EE 442

Economics of Public Revenue

Topic 14
Local Public Finance

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1. The Division of Responsibilities
2. Principles of Fiscal Decentralization
3. The Tiebout Model
4. Production VS Finance
5. Optimal Decentralization
    - Advantages of the Decentralized System
    - Disadvantages of the Decentralized System
6. Fiscal Decentralization in Thailand

1. The Division of Responsibilities

There are 2 key issues.

1. Who makes the decisions about the programs?
2. Who pays for the programs?

- The central government can give a “matching grant”.

- The central government provides a “block grant” (a fixed amount of money).

Other Interaction between the Central Government and the Local Governments

1. Regulation

2. Incentives

3. Tax Expenditures

The Size of Financial Transfers

The magnitude of governmental expenditures does not provide a complete picture of government's role in the economy. We should consider the magnitude of central government transfers to localities too.

2. Principles of Fiscal Decentralization

What principles should guide the assignment of responsibilities?

National Public Goods VS Local Public Goods

The benefits from national public goods can benefit everyone in the nation.

In contrast, the benefits of local public goods accrue to residents of a particular community.

3. The Tiebout Model

Tiebout hypothesis: Just as competition among private firms leads to the efficient provision of private goods, so the competition among local communities leads to efficiency in the provision of local public goods.

The fundamental theorem of welfare economic implies that

- In the absence of a market failure, such as public goods, the economy will be Pareto efficient.
- Individuals, each acting in their own self-interest, will make decisions that lead to Pareto efficiency.
- Competition among producers leads them to supply the goods individuals want at the lowest possible cost.

Competition among communities will result in communities' supplying the goods and services individuals want and producing these goods in an efficient way.

Tiebout argued that individuals can "vote with their feet".

So their choice of communities revealed their preferences toward locally provided public goods in the same way as their choices of products reveal their preferences for private goods.

Tiebout voting does not ONLY imply that communities will compete by trying to provide public goods as efficiently as possible.

Communities can also offer different mixes of goods, to appeal to different groups, who then sort themselves into different communities that provide the mix they want.

Examples: Parents with children want good public schools and safe, quiet neighborhoods, and parks.

College students want restaurants that are open late, and loud nightclubs.

Different localities can provide different goods, and people will naturally sort themselves over time.

Firms	Communities
- Individuals' choices of products reveals their preferences for private goods.	**- Individuals' choice of communities revealed their preferences toward locally provided public goods.**
- There are incentives for firms to find out what commodities individuals prefer and to produce those commodities efficiently.	**- There are incentives for communities to find out what kinds of community-provided goods individuals prefer, and to provide them efficiently.**
- A firm that fails to provide a commodity individuals like will find its sales declining; a firm that succeeds will find its sales increasing.	**- Communities that provide the services individuals like, and provide them efficiently, will experience an inflow of individuals; communities that fail to do so will experience an outflow.**

Two fundamental qualifications to the Tiebout hypothesis concerning the circumstances in which market allocations might not be Pareto efficient are as follows.

1. The presence of market failures.

2. The dissatisfaction with the distribution of income.

1. Market Failures

1. Externalities

2. Competition and Profit maximization

3. Tax Competition

2. Redistribution

1. Inequality among individuals

2. Inequality across communities

Some arguments that are against providing programs aimed at reducing inequality in the provision of local public services.

1. Consumer sovereignty

2. The difficulty of targeting communities for redistribution

3. Location inefficiencies

4. Production Versus Finance

We will compare 3 types of federal aid to local communities.

1. A block grant not tied to any specific use

2. A block grant tied to a specific purpose

3. Matching aid for a specific purpose

5. Optimal Decentralization

- Advantage of the Decentralized System

- Disadvantage of the Decentralized System

Advantages of the Decentralized System

1. Better correspondence to Demand Variation

2. Restriction of self-interested politicians' taxing power

3. Controls Rent Seeking

4. Fostering Intergovernment Competition

5. Experimentation and Innovation in Locally Provided goods and Services

Disadvantages of the Decentralized System

1. Economies of Scale

2. Interjurisdictional Externalities

3. Redistribution

4. Inefficient Tax System

Fiscal Decentralization in Thailand: Revenue Assignment

Outlines

- Revenue assignment
- Intergovernmental transfer
- Local governments' borrowing

Local governments in Thailand as of March 23rd, 2020

Types of local governments	Number
1. Provincial administrative organization (PAO)	76
2. Municipality	2,452
Nakorn municipality	30
Mueng municipality	187
Tambon municipality	2,235
3. Tambon administrative organizations (TAO)	5,322
4. Speical units of local governments (BMA and Pattaya city)	2
Total	**7,852**

Revenue Assignment

Local Revenue Structure: 1999-2006

Unit: million baht

Revenue Sources	Fiscal Year							
	1999	2000	2001	2002	2003	2004	2005	2006
1. Locally levied revenue	17,516.80	19,475.30	17,701.88	21,084.47	22,258.28	24,786.27	27,018.00	29,110.41
(%)	(17.92)	(19.51)	(11.08)	(11.99)	(12.09)	(10.24)	(9.20)	(8.90)
2. Shared revenue (Central government collects revenue for local governments)	42,731.60	45,527.50	55,651.90	58,143.52	60,217.71	82,623.37	102,520.34	110,189.59
(%)	(43.72)	(45.62)	(34.84)	(33.06)	(32.72)	(34.15)	(34.90)	(33.69)
3. Shared revenue (Central government shares some revenue with local governments)	-	-	12,669.00	19,349.00	35,504.44	43,100.00	49,000.00	61,800.00
(%)	(0.00)	(0.00)	(7.93)	(11.00)	(19.29)	(17.81)	(16.68)	(18.89)
4. Grants	37,499.30	34,800.00	73,729.80	77,273.30	66,085.72	91,438.00	115,210.70	126,013.00
(%)	(38.36)	(34.87)	(46.15)	(43.94)	(35.90)	(37.79)	(39.22)	(38.52)
Total	**97,747.70**	**99,802.80**	**159,752.58**	**175,850.29**	**184,066.15**	**241,947.64**	**293,749.04**	**327,113.00**
(%)	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**
Central government's revenue	708,826.00	749,945.00	772,574.00	803,651.00	829,495.56	1,063,600.00	1,250,000.00	1,360,000.00
Proportion of local governments' revenue	**13.79**	**13.31**	**20.68**	**21.88**	**22.19**	**22.75**	**23.50**	**24.05**

Source: NDC

Local Revenue Structure: 2007-2013

Unit: million baht

Revenue Sources	Fiscal Year						
	2007	2008	2009	2010	2011	2012	2013
1. Locally levied revenue	32,021.45	35,223.60	38,745.96	29,110.41	38,745.96	46,529.72	50,281.54
(%)	(8.96)	(9.35)	(9.35)	(8.54)	(8.99)	(8.78)	(8.78)
2. Shared revenue (Central government collects revenue for local governments)	120,728.70	128,676.40	140,679.27	126,589.59	148,109.04	175,457.28	187,988.46
(%)	(33.78)	(34.16)	(33.95)	(37.12)	(34.34)	(33.10)	(32.83)
3. Shared revenue (Central government shares some revenue with local governments)	65,300.00	65,000.00	71,900.00	45,400.00	70,500.00	86,900.00	97,900.00
(%)	(18.27)	(17.25)	(17.35)	(13.31)	(16.35)	(16.40)	(17.10)
4. Grants	139,374.00	147,840.00	163,057.00	139,895.18	173,900.00	221,091.79	236,500.00
(%)	(38.99)	(39.24)	(39.35)	(41.03)	(40.32)	(41.72)	(41.30)
Total	**357,424.15**	**376,740.00**	**414,382.23**	**340,995.18**	**431,255.00**	**529,978.79**	**572,670.00**
(%)	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**
Central government's revenue	1,420,000.00	1,495,000.00	1,604,640.00	1,350,000.00	1,650,000.00	1,980,000.00	2,100,000.00
Proportion of local governments' revenue	**25.17**	**25.20**	**25.82**	**25.26**	**26.14**	**26.77**	**27.27**

Source: NDC

Local Revenue Structure: 2017-2019

Unit: million baht

Revenue Sources	Fiscal Year		
	2017	2018	2019
1. Locally levied revenue (%)	112,000.00 (16.28)	112,000.00 (15.54)	112,000.00 (14.90)
2. Shared revenue (Central government collects revenue for local governments) (%)	218,800.00 (31.81)	229,900.00 (31.89)	240,350.00 (31.98)
3. Shared revenue (Central government shares some revenue with local governments) (%)	111,000.00 (16.14)	115,000.00 (15.95)	123,000.00 (16.37)
4. Grants (%)	246,091.62 (16.14)	263,922.04 (15.95)	276,130.0627 (16.37)
Total (%)	687,891.62 (100.00)	720,822.04 (100.00)	751,480.0627 (100.00)
Central government's revenue	2,343,000.00	2,450,000.00	2,550,000.00
Proportion of local governments' revenue	**29.36**	**29.42**	**29.47**

Source: NDC

Revenue Assignment in Thailand

	Municipalities	TAO	BMA	Pattaya City	PAOs
Locally collected taxes					
Property tax	✓	✓	✓	✓	
Signboard tax	✓	✓	✓	✓	
Animal slaughter tax	✓	✓	✓	✓	
Bird nest collection tax	✓	✓	✓	✓	
Retail sale of cigarettes, tobacco, gasoline					✓
Hotel rental tax					✓
Shared taxes					
Value added tax	✓	✓	✓	✓	✓
Specific business tax	✓	✓	✓	✓	
Excise tax	✓	✓	✓	✓	
Liquor tax	✓	✓	✓	✓	
Motor vehicles tax					✓
Mineral and petroleum tax	✓	✓	✓	✓	✓
Gamble tax	✓	✓	✓	✓	
Fee, Fines, and Charges					
Underground water fee		✓			
Royalty fee for forestry		✓			
Royalty fee for fishery		✓			
Airport fee	✓	✓	✓		

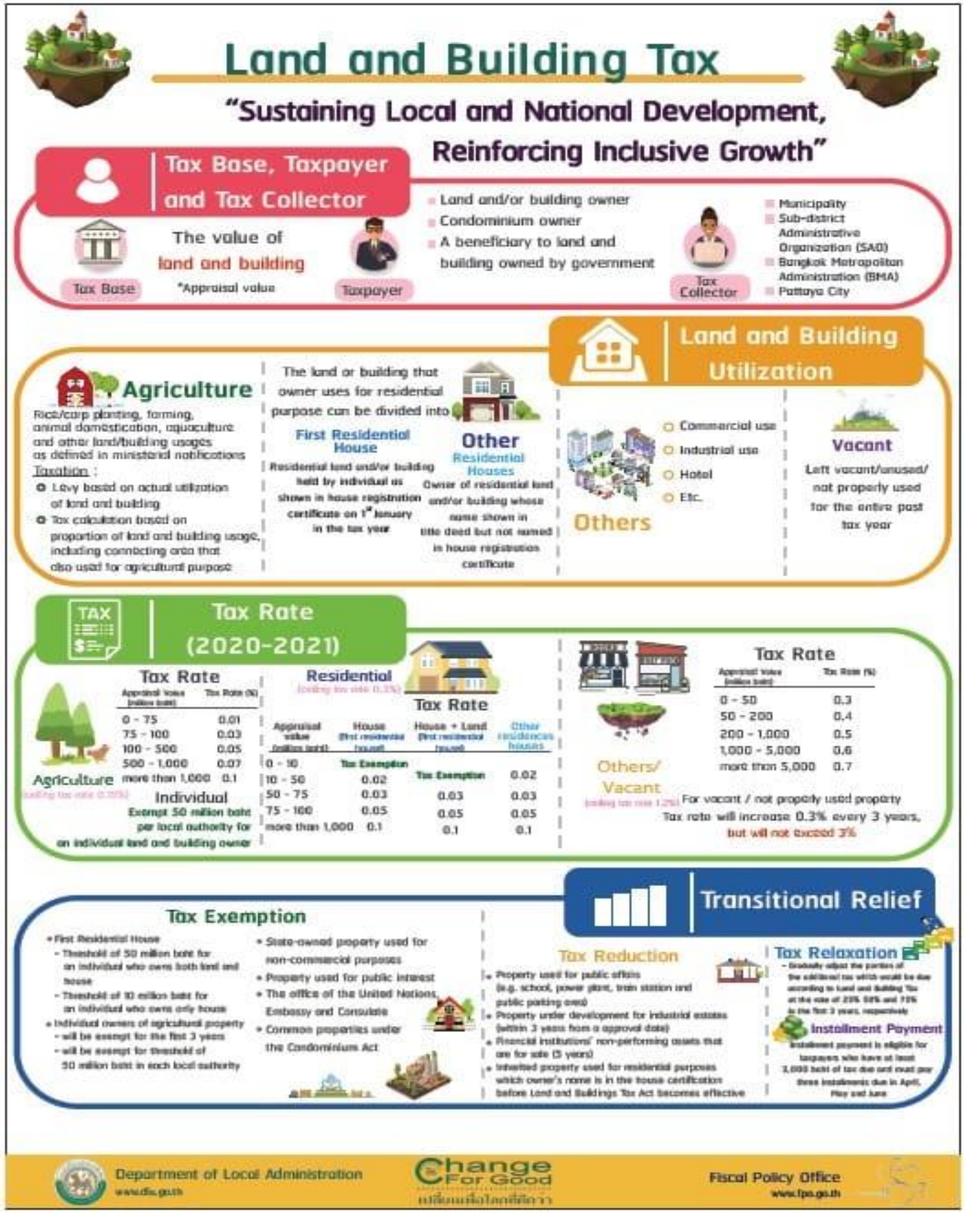
Intergovernmental Transfer

Intergovernmental transfer objectives

- To enable local governments' autonomy, and to finance local public services.
- To provide resources needed to support programs imposed by central government.

Critical Observations

- Local revenue sources are out of dated, some are over 30 years old and can not support expenditure responsibility. → New Land and building tax bill.
- Local governments rely very much on intergovernmental transfer.


Land and Building Tax
"Sustaining Local and National Development, Reinforcing Inclusive Growth"
Tax Base, Taxpayer and Tax Collector
The value of land and building
*Appraisal value
Tax Base
Taxpayer
Land and/or building owner
Condominium owner
A beneficiary to land and building owned by government
Tax Collector
Municipality
Sub-district Administrative Organization (SAO)
Bangkok Metropolitan Administration (BMA)
Pattaya City
Land and Building Utilization
Agriculture
Rice/crop planting, farming, animal domestication, aquaculture and other land/building usages as defined in ministerial notifications
Taxation :
Levy based on actual utilization of land and building
Tax calculation based on proportion of land and building usage, including connecting area that also used for agricultural purpose
The land or building that owner uses for residential purpose can be divided into
First Residential House
Other Residential Houses
Others
Commercial use
Industrial use
Hotel
Etc.
Vacant
Left vacant/unused/not properly used for the entire past tax year
Tax Rate (2020-2021)
Tax Rate
Agriculture
Individual
Residential
Others/Vacant
For vacant / not properly used property Tax rate will increase 0.3% every 3 years, but will not exceed 3%
Transitional Relief
Tax Exemption
Tax Reduction
Tax Relaxation
Installment Payment
Department of Local Administration
Change For Good
Fiscal Policy Office

Local Governments’ borrowing

LOCAL GOVERNMENTS' DEBT CLASSIFIED BY SOURCES OF FUND: 2004-2017
(AS OF FEBRUARY 12, 2018)

						Unit million Baht								
Sources of fund	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Promoting Municipalities' affairs Fund	2,584	2,690	3,270	5,470	6,730	7,359	8,091	8,478	9,478	10,306	10,325	11,199	11,516	11,364
Provincial Administrative Organizations' Collected Fund	1,108	1,043	1,168	929	1,027	1,217	1,495	1,553	1,927	2,248	2,250	1,765	2,347	2,350
Commercial Banks and Specialized Financial Institutions	732	1,622	2,467	3,329	4,730	5,064	7,691	10,648	12,069	11,681	10,548	9,426	8,323	7,585
Regional Urban Development Fund (RUDF)	569	564	550	557	580	619	531	507	452	403	342	291	240	213
Government Saving Bank (Co-funding with RUDF)	0	0	0	0	0	0	3,235	6,622	9,288	12,854	12,497	10,644	10,017	9,519
Total	4,993	5,919	7,455	10,285	13,067	14,259	21,043	27,808	33,214	37,492	35,962	33,325	32,443	31,031

Source: Fiscal Policy Office, as of February 12, 2018

PROPORTION OF LOCAL GOVERNMENTS' DEBT CLASSIFIED BY SOURCES OF FUND: 2004-2017 (AS OF FEBRUARY 12, 2018)

						Unit: percent								
Sources of fund	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Promoting Municipalities' affairs Fund	51.75	45.45	43.86	53.18	51.50	51.61	38.45	30.49	28.54	27.49	28.71	33.6	35.5	36.6
Provincial Administrative Organizations' Collected Fund	22.19	17.62	15.67	9.03	7.86	8.53	7.10	5.58	5.80	6.00	6.26	5.3	7.2	7.6
Commercial Banks and Specialized Financial Institutions	14.66	27.40	33.09	32.37	36.20	35.51	36.55	38.29	36.34	31.16	29.33	28.3	25.6	24.4
Regional Urban Development Fund (RUDF)	11.40	9.53	7.38	5.42	4.44	4.34	2.52	1.82	1.36	1.07	0.95	0.9	0.7	0.7
Government Saving Bank (Co-funding with RUDF)	0	0	0	0	0	0.00	15.37	23.81	27.96	34.28	34.75	31.9	30.9	30.7
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.0

Source: Fiscal Policy Office, as of February 12, 2018

Challenging Issues

Challenging issues

- Too many local government units (over 7,000 units).
- Clear criteria on division of responsibilities between government and local governments, and among local governments
  - What functions should be solely provided by the government and what functions should be jointly provided by government and local governments?
- How to match between function responsibilities and revenue?

Challenging issues

- How to build up supporting role of government agencies toward decentralization?
  - Transferring functions.
  - Maintaining minimum quality of services standard.
  - Technical support.
  - Ensure revenue to match expenditure.
  - Proper grant equalization formula.
  - Establishing monitoring and evaluation system.