

MIT 11.487
URBAN PUBLIC FINANCE IN DEVELOPING COUNTRIES
Fall 2009

Mondays
5-7 PM
Room 9-450A
Course website: stellar.mit.edu/S/course/11/fa09/11.487/

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Office Hours: Wednesdays, 2:30-3:30 PM, please use signup posted on sheet outside office door

Course Description and Objectives:

Cities in the developing world are faced with a dilemma: they have some of the fastest growing populations in the world that require more urban services than ever but also limited fiscal and institutional capacity to provide them. This course explores the question of how to choose and pay for urban public services in developing countries. It surveys both public finance theory and applied policy debates. Students of this course should come away with facility in public finance analysis, familiarity with a variety of sources of public finance and their tradeoffs, and a general theoretical framework with which to approach real urban financing problems in developing countries. The course material also provides students with insights into the political economy of cities and the structural forces behind the urban physical environment.

Course text:

The course readings are available on the class website. A hard copy of all the materials are also available on course reserve at Rotch library. The readings are separated into those that are required for the day's session and some optional "recommended" readings for those who would like to read further. The students are responsible for responding to the required list.

Assignments and Grading:

This course is based on the premise that students learn and retain more by writing down their reflections, observing and directly interacting with peers (Bandura, 1986), and if the ideas relate to and build upon their previous knowledge (including experiential) (Rogoff, 1990). In other words, please share your ideas with your classmates. The hope is that this course will feed upon students' questions and curiosities and invite students to consider new frameworks and issues.

Accordingly, students are responsible for submitting the following work. Course grades will be calculated according to the following weights:

Reading responses and class participation	60%
Final paper and presentation	40%

Reading responses and class participation

It is essential for students to read the material assigned each week and to participate in the discussions in the seminar. In order to promote reflection and substantive discussion, students will post a message to the class on the forum section of the class website, responding to the required readings (not the recommended). These will be due on Mondays by 10am so that everyone can read each other's responses before class.

The reading responses will be graded more for effort rather than quality so that students should feel free to write about any thoughts and questions about the day's assigned reading. Please note that while I have provided discussion questions in this syllabus for each class session in order to help guide students in the reading, you need not answer these questions in your reading responses.

Final paper

This assignment is meant to serve the student's interests and to develop their critical thinking on a topic. Students may use this assignment in preparation for thesis work or to pursue a question of personal interest. However, the topic must be chosen in consultation with the professor.

This paper should have three components: a literature review, preliminary analysis of available secondary data, and a proposal for further study. For the literature review, you should be able to identify a broad topic area, but then quickly narrow your focus to a manageable thread of the literature. You are required to survey no less than 10 articles, books, etc. The use of practitioner writings and publications is encouraged but may not be the sole source of the literature review. Although you will be relating information about prior research done by others, you should have your own story to tell in the context of a critical assessment of that research. Ideally, this process results in conclusions about important questions yet to be answered or that can be answered in a better or more rigorous way.

Next, you should find available secondary data (qualitative and/or quantitative) about your question and analyze it. This does not mean simply presenting published tables as facts but to critically question and interpret what it is saying, especially in regards to the literature you just reviewed. And then you should present a brief proposal for further study including a well-honed research question and a possible study design.

If you choose a topic related to one of the class lectures, you must be sure to differentiate your work from the information already covered in class. The point of the exercise is to allow you to investigate a topic area more deeply or a particular strand of literature not already explored in class.

Deadlines and Dates

- 9/25:** Turn in a one page explanation of proposed research topic.
- 10/16:** Hand in a write-up (up to 2 pages) refining the topic and approach with a preliminary reference list.
- 10/19** **Schedule a meeting for this week to discuss your paper topic with the professor.**
- 11/6:** An outline of the paper is due with extended reference list.
- 11/30 or 12/7:** Student presentations of papers for feedback.
- 12/10:** Final paper due – around 15-20 double-spaced pages.

Statement of Academic Integrity:

Academic dishonesty is not tolerated at the Institute. Please refer to MIT's Handbook of Academic Integrity for the definitions of cheating, plagiarism, unauthorized collaboration, facilitating academic dishonesty and an outline of disciplinary action procedures

Overview of Course Topics:

SECTION 1: Public Expenditures: justification and organizational challenges

Session #

- 1 Introduction to Course
Justification for Public Finance: public goods, externalities
- 2 Justification for Public Finance: economic development
- 3 the Fiscal Gap: assessing fiscal health, budget deficits and inflation
- 4 Central and Local government public finance decisionmaking
- 5 Experiences of fiscal decentralization in developing and transition countries

SECTION II: Public Revenues: Taxation

- 6 Efficiency: Optimal Taxation, Optimal User Fees
- 7 Equity: Tax Incidence
- 8 Real Property Tax in Developing Countries
- 9 Challenges in Tax Reform

SECTION III: Other Sources of Financing for Urban Services and Infrastructure

- 10 Private Sector Participation: Fiscalization of land, land development exactions
- 11 Debt Financing
- 12 International Development Lending Institutions
- 13 Class Presentations

Course Content and Schedule:

I. Public Expenditures: justifications, organizational challenges

Session 1

September 14 **Introduction to Course**

Justifications for public finance: public goods and externalities

Required Reading:

Coase, Ronald. 1960. "The Problem of Social Cost," *Journal of Law and Economics*. vol.3 pp.1-44.

Kaul, Inge and Pedro Conceição. 2006. *The New Public Finance: Responding To Global Challenges*. New York: Oxford University Press Published for The United Nations Development Programme, 1-25.

Recommended Reading:

Public Finance by Harvey Rosen, 2002. McGraw Hill. Chapters 4 and 5 (basic textbook theory).

Jürgen G. Backhaus and Richard E. Wagner. 2004. Public Finance: A Historical Overview. *Handbook of Public Finance*. Jürgen G. Backhaus and Richard E. Wagner, eds. Berlin, Germany: Springer. (public finance is currently too narrow in economics literature, review of intellectual history)

(also Stiglitz' piece in Session 9 questioning market failure concept)

Session 2

September 21 **Justifications for public finance: economic development**

Discussion Question:

Is there sufficient evidence for the economic productivity benefits of public infrastructure investments? Why do the findings of studies conflict? Do we need evidence?

How is the Chinese stimulus package different from the U.S.'s? Why are they different and whose do you predict will be more successful? Why?

Reading:

China stimulus package versus U.S. stimulus package readings

David Alan Aschauer. 1989. "Is public expenditure productive?" *Journal of Monetary Economics*. vol.23, issue 2. March 1989. pp. 177-200

Holtz-Eakin, Douglas. 1994. "Public-Sector Capital and the Productivity Puzzle," *Review of Economics and Statistics*. vol.76, no.1. pp.12-21.

Recommended reading:

Lewis, Blaine D. 1998. "The Impact of Public Infrastructure on Municipal Economic Development: Empirical Results from Kenya," *Review of Urban and Regional Development Studies*. vol.10, no.2, pp. 142-156. (local unit of analysis, in Kenya)

September 24 or 25: Optional recitation on reading national accounts if there is student demand.

Session 3

September 28 **The Fiscal Gap: fiscal health and analysis, budget deficits and inflation, income producing versus consumption expenditures**

Discussion Question:

What are some indicators for assessing fiscal health in developing country cities? Are there ways to increase fiscal discipline through institutional reforms for budgeting?

In reading the national accounts of Thailand and Venezuela, what can you surmise about the strategies that their governments used.

Reading:

Government Finance Statistics Manual 2001, IMF. 2001 chapters 1, 8, 9.

National accounts of Thailand, *Government Finance Statistics 2002*

National accounts of Venezuela, *Government Finance Statistics 2007*

Urban Public Finance in Developing Countries by Roy Bahl and Johannes Linn, 1992. Oxford University Press. chapters 2 and 3

Nwagwu, Emeka O.C. 1992. "Budgeting for Development: the case of Nigeria" *Public Budgeting and Finance*, 12(1): 73-82.

Alesina, Alberto and Roberto Perotti. 1996. "Fiscal Discipline and the Budget Process," *American Economic Review*, 86(2):401-407.

Recommended reading:

Burchell, Robert. 1994. "Fiscal Impact Analysis," chapter 8 in Buchell, R. et al, eds. *Development Impact Assessment Handbook*. Washington, D.C. 1994.

Session 4

October 5 **Intergovernmental relations, Fiscal Federalism, Decentralization**

Discussion Question:

What are the elements of horizontal and vertical fiscal balance? Make a quick attempt at setting up the spreadsheet for the problem set and see if it can help you understand some of the challenges in grant design.

What are some of the theorized pros and cons of decentralization? What factors do you think they depend upon?

Reading:

Richard Bird and Michael Smart. 2002. "Intergovernmental Fiscal Transfers: International Lessons for Developing Countries," *World Development*, vol.30, no.6, pp.899-912.

Problem Set for Discussion: Grant design for Primary Education

Tiebout, Charles M. 1956. "A Pure Theory of Local Expenditures," *Journal of Political Economy*. vol.64, no.5, pp.416-424.

“Dangers of Decentralization” by Remy Prud-homme, *World Bank Research Observer*, vol.10, no.2 (August 1995), pp. 201-20.

Recommended reading:

Oates, Wallace. E. 1972. *Fiscal Federalism*. New York: Harcourt Brace Jovanovich. Chapters 1 and 2. (another classic read, lays out a framework for thinking about optimal government structures, no need to worry about the appendices)

Quigley, John M. and Daniel L. Rubinfeld. 1986. "Budget Reform and the Theory of Fiscal Federalism," *American Economic Review*. 76,2:132-137. (gives background of the devolution, decentralization trend in the 1980s)

October 12, no class - Columbus Day MIT Holiday

Session 5

TUESDAY October 13 Experiences of Fiscal Decentralization in Developing and Transition Countries

Discussion Question:

What is the theory and evidence of fiscal decentralization’s relationship with economic growth? What governance issues are key to decentralization’s impacts?

Video: Michelle Rhee and Washington D.C. Public School Reform

Link 1: please view episodes 6 and 8

Link 2: please view sections 1-8, 14, 19, 23

Reading:

“Fiscal Decentralization and Economic Growth: a Cross-Country Study” by Hamid Davoodi and Heng-fu Zou, 1998. *Journal of Urban Economics*, vol. 43, issue 2, pp. 244-257.

Agrawal Aruk and Jesse Ribot. 1999. “Accountability in Decentralization: A Framework with South Asian and West African Cases,” *The Journal of Developing Areas*, vol. 33, no.4: 473-502.

Parry, Taryn Rounds. 1997. “Achieving Balance in Decentralization: a Case Study of Education Decentralization in Chile,” *World Development*. vol.25, no.2, pp. 211-225.

Jin, Jing and Heng-fu Zou. 2005. “Fiscal decentralization, revenue and expenditure assignments, and growth in China,” *Journal of Asian Economics*. 16(2005): 1047-1064.

Recommended reading:

Bardhan, Pranab. 2002. “Decentralization of Governance and Development,” *Journal of Economic Perspectives*, vol. 16, no.4: 185-205. (lays out how developing country conditions alter the decentralization hypothesis)

Bahl, Roy and Richard Bird. 2008. “Subnational Taxes in Developing Countries: the Way Forward,” *Public Budgeting and Finance*, Winter 2008: 1-25. (reviews different types of taxes and which might be appropriate for subnational government).

II. Public Revenues: Taxation

Session 6

October 19 **Efficiency: Optimal Taxation, Optimal User Fees**

Discussion questions:

In trying to raise public revenues through taxes, what are some considerations for the impact on the economy's efficiency? What are some of the pros and cons of cash assistance versus in-kind assistance? What are the pros and cons of user charges versus general taxes as a way to finance government services? By what criteria would user charges be a more appropriate choice than taxes?

Reading:

Public Finance by Harvey Rosen, chapters 13 and 14

"Financing Indonesia's Roads" Kennedy School of Government Case C95-86-719.0

Recommended reading:

Anderson, D. 1989. Infrastructure Pricing Policies and the Public Revenue in African Countries. *World Development*, 17, 4 (1989): 525-542. (the detriments of pricing services too low)

Bahl, Roy W. and Jonannes F. Linn. 1992. *Urban Public Finance In Developing Countries*. Washington, D.C.: The World Bank and Oxford University Press. Chapters 9. (about pricing urban services in developing countries, particularly water)

Fullerton, Don. 1982. On the Possibility of an Inverse Relationship Between Tax Rates and Tax Revenues. *Journal of Public Economics*, 19, 3-22. (discussion about when taxes might be counter-productive).

Session 7

October 26 **Equity: Tax Incidence in the General Equilibrium Model**

Discussion Question:

What is the difference between vertical and horizontal equity?

Reading:

Public Finance by Harvey Rosen, chapter 12

Devarajan, Shantayanan and Shaikh I. Hossain. 1998. "The Combined Incidence of Taxes and Public Expenditure in the Philippines," *World Development*, 26(6): 963-977.

Facts at a Glance: the Sales Tax. April 2009. Massachusetts Budget and Policy Center.

Session 8

November 2 **Real Property Taxation in Developing Countries**

Guest speaker: Yu-hung Hong, Lincoln Institute of Land Policy

Discussion Question:

What features of the real property tax make it a possible ideal source of revenue for local governments in developing countries? What are some of the problems in practice?

Reading:

Hong, Yu-hung. 200X. "Taxing Public Leasehold Land in Transactional Economies,"

Zodrow, George R. 2001. Reflection on the New View and the Benefit View of the Property Tax. *Property Taxation and Local Government Finance: Essays in Honor of C. Lowell Harriss*, Wallace E. Oates, ed. Cambridge, MA: Lincoln Institute of Land Policy.

Lewis, B. 2003. Property Tax in Indonesia: Measuring and Explaining Administrative (Under-) Performance. *Public Administration and Development*, 23, 2 (2003): 227-239.

Recommended reading:

Bahl and Linn, chapters 4 and 5

(slightly outdated but a still helpful review of property tax situations and issues in developing countries)

Session 9

November 9 **Challenges in Tax Reform**

Reading:

Joseph E. Stiglitz. 2002. New Perspectives on Public Finance: Recent Achievements and Future Challenges. *Journal of Public Economics*, 86 (3): 341-360.

Bahl, Roy W. and Richard M. Bird. 2008. "Tax Policy in Developing Countries: Looking Back – and Forward," *National Tax Journal*, vol. LXI, No.2: 279-301.

Bergman, Marcelo S. 2003. "Tax Reforms and Tax Compliance: the Divergent Paths of Chile and Argentina," *Journal of Latin American Studies*, vol.35: 593-624.

"Raising Revenues or Raising Hackles?: Radical Public Sector Reform in Peru's National Tax Administration Superintendency," Kennedy School of Government Case CR15-00-1596.2. (details of factors contributing to SUNAT reform success)

Recommended reading:

Taliercio, R. 2004. Administrative Reform as Credible Commitment: The Impact of Revenue Autonomy on Revenue Authority Performance in Latin America. *World Development*, 32, 2 (2004): 213-232. (semi-autonomous tax revenue authorities in Bolivia, Mexico, Peru, and Venezuela's reforms)

Goode, Richard. 1993. "Tax Advice to developing countries: an historical review," *World Development*. vol.21, no.1, pp. 37-53. (history of reform strategies)

"Why People Pay Taxes: the Case of the Development Levy in Tanzania" by Odd-Helge Fjeldstad and Joseph Semboja in *World Development*, vol.29, no.12, pp. 2059-2074, 2001. (another case)

III: Other sources of Financing for Urban Services and Infrastructure

Session 10

November 16 Private Sector Participation, Fiscalization of land

Discussion Questions:

What are the various methods of directly engaging the private sector in the provision of public urban services? What are some of their advantages and disadvantages? Essentially, why is the private sector supposed to be more effective/desirable than the public sector? Are there ways that some of those aspects could be incorporated into the public sector?

Annez, Patricia Clarke. 2006. Urban Infrastructure Finance from Private Operators: What Have We Learned from Recent Experience? *World Bank Policy Research Working Paper 4045, November 2006.*

Peterson, George E. 2006. Land leasing and Land Sale as an Infrastructure Financing Option. *World Bank Policy Research Working Paper 4043, November 2006.*

Kim, Annette M. 2008. *Learning to be Capitalists: Entrepreneurs in Vietnam's Transition Economy.* Oxford University Press. Chapter 4.

Harvey, David. 1989. "From Managerialism to Entrepreneurialism: The Transformation in Urban Governance in Late Capitalism," *Geografiska Annaler. Series B, Human Geography*, Vol. 71(1): 3-17.

Recommended Reading:

Jose A. Gomez-Ibanez and John R. Meyer. 1993. *Going Private: the International Experience with Transport Privatization.* Washington, D.C.: The Brookings Institution. (typical cycle of the public sector engaging the private sector).

Birdsall, Nancy and John Nellis. 2003. "Winners and Losers: Assessing the Distributional Impact of Privatization," *World Development*, 31(10): 1617-1633.

Chapman, Jeffrey I. 2008. The Fiscalization of Land Use: The Increasing Role of Innovative Revenue Raising Instruments to Finance Public Infrastructure. *Public Works Management and Policy* 12, 551. (review of ways to raise revenue through land)

Session 11

November 23 Debt Financing

Discussion Questions:

Diagram the principal agents and the flow of funds involved in this scheme. What are the potential benefits and risks to each party and how have they been managed? What risks remain?

Reading:

"The Tribasa Toll Road Trust" Kennedy School of Government Case Program, CR 15-99-1485.0

Pradhan, HK. 2002. "Local Government Finance and Bond Market Financing: India" a report for the Asia Development Bank.

Recommended Reading:

Peterson, J, with J. Cihfield. 2000. *Linkages between Local Governments and*

Financial Markets: A Tool Kit for Developing Sub-sovereign Credit Markets in Emerging Economies. Urban and Local Government Background Series, No. 1
Washington, DC: The World Bank

Session 12

November 30 **International Lending Institutions: conditionalities, fiscal austerity, monetary policies, debt.**

Discussion Questions:

What are the inter-relationships between aid loans and fiscal health?

Reading:

Stiglitz, Joseph. 2003 "What I Learned at the World Economic Crisis," in William Driscoll and Julie Clark, eds. *Globalization and the Poor*. International Debate Education Association, pp.195-205.

Thomas, Landon. "Turkey Tries to Resist Aid from I.M.F." *New York Times*, November 8, 2008.

Molina, Nuria. 2009. "IMF emergency loans: greater flexibility to overcome the crisis?" Bretton Woods Project. April 17, 2009.

Toye, John. 2000. "Fiscal Crisis and Fiscal Reform in Developing Countries" *Cambridge Journal of Economics*, vol.24, pp.21-44.

Recommended Reading:

Hanlon, Joseph. 2000. "How Much Debt must be Cancelled?" *Journal of International Development*, vol.,12, pp. 877-901.

Some students can elect to do their presentation during this class session.

Session 13

December 7 **Class presentations**

Students make a 15 minute presentation of their final paper and will receive an additional 5 minutes for questions and responses. This will be an extended class session, with dinner provided.

MIT 11.487: URBAN PUBLIC FINANCE IN DEVELOPING COUNTRIES
Fall, 2009
Informational Questionnaire:

Student Name: _____

Email: _____

Phone number: _____

Ethnicity and/or Nationality: _____

Circle one:

Department: DUSP another _____

Program: MCP PhD other _____

Year in the program: 1 2 3 4

What economics or other courses have you taken to provide background for this course?

Any relevant work experience?

Why are you interested in taking this course? What do you hope to learn?