

**University of Wisconsin-Madison
Robert M. La Follette School of Public Affairs**

**Public Affairs 867
Economics/AAE 567
Spring 2012**

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Government Finance in Developing Countries

Course Description

An important requirement for robust economic growth and development is a well functioning government able to efficiently provide basic public services. In much of the developing world, efforts are underway to improve the performance of governments. In many countries this involves the decentralization of the existing fiscal system and the transferring of fiscal decision-making power to local governments. This course examines the changing structures and operations of government fiscal systems in developing countries, with particular emphasis on the growing trend to strengthen sub-national governments. The course will explore how governments make decisions about what public services to provide; alternative ways that governments raise revenues to finance the delivery of services; determine an appropriate division of fiscal responsibilities among levels of government; and, assess prospects and options for pursuing decentralization and intergovernmental fiscal reform. The class focuses on economic analysis of these issues, but attention is also given to political, institutional and cultural considerations.

Course Requirements

Class meetings will consist of a mixture of lecture and *discussion*. Active class participation is expected and encouraged. To this end, each week two students will be assigned to lead a class discussion on the assigned readings. To facilitate the discussion, all other students in the class will be expected to submit prior to class at least one question based on the assigned readings. Questions will be submitted on the course website.

This course will have two exams; a mid-term tentatively scheduled for March 12th and a take-home final exam at the end of the semester. Additional course requirements include participation in one team project, participation in one of three formal debates, one short written assignments, and a research paper.

The *team project* is a description and assessment of the public sector fiscal system in a specific country conducted by teams of students. Each team will write a short paper and then summarize their results in a class presentation.

We will conduct three in-class *debates* during the course of the semester on to-be-assigned

policy issues related to the financing of public services in developing countries. Students will be assigned to either the pro or con side of one of the debates. Each debate team will present their arguments and respond to arguments from the opposing side.

The individual *written assignment* will involve the design of an intergovernmental grant formula. Students will be given some data and be asked to design a formula to achieve a given distributional goal. Students will then write a short policy memo to describe their formula and evaluate the results.

The *research paper* should focus on some aspect of public finance in a developing country of your choice. A short description of your proposed paper topic should be submitted to me by February 27th. The completed paper must be submitted by May 9th. Each student will be expected to make a brief PowerPoint presentation to the class of the findings of their research paper during the final weeks of the course.

The final course grade will be based on the following weighting of the course requirements:

Exams	45%
Research paper	25%
Individual written assignment	5%
Team project and debate participation	15%
Class discussion	10%

Readings

There is no available textbook that is appropriate for this course. Readings for the course will consist primarily of journal and working paper articles and book chapters. Assigned readings will be available through *UW Electronic Reserves*. Some readings may be placed on the course web site on *learn@UW*.

COURSE OUTLINE

WEEK 1 January 23rd and 25th

Introduction

“Introduction: New Directions in Development Thinking,” in World Bank, *Entering the 21st Century: World Development Report, 1999-2000*, pp. 13-30.

David Brooks, “The Underlying Tragedy,” *New York Times*, January 14, 2010. Available at <http://www.nytimes.com/2010/01/15/opinion/15brooks.html?emc=eta1> and on the course website.

Multi-level Government Finance and Introduction to Decentralization

Vito Tanzi, "Globalization and the Need for Fiscal Reform in Developing Countries," *Occasional Paper*, No. 6, Institute for the Integration of Latin America and the Caribbean, Washington, DC: Inter-American Development Bank, 2004.

WEEK 2 January 30th and February 1st

Introduction to Decentralization (cont.)

Anwar Shah, "Fiscal Decentralization in Developing and Transition Economies: Progress, Problems and Promise," World Bank Working Paper 3282, 2004, p. 1-28.

Vito Tanzi, "Pitfalls on the Road to Fiscal Decentralization," Economic Reform Project, Working Paper no. 19, Washington, DC: Carnegie Endowment for International Peace, 2001.

Team assignment handed out

WEEK 3 February 6th and 8th

The Political Economy of Local Governments

Robert D. Ebel and Serdar Yilmaz, "On the Measurement and Impact of Fiscal Decentralization," Chapter 5 in *Public Finance in Developing and Transitional Countries; Essays in Honor of Richard Bird*, edited by Jorge Martinez-Vazquez and James Alm.

Richard M. Bird, "Are There Trends in Local Finance? A Cautionary Note on Comparative Studies and Normative Models of Local Government Finance," IMFG Papers on Municipal Finance and Governance, No. 1, 2011.

Presentations by teams (Feb. 6th)

WEEK 4 February 13th and 15th

Organizing the Delivery of Public Services

Jonas Prager, "Is Privatization a Panacea for LDCs? Market Failure versus Public Sector Failure," *The Journal of Developing Areas*, April 1992, pp. 301-22.

Eric A. Hanushek, "Interpreting Recent Research on Schooling in Developing Countries," *The World Bank Research Observer*, August 1995, pp. 227-46.

Michael R. Kremer, "Research on Schooling: What We Know and What We Don't—A Comment on Hanushek," *The World Bank Research Observer*, August 1995, pp. 247-54.

Debate #1 (Feb. 15th)

WEEK 5 February 20th and 22nd

Introduction to taxation

Richard M. Bird and Eric M. Zolt, "Introduction to Tax Policy Design and Development," World Bank, April 2003.

Chapter 12, "Principles of Tax Analysis," in Ronald Fisher, *State and Local Public Finance*, 3rd edition, Thomson South-Western, 2007.

Vito Tanzi and Howell Zee, "Tax Policy for Developing Countries," *Economic Issues*, no. 27, Washington, DC, International Monetary Fund, 2001. Also available at <http://www.imf.org/external/pubs/ft/issues/issues27/index.htm>.

Revenue Sources Used by National Governments

Richard A. Musgrave, "Income Taxation of the Hard-to-Tax Groups," in *Taxation in Developing Countries*, 4th edition, edited by Richard M. Bird and Oliver Oldman, Johns Hopkins University Press, 1990.

George E. Lent, Milka Casanegra, and Michèle Guerard, "The Value-Added Tax in Developing Countries," *IMF Staff Papers*, July 1973.

WEEK 6 February 27th and 29th

Term paper abstract due (February 27th)

Property and land taxation

Roy Bahl and Jorge Martinez-Vazquez, "The Determinants of Revenue Performance," chapter 3 in *Making the Property Tax Work; Experiences in Developing and Transitional Countries*, edited by Roy Bahl, Jorge Martinez-Vazques, and Joan Youngman, Cambridge, MA, Lincoln Institute of Land Policy, 2008.

Roy Kelly, "Property Taxation in East Africa: The Tale of Three Reforms," Working Paper, Lincoln Institute of Land Policy, 2000.

Blane D. Lewis, "Property Tax in Indonesia: Measuring and Explaining Administrative (Under-) Performance," *Public Administration and Development* 23, No. 3, 2004: 227-239.

David Solomon with Ndumiso Gola, Mbulelo Ngxesha, and Wycliffe Ndlela, "Tribal Land and the Property Tax," in *Property Taxes in South Africa; Challenges in the Post-Apartheid Era*, edited by Michael E. Bell and John H. Bowman.

WEEK 7 March 5th and 7th

Debate #2 (March 3rd)

Corruption, tax evasion, and “good” governance

Vito Tanzi and Hamid R. Davoodi, “Corruption, Growth, and Public Finance,” IMF Working Paper, WP/00/182, International Monetary Fund, 2000.

James Alm and Jorge Martinez-Vazquez, “Institutions, Paradigms, and Tax Evasion in Developing and Transition Countries,” Chapter 7 in *Public Finance in Developing and Transitional Countries; Essays in Honor of Richard Bird*, edited by Jorge Martinez-Vazquez and James Alm.

WEEK 8 March 12th and 14th

Midterm exam (March 12th)

User Fees

Richard M. Bird, “User Charges in Local Government Finance,” Intergovernmental Fiscal Relations & Local Financial Management Program, World Bank Institute, 1999. Read at least through section on “Pricing Local Services.”

John J. Boland and Dale Whittington, “The Political Economy of Water Tariff Design in Developing Countries: Increasing Block Tariffs versus Uniform Price with Rebate,” in *The Political Economy of Water Pricing Reforms*, edited by Ariel Dinar.

Arye Hilman and Eva Jenker, “User Payments for Basic Education in Low-Income Countries,” in Sanjeev Gupta, Benedict Clements, and Gabriela Inchauste, eds., *Helping Countries Develop : the Role of Fiscal Policy*, Washington, DC, International Monetary Fund, 2004.

Andrew Reschovsky, “Financing Schools in the New South Africa,” *Comparative Education Review* 50, February 2006. Pay particular attention to the section on “The Role of School Fees in the Funding of Education.”

WEEK 9 March 19th and 21st

The role of borrowing—financing capital infrastructure

George Peterson, “Building Local Credit Systems,” *Background Series*, no. 3, Washington, DC, World Bank, 2000. Read parts I and II.

Junaid Ahmad, “Decentralizing Borrowing Powers,” *Decentralization Briefing Notes*, edited by Jennie Litvack and Sessica Seddon, World Bank Institute, 2000: 32-38.

(optional) Christine R. Martell and George M. Guess, “Development of Local Government Debt Financing Markets: Application of a Market-Based Framework,” *Public Budgeting & Finance*, Spring 2006.

WEEK 10 March 26th and 28th

Intergovernmental finance

Anwar Shah, “A Practitioner’s Guide to Intergovernmental Fiscal Transfers,” chapter 1 in *Intergovernmental Fiscal Transfers: Principles and Practice*, edited by Robin Boadway and Anwar Shah, Washington, DC, The World Bank, 2007. Read pages 1-20 and 37-51.

Richard Bird and Michael Smart, “Intergovernmental Fiscal Transfers: International Lessons for Developing Countries,” *World Development* 30, No. 6, 2002: 899-912.

Bert Hofman and Susana Cordeiro Guerra, “Fiscal Disparities in East Asia: How Large and Do they Matter?” chapter 4 in *East Asian Decentralizes: Making Local Government Work*, Washington, DC, The World Bank, 2005.

Spring break

WEEK 11 April 9th and 11th

Intergovernmental finance

Howard Chernick and Andrew Reschovsky, “Financing Health, Education, and Welfare in the New South Africa,” *La Follette Policy Report*, Spring/Summer 2001.

Roy W. Bahl, “[Chinese] Intergovernmental Fiscal Relations and Local Public Finance: What is Next on the Reform Agenda,” in *China’s Local Public Finance in Transition*, Joyce Y. Man and Yu-Hung Hong, eds., 2011.

Debate #3 (April 8th)

Individual assignment on grant design due on April 8th

WEEK 12 April 16th and 18th

Implementing decentralization

Rémy Prud’homme, “The Dangers of Decentralization,” and Charles E. McLure, Jr., “Comment on the ‘The Dangers of Decentralization,’ by Prud’homme,” *The World Bank Research Observer*, August 1995, pp. 201-226.

Roy Bahl, “How to Design a Fiscal Decentralization Program,” in *Local Dynamics in an Era of Globalization: 21st Century Catalysts for Development*, Edited by Shahid Yusuf, Simon J. Evenett, and Weiping Wu, Oxford University Press, 2000: 94-100.

Jonathan Rodden, Gunnar S. Eskeland, and Jennie Litvack, “Introduction and Overview,” Sections 1.1 through 1.4 of Chapter 1 in *Fiscal Decentralization and the Challenge of Hard Budget Constraints*, edited by Jonathan Rodden, Gunnar S. Eskeland, and Jennie Litvack.

Paul Smoke, “Strategic Implementation of Fiscal Decentralization in Developing Countries,” *Proceedings of the National Tax Association Annual Conference*, 2001.

Read two of the following five articles:

Stephen B. Webb, “Argentina: Hardening the Provincial Budget Constraint, Chapter 6 in *Fiscal Decentralization and the Challenge of Hard Budget Constraints*, edited by Jonathan Rodden, Gunnar S. Eskeland, and Jennie Litvack, Cambridge, MA, The MIT Press, 2003.

Jonathan Rodden, “Federalism and Bailouts in Brazil,” Chapter 7 in *Fiscal Decentralization and the Challenge of Hard Budget Constraints*, edited by Jonathan Rodden, Gunnar S. Eskeland, and Jennie Litvack, Cambridge, MA, The MIT Press, 2003.
Joyce Y. Man, “Local Public Finance in China: An Overview,” in *China’s Local Public Finance in Transition*, Joyce Y. Man and Yu-Hung Hong, eds., 2011.

(optional) David Dollar and Bert Hofman, “Intergovernmental Fiscal Reforms, Expenditure Assignment, and Governance,” chapter 3 in *Public Finance in China: Reform and Growth for a Harmonious Society*, edited by Jiwei Lou and Shuilin Wang, Washington, DC, The World Bank, 2008.

M. Govinda Rao and Richard M. Bird, “Coping With Change: The Need to Restructure Urban Governance and Finance in India,” IMFG Papers on Municipal Finance and Governance, No. 4, 2011.

Ehtisham Ahmad and Ali Mansoor, “Indonesia: Managing Decentralization,” Chapter 14 in *Managing Fiscal Decentralization*, edited by Ehtisham Ahmad and Vito Tanzi, New York, Routledge, 2002.

WEEK 13 April 23rd and 25th

Urban finance in developing countries

Edwin S. Mills, “The Importance of Large Urban Areas and Governments’ Roles in Fostering Them,” in *Local Dynamics in an Era of Globalization: 21st Century Catalysts for Development*, edited by Shahid Yusuf, Simon J. Evenett, and Weiping Wu.

Enid Slack, "Financing Large Cities and Metropolitan Areas," IMFG Papers on Municipal Finance and Governance, No. 3, 2011.

Howard Chernick and Andrew Reschovsky, "Local Public Finance: Issues for Metropolitan Regions," in *Competitive Cities in the Global Economy*, OECD Territorial Reviews, Paris, Organization for Economic Cooperation and Development, 2006: 417-432.

WEEKS 14-15 April 30th, May 2nd, May 7th, and May 9th

Student presentations

Term papers due on May 9th

Take-home final exam (dates to be determined)