

Decentralization and the Politics of Local Taxation in Indonesia and the Philippines

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Local solutions to local problems?



Source: VIVAnews, December 25, 2012.

Research Question

Under what conditions do fiscal and political decentralization encourage efficient local taxation?

Substantive and Theoretical Importance

Taxes affect development

- ▶ ability to finance public goods
- ▶ rate of economic growth
- ▶ distribution of wealth

Substantive and Theoretical Importance

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- ▶ rate of economic growth
- ▶ distribution of wealth

Unresolved theoretical questions

- ▶ What causes “fiscal deepening”?
- ▶ What are the effects of decentralization?

Three Literatures

1. Public finance
2. Decentralization
3. Political economy

Argument

1. Competitive elections generate demand for expensive public goods, especially where there is income inequality.
2. The supply of revenue depends on the ability of wealthy taxpayers to resist taxation by fleeing or organizing.
3. The effects of these variables vary across types of taxes.

Research Strategy

Indonesia and the Philippines

- ▶ Most-likely cases for efficient local taxation
- ▶ Variation across cities within each country
- ▶ Variation in fiscal autonomy between countries

Plan of the Talk

1. Theory

- ▶ Literature review
- ▶ Hypotheses

2. Research design

- ▶ Quantitative
- ▶ Qualitative

3. Feasibility

- ▶ Alternative explanations
- ▶ Preliminary results

Public Finance Literature

Local taxes are inefficient, except in the case of

1. property taxes
2. user fees.

Public Finance Literature

Table: Types of taxes

Type of tax	Base
Property	land and buildings
Sales and excise	consumption
Business	trade, production, licenses
User fees	service beneficiaries

Adapted from Bird (2010, Table 3)

Public Finance Literature

The dilemma of local finance:

- ▶ Locally collected taxes are inefficient,
- ▶ but fiscal transfers are prone to mismanagement.

Decentralization Literature

Interjurisdictional competition among local units achieves market efficiency (Weingast 1995, Tiebout 1956).

Decentralization Literature

Interjurisdictional competition among local units achieves market efficiency (Weingast 1995, Tiebout 1956).

...but the underlying model assumes only one tax – a residential head tax.

Political Economy Literature

Political demand for revenue:

1. More competitive elections pressure public officials to provide public goods (Weingast and Careaga 2003).
2. Elections create pressures for redistribution when incomes are unequal (Meltzer and Richard 1981).

Political Economy Literature

Economic supply of revenue:

1. Mobile capital relocates to avoid taxation (Bates and Lien 1985)
2. Fixed capital must lobby to resist taxation, which is easier when property ownership is concentrated among fewer taxpayers (Olson 1965, Frieden 1991).

Political Economy Literature

Four variables

1. Competitiveness of elections
2. Income inequality
3. Asset mobility
4. Asset concentration

Hypotheses

1. The less competitive elections, the higher **sales, excise taxes and user fees** as a share of local revenue.
2. The more competitive elections, the higher **business tax** revenues as a share of the economy – if business assets are immobile.
3. The more competitive elections, the higher **property tax** revenues as a share of the economy – if income is unequal and property ownership is dispersed.

Research Design

Table: Three Cases of Local Tax Regimes

Case	Period	Types of taxes			
Indonesia	1997 - 2010	user fees	sales, excise	business	
Indonesia	2011 -	user fees	sales, excise		property
Philippines	1991 -	user fees		business	property

Research Design

93 Indonesian cities

398 Indonesian districts

144 Philippine cities, including 38 independent cities

approximately 1500 Philippine municipalities

Quantitative tests

OLS models

$$\frac{\text{Revenue by type of tax}}{\text{Total tax revenue}}$$

$$\frac{\text{Revenue by type of tax}}{GDP}$$

Independent variables

Variable	Measures
Electoral competitiveness	margin of victory, winning vote share, incumbent turnover
Inequality	mean log deviation of income, Theil index, property owners as share of population
Capital mobility	share of GDP from agriculture and industry
Asset concentration	Herfindahl-Hirschman index

Qualitative tests

8 case studies

Controlled comparisons (Slater and Ziblatt 2013)

Logic of inference

Most similar, different outcome

Vary competitiveness of elections, taxpayer resistance

Hold constant economy, demography, institutional capacity,
revenue sources

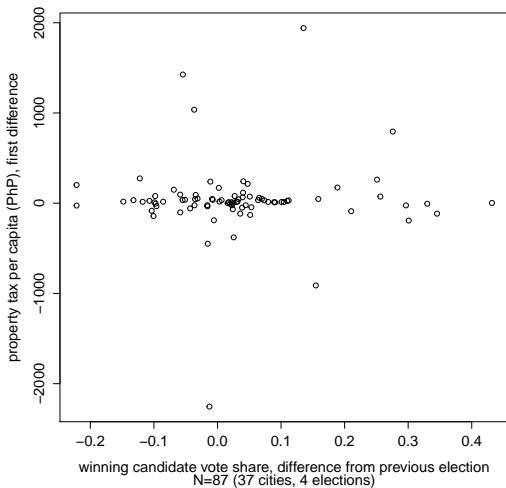
Three Alternative Explanations

1. Inherited institutions

It could be the case that the composition of local tax revenues depends on pre-existing administrative capacity regardless of the competitiveness of elections or economic structure.

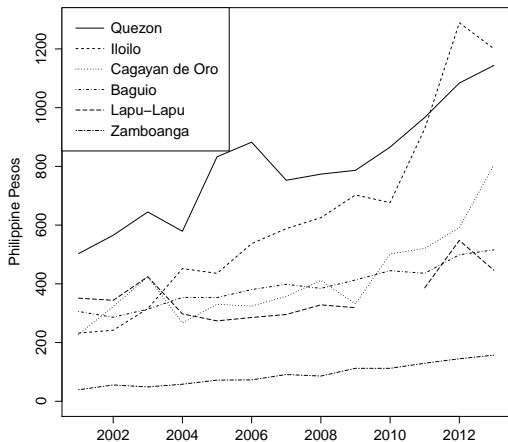
Inherited Institutions, preliminary evidence

Figure: Change in per capita property tax revenues and change in competitiveness of elections



Inherited Institutions, preliminary evidence

Figure: Property tax revenue per capita, selected Philippine cities



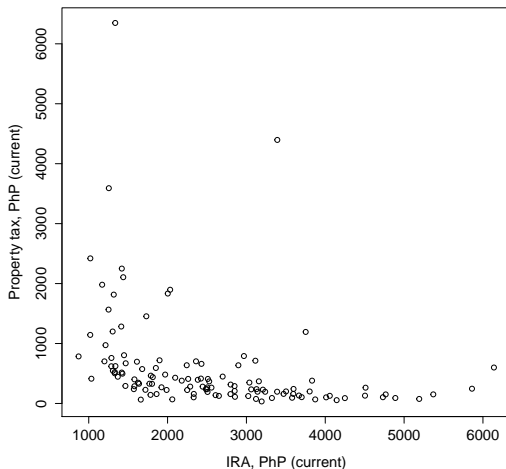
Three Alternative Explanations

2. Alternative revenue sources

It could be the case that local officials with access to easy rents neglect tax collection regardless of the competitiveness of elections or economic structure.

Alternative revenue sources, preliminary evidence

Figure: Bivariate relationship, per capita property tax revenue and IRA, 2013



Alternative revenue sources, preliminary evidence

Indonesian cities raise as much money as their Philippine counterparts despite receiving on average four times as much financial support from the central government.

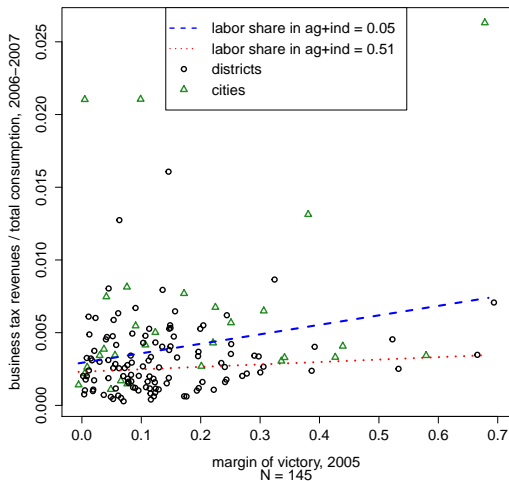
Three Alternative Explanations

3. Coalition politics

It could be the case that the incentives of local officials are shaped more by their supporting coalitions than by the competitiveness of elections.

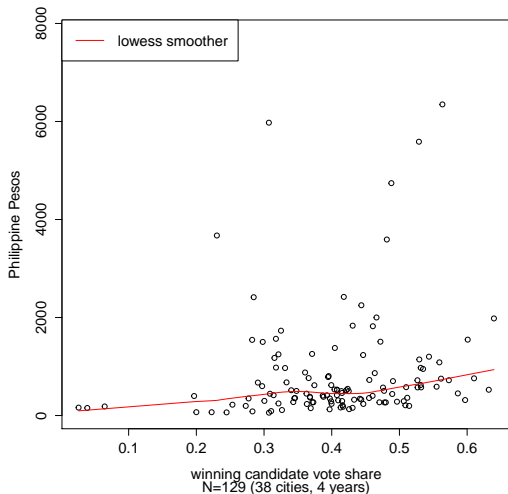
Coalition politics, preliminary evidence

Figure: The more competitive elections, the lower business taxes.



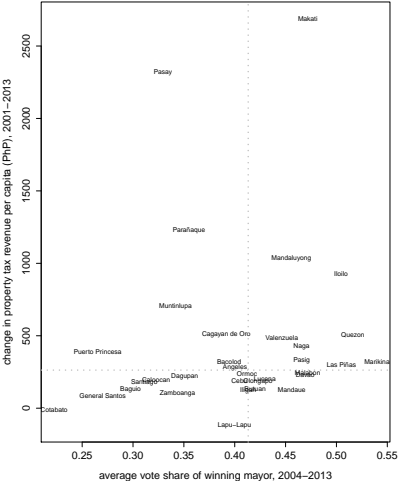
Coalition politics, preliminary evidence

Figure: Property tax revenues per capita and the competitiveness of elections, pooled observations of Philippine cities, 2004, 2007, 2010, 2013



Case selection

Figure: Property tax revenues per capita and the competitiveness of elections, ten year trends



Fieldwork timeline

September 2 - October 17: Manila

- ▶ Tagalog lessons
- ▶ Preparation

October 20: Begin city visits

- ▶ Approximately six weeks per city

May 16, 2015: Depart

Appendix

Literature

Hypotheses

- Necessary Conditions

- Coalitions

- Interaction among IVs

- The “empty cell” problem

Descriptive Statistics

- Indonesia tax structure

- Philippines property tax revenues

- Philippines business tax revenues

Measures

- DV

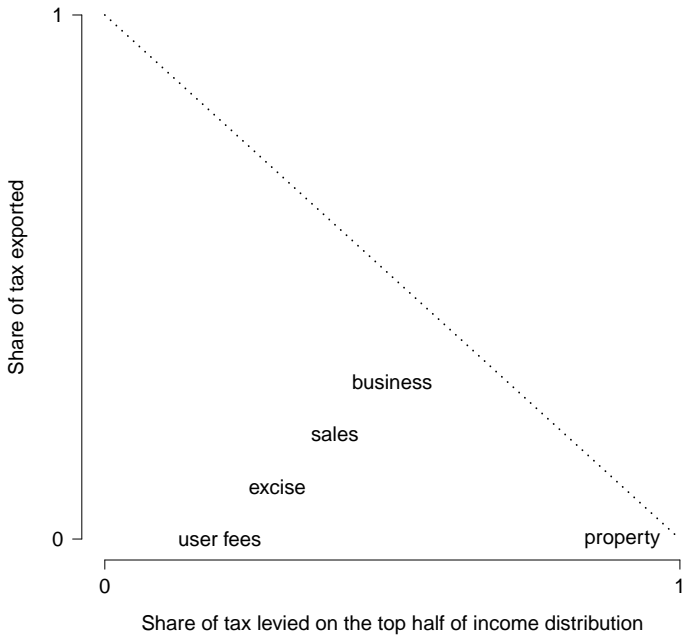
- MRP

Preliminary results

Case selection

- Controlled comparison

- Cases over time



Political “Demand and Supply” for Revenue

	Demand	Supply
Public finance:	?	tax administration
Decentralization:	interjurisdictional competition	interjurisdictional competition
Political economy:	political competition	ability to resist

Potential Implications

1. Competitive elections cause “fiscal deepening” by pressuring local governments to collect property taxes, but only under specific economic conditions.
2. The economic effects of decentralization vary depending on the types of taxes that local governments emphasize.
3. Democracies with access to certain types of taxes can defuse redistributive conflict by shifting the tax burden to non-residents.

Hypotheses

Necessary Conditions

For elections to generate political demand,

1. Tax policy must be salient to campaigns.
2. Turnout must be high among poor voters.

For immobile taxpayers to resist,

1. They should publicly endorse particularistic appeals, such as clientelism and ethnic pride.

Defining coalitions

urban regimes: “the informal arrangements by which public bodies and private interests function together to make and carry out governing decisions” (Stone 1989)

electoral coalitions: a public, joint effort to support a candidate

Operationalizing coalitions

1. joint public appearances
2. jointly issued public statements
3. coalition names

The “expensiveness” of elections

Campaign finance markets? (Samuels 2001, Bardhan and Mookherjee 2000)

Demand for finance depends on the total cost of elections, which increases with

1. the number of voters
2. the number of undecided voters

Supply of finance depends on

1. the availability of private funds
2. the value of office

Interaction

Dichotomous DV

necessary condition

sufficient condition

Continuous DV

conditional effect

constant effect

Hypotheses

Electoral Competition	Income Inequality	Asset Mobility	Asset Concentration	Political Incentive
non-competitive				⇒ regressivity
competitive	equal			⇒ burden-shifting
competitive	unequal,	mobile		⇒ capital flight
competitive	unequal,	fixed,	dispersed	⇒ redistribution
competitive	unequal,	fixed,	concentrated	⇒ burden-shifting

Hypotheses

Electoral Competition	Income Inequality	Asset Mobility	Asset Concentration	Tax
non-competitive				⇒ sales/excise
competitive	equal			⇒ business
competitive	unequal,	mobile		⇒ no business
competitive	unequal,	fixed,	dispersed	⇒ property
competitive	unequal,	fixed,	concentrated	⇒ business

The “empty cell” problem

In a matrix of all possible combinations of independent variables, some of the cells will be empty if the value of one variable influences the value of another variable.

An example of the “empty cell” problem

H3: Competitive elections, income inequality, capital immobility, and asset dispersion lead to higher property tax revenues.

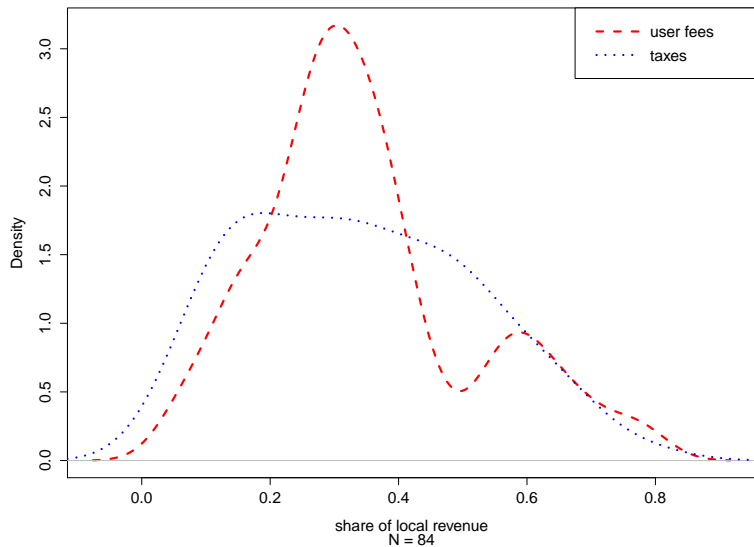
1. High capital mobility is an “empty cell”, because property is by definition fixed capital.
2. High income inequality and low asset concentration is probably an empty cell, because dispersed wealth is likely to equalize incomes.

Possible implications of the “empty cell” problem

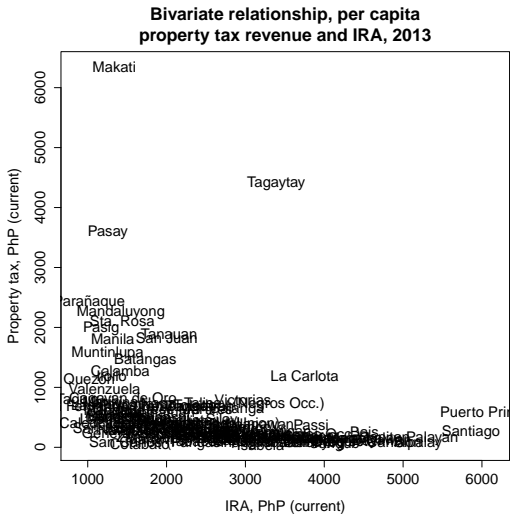
1. The conditions for increasing property taxes are never met.
2. High income inequality and low asset concentration occur together in rare cases.
3. Property tax increases are possible only at moderate levels of income inequality and asset concentration.
4. Wealthy citizens desire public subsidies, public goods, and public investment, and are sometimes willing to pay for them.

Descriptive Statistics

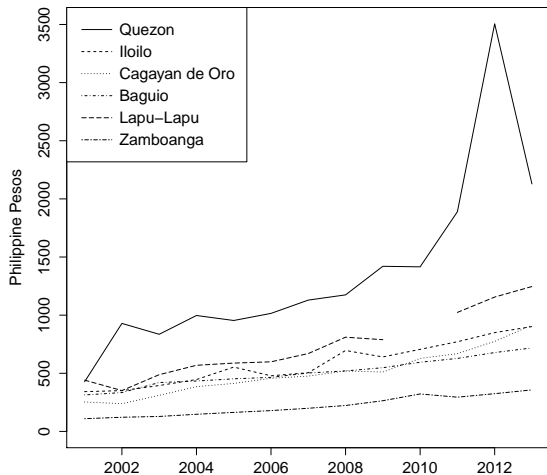
Indonesia, 2007: Distribution of Cities by Composition of Local Revenues



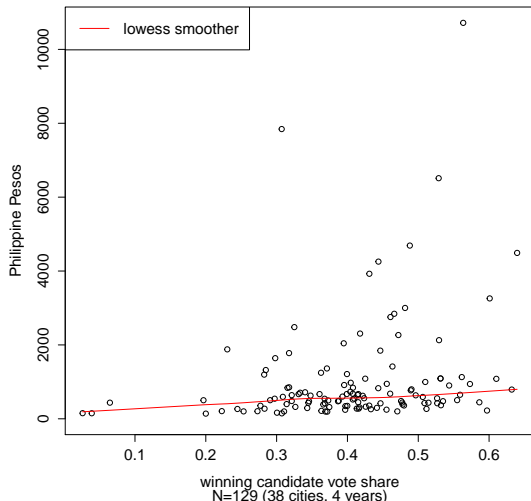
Alternative revenue sources, preliminary evidence



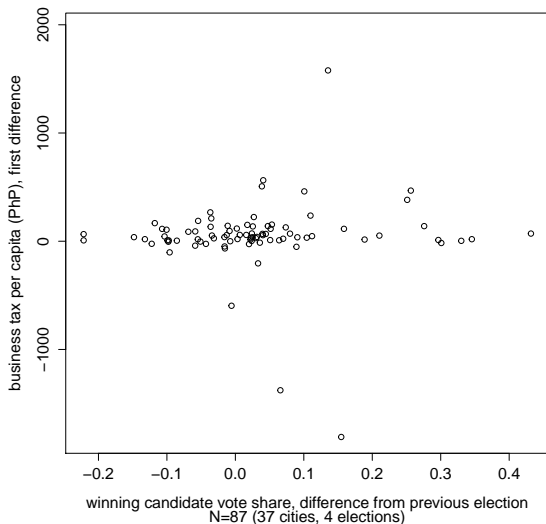
Business tax revenue per capita, selected Philippine cities



Business tax revenues per capita and the competitiveness of elections, pooled observations of Philippine cities, 2004, 2007, 2010, 2013



Change in per capita business tax revenues and change in competitiveness of elections, Philippine cities



Measures

Data

Data I have:

- ▶ Indonesian Ministry of Finance
- ▶ Jan Pierskalla's personal election data
- ▶ Indonesian Family Life Survey, 2007
- ▶ Indonesian 2000, 2010 Census
- ▶ Philippine Commission on Elections
- ▶ Philippine Bureau of Local Government Finance
- ▶ Philippine 1995, 2000 Census

Data I need:

- ▶ Indonesian Election Commission
- ▶ BPS Statistics Indonesia
- ▶ Philippine Statistics Authority
- ▶ Philippine 2010 Census

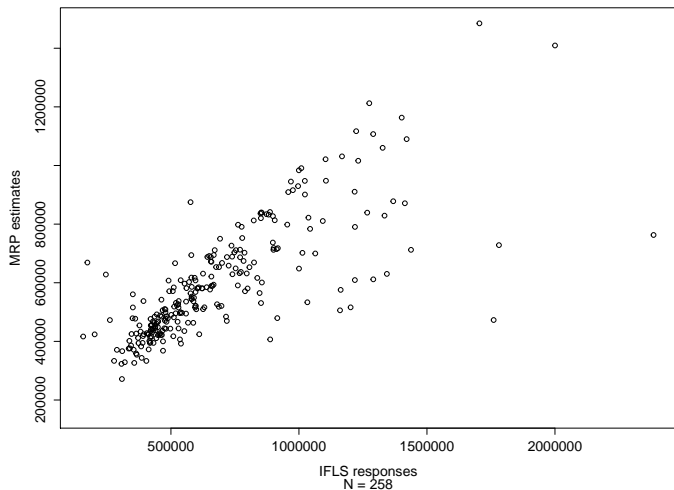
Dependent variable

1. Official tax rates

2. $\frac{\text{Type of tax}}{\text{Total tax revenue}}$

3. $\frac{\text{Type of tax}}{GDP}$

Average Per Capita Household Expenditure in Indonesian Cities and Districts, MRP estimates versus IFLS survey responses



Preliminary results

Sample

145 districts and cities
that conducted mayoral elections in 2005

Data

- ▶ Indonesian Ministry of Finance
- ▶ Jan Pierskalla's personal election data
- ▶ Indonesian Family Life Survey, 2007
- ▶ Indonesian 2010 Census

Dependent Variables

$$\text{“Tax take”} = \frac{\text{Tax revenue}}{GDP}$$

Dependent Variables

Ministry of Finance reporting categories:

“Local Taxes”

- ▶ hotel
- ▶ restaurant
- ▶ entertainment
- ▶ electricity
- ▶ water

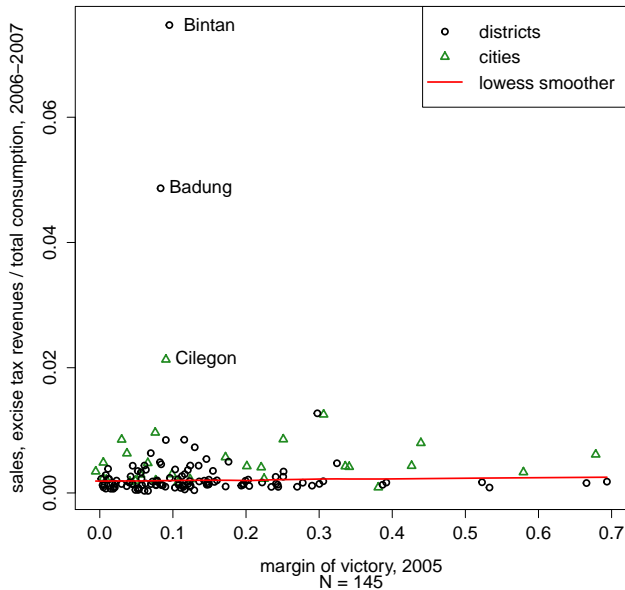
“Local User Fees”

- ▶ health services
- ▶ official documents
- ▶ market stall rentals
- ▶ commodity excises
- ▶ transport fees

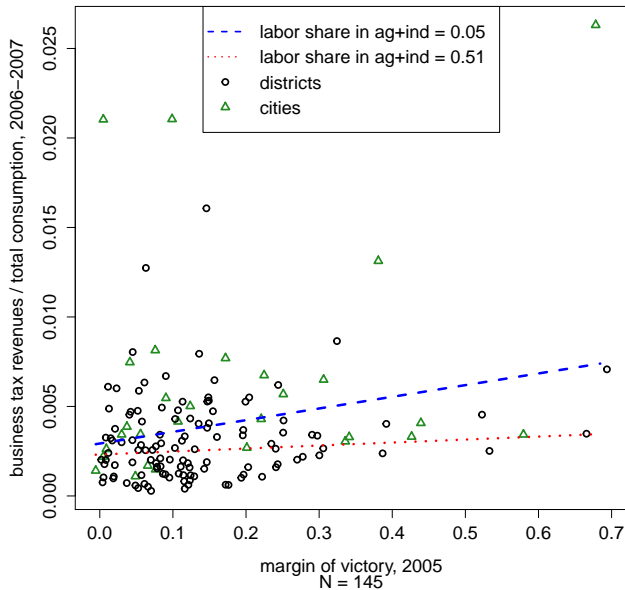
Independent Variables

Electoral competitiveness	=	margin of victory
Capital mobility	=	share of labor force in agriculture or industry
City or district	=	dummy variable
Income	=	estimated average per capita household consumption
Population	=	log of population

Sales and Excise Tax Take: No relationship



The more competitive elections, the lower business taxes.



How much money?

approximately \$180,000

\$0.70 per person

30% of business tax revenues

8% of total own-source revenues

0.5% of total revenue

OLS Model Results: Business Tax Take

	Basic	Interaction	Full	"Tax effort"
winning margin	0.0054 (0.0022)	0.0104 (0.0049)	0.0071 (0.0047)	
ag+industry labor share	-0.0068 (0.0026)	-0.0036 (0.0038)	-0.0014 (0.0046)	
winning margin x labor share		-0.0228 (0.0199)	-0.0107 (0.0193)	
city			0.0038 (0.0012)	0.0043 (0.0008)
hh expenditure			-0.0005 (0.0002)	-0.0004 (0.0002)
R^2	0.10	0.11	0.22	0.17
σ^2	0.004	0.004	0.004	0.003
N	145	145	145	151

Notes:

Standard Errors in Parentheses. Constant and population coefficient not shown.

Case selection

Slater and Ziblatt 2013

1. General variables
2. Representative variation
3. Control for alternative explanations

Case selection

Case	Variable 1	Variable 2	Variable 3
Philippines 1	high	high	high
Philippines 2	high	high	low
Philippines 3	high	low	high
Philippines 4	high	low	low
Indonesia 1	low	high	high
Indonesia 2	low	high	low
Indonesia 3	low	low	high
Indonesia 4	low	low	low

Case selection

Case	Fiscal autonomy	Electoral Competitiveness	?
Philippines 1	high	high	high
Philippines 2	high	high	low
Philippines 3	high	low	high
Philippines 4	high	low	low
Indonesia 1	medium	high	high
Indonesia 2	medium	high	low
Indonesia 3	medium	low	high
Indonesia 4	medium	low	low

Rival explanations

1. Institutional design
2. Competitiveness of elections
3. Income inequality
4. Asset mobility
5. Asset concentration
6. Administrative capacity
7. “Easy rents”
8. Coalitions

Logic of inference

MDSO shows sufficiency

Hold constant outcome

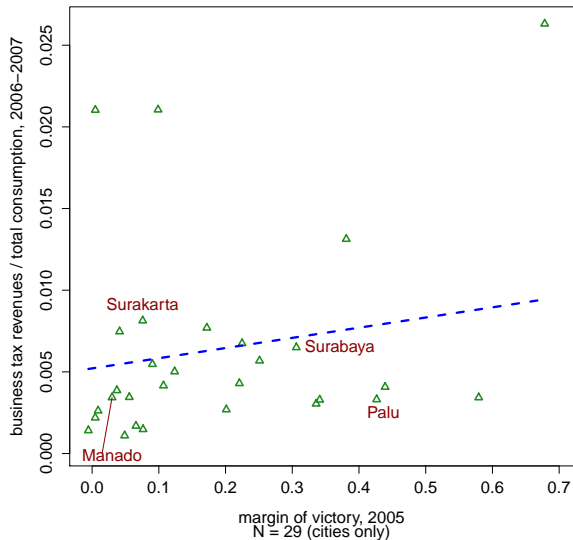
Vary everything else

Validity

Case studies increase confidence in the internal validity of regression results.

Regressions increase confidence in the external validity of case study findings.

Case studies



2 “typical” cases for hypothesis testing.

2 “deviant” cases for hypothesis generating.

Variation over time

Table: Indonesia

Period	Regime
prior to 1997	appointments
1999 - 2004	indirect elections
2005 - present	direct elections

Variation over time

Table: Philippines

Period	Regime
prior to 1972	decentralization
1972 - 1986	Marcos regime
1991 - present	decentralization