of local governments within the national public finance system require near to full self-financing by those local governments that have the fiscal means –i.e., the necessary own tax base — to do so, while other local governments with lower tax bases also ought to be helped through equalization grants. This second view also allows for the existence of conditional central government grants to support the implementation of national development programs and priorities at the local level. Although newer and less well-known, the second view offers all the advantages of the first view plus it can add significantly on the fiscal responsibility and government accountability sides. However, it could be argued that fuller financing of municipalities with their own taxes may not be possible because of tax administration issues; for example, collecting some taxes at the central level could allow economies of scale and information advantages that would not be present if those taxes were collected locally. But here it is very important to differentiate between the assignments of certain taxes to local governments (in the sense of which level gets the revenues and decides on the applicable tax rates) and who actually does the administration of those taxes. In particular, it is quite possible to assign a certain tax at the local level and have it administered by the central tax administration authorities.[62] For example, in Chile, the real estate tax is entirely designed for municipal use but it is collected by a specialized agency of the central government (Servicio de Impuestos Internos, SII), which manages to keep the levels of tax evasion low.

The lion's share of financing for local governments in the region continues to come from different forms of central government transfers including revenue sharing. This is a common feature in other regions of the world; transfers have experienced an increasing trend as they are the most often used form of financing newly devolved responsibilities to local governments. With this in mind, some important and correct policies have been adopted in various countries of the region. For example, many countries in the Latin American region have taken steps to increase the share of own taxes in local budgets. Most countries have now assigned the property tax to the local level. This is a good thing because there are many features of the property tax that make it an ideal tax for local governments.[63] However, the property tax remains highly underutilized in the region for a variety of reasons.[64] As we have seen, several other taxes have also been assigned to local governments in many countries, including vehicle tax, betterment levies, and different forms of business taxes and licenses. These are good measures to be imitated by those countries that still allow too little local tax autonomy. Another best practice measure to be imitated by all countries in the region is to allow a

[62] See, for example, Martinez-Vazquez and Timofeev (2005). We must note that there is no guarantee that the central tax administration will be more efficient and productive in the collection of local taxes; among several concerns, the central administration may have low incentives to collect local taxes. Recently in Costa Rica collections from the property tax increased very significantly after the administration and enforcement of this tax was shifted from the central tax administration to the municipalities.

[63] The property tax is highly visible and because of the low geographical mobility of its base and because property values tend to reflect well in general the quality of local services, the property tax can approximate well the concept of a benefit tax, where residents pay for the services they receive (see Sepulveda and Martinez-Vazquez, 2009). All of this is likely to increase political accountability of local officials. The property tax may also have relatively low efficiency losses compared to other local taxes. In terms of administration, there can be flexibility in taking advantage of a mixed local and central administration and enforcement approaches See Bahl, Martinez-Vazquez and Youngman (2008 and 2010).

[64] See Sepulveda and Martinez-Vazquez (2009) for an evaluation of the performance of property taxes in the region.

certain degree of discretion to municipalities in setting the rates of their local taxes, between some maximum and minimum approved levels.

Nevertheless, it is difficult to make a strong case for the policy design of a greater degree of tax autonomy for local governments when there is at least a perception that many local governments in the region do not make effective use of the tax autonomy that is currently granted to them in the law. This is most clear in the case of the property tax for which actual revenues collected are a small fraction of the revenue potential.[65] So the realization of more revenue autonomy for local governments may need to be accompanied by a significant improvement in local tax effort. However, it is important to note that low tax effort (known in the region as 'pereza fiscal') is a complex problem. First, there is often confusion between low tax effort ('pereza fiscal') and low tax capacity or economic/fiscal poverty of jurisdictions. Establishing the presence of 'pereza fiscal' requires a comparison between actual tax collections and potential tax collections of every particular jurisdictions; this is a difficult and complex task in many cases. Second, once the presence of 'pereza fiscal' can be established, it is important to understand its multiple roots, from simple political economy issues (local officials may simply be happy spending funds but never raising them), to lack of economic resources (building an updated fiscal cadastre is expensive), to inadequate methodologies for evaluation, to the lack of skilled human resources, or even to the negative incentives to local tax effort provided by the central government's existing fiscal transfer system. However, the region offers success stories in raising local tax effort, as provided by the recent experiences of Bogotá and Lima (see Box 3).

Box 3: A Tale of Two Cities: Bogotá's Success Story in Raising Local Tax Effort and Lima's Success with a New Approach to Tax Administration

<u>Bogotá</u> provides an example of a local government that has had success in raising local tax effort (the city was awarded a prize by the United Nations in 2002 for being the most improved local government in the world.) Starting in the late 1980s, The Municipality of Bogotá began a program of civic education during which it emphasized the importance of paying taxes and the accompanying benefits for citizens that derive from a stronger local government. It significantly increased property tax collections through a series of administrative improvements, enforced business taxes, privatized certain government run

[65] See Sepulveda and Martinez-Vazquez (2009)

organizations, and successfully issued its own bonds, including foreign markets, receiving a AAA rating, [66] Particularly noteworthy is that the Municipality of Bogotá in 2006 raised 42 percent of its tax revenues from the local business tax (Impuesto de Industria y Comercio, ICA). The updating of the fiscal cadastre in 2009 has also produced significant increases in revenues from the property tax. It is expected that the assessed tax base for this levy will increase by more than 50 percent by 2010, bringing additional $51 millions in revenues or a 13.3 percent increase over collections before the updating of the cadastre.

Lima introduced in 1996 with some other provincial Peruvian municipalities a semi-autonomous Tax Administration Service (SAT in Spanish), with the goal of increasing collections for own local taxes. This followed the model of a national-level SAT. The SAT of Lima is autonomous in its financial and human resource management and it is financed through a share of the taxes and fees commissions it collects. The sharing in collections by Peruvian municipalities range from 3% to 10%. But note that the local authorities are still responsible for regulating and controlling the SATs' work. There have been some clear benefits for those Peruvian municipalities that, like Lima, adopted a SAT approach. For example, those municipalities that adopted a SAT increased their own revenue by 80.9 %, or 9 % annual average, between 1998 to 2007; by comparison over the same period the municipalities that did not adopt a SAT saw their revenues increase by 61.2%, or 6.8% annual average. The empirical studies show that the trust in tax administration in Lima and other municipalities where a SAT was adopted has increased. This could be attributed to lower political intervention in administrative processes, higher client focus management, improved public relations, and a reduction of corrupt practices. But not all have been kudos for the new local tax administration. The same empirical survey studies identify some issues associated with the SATs: a limited link between the revenue collection and public services and the public perception of tax administration as "insensible." But some of this is to be expected since the SATs have gone against the conventions and took advantage of not well defined rules, especially in the SAT of Lima. One of the key characteristics of the SAT agencies has been their innovation drive, including internal processes, the use of modern technologies, human resource development, improved financial management, and the collaboration across tax administrations.

A third issue is the need to explore what other taxes with significant revenue potential could possibly be assigned to local governments in order to increase their revenue self-sufficiency, such as, for example, a flat-rate piggy back personal income tax or local surtaxes on some excise duties, such as those on vehicle fuel. Another possibility may be the wider adoption of other taxes that have been working quite well in some countries in the Latin American region. An example of that is the more intense use of betterment levies of taxes, which can complement annual real property taxes. Betterment levies are being used quite successfully, for example, in Colombia. See Box 4**.** Another possibility is the adoption of some form of final retail tax such as in the case of Brazil's ISS (Tax on Services, as discussed in Box 5**.)** But although this type of tax fits fine within the Brazilian tax system where the federal and state VAT levies exclude for their bases

[66] See Acosta (2004).

many important services, it may be more problematic in most other country contexts for overlapping with the existing VATs.[67]

An alternative to the ISS, that would not present potential conflicts with the existing national VATs, is the broader base local business tax (Impuesto de Industria y Comercio, ICA) in Colombia. This is a local "direct" tax on all business activities (industry, trade and services) that uses as the presumptive base the monetary value of annual transactions and it is levied at different rates depending on the sector ranging from 0.41 percent for the production of food stuffs to 1.38 percent for the sales of alcoholic beverages, tobacco products and fuels; financial transactions pay a rate of 1.1 percent. The ICA is one of the most important sources of municipal tax revenues in Colombia, on average representing approximately 42 percent of annual tax revenues of municipalities, but as much as 72 percent in the Municipality of Cali.

Another form of local business tax with revenue potential is Chile's "patente municipal." This annual levy, which is administered by the municipalities, is paid on any commercial activity (trade, professional, industrial, and sale of alcoholic beverages) that requires a permanent office location; municipalities select rates between 0.25 and 0.5 percent that fall on the declared (to the national tax administration) own capital of the business. The "patente municipal" raises approximately the same amount of municipal revenues in Chile as the property tax ("impuesto territorial.")

In order of importance, in terms of revenue collections in the Latin American region, the two sets of taxes that are generally of equal importance include, first, the property taxes (impuesto sobre los bienes inmuebles, IBI) and the different taxes on business activities and services. In a distant third place we find those taxes falling on the use of motor vehicles. Generally, there would appear to be fiscal space to increase local revenues for taxes on motor vehicles. This is also the case in many countries in the regions for local fees and charges where in many cases these can be completely out of date.[68]

[67] For example, in the recent past Nicaragua eliminated a quite productive local sales tax as part of policy conditionality from the International Monetary Fund precisely because of the conflict it represented with the existing national VAT.
[68] For example, reportedly in the case of El Salvador municpal fees and charges date from 1954.

Box 4: Betterment Levies ("Contribución de Valorización") in Colombia

In general terms, a betterment tax recoups some of the benefits accrued to property owners due to adjacent public investment that increases the value of that property. (Bird & Slack 2006). Since most real state property is significantly affected by public facilities surrounding it, this tax has significant revenue potential. In Colombia, this tax receives the name *Contribución de Valorización*, with a long history dating back to colonial times. The constitution gives municipalities and other public entities the right to a share on the added value produced by investments made in urban settings (e.g. infrastructure works). The tax is being looked at with interest in other countries and the first Latin American conference of Valorization was held in Bogota (Colombia) in 2009.[69] The levying of the tax implies a series of steps including, the determination of the costs and benefits of the project, the geographical area that is expected to benefit and a method to distribute the costs and benefits of the project among the different properties. This distribution can use an array of 'benefit factors'(use of property, closeness, access, etc.) or simply a land area, linear size of lot front, etc.

Bogotá also levies a tax called *Participación en Plusvalia*[70] defined as the contribution owed by owners of real estate property as a result of modifications that increase the value of property. This is similar to the betterment tax except that it captures only changes in urban codes that affect the ways the property can be used or the intensity of its use (how much can be constructed) that may increase its value.

Box 5: The ISS in Brazil[71]

The ISS (Imposto sobre Servicos/Tax on Services) is a municipal level tax levied on those services that are left out of Brazil's state value added tax (ICMS). The services that may be taxed under ISS are defined by federal law, but the states may decide whether to tax or exempt some of those services. The base covers a wide range of services including, IT services, rental of premises, medical services, veterinary services, personal services (barber shops, etc), professional services (engineering, architecture, law, accounting, etc.), education and training, hotels and tourism, parking, leisure entertainment (movies, shows), repair services, financial services (by banks, etc.), municipal transportation, port, terminal, and airport services. The tax base is the revenue generated from the provision of services. The rate that municipalities may charge for ISS is locally set but cannot exceed 5 percent (in the past, it could go as high as 10 percent). Although the tax rate to be applied is the one charged by the municipality in which the business resides, there are exceptions in which the tax rate is the one belonging to the municipality where the service is rendered (e.g. construction). Producers of services are charged with paying and recordkeeping of the ISS. Buyers of services do not directly see the tax they pay as it is included in the price charged to them by vendors.

Although the ISS is collected at the municipal level, its importance varies greatly across local governments; according to the Receita Federal (national tax administration) 1 percent of municipalities (out of more than 5,500) account for 73 percent of the tax collection. The ISS collected approximately 0.5% of GDP in the mid-to-late 1990s and more recently, tax collections are near 0.8% of GDP. As the maximum tax rates were lowered sometime in the early 2000s, the observed increase in collections as share of GDP might come either from an expanded tax base and/or better efforts in collecting the tax. There is some evidence of the expansion of the tax base; when the rates were lowered in 2003, the ISS

[69] I Congreso Latinoamericano de Valorizacion; http://www.lonjadebogota.org.co/Portals/0/Docs/
[70] Information about this tax may be found at:
http://www.shd.gov.co/portal/page/portal/portal_internet/impuestos/impuestos_imp/Plusvalia/INFO%20PLUSVALIA
[71] See, among others, Deloitte (2010), Government of Brazil (2009), KPMG (2006), Banco Central do Brasil (2000) and Purohit (1997).

was also extended to services provided by financial institutions –in particular banking services.

The ISS is not without problems. One issue is the multiplying of the tax in the production of products/services for future use, since users of services cannot identify the amounts of ISS paid to balance against the ISS they would receive; remembering that the price for the services are ISS inclusive. Another issue has been the treatment given to exports. The import of services is subject to this tax, and although it should not apply to exported services, in fact in serveral circumstances some exports may become subject to this tax.[72] .

With regard to the future of the ISS, there have recently been calls in Brazil for the simplification of the tax system where–one way or another- the elimination of the ISS was contemplated. This viewpoint supports the integration of the federal-based IPI and state-based ICMS (both value-added type taxes) and the locally-based ISS within a general VAT whose revenues could be shared by all three levels of government. However, the increasing importance of the ISS in municipal budgets, the potential loss in local autonomy, and the difficulties of coordination at different levels of government weigh-in on the other side of the argument.

Unbundling revenue sharing

Revenue sharing is the most common mechanism for arranging fiscal transfers to sub-national governments in Latin America and in many countries provisions for revenue sharing are enshrined in the constitution. As mentioned in Section 1, fiscal decentralization to local has often been understood simply as the sharing of central government revenues without relating the additional revenue to any particular expenditure assignments to local and regional governments.

One of the most negative aspects of revenue sharing in other parts of the world is that it can exacerbate the substantial horizontal disparities across local governments when carried out on a derivation (i.e. origin basis). Fortunately, this has generally been avoided in Latin American countries.[73] An important exception has been the revenue sharing in natural resources, which in countries such as Peru and Ecuador is fundamentally implemented on a derivation basis. This has led to significant horizontal disparities among municipalities.[74] In most Latin American countries fiscal transfers from revenue

[72] See KPMG (2006).
[73] Note that this does not mean that there are no significant regional disparities in the Latin American region, it simply means that the more frequent use of the derivation or origin principle would have made things worse. As discussed above, regional fiscal disparities arise from the differences in economic bases. And the more tax autonomy is provided the higher the potential for enlarged fiscal disparities and therefore the higher need for the implementation of equalization grants.
[74] In the case of Peru, the evolution of international prices for natural resources has had a significant impact on the transfers system. The Ministry of Economy and Finance (MEF) currently shares 50 percent of mining and hydrocarbon revenues with local governments. Transfers from central government to regional

sharing are distributed according to a set of parameters or formulas that tries to achieve several objectives, one of which is some degree of equalization. One of the positive aspects of revenue sharing is that it manages to combine the unconditional use of funds with rather plentiful and buoyant sources of revenue.

The main problem with general revenue sharing is that there is some confusion over what exactly distribution formulas are trying to achieve; pursuing many objectives with essentially one instrument tends to be the source of that confusion. Also, it is not always clear that the best way to proceed is to give local governments the unconditional use of all of these funds.[75] The reforms being introduced or contemplated in some Latin American countries consist fundamentally of the unbundling of the revenue sharing system into two additional separate transfer mechanisms, namely: (i) an equalization transfer with unconditional use of funds and financed from a pool extracted from the shared revenues. This would exclusively pursue the goal of equalization of horizontal fiscal disparities, and (ii) a system of specific or conditional grants for current expenditure and investment purposes, financed with also some of the revenue sharing funds. The use of these funds would be earmarked in pursuit of a variety of sectoral objectives. Advances in this general direction have been made in countries like Brazil and Chile, while countries like Ecuador, El Salvador and Honduras are still using an unbundled revenue sharing scheme as the main funding source of local governments,

The need to rationalize the transfer system

The system of transfers plays a pivotal role in drawing together the other elements of the intergovernmental fiscal system—making up for the vertical and horizontal gaps

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and local governments increased exponentially after 2000 but plummeted in 2009. This experience has given rise to very significant horizontal imbalances between municipalities because the sharing of mining revenues is highly concentrated on seven departments, accounting for close to 80% of the total. This has created problems with increased unspent balances during the boom years because of limited capacity to identify and execute productive investment projects. It has also continued to expose local governments to high volatility in revenue streams**,** as witnessed with the oil price boom of two years ago and the more recent global recession. This raises the larger issue of the need for diversification of the subnational revenue pool.

[75] The point here is to achieve in the shorter term a more appropriate mix of unconditional and conditional grants, but without losing sight of the fact that, in the longer term, it is desirable to increase unconditionality of local governments funding – although obviously not for everything--, as new functions are undertaken, local performance improves, and so on.

that own source revenues and revenue sharing cannot meet, not undermining local tax effort, creating incentives for externality generating spending that local governments would not fund out of their own sources, not undermining incentives for creditworthy municipalities to borrow, and so on. This all requires a carefully executed structure of transfers, using different instruments to pursue different objectives and making sure these instruments do not work against each other.

With the exception of a few countries, the current system of transfers to local governments in Latin America lacks a clear orientation. Most countries still have to introduce unconditional equalization grants that incorporate in some formula-based measures of expenditure needs and fiscal capacity.[76] When some equalization elements are introduced into the revenue sharing formulas, actual revenue collections are often used instead of measures of tax capacity, thereby creating problems of negative incentives for tax effort. The current approaches used to incorporate differences in expenditure needs in the revenue sharing formulas are also problematic. For example, the use of population, which is very common, is a good approximation of need for some services but not so good for others. The number of children of school age provides a better approximation for basic education needs than population as a whole. The relative share of infants and the elderly in the population provides a better approximation for health care needs than the population per se. In some cases, especially in Central American countries like El Salvador and Nicaragua, the existing formulas positively discriminate in favor of small municipalities, which in turn create problems of fairness and economic viability and regional development.

Even though many countries have some form of conditional grants, these lack structure and predictability, especially in the area of capital grants. When conditional grants are used, complexity of the system is often a problem.[77] This complicates compliance-administrative costs by local governments, in many cases penalizing smaller jurisdictions with low administrative capacity, and also dilutes the achievement of central government goals. A remedy to these problems, following best international practice, has been to consolidate many of these specific or conditional programs into block grants.

[76] Some exceptions include Chile's revenue equalization grant.

While the specific conditional grants impose on local governments a narrow use of funds (e.g. funds to buy furniture for primary schools), block grants are still conditional but have much broader parameters for the use of funds (e.g., the funds must be spent on primary education). The advantages of using just a few block grants are simplification and expansion of choices for local governments, thus aligning the final allocation of public resources more closely to the priorities of individual local governments (e.g., repairing the school building instead of buying new furniture), without unduly compromising the general goals of central government sectoral policies (e.g., promoting the quality and standards of primary education in the country.)

Increasing fiscally responsible local borrowing

Historically the Latin American region has suffered some of the worst incidences of fiscally irresponsible sub-national borrowing in the world. The negative experiences of Brazil and Argentina, with uncontrolled sub-national borrowing and hyperinflation during the 1980s and 1990s, are still used as examples of what can go wrong in this area of sub-national finance. One consequence of those experiences is that the policy of some countries in the region towards local government borrowing has become excessively conservative and restrictive.

For example, in Chile, local governments are—in principle—not allowed to borrow or take out loans of any kind. But outright prohibitions are not necessary or effective either. In the same country, indirect borrowing through leasing contracts or by delaying the payment of current expenditure makes that norm difficult to enforce. In Uruguay, any domestic or foreign debt issue by local government needs to be approved by the national congress. Peru also provides an example of legislative conservatism in the matter of local borrowing: The central government has established indebtedness rules to maintain fiscal prudence by two laws (the Law on Fiscal Prudence and Transparency -LPTF- and the Law on Fiscal Responsibility and Transparency – LRTF-) Besides limits on debt service ratios and total debt the laws also limit the rate of growth of municipal expenditures to a maximum of 3 percent per year. However, this framework has not been fully enforced because of insufficient monitoring and the lack of effective sanctions and many local governments in Peru carry large budgetary arrears. At the other extreme, and more like an exception, is the case of Paraguay, where there is practically no limit or restriction on local borrowing.

Thus a pending challenge for several countries in the region is how to set up institutions that effectively regulate and monitor borrowing without becoming overly restrictive of local governments. Many countries are still struggling to introduce a credible system of penalties for lack of compliance. The development of information and monitoring systems covering all aspects of borrowing,[78] including budgetary arrears with official institutions and private providers, is urgently needed. But the key ingredient for fiscally responsible behavior of sub-national units remains the political will of the central government authorities to implement the existing regulatory frameworks.

A second challenge for practically all countries is how to make more credit available to local governments for responsible borrowing.[79] In practice, the level of borrowing by local governments in Latin America is far too low to meet the present large needs for public infrastructure across the sub-continent.[80] The exceptions are large cities, which tend to have ample access to domestic credit markets and in many cases also to international markets with accompanying international credit ratings. Thus, the capital cities of La Paz (Bolivia) and Lima (Peru) display a very different picture from that of most other municipalities.

The absence of real access to borrowing by the average municipality in the region is a complex issue. It is explained by a multitude of causes, ranging from the lack of tax autonomy of local governments to the lack of development of national financial markets. One potential remedy for the scarcity of local credit is the creation of semi-official financial intermediaries or municipal banks.[81] As shown in Table 6, several Latin

[78] Monitoring systems for local indebtedness have often proved of doubtful utility. For example, in Ecuador and Peru information on debt is taken directly from the financial statements of sub-national governments and is not crosscheck with other sources. In Argentina, the Federal Council for Fiscal Responsibility created by the Fiscal Responsibility Law of 2004 and in charge of monitoring compliance with norms and rules of fiscal and financial behavior does not receive timely information from the majority municipalities as of 2009.

[79] Part of the solution can be direct on-lending to municipalities by regional-multinational institutions such as the Confederation Andina de Fomento (CAF) or the Banco Centroamericano de Inversiones, or international organizations such as the Inter-American Development Bank (IDB) or the World Bank. However, a large part of the solution needs to be the mobilization of domestic credit sources.

[80] Brazil is an exception.

[81] Central governments also guarantee on-lending to local governments from multilateral international organizations, including the World Bank, the IDB, and CAF.

American countries have created this type of institution to facilitate long-term credit to local governments. However, the experience of these institutions has been mixed because of the difficulty of maintaining them at arms' length from central government officials and of operating them with strict banking criteria. See Box 6.

Box 6: Practice with Municipal Development Banks and Funds in Latin America[82]

Experience with municipal development banks in Latin America has been mixed, as has been the case in many other countries around the world. Although quite a few countries have introduced some sort of specialized financial intermediaries or municipal development funds to raise capital financing for local governments, fewer of those institutions have been transformed into financial institutions with market-oriented practices and controls channelling private savings to finance public infrastructure. This box presents a summary of experiences with municipal development banks and funds in the Latin America region.

Bolivia
The National Urban Development Service (Servicio Nacional de Desarollo Urbano (SENDU)) existed from 1972 to 1986. It was a semi-autonomous agency of the Ministry of Housing and Urban Affairs, which provided loans (as well as training courses and technical assistance) to municipalities. This body was severely criticized for its liberal loan policy, abolished in 1986 under the structural adjustment program imposed by the IMF, and not replaced.

Brazil
The Integrated Program of State Improvements (PIMES) was established as a municipal development fund administered by BADESUL, the development bank of the Rio Grande do Sul, which owns and controls it. The program has two components: 1) institutional and human resource development, and 2) infrastructure investments. The first component comprises about 10 percent of the total project costs and includes technical assistance, training and equipment for municipalities, the State Water Company (CORSAN), other state sector agencies, etc. The second component represents about 90 percent of the total programs budget and includes the financing of projects in water supply and sanitation, street paving and lighting, drainage and erosion control, and so on. The Municipal Action Program (PRAM) was established in 1991 by the Parana state bank BANESTADO, originally serving as the bank's financial agent. PRAM was eventually converted into a revolving State Urban Development Fund (FDU), administered by BANESTADO with technical assistance provided by a legally autonomous organization that in practice functions as a department of the State of Parana Secretariat of Planning.

PARANACIDADE was created in 1996 as a non-profit corporate entity to provide institutional and technical services to municipalities in Parana; this institution also collects and invests financial resources from the state's urban and regional development program, managing the State Urban Development Fund (FDU), which makes loans to municipalities at maturity ranging from 8 years for urban infrastructure to 10 years for social infrastructure. One of the main explanations for PARANACIDADE's success is its support of capacity building for municipalities.

[82] See Peterson (1996). There are other relevant initiatives in the region that for space reasons are not developed in this box, including the Banco del Estado (BEDE) in Ecuador and La Caixa in Brazil. At the regional level the Confederacion Andina de Fomento (CAF) and the Inter-American Development Bank (IDB) have been active supporters of on-lending programs for the development of local public infrastructure.

Colombia
Colombia has been successful in using its Municipal Development Funds to accelerate the development of private credit markets for local government. The Territorial Financing Institution (FINDETER), which began in 1994 as an infrastructure financing window within the National Mortgage Bank, eventually evolved into a development bank for municipalities, working through the commercial banking system. In essence, FINDETER operates as a second-level financing institution which re-discounts commercial bank loans to municipalities. The banks' good credit experience through FINDETER has led them to commit their own resources to municipal lending. Intermediate-sized cities and departments in Colombia now borrow primarily through commercial bank loans, while small cities and towns continue to rely on FINDETER. The largest cities now finance their credit requirements primarily through bonds.

Honduras
The Municipal Bank (BANMA) was established in 1961 as a bank owned by municipalities with the intent of providing municipalities with financial resources for investment projects and strengthening their administrative capacity. However, in 2002 the National Congress approved a decree liquidating BANMA due to the failure of its officials to raise enough capital to meet national standards of operation.

Mexico
The federal public works bank, BANOBRAS, was founded in 1933 as the Banco Nacional Hipotecario Urbano y de Obras Públicas, S.A (National Urban Mortgage and Public Works Bank), and has long had a loan program for municipal development. Its operations, however, became complex and bureaucratic and the allocation of financial resources soon responded more to political than financial criteria. The bank's heavily subsidized loan program used to focus on social housing, water supply systems and the construction of markets and abattoirs. Since 1988, its interest rates have come close to market rates and BANOBRAS has switched its focus to improvements of municipal land registers.

II.c Issues on the Budget Process and Transparency

Streamlining the budget process at the local level

Budgets and the budget process at the local level in Latin America have improved significantly in recent times. A significant innovation has been the introduction of participatory budgeting (See Box 7). Nevertheless, a variety of issues at different stages of the budget process still need to be addressed in several countries in the region. In terms of budget planning and formulation, as we have seen, there are still countries where local governments must have their budgets, or certain aspects of them, approved on an annual basis by higher levels of government. [83] Ex-ante monitoring and approval of local budgets by higher level authorities is not needed, where you have local elected councils and an effective ex-post audit system and the use of the courts to address irregularities. Local budget autonomy is often also limited in the case of investment projects.[84] This

[83] These countries include: Bolivia, Costa Rica, Jamaica, Mexico, Nicaragua, Panama, Paraguay,.
[84] For example, in Peru all public investment projects must be approved by the National Public Investment System (SNIP) which is managed by the Ministry of Economy and Finance (MEF). Through the General

type of approval is not desirable either even though coordination and exchange information can be very useful.[85] This does not mean that smaller rural municipalities may not benefit from technical assistance in putting together improved budget documents. Another issue in the preparation stage is the lack of linkages between planning and budgeting. It is frequent to see many development plans at the local, regional, and national levels that lack coordination and that do not relate to actual budgets in terms of the cost of activities for the fulfilment of strategic objectives.

In terms of budget execution, the misappropriation or lack of the proper appropriation of funds by central government is still a problem in several countries. For example, in Haiti, 90 percent of local government income supposedly comes from transfers from the Funds for the Operation and Development for the Territorial Collectives (FGDCT), administered by the Department of the Interior. This central government agency claims to distribute those revenues as follows: 50 percent to local governments,[86] 40 percent for capital investments and 10 percent remaining within the Department of the Interior to cover administrative costs. However, recent studies show that these funds are not being distributed as the Department of the Interior claims, and that a significant share is retained by the Department to finance its own projects. The budgets of communes (i.e. the local governments in Haiti) are the most directly hurt, receiving 33 percent less than what they are budgeted to receive. In nominal terms, local governments are receiving only $2.50 per person annually, which dramatizes the significance of the lower revenues that they actually receive. Honduras provides another example, where the law is not complied with by the central authorities. In particular, while the Municipal Code establishes that the central government should allocate 5 percent of its tax revenue to the municipalities, in fact only 3 percent appears to have been allocated in the most recent years.[87] Other countries, as the Dominican Republic, are experimenting similar situations.

Directorate of Multi-Sector Programming (DGPM), MEF has the power to cancel any approval made by regional and local governments if DGPM consider that SNIP criteria have not been properly applied.

[85] The agreements of the local councils can be challenged as in the case of other laws in the constitutional courts.

[86] Of this 50 percent that is designated for local governments, half is supposed to go to the communes, 30 percent to communal section councils, 7 percent to departmental councils and the remaining to other local government assemblies and councils.

[87] See Cardona (2006). http://www.diba.es/innovacio/fitxers/centroamerica.pdf

There are still deficiencies in some countries in relation to ex-post audit of local budgets.[88] For example, in Paraguay, many municipalities do not comply with the requirement to send their annual financial reports to the Comptroller General of the Republic.

Box 7: Participatory Budgeting in Porto Alegre (Brazil)[89]

Participatory budgeting has been functioning successfully in the municipality of Porto Alegre, in the state of Rio Grande do Sul (Brazil) for the last two decades. The participatory budget of Porto Alegre, called OPPA, is a process through which ordinary citizens and a team of elected local government officials work together to define a list of projects to be included within the local government budget. Through this mechanism for the shared management of budgetary resources, local residents perform the role of identifying and controlling the implementation of projects. Thus, through the OPPA, local residents are closely associated with the formulation of public policy at the initial stages, including diagnosis and needs assessment, the intermediate phase of monitoring and implementation, and the final phase of control and accountability.

Since its inception the OPPA has contributed to the improvements in the lives of local resident. The number of participants in Porto Alegre has increased year by year, from approximately 1,000 in 1990 to nearly 15,000 in 2004. The process has also brought opportunities to better integrate traditionally marginalized groups of the population in the community's development. In 2002, there was a predominance of women among the leaders of neighbourhood associations, delegates and counsellors. In addition, most of the OPPA participants belong to lower income groups. Other groups, such as the black population or, manual and unskilled workers have also seen higher participation rates in the OPPA process (City, 2003). According to Abers (2000), who studied the profile of OPPA's participants, contrary to some expectations, the process has not given rise to the influence of an elite field of people with more education or income. In addition, Santos (2003) has shown that OPPA resulted in an increase in the provision of basic public services. In 1999 the volume of garbage collected and the number of additional lights installed nearly doubled from the annual average for the period prior to the existence of OPPA (1985-1988). In 1996, the sewer lines in the municipality were expanded to cover 98% of households (from a coverage of about 50% in 1989). The World Bank (1999) also attributed to OPPA the paving of half of the municipality streets and the doubling in the number of students enrolled in primary and secondary schools.

Addressing the Scarcity of Data on Local Finance

The lack of adequate data on local finance is a widespread problem in the region. Only a handful of countries currently make municipal data openly available to the public.[90] The lack of municipal budget data has major consequences. First, it makes policy analysis of the performance of the whole sector and of individual municipalities

[88] In El Salvador and other countries in the region, municipalities are required to undergo a full independent audit once a year to search for signs of corruption and misuse of public funds. This practice does not eliminate corruption but it goes a long way to keep it under control.
[89] See http://www.internationalbudget.org/ for other experiences in participatory budgeting and other innovations for more open and transparent budgeting practices.
[90] See Table A.7 for the list of countries for which municipal budget data is available on a consistent basis.

much harder and overall less meaningful. Second, it deprives municipalities of the ability to introduce different forms of "bench marking" competition among themselves, which could lead to improved efficiency and fiscal performance. The publication of municipal accounts also provides early signals of fiscal imbalances and other problems, allowing early intervention to fix these problems. Finally, the lack of easily accessible budget data reduces the overall level of accountability of local authorities to their citizens. For an example of best practice in the region see Box 8.

Box 8: ***Annual Publication of Executed Budgets in Colombia***

Law 617 of 2000 in Colombia charges the National Planning Department (DNP) with the annual publication of the budget results (revenues, expenditures and financial indicators) for all departments and municipalities, together with an explanation of where there have been problems and where there has been progress. Included in these records is a detailed recording of the municipalities' fiscal performance and information on all income and expenditures during the past fiscal year. This annual publication is of high quality. The DNP collects annual data on revenues and expenditures, as well as the debt levels of all local governments. Each local government reports and certifies the accuracy of its executed budgets to the DNP through an automated system, the "Sistema de Información para la Captura de la Ejecución Presupuestal de Departamentos y Municipios (SICEP). The DNP also receives information on debt levels from the Controloría General de la República (CGR). These data are regularly used by government institutions and nongovernmental organizations to monitor the performance of sub-national governments. The comparisons in performance also allow some form of benchmarking competition among local governments; which governments are doing relatively better and which are doing worse.

Peru and Ecuador provide other examples of best practice in this area. In Peru, the Ministry of Economic and Finance manages, among many other data, budget information of all regions and on an easily accessible website. In Ecuador similar information is made available by mandate through the Organic Law of 2004 on Transparency and Access to Public Information (LOTAIP). In terms of the collection and dissemination of budget information, Brazil is ahead of the two other major federal countries in the region, Argentina and Mexico. Brazilian municipalities are charged with reporting their budgets in a standard specific format to the Ministry of Finance every year and this data is then published with only a twelve month year delay.

II.d Short-Term and Long-Term Structural Challenges

Municipal governments in Latin America face both short-term challenges, the most serious being the after-effects of the ongoing global financial crisis, as well as many long-term structural challenges.

Short term: Addressing the impact of the global crisis

One of the important consequences of the on-going global financial crisis has been the serious deterioration of the fiscal position of governments around the world. The ability to weather this type of crisis in the past has been different for central governments and sub-national governments due to the fact that the latter are often extremely constrained in running budget deficits and borrowing. The situation is aggravated by the fact that many local governments in the Latin America region are quite dependent on central governments transfers and due to this their fiscal autonomy is more limited.

If budgets are reduced due to revenue shortfalls, local governments will be less able to meet their service delivery responsibilities; there is also the danger that central governments may use the crisis to justify slowing down ongoing decentralization programs. At the same time, some countries have recognized the need to keep resources flowing to local governments during the crisis and therefore local governments may play an important role in shaping counter-cyclical policy.

In the following paragraphs we use information about the impact of the financial crisis extracted from responses to a survey sent out by United Cities and Local Governments (UCLG) to its constituent member associations of local governments in Latin America and around the world during the third quarter of 2009.

The most significant direct impact of the crisis has been on the level and composition of local government finances on both the revenue and expenditure sides of the budget. Although it is generally reasonable to expect decreases in revenues and expenditures in local government budgets, there is little reason to expect that they will be in the same proportion across all items.

As in many other countries around the world, many municipal governments in Latin America have experienced reductions in own revenues. Significantly, municipalities in several Latin American countries have also experienced reductions in the yields of specific tax shares. In particular, significant reductions in revenue sharing from natural resources are reported by Bolivia (20 %) and Peru (30 %). There have also been reductions in transfers from central governments. Mexico reports a 20% reduction in municipal transfers, and Nicaraguan municipalities report transfer losses of $12.5 million.

As in previous financial crises, capital expenditures may be cut more drastically than current expenditures because they are more easily interrupted or postponed. The responses to the UCLG survey confirm these expectations for some Latin American countries. Reductions in capital spending are reported in Mexico and Nicaragua. Some countries, however, report no decreases or even increases in local capital expenditures, in part due to the local participation in national counter-cyclical economic stimulus programs. Increases in municipal capital expenditures are expected in Brazil and Colombia. In addition, reductions in recurrent spending are expected in Mexico, Nicaragua, and Peru. But, as in the case of capital expenditures, several countries report increases in recurrent expenditures as part of central government stimulus packages; for example, Chile and Colombia.

These results are a consequence of the crisis but also of the policies that have been implemented to cope with the crisis. Thus, for example, Colombia reports increases in expenditures despite (in fact, as a means to offset) the crisis. Another potential response of local governments to deteriorating revenue collections and unchanged or increased needs for expenditures is to introduce new taxes and fees or to increase the rates on existing ones. However, no country in Latin America indicates that such action has been taken. There are no reports either of increased borrowing by municipal governments in Latin American countries.

Beyond the impacts of the crisis and measures implemented by local governments in response to it, some local governments in the region are taking advantage of the crisis to take a harder look at their systems of intergovernmental fiscal relations. For example, local governments in Ecuador are seeking a timelier and more frequent payment of transfers by the central government, while those in Bolivia are seeking the promotion of local economic development policies. Similarly, local governments in Mexico are seeking the deregulation of local government investment funds and those in Chile and

Colombia are seeking greater flexibility in the legal framework so that local governments can develop anti-cyclical policies. Municipalities in several Latin American countries (Colombia, Ecuador, Nicaragua, Mexico, and Peru) point out in the survey to the potential role played by international organizations through foreign aid for the provision of increased funds and better coordination in the allocation of those funds to improve local investments and capacity building.

In summary, municipal governments in Latin America, like their counterparts in other regions of the world, are going through a financial and economic crisis of unprecedented depth. The crisis has affected practically all central governments in the region and it has also affected most local governments in some way. However, as indicated by the responses to the UCLG survey, there is a great variety in how local governments across and within different countries have fared. While some local governments have seen their funding cut and all types of expenditures reduced, others have actually experienced increases in funding and have increased certain types of expenditures.

Long term: Structural challenges:

Beyond the short-term issue of regaining fiscal balance, many local governments across the region face similar long-term structural challenges. Here we highlight three of these challenges.

1. Strengthening tax capacity and its effective use by local governments. This will require looking into the entire array of local taxes including some more recent innovations, such as betterment levies and Brazil's ISS (local service tax). But it would also mean making more effective use of the *impuesto predial* (local property tax). The more effective use of property tax will require the periodic updating of fiscal cadastres with the reassessment of property values and putting more emphasis on collection efficiency through reductions in compliance costs and consistent use of penalties.[91] However, there will continue to be limitations in

[91] See Sepulveda and Martinez-Vazquez (2009) for an analysis of the relative potential of property taxes in the Latin American region.

the overall level of tax capacity for many municipal governments, so there will be a need to continue to provide significant attention to the systems of intergovernmental transfers, comprising equalization transfers with unconditional use of funds and conditional block grants.

2. Increasing the efficiency of public expenditures and the quality of public services, which will mean, among other things, containing budgetary amounts assigned to salary costs –and not the level of salaries themselves- and getting rid of the biased belief among central government officials that capital spending is always more desirable (efficient) than current spending, including non-wage and salary items.[92]
3. Finding avenues to finance the large capital infrastructure deficit for municipal services in the region, which will require a combination of capital transfers from central governments, improving creditworthiness where feasible, and facilitating prudent borrowing by local governments through the deepening of the development of private credit markets in the region.

III. Policy Recommendations

The analysis in the above sections has shown that the Latin America region contains a rich variety of experiences and many lessons, good and bad, about decentralization and municipal finance. This rich variety of experiences and challenges, sometimes quite unique,[93] has made it difficult to draw up a cross-country analysis. Nevertheless, there are many common themes and challenges facing municipal governments in Latin America and different countries have been able to address them with varying degrees of success. For example, in Chile, the central government has made

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[92] Several countries in the region have introduced general regulations on salary levels in their legislation. For example, in Brazil the share of wages and salaries in local budgets cannot exceed 65 percent of the municipal budget. In Chile no municipality may spend more than 35 percent of its own revenues on wages and salaries. Many other countries impose restrictions as to how different kinds of funds can be spent, typically requiring spending on capital infrastructure a certain share of their budgets. These measures can be seen as paternalistic and they reflect existing serious doubts about the efficacy of horizontal accountability mechanisms at the local level to ensure that local officials make the best choices for their citizens.

[93] For example, the challenges faced by some municipalities in Colombia go beyond fiscal issues. Here, municipalities in the war-torn areas must face the challenge of being on the frontlines against armed actors such as drug traffickers, paramilitaries and the Revolutionary Armed Forces of Colombia (FARC) and many of these municipalities are encouraged to "share" their resources with these armed groups (Rubio, 2002).

use of municipal governments to increase the effectiveness of social policies and has been able to encourage innovation and competition among them. In Colombia, central legislation can provide administrative flexibility, with local governments exercising control over staff hiring and salary decisions and at the same provide effective accountability mechanisms to maintain fiscally responsible decisions by local officials. In Honduras, a municipal association can successfully provide technical assistance and training to its members. Changes in the attitudes of municipal officials toward broader community participation in budget decisions have taken place in countries such as Bolivia, Brazil, and Peru.

In this concluding section we offer some policy recommendations grouped according to the set of issues examined in the previous section. Nevertheless, there remain challenges to be addressed and it will be necessary to continue looking for new orientations in future research about public local finances in the region.

III.a Recommendations on Organizational Structure:

Countries with problems of fragmentation and small municipalities, should introduce legislation and practical support for the creation of associations of municipalities into *mancomunidades* for the delivery of certain public services requiring a certain minimum scale. Other solutions to the problem of insufficient scale that could be pursued include cooperative services agreements between larger and smaller municipalities, and the contracting of services with private enterprises for the delivery of services. In addition, careful critical study and consideration should be given to the creation of new tiers of vertical government (for example, regional governments) as a solution to some of the weaknesses observed at the existing local governments. A cheaper more efficient solution can be strengthening through technical assistance and additional funding of existing governments.

In any case, existing potential incentives to further fragmentation should be removed. In particular, those countries with transfer formulas that ensure the same amount of funds to all municipalities independently of their size should discontinue this practice. Where they do not exist now, new legislation with minimum population and fiscal viability requirements should be introduced to prevent any further undesirable fragmentation of local governments.

Most central governments in the region, and provincial or state governments in the case of federal systems, should devote more time and resources to developing administrative capacity, especially in the case of small and rural local governments. Some of this assistance can be provided for example by working together with and offering support to municipal associations in order to give more and better technical assistance and training to local officials in the most cost-effective manner or by tutoring local governments through contracting with regional universities and colleges.

III.b Recommendations on intergovernmental fiscal system design:

Without clear assignments of expenditure responsibilities to local governments it is not possible to have an informed judgment on whether or not the level of financing of these governments is adequate. Most systems of intergovernmental fiscal relations in the region would benefit from an explicit clarification of the competencies assigned to local governments. First, this will require the clear identification of the exclusive responsibilities of local governments. Second, in the case of concurrent or shared responsibilities between the local and central (or intermediate level) governments, it will be necessary to identify which attributes of the particular competence (regulation, financing, and implementation) are the responsibility of the local governments and which are that of higher levels of government. Having a clearer and more transparent assignment may mean that the assignment would have to identify responsibilities for sub-functions concerning regulation, financing and implementation. There will be no clear assignments of responsibilities, especially in the case of concurrent functions, until it is transparent which level of government is exclusively responsible for the different sub-functions involved. Of course, the implementation of services may be done directly by the local jurisdiction or this unit can make arrangements for its provision, for example by a private company or some other jurisdiction.

If there are significant differences in administrative capacity among local governments it may be desirable to introduce temporarily two or at most three different packages of expenditure responsibilities that can be devolved to local governments depending on their administrative capacities and over time, as capacity is acquired, graduate municipalities to the more complete levels of responsibility.

It is also desirable to adopt transparent approaches to translate the assignment of local functional responsibilities into expenditure needs in order to have a clear idea of the financing requirements of local governments.

Greater local revenue autonomy is a challenge not yet being adequately addressed by most countries in the region. However, there is a need to find a better balance between the decentralization of expenditure responsibilities and the authority to collect local taxes from the residents directly benefiting from local services. This will lead to more fiscally responsible and politically accountable forms of decentralization. Several options are open going forward with this agenda.

- First, in countries that have not assigned property tax to local governments should do so. Property tax has several characteristics that make it ideal as a local tax.
- Second, other taxes that should be assigned to local governments are, for example, vehicle taxes, business licenses, and betterment levies on real estate for financing basic infrastructure improvements.
- Third, for countries that have not done so, some degree of discretion in setting tax rates should be granted to all local governments so that they can adjust their tax bases, within legislated maximum and minimum rates. Other forms of autonomy beyond rate setting (e.g., adjustments to the tax base or the freedom to introduce new taxes) are not generally desirable.
- Fourth, coordinated efforts of local and central governments should be made to increase the revenue yield of property tax and other taxes assigned to local governments. In the case of property taxes, these should include: regularly updated and improved property cadastres and property value assessment methodologies, increased effectiveness in the collection of tax bills, and removal of disincentives for increases in tax effort by local governments (such as , reductions in transfers when more local revenues are collected).
- Fifth, the introduction of new taxes assigned to the local level should be considered, including wider use of betterment levies and local business taxation,

such as the ICA (impuesto de industria y comercio) in Colombia or Chile's *patente municipal*.

Going further in the direction of increasing local tax autonomy would be the introduction of a local piggy-back personal income tax with a flat rate collected at the same time as the national income tax is collected. This latter form of local tax is common, for example, in northern and central Europe, but it has not been tried yet in the Latin America region. Finally, there is a possibility of considering the introduction of environmental or 'green' taxes enabled by national legislation on the regulation of the environment. This form or taxation has not taken root in many Latin American countries though it provides several important advantages. The first is the so-called "double dividend" since these taxes not only collect needed revenues but also contribute to a cleaner environment. These taxes can also fit well in regional and local contexts. Potential levies in this area would include taxes on the emission of solid waste and water contamination.

In those countries where revenue sharing is a major source of local finance, it would be desirable to un-bundle part of the revenue sharing system into separate transfers, including: (i) an equalization transfer with unconditional use of funds and (ii) a system of block conditional grants for current and capital purposes. An explicit unconditional equalization grant is needed to address the important and increasing problem of regional fiscal disparities in many countries in the region—based on differences in tax capacity or economic base and differences in expenditure needs due to geography or the structure of population. Explicit conditional grants are necessary to ensure national standards and objectives in the provision of important services that have been decentralized, such as education and health. However, despite the introduction of those transfers, revenue sharing is likely to remain an important source of general funding for local governments and a way to address vertical imbalances, especially where it is more difficult to devolve higher taxing powers to local governments.

In those countries where local borrowing is not allowed, new legislation should introduce the possibility of responsible local borrowing. In those countries that already allow municipal borrowing, it would be desirable in many cases to review the current status of regulations, streamlining them when necessary so that they are not overly restrictive. This review should also be focused on the monitoring capabilities of the central government (including “floating debt” or budgetary arrears with official institutions and private suppliers, and guarantees through municipal enterprises) and the introduction of a credible system of penalties for lack of compliance.

Beyond the regulation and monitoring of local borrowing, an even more important challenge for most countries in the region is to facilitate a significant increase in credit availability to local governments for responsible borrowing, especially for smaller municipalities. The solution may sometimes be the creation of official financial intermediaries or municipal banks. A large amount of information is available within Latin America and other regions of the world regarding the positive features of these institutions that should be replicated (e.g., operating with strict banking criteria) and those features that should be avoided (e.g., operating with less than arms’ length distance from political authorities). Policies to encourage the development of private markets for local credit are equally, or even more, desirable. But it must be recognized that local credit from private sources is unlikely to develop without more revenue autonomy and greater transparency of local budgets.

III.c Recommendations on budget process and transparency:

Those countries still requiring ex-ante approval of municipal budgets by higher-level authorities should phase out this practice and increasingly rely on local accountability and effectiveness of ex-post audits and the rule of law in order to keep an eye on the probity of local budget execution. The misappropriation or lack of proper appropriation of funds in a selected number of countries is a practice that needs to be stopped and full compliance with ex-post audit rules should be ensured. The ultimate effectiveness of local public expenditures will depend on the adoption of modern budget evaluation practices, which remains a pending assignment for most countries in the region.

The low reliability on municipal finances remains an important problem in the Latin American region, affecting the quality of policy design and of analytical work. Best practice in budget transparency and data dissemination in countries such as Colombia and

Peru, for example, should be replicated by all countries in the region where publicly available data on annual budgets and other aspects of the local finances are still missing. An effective way to encourage and sustain good practices in budget reporting and data generation is to put those data to good use by, for example, providing information to experts and ordinary citizens on performance and by publicizing the results in order to create benchmark competition across jurisdictions.

There has been continued progress over the past decade with the institutions that manage finances and with the practice itself of municipal finance in the Latin American region. Nevertheless, there is a long road ahead of us for further improving the overall efficiency, equity and accountability of municipal finances in the region.

Annex 1: Assignments of expenditures functions (C=central; R=regional; L=local)

Functions	Argentina	Bolivia	Brazil	Chile	Colombia	Costa Rica	Dominican Republic	Ecuador	El Salvador	Guatemala
Constitution defines assignments	**No**	**Yes**	**Yes**	**YES**	**YES**	**Yes**	**YES**	**Yes**	**YES**	**YES**
General administration										
Security, police	C/R	C	R	C	C	C	C	C/L	NA	L
Fire protection	C/R	C	R	C	L	C	L	NA	L	C/L
Civil protection	C/R	C	R	C	L	C	C/L	C/L	L	C
Justice										
Civil status register	C	C	C	C	C	C	C	C	L	L
Statistical office	C/R	C	C/L	C	C	C	C	C	L	C
Electoral register	C/R	C	C	C	C	C	C	C	L	C
Education										
Pre-school education	R	C/L	L	C	L	C	C	C	L	L
Primary education	R	C/L	L	C	L	C	C	C	L	L
Secondary education	R	C/L	R	C	L	C	C	C	L	NA
Vocational and technical	R	C/L	R	C	L	C	C	C	L	NA
Higher education	C	C/L	C	NA	C	C	C	C	C	NA
Adult education	R	C/L	R/L	NA	C	C	C	C	C	L
Public Health										
Health protection	R	C/L	C/R/L	NA	L	C	C	C	L	NA
Primary care	R	C/L	C/R/L	C/L	L	C	C	C	L	NA
Hospitals	R	C/L	C/R/L	C/L	R	C	C	C	NA	NA
Social Welfare										
Kindergarten and nursery	R	C/L	L	L	C	C	NA	C	L	NA

Annex 1: Assignments of Expenditures Functions (C=central; R=regional; L=local) (continued)

Functions	Argentina	Bolivia	Brazil	Chile	Colombia	Costa Rica	Dominican Republic	Ecuador	El Salvador	Guatemala
Family welfare services	C/R	C/L	C/R/L	L	C	C	NA	C	L	NA
Welfare homes	C/R	C/R	C/R/L	NA	NA	C	NA	C	L	NA
Social security	C/R	C	C	C/L	C	NA	C	C	NA	NA
Housing and town planning										
Housing	L	C/L	C/L	L	C/L	C	C	L	L	L
Town planning	L	L	C/L	L	L	C	L	L	L	L
Regional/spatial planning	R	C/L	C/L	R	C/R	NA	NA	L	L	NA
Environment, sanitation										
Water & sewage	R	C/R/L	L	L	R/L	C/R	C	L	L	L
Refuse collection & disposal	R	C/R/L	L	L	L	L	L	L	L	L
Cemeteries & crematoria	R	C/R/L	L	L	L	L	L	L	L	L
Slaughterhouses	R	C/R/L	L	L	L	L	L	L	L	L
Environmental protection	R	C/L	C/L	L	R/L	C/R	C/L	L	L	L
Consumer protection	C	C	L	NA	C	C	NA	NA	L	NA
Culture, leisure & sports										
Theatres & concerts	NA	C/R/L	R/L	NA	L	L	C	NA	L	L
Museums & libraries	NA	C/R/L	C/R/L	NA	L	C	C	NA	L	L
Parks & open spaces	NA	C/R/L	C/R/L	L	L	C\L	L	NA	L	L

Annex 1: Assignments of Expenditures Functions (C=central; R=regional; L=local) (continued)

Functions	Argentina	Bolivia	Brazil	Chile	Colombia	Costa Rica	Dominican Republic	Ecuador	El Salvador	Guatemala
Sports & leisure	NA	C/R/L	C/R/L	L	L	NA	C/L	NA	L	L
Religious facilities	NA	C/R/L	C/R/L	NA	NA	NA	NA	NA	L	NA
Other cultural facilities	NA	C/R/L	C/R/L	L	NA	NA	NA	NA	L	NA
Traffic, transport										
Roads	C/R/L	C	C	L	C/R/L	C/L	C	R/L	NA	C/L
Transport	C/R	C	C/L	L	C/L	NA	C/L	R/L	NA	L
Urban road transport	C/R/L	C	L	L	L	C/L	C/L	R/L	NA	L
Urban rail transport	C	C	C	NA	L	NA	NA	NA	NA	NA
Ports	C	C	C	NA	C/L	C	C	NA	NA	NA
Airports	C	C	C	NA	C/L	C	C	NA	NA	NA
Utilities										
Gas	R	C	C	NA	C/L	NA	NA	NA	L	NA
District heating	R	C	C	NA	NA	NA	NA	NA	L	NA
Electricity	R	R	C/R/L	NA	C/L	C	C	NA	L	NA
Water supply		R	R/L	NA	R/L	C	C	L	L	L
Economic										
Agriculture, forests, fishing	C/R	C/R/L	C/L	NA	C/L	C	C	L	L	NA
Economic promotion	C/R	C/R/L	C/L	NA	C/R/L	C	C/L	L	L	NA
Trade & industry	C/R	C/R/L	C/L	NA	C/L	C	C	L	L	NA
Tourism	C/R	C/R/L	C/L	NA	C/R/L	C	C	NA	L	NA
Other economic services	NA	C/R/L	C/L	NA	L	C	NA	NA	NA	NA
Employment	NA	C/R/L	C/L	L	C/L	C	C	NA	NA	NA

Annex 1: Assignments of Expenditures Functions (C=central; R=regional; L=local) (continued)

Functions	Honduras	Jamaica	Mexico	Nicaragua	Panama	Paraguay	Peru	Uruguay	Venezuela
Constitution defines assignments	**YES**	**No**	**No**	**Yes**			**YES**	**Yes**	**Yes**
General administration									
Security, police	L	C	C/R/L	c			C/L	C	C/R/L
Fire protection	L	L	L	c			L	C	C/R/L
Civil protection	L	C	C/R/L				C/R/L	C	C/L
Justice									
Civil status register	L	C	R/L	L			C/L	C	L
Statistical office	L	C	C/R/L				C	C	C
Electoral register	L	C	C				C	C	C
Education									
Pre-school education	C/L	L	C/R/L				C/R	C/L	C/R/L
Primary education	C/L	L	C/R/L				C/R	C/L	C/R/L
Secondary education	C	L	C/R/L				C/R	C	C/R/L
Vocational and technical	C	C	C/R				C/R		C/R/L
Higher education	C	C	C/R				C/R	C	C
Adult education	C	C	R				C/R		C
Public Health									
Health protection	C/L	L	C/R				C/R	C/L	C/R/L
Primary care	C/L	L	C/R/L	C/L			C/R	C	L
Hospitals	C/L	C/L	C/R				C/R	C	C/R

Annex 1 Assignments of Expenditures Functions (C=central; R=regional; L=local) (continued)

Functions	Honduras	Jamaica	Mexico	Nicaragua	Panama	Paraguay	Peru	Uruguay	Venezuela
Social Welfare									
Kindergarten and nursery	NA	C	C/R					C	C/R/L
Family welfare services	NA	C/L	C				C/L	C	C/R/L
Welfare homes	NA	C	C/R				L	C	C/R/L
Social security	NA	C	C					C	C
Housing and town planning									
Housing	L	C	L	L			C	L	C
Town planning	L	C/L	L	L			L	L	L
Regional/spatial planning	L	C/L	R				R	L	R/L
Environment, sanitation									
Water & sewage	L	C/L	R/L	L			C/R/L	L	L
Refuse collection & disposal	L	C/L	L	L			L	L	C/L
Cemeteries & crematoria	L	na	L	L			L	L	L
Slaughterhouses	L	na	L	L			L	L	L
Environmental protection	L	C	C/R/L	L			C/R/L	L	C/L
Consumer protection	L	C	C/R/L				C		C
Culture, leisure & sports									
Theatres & concerts	L	na	R/L				C/L	L	C/R/L
Museums & libraries	L	na	R/L	L			C/L	L	C/R/L
Parks & open spaces	L	C/L	L	L			L	L	R/L

Annex 1: Assignments of Expenditures Functions (C=central; R=regional; L=local) (continued)

Functions	Honduras	Jamaica	Mexico	Nicaragua	Panama	Paraguay	Peru	Uruguay	Venezuela
Sports & leisure	L	C/L	C/R/L	L			L	C/L	C/R/L
Religious facilities	L	na	C	L			L		
Other cultural facilities	L	C/L	C/R/L	L			L	L	
Traffic, transport									
Roads	L	C/L	L	C/L			C/R/L	L	C/R/L
Transport	L	C/L	C/R	C/L			C/R/L	L	C/R/L
Urban road transport	L	C/L	R/L	C/L			L	L	L
Urban rail transport	C	C/L	L						L
Ports	C	C	C	L			R		C/R
Airports	C	C	C				C		C/R
Utilities									
Gas	L	C					C	L	C/L
District heating	L	C						L	
Electricity	L	C	L	L			C/R/L	C/L	C/L
Water supply	L	C	L	L			C/R/L	L	C/L
Economic									
Agriculture, forests, fishing	L	C	C				C/R	L	C
Economic promotion	L	C	C/R/L				C/R	L	C/R/L
Trade & industry	L	C	C/R				C/R	L	C/R/L
Tourism	L	C	C/R	L			C/R	L	L
Other economic services	L	C	C/R/L						C/R/L
Employment	L	C	C/R/L						C

Annex 1: Revenues and Expenditures by Government Level (in millions of dollars)

	Revenues			Expenditures			Revenues (% total)			Expenditures (% total)		
Country (Most recent year)	**Federal / central**	**Regional**	**Local**	**Federal / central**	**Regional**	**Local**	**Federal / central**	**Regional**	**Local**	**Federal / central**	**Regional**	**Local**
Argentina(2006)	81,428	56,207	11,050	26,190	15,093	3,107	55%	38%	7%	59%	34%	7%
Bolivia(2008)	4,298	743	957	3,962	660	880	72%	12%	16%	72%	12%	16%
Brazil(2007)	347,330	187,482	113,905	314,445	174,513	112,332	54%	29%	18%	52%	29%	19%
Chile(2007)	23,533	na	2,307	22,876	na	3,119	91%		9%	88%		12%
Colombia(2006)	57,134	12,567	20,208	32,432	5,809	10,165	64%	14%	22%	67%	12%	21%
Dominican Republic(2006)	na	na	na	na	na	na						
Ecuador(2007)	8,177	na	1,133	7,934	na	2,423	88%		12%	77%		23%
El Salvador(2007)	2,973	na	na	3,602	na	108	100%			97%		3%
Guatemala(2002)	4,621	na	na	5,174	na	na	100%			100%		
Haiti(2004)	1,050	na	na	802	na	na	100%			100%		
Honduras(2004)	37,145	n.a	3,096	1,788	na	195	92%		8%	90%		10%
Jamaica(2008)	na	na	1,233	4,188	na	73	100%			98%		2%
Mexico(2007)	248,578	89,412	20,484	226,301	81,993	19,678	69%	25%	6%	69%	25%	6%
Nicaragua(2002)	n.a	n.a	n.a	na	na	na						
Panama(2005)	3,107	na	59.74	6,718	na	137	98%		2%	98%		2%
Paraguay(2006)	10,943	na	898	4,868	na	423	92%		8%	92%		8%
Peru(2007)	13,984	3,313	3,703	11,087	3,043	2,774	67%	16%	18%	66%	18%	16%
Trinidad and Tobago(1995)	n.a	n.a	na	8,600	na	na						
Uruguay(2007)	n.a	na	na	8,611	na	na				100%		
Venezuela(2007)	65,736	na	177	58,515	na	373	100%			99%		1%

Table Annexe.2: Origin of Revenues of Local Governments (millions US$)

Country (Most recent year)	Own taxes and Fees	Shared revenues	Conditional Transfers	Unconditional transfers/Aid	Own taxes and fees (% of the total)	Shared revenues (% of the total)	Conditional Transfers (% of the total)	Unconditional transfers/Aid (% of the total)	Own taxes and fees (% of GDP)	Shared revenues (% of GDP)	Conditional Transfers (% of GDP)	Unconditional transfers/Aid (% of GDP)
Argentina(2006)	5,502.90	4,685.20	na	861.9	49.80%	42.40%	0.00%	7.80%	1.22%	1.04%	0.00%	0.19%
Bolivia(2008)	165024	478203	268625	4,571.00	11.40%	17.20%	0.00%	71.40%	2.65%	4.01%	0.00%	16.63%
Brazil(2007)	22,746.19	87,345.70	na	3,856.38	20.10%	76.50%	0.00%	3.40%	1.75%	6.67%	0.00%	0.29%
Chile(2007)	1,453.41	na	na	853.59	63.00%	0.00%	0.00%	37.00%	0.66%	0.00%	0.00%	0.39%
Colombia(2006)	8,325.70	na	11882.304		41.20%	0.00%	58.80%	0.00%	2.11%	0.00%	3.02%	0.00%
Dominican Republic(2006)	na	na	na	na	58.40%	10.40%	31.20%	0.00%	0.69%	0.12%	0.37%	0.00%
Ecuador(2007)	392.02	0.00	0	740.982	34.60%	0.00%	0.00%	65.40%	1.62%	0.00%	0.00%	3.07%
El Salvador (2007)	na	na	Na	na	69.90%	0.00%	0.00%	30.10%	0.00%	2.07%	0.00%	3.51%
Guatemala(2002)	na	na	Na	na	25.00%	5.00%	60.00%	10.00%	0.53%	0.11%	1.28%	0.21%
Honduras(2004)	1,798.78	340.56	185.76	770.904	58.10%	11.00%	6.00%	24.90%	0.95%	0.18%	0.10%	0.41%
Jamaica(2008)	1,233.00	0.00	0	0	100.00%	0.00%	0.00%	0.00%	0.16%	0.00%	0.00%	0.00%
Mexico(2007)	3,195.50	9,279.25	0	8009.244	15.60%	45.30%	0.00%	39.10%	2.38%	6.91%	0.00%	5.98%
Nicaragua(2002)	na	na	Na	na	44.00%	5.00%	11.00%	40.00%	0.56%	0.06%	0.14%	0.51%
Panama(2005)	29.27	27.54	2.92726	0	49.00%	46.10%	4.90%	0.00%	0.33%	0.31%	0.03%	0.00%
Paraguay(2006)	306.22	16.16	96.984	478.634	34.10%	1.80%	10.80%	53.30%	1.23%	0.07%	0.39%	1.91%
Peru(2007)	1,599.70	1,788.55	0	314.755	43.20%	48.30%	0.00%	8.50%	2.62%	2.92%	0.00%	0.52%
Venezuela(2007)	167.97	0.00	9.027	0	94.90%	0.00%	5.10%	0.00%	0.07%	0.00%	0.00%	0.00%

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