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FINANCING URBAN LOCAL GOVERNMENT IN PAPUA NEW GUINEA

by

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PREFACE

This study was undertaken by Professor Andrew Axline as part of a more general concern with public sector financing in Papua New Guinea.

With three levels of government in Papua New Guinea, each with some revenue-raising powers, investors' concern is with the overall tax burden. National governments have shown a great appetite for revenue under the twin objectives of achieving economic independence by reducing foreign aid and providing more roads, schools, health centres and other services for the people. Under this squeeze, national government encourages lower levels of government to raise more of their own revenue. This approach carries the risk that rising total tax burdens will retard economic growth (a risk government has sought to contain by reducing company and personal tax rates in line with world trends).

Although Papua New Guinea is predominantly rural its towns are growing faster than the population generally. It seems sensible therefore to make urban communities self-financing as previous INA research has suggested (Bird 1984) and this is the subject of this study.

Professor Axline is no stranger to Papua New Guinea having spent two years with the Institute of Applied Social and Economic Research from 1984-86. He was a member of the committee set up by national government in 1983 to review intergovernmental fiscal relations.

INA thanks Professor Axline for his contribution to understanding public finances in Papua New Guinea and to the INA's ongoing research.

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INTRODUCTION

The purpose of this paper is to provide a general understanding of the financing of urban local government in Papua New Guinea. It is specifically designed to present a background for more detailed studies into the future needs and financial resources of urban local governments. It presents the broad context of the financing of local government in Papua New Guinea, with a focus on the revenue available to urban authorities. It also provides a description of the relationship between urban local government and provincial government, a discussion of future demands on urban services and investment in infrastructure, and an assessment of the potential for developing financial resources permitting urban authorities to meet these demands on a self-sufficient basis.

The structure of the paper takes the following form:

- a brief background of urban local government in Papua New Guinea;
- an understanding of the particular situation of local governments in the main town centres;
- a detailed description of the financial position of local government within the decentralised political system of Papua New Guinea, and the trends in funding over the past ten years;
- an examination of the present and potential sources of funding for local urban governments;
- some observations regarding future financing of urban local governments.

Chapter 2

LOCAL-LEVEL GOVERNMENT IN PAPUA NEW GUINEA

The origins of local government in Papua New Guinea are described in detail by Fenbury, who characterised the process as "practice without policy" (Fenbury 1980). A study by Norman Bonney provides a more recent assessment of the local government system (Bonney 1982, 113-127). Local government councils were to be the first step in what was clearly envisaged to be a very long process of familiarizing the indigenous population with democratic procedures to prepare them at some indefinite and distant future date for political independence. They were first established in Papua New Guinea under the Native Local Government Ordinance of 1949. Their start was slow and confined at first to the areas with the most experience of colonial contact. By 1956, only nine had been established; five in the Gazelle Peninsula, two in Milne Bay, one in Manus Island and one in Hanuabada. By 1961, 43 councils had been established, covering 1,011 villages and 305,000 people with a combined revenue of 312,000 pounds. By 1964, the year of the first indigenous national elections, most of the population were still not participating in the system, but by 1968 there were 142 councils representing 8,000 villages and 1.82 million people.

The Local Government Ordinance 1963, which came into effect in 1965, replaced the previous legislation, and is still the parent "national" government law on local government. By June 1973 a total of 163 councils had been established covering about 92 percent of the population of the country. It was a uniform system throughout the country and the ordinance was considered to be flexible enough by the colonial administration to be adapted to particular local conditions in different areas. According to a recent review of local-level government by the Morobe Provincial Government (Morobe Provinsel Gavman 1986, 5-7) the main objectives of the local government councils were:

(a) to teach the indigenous population to assume responsibilities in the management and administration of local affairs in accordance with democratic procedures;

(b) to decentralise power to the local level;

(c) to provide local government machinery and funding for extending and coordinating social and public services at the village level and hence to enlist active local support in endeavours to raise the standard of living;

(d) to make apparent the relationship between progress, order and the cost of providing government services;

(e) to provide a means for political socialisation and to bring local-level government into the broader national political system.

According to this report most of the objectives of local level government were not achieved for a number of reasons, not the least of which was the absence of any well-established financial system at the local or central level (Ibid. 6).

The administrative structure of the councils depended heavily on the kiaps for its effective functioning. Councillors often had little understanding of the appropriate procedures; motions might be passed which could not be acted upon or rules proposed which were illegal or unenforceable. Budgeting procedures were often not understood, funds were sometimes misused or misappropriated and accounting procedures were lax. Councillors tended to think largely in terms of projects for their clan and home areas and they were often accused of being preoccupied with allowances and perquisites. Councils were held to be poorly managed and to lack the expertise to supervise economic and social development projects. Head tax collections fell considerably. The councils only managed to collect 25 percent of their potential tax yield, and from 1977, with the introduction of provincial governments, became largely dependent on provincial government funding. The deteriorating state of local feeder roads, for which they are responsible, was another example of their low level of effectiveness (Bonney 1982, 119).

When interim devolution powers were granted to Bougainville in 1974, as the first step towards the establishment of provincial governments, one of the first acts of the new administration was to abolish the system of local government councils, a much resented symbol of colonial rule and control, and to plan a new system of community government to replace it. A few provinces, including North Solomons, East New Britain, New Ireland, Morobe, and Milne Bay subsequently passed their own Community Government Acts, under which a new system of community government was established, with emphasis on popular participation and control.

Most of the provinces in Papua, Mamose and Highlands regions now operate either under the inherited national legislation - The Local Government Ordinance, 1963, which became the Local Government Act, Chapter No. 57 - or have adopted the National Act as provincial legislation with only minor amendments. Today, few of these councils work well. Councils, in the less developed provinces especially, have been beset by problems of communication, sparse population, low economic development potential, and the lack of experienced manpower to manage, advise and audit councils (Ibid.).

The present situation of funding local government in Papua New Guinea is the result of the development of the system of local-level government over a period that covers the Australian colonial administration, self-government, national independence, and the decentralisation of government power in the country. As a result of a series of fundamental political changes, the present system does not reflect a coherent framework that matches responsibilities with resources, or the power to deliver services and maintain assets with the means to fund these activities.

A report of a committee of enquiry into local government and finance in 1972 identified five classes of local councils: village integration, transitional, rural developed, semi-urban, and urban (Report of the Committee of Enquiry 1972, 10). Although the present paper is concerned mainly with urban local government, and will limit itself to that class of government, a general background of both urban and rural local government is useful for understanding the particular situation of the urban examples.

A. Local Government in Rural Areas

Until 1970, local government councils in Papua New Guinea existed mainly in rural areas. Under the Local Government Act of 1963 these local governments were empowered to impose personal taxes (other than income tax) at flat rates or on graduated scales on both natural persons and corporations; levy fees and charges for council services, impose taxes on such prescribed animals and vehicles as pigs, dogs, and bicycles; levy rates and taxes on land situated in their areas calculated in relation to the unimproved value of the land and applied (with specified exemptions) equally to all land in the council area, and generally to impose any other rates and taxes. Local governments were also allowed a limited borrowing authority, and they could engage in business activities.

These sources of finance proved to be insufficient for their purposes and local government councils suffered from a general lack of financial viability. Their resources were unable to meet the needs of their constituents (Peasah 1987, 5).

Underlying the problem of insufficient revenue was the low level of economic activity and the general poverty of the rural areas, which reduced the effectiveness of revenue sources that were based on economic activity or levels of wealth. In reality the major sources of revenue were the personal tax (head tax) and a narrow range of fees and charges for services, and rates on land (Ibid. 6). The head tax remained through the early period of local government the most important internal source of revenue for local governments. Between 1965/66 and 1970/71 fiscal years it declined from 80.4 to 60 percent of internally raised revenue. Yield from this tax increased at an annual average of 15 percent from 1966/67 to 1970/71, but in the last two years had levelled off at an annual increase of only 4 percent. This was because the head tax was an unpopular levy that is difficult to administer (Ibid. 12-14). Even though local councils had the power to impose land rates they were unable to collect it because of the complexity involved on imposing rates on all land as the legislation required (Regan 1987, 2).

Local governments also entered into business activities such as shipping, copra and cocoa marketing, trucking and bus services, brick manufacturing, savings bank agencies, taverns, hostels, garages and service stations, cattle breeding, operation of sawmills, and commercial shops. For the most part these business activities suffered from poor management and insufficient finance (Peasah 1987, 24). Loans to local government councils were limited mainly to road building and other capital works.

Capital works funding was made available to local government councils through the form of Rural Development Programme (RDP) grants from 1967. The RDP Fund first appeared in the 1967/68 budget of the Administration as part of the Works Programme to help development at the district level and especially to assist and supplement locally initiated self-help projects. They were available to all local governments and were matching grants. RDP grants were tied to projects selected by the local governments and approved by the Administration.

The name of the program was changed to Rural Improvement Programme (RIP) for the 1973/74 fiscal year, and at the same time the grants were made specifically to councils, provided they were matched by local contributions on a 50-50 basis. There was a dramatic increase in funding from the first Somare government in 1972, and RIP Grants came to be the most important source of funding for local government (Ibid. 36-39). A detailed history of the RIP has been provided by Colebatch (Colebatch 1979).

B. Local Government in Urban Areas

Under the Local Government Act (which applied to rural and urban situations) local councils had been established mainly in rural areas while the Administration provided government services in the larger towns. In August 1969 a white paper announced the intention of the Administration to establish local government councils in the towns of Port Moresby, Lae, Rabaul, and Madang by 1 July, 1970, and to confer responsibility for various municipal services upon other Councils which embraced urban areas (Papua New Guinea Government White Paper 1969). This policy marked the beginning of a system of urban local government in Papua New Guinea that coexisted with the system of local government in rural areas that had been in existence since 1963.

This policy provided for the establishment of councils in the four major towns of the Territory, Port Moresby, Lae, Rabaul and Madang, all of which were outside the existing local government framework. The Administration considered each of these centres to be sufficiently large to support an individual council, independent of its adjacent rural area, and treated them as a single group.

The medium-sized towns of Goroka, Mount Hagen, Wewak, Daru, Kainantu, Kavieng, Kundiawa, Mendi and Popondetta (all of which had earlier come within the general ambit of local government) were each considered to be large enough to come within the general scope of the urban local government scheme, but none was considered large enough to be established as an independent council. Other towns were to be brought into the scheme as conditions dictated.

Under the policy urban councils were required to perform a limited range of obligatory functions, and were permitted to perform other activities as part of their responsibilities. As the capacity of the urban authorities increased they would become responsible for a greater number of functions. The obligatory functions of urban councils were:

- sanitation and garbage disposal;
- health inspection;
- town and street cleaning;
- maintenance of parks, gardens and reserves;
- licensing and policing of defined licences; and
- street lighting.

The specific sources of financing required to provide the obligatory services were the following:

- rates on land within urban areas;
- personal taxes;
- charges for services;
- licence fees;
- administration guaranteed loans;
- various types of administration assistance.

An underlying premise of these obligatory services and sources of funding was that the major services, such as sanitation and garbage disposal would be economically self-supporting through direct charges for each service. Additional funding necessary to carry out the other activities was to come from the other sources indicated. It was estimated that the costs of obligatory services at that time could be met through a general rate on all occupied land at the level of one percent of the unimproved value of the land, and that this levy, along with the personal tax and other revenue sources would be sufficient to cover the costs of urban services in the major towns as well as in some of the medium-sized ones.

The Administration recognised that much of the land within the designated urban areas was being utilised for government purposes, and that under Section 75 of the Local Government Act rates could not be imposed on government land. Accordingly, it accepted responsibility for paying the councils a grant in lieu of rates assessed on the unimproved value of all government occupied land, at the same rate as the general rate struck by the council.

The Administration also provided assistance to councils through transfer of assets used for urban council functions, provision of land for the establishment of municipal offices, provision of a building and furnishings necessary to the provision of services, bridging finance, and grants for municipal works for projects approved by the Administration.

In 1977 the situation of local government in Papua New Guinea was fundamentally altered with the decentralisation of political power and the enactment of the Organic Law on Provincial Government (OLPG), which created nineteen provincial governments, largely following the lines of the existing districts. With the shift of responsibility for local government to provincial governments, along with their power to finance activities, the future of financing local government became inextricably tied in with the overall question of the funding of provincial governments. The pattern of provincial government funding has had a major impact on urban local government finance.

Chapter 3

DECENTRALISATION AND THE FINANCING OF LOCAL GOVERNMENT

The decentralisation of government in Papua New Guinea represented a fundamental change in the legal and financial bases of local government. Section 187 I [2] of the Constitution of Papua New Guinea provides that an organic law can distribute powers on "local-level government" between the national government and provincial governments. Section 24 I (i) of the OLPG provides that legislative power over all "local-level governments" as defined in the Constitution is primarily a provincial matter. This means that provincial legislation dealing with local-level government takes precedence over national laws that are inconsistent with it.

The effect of this was to transfer to provincial governments the responsibility for local-level government in Papua New Guinea. Until provincial governments enact legislation governing local government the national act remains in force. But once a provincial government enacts a local government act the national legislation ceases to have effect insofar as it is inconsistent with the provincial act. The legal situation with respect to the relationship of provincial and national legislation dealing with local government is complex, and is to be dealt with in detail in a separate paper.

With respect to the impact of decentralisation on the financial bases of local government the situation is less complex. Along with the package of grants, transferred taxes, and provincially-raised revenue that forms the basis for funding provincial government activities, the OLPG provides that provincial governments have the right to impose any tax that was previously allowed to local government councils. This is an appropriate situation in that the transfer of sources of local government funding corresponds to the transfer of the responsibility over local governments to provincial governments. One result of this is that the capacity of local governments to meet their responsibilities now depends on policies of provincial governments, which has important consequences for the fiscal viability of local government.

Related to the effective financing of urban governments, a new series of problems and obstacles (and opportunities) arises out of the transfer of responsibility for, and financing of, local government to provincial governments. The central issue is the way the provincial government treats local government financing as part of an overall financial package that is, for most provincial governments, not keeping pace with the demands on it. Generally, provincial governments have been under the pressure of meeting rising demands in face of resources that are not keeping pace with these demands. At the same time the national government has utilised idiosyncrasies in the implementation of the funding formula to pursue a policy of redistribution to less well-off provinces. These broad trends have had an impact on the policy of funding local governments which can be better understood by examining the trends in provincial government funding over the past years, and by examining their impact on local government funding.

The funding arrangements for provincial government have been treated extensively elsewhere, and will not be examined in detail in this report (Chelliah 1981; May 1981; Manning 1979; Committee of Review 1982; Specialist Committee 1984; Axline 1986; Axline 1988a). For purposes of understanding the present financial situation of local-level government it is important to have a general overview of the sources of funding of provincial governments, and the pattern that the actual funding has taken, as a background to its impact on local government funding.

A. The Provincial Funding Package

The various sources of funding for provincial governments are set out in the OLPG (Section 53) and include the following:

- receipts from taxation imposed by provincial laws or imposed under delegation from the national government;
- grants, unconditional and conditional, from the national government;
- transferred national taxes;
- the proceeds of court fees, fines and penalties and other fees and charges under provincial laws;
- returns on and proceeds of investments;
- income from commercial enterprises conducted by provincial governments;
- proceeds from short-term borrowings, loans from the national government and long or medium-term loans, if any, specifically approved by the national Minister for Finance; and
- such other moneys that are lawfully available to it under an Act of Parliament or a provincial law.

Grants to provincial government

The Minimum Unconditional Grant: The principal source of funding for provincial governments takes the form of grants from the national government. The most important of these grants is the Minimum Unconditional Grant (MUG). Of all the provisions for financing provincial governments the MUG most clearly provides the underpinning for the decentralisation of political power, since it was designed to provide the basis for provincial governments to carry out successfully the activities transferred to them from the national government.

The formula for the MUG is set out in Schedule 1 of the OLPG, which requires the national government each year to pay provincial governments an unconditional grant adequate to permit the provincial governments to maintain government services transferred to them at the level of spending in 1976/77 which is designated as the base year. The grant is a "minimum" grant in that the national government is obligated to pay no less than the amount determined by the formula fixed by the OLPG. It is an "unconditional" grant in the sense that no formal conditions are imposed on the provincial government with regard to the expenditure of the funds. In another sense it is conditional on the provincial government continuing to perform the functions on which the grant is based (Regan 1988). The MUG is calculated in such a way as to provide provincial governments each year with funds to maintain the cost of activities transferred to them at the level they were in fiscal year 1976/77. This is done though the mechanism of annual adjustments according to a formula designed to take into account increases in the cost of providing these services and changes in the overall level of government revenue in Papua New Guinea. The first period of the MUG was the half fiscal year July to December, 1977 (the fiscal year was adjusted to coincide with the calendar year in 1978), which then became the adjusted base year on which the formula was applied to calculate the MUG for the following year, and so on.

The annual increment in the MUG is calculated as the lesser of changes in "cost of living" or "government revenue" from the preceding year. At best, the formula for calculating the MUG would allow for the maintenance of the status quo with regard to the level of services that were delivered in the base year 1976/77, since it allows for no adjustment for population increases or expansion of existing services beyond that level (Committee of Review of the Financial Provisions of the Organic Law on Provincial Government 1982, 63; Garnaut 1978, 9). In addition to not allowing for expansion of activities the formula also has the effect of freezing the status quo with regard to the unequal levels of services existing among different provinces in the base year. Moreover, since the formula is geared to maintaining the cost of the services rather than a given level of delivery, there is no guarantee that the actual level of services will not fall as costs rise.

The way in which the salaries component of the cost of delivering government services was treated reduced even further the likelihood that the MUG would be adequate to satisfy the original goal of maintaining the level of transferred activities. The original base year figures used to estimate the cost of these activities included the salaries of public servants, as do the annual adjusted base year figures. However, the MUG that is paid to provincial governments consists of this adjusted base year figure minus the estimated cost of public service and teaching salaries, which are deducted by the national government and paid directly to the public servants and teachers with the remainder paid to the provincial government. This means that any year in which public servants receive a pay increase greater than the increment in the adjusted base year figures the actual MUG received by provincial governments will increase by less than the annual increment in the formula. Provincial governments have no control over the level of salaries and thus can only limit the amount by which the MUG is reduced by employing fewer or lower-level public servants.

Additional unconditional grants: The national government is to make other unconditional grants to provincial governments, in addition to the MUG, under Section 64 of the OLPG (Chelliah 1981, 17). Unlike the MUG, the amount of any further unconditional grants is not specified. The national government was to determine the amount of the grants, acting upon the advice of the National Fiscal Commission (NFC), a five-person independent body appointed by the national government to make recommendations on a number of intergovernmental fiscal matters (OLPG Sections 76, 77, 78). The NFC, which has since been left in abeyance, along with the grants it allocated, was required to base its recommendations on equal grants per head, but could depart from this principle when it believed other factors should be given greater importance (OLPG Section 79 (4)). Whereas the MUG was designed to allow provincial governments to finance the costs of services transferred to them, the additional unconditional grants were seen as a means to allow new activities to be undertaken, services to be expanded, and inequalities among provinces to be redressed (Manning 1979, 121).

The Derivation Grant: The third kind of grant made to provincial governments by the national government is the derivation grant, which is based on the value of exports originating in a province. The amount of the grant is fixed at 1.25 percent of the value derived from goods exported from that province in the preceding year, minus any royalties paid to the provincial government for that year (OLPG Section 63). This meant that only provinces from which exports originate would receive a derivation grant, and that they would receive only that amount which exceeded any royalties they earn for that year. This exclusion was adopted specifically to prevent North Solomons Provincial Government from collecting both royalties and derivation grants on its copper production, a consideration which also caused the level of the derivation grant to be fixed at 1.25 percent (equal to the copper royalty rate) rather than at a higher rate that had been earlier suggested (Tordoff and Watts 1971). In the 1989 budget royalties are no longer deducted from the derivation grant, but the grant is not paid on a product which attracts a royalty. This prevents royalties on timber, which are paid at a higher rate, from reducing the derivation grant receivable on other products. Since the derivation grant is based on the production of exports, it is likely to be greater in the more economically advanced provinces.

Conditional grants: The national government also makes grants to provincial governments for specific purposes under the condition that the money may only be spent for that purpose. The major conditional grants which provincial governments received from 1978 to 1984 were for projects under the National Public Expenditure Plan (NPEP), which in 1986 was replaced by the Public Investment Programme (PIP). Provincial governments were eligible to apply for project grants on the same basis as national departments, and the National Planning Office (NPO) (integrated into the Department of Finance and Planning in 1986) makes a distinction between provincial government projects and those of national departments in provinces. Provincial governments participate in the formulation and implementation of the former, but in the latter they may have little or no involvement. These grants, allocated under the national planning system, are the principal tool in the hands of the national government for equalisation among provinces.

Revenue from taxation

Transferred taxes: Section 67 of the OLPG provides for the transfer of net proceeds of certain national taxation to provincial governments, with royalties, motor vehicle registration and licence fees being specified. In addition, revenues produced by a bookmakers' tax, a cigarette and tobacco excise tax, and drivers' licence fees are transferred to the provinces net of collection costs.

Royalties are national government revenues part of which is transferred to provincial governments to compensate for the costs associated with the exploitation of resources. Under Section 67 of the OLPG royalties are payable by the national government to provincial governments with respect to minerals, petroleum, natural gas, timber, fish, and hydro-electricity.

Provincial taxes and fees: Provincial governments have been given the power to raise their own revenue in the form of certain taxes and fees. Section 57 of the OLPG provides that they have the power to impose a retail sales tax, a public entertainment tax, and a land tax; that they can collect fees for licensing mobile traders, liquor sales and gambling; and that they have the right to impose any other tax previously allowed local government councils. The different kinds of taxes and the rates applied vary greatly from province to province, with some provinces having virtually no provincial tax sources at all (Bird 1983, 48-50; Specialist Committee 1984).

The only new taxing source available to provincial governments was the general retail sales tax, which has become a significant source of provincial government funds, and which is generally regarded by provincial governments as having the potential to become their most important means of provincially-generated revenue (Regan 1982; Crawley 1982). Discussions have been going on for several years between provincial governments and the national government concerning the establishment of a uniform collection system and coordinated rate structure in order to create an efficient administrative structure for a provincial general retail sales tax.

Provincial governments also collect revenues from licence fees, notably for mobile traders and liquor licences. In addition to this they receive the proceeds of provincial court fees and fines, which are often not sufficient to cover the costs of collection. As indicated above, provincial governments also may collect revenue from any source that was previously available to local-level government.

Other revenue sources

Many provincial governments have a "business arm", or development corporation, which engages in a number of commercial activities. It appears that in most instances these provincial business corporations are unsuccessful, and are a drain on public resources rather than a generator of provincial revenue (Trebilcock 1982, 165-70; Bird 1983, 61).

The national government also provides a small town services grant to provincial governments to subsidise services for towns without land rates. In addition to this there is a direct conditional grant to local government councils from the national government which is given through the member of National Parliament, and is paid through the provincial Bureau of Management Services (BMS) office.

A final source of provincial government funds is that of short-term loans and investments, often in the form of term deposits, which provide a small amount of funding for a number of provinces.

The various elements of the funding package were perceived as responding to specific needs, and taken together they were considered adequate to provide provincial governments with sufficient resources to carry out the functions transferred to them. An examination of the pattern of funding of provincial governments as it has evolved over the years shows that it has not operated in the way that was foreseen.

B. Funding Patterns

The two most striking ways in which the pattern of provincial government funding has diverged from the way it was intended to develop are with respect to the ability of the package to provide provincial governments with sufficient resources to carry out their functions, and the influence it has had on affecting the ability of the national government to pursue a policy of redistribution towards less well off provinces.

It was recognised from very early on that the funding arrangements for provincial governments in Papua New Guinea contained a number of shortcomings. Since their inception in 1978 these arrangements have also undergone some evolution, resulting in further weaknesses in their ability to fulfill the functions for which they were intended. Weaknesses in the MUG have included the inadequacy of the base year amounts to meet the cost of transferred activities, the failure of the annual adjustments to keep up with the costs of providing those activities, the further erosion of available funds by more rapidly increasing salaries of teachers and public servants, and the incomplete implementation of the MUG provisions as a result of the failure of eleven provincial governments to attain full financial responsibility.

The Minimum Unconditional Grant (MUG)

By virtue of the fact that the annual adjustments to the Adjusted Base Year amounts is the lesser of increase in prices or increases in revenue, the amounts by which the basis for the MUG has been increased have fallen behind the cost of providing the activities it is meant to fund. Table 1 compares the annual changes in the Consumer Price Index (CPI), total government expenditure on goods and services, and the annual adjustments to the adjusted base year (sometimes referred to as the gross MUG). From these figures it can be seen that for the five years from 1982 to 1988 the MUG has increased by 23.2 percent while the CPI increased by 36.9 percent. Total expenditure on goods and services grew at a rate just half-way between the two at 30.8 percent. The change in the MUG real terms (current amounts deflated by the CPI) showed a decline of more than 10 percent.

This decline in real terms affects funding for all transferred activities for provincial governments with full financial responsibility but only the capital works activities for those without full financial responsibility, since funding for the seven transferred activities is paid through divisions 271-290 of the national budget for the latter eleven governments. As was indicated in the Specialist Committee Report, the funding of these transferred activities at levels far exceeding the amounts prescribed by the MUG formula can be taken as an implicit recognition on the part of the national government that the MUG has been inadequate to meet the needs of provincial government financing of transferred service activities. In 1984 the level of financing of these activities exceeded amounts prescribed by the MUG by K16.5

million and that amount had increased to K22.8 million for provincial governments without full financial responsibility in 1988. The figures in Table 2 indicate the drop in provincial funding for transferred activities that would occur if a provincial government had attained full financial responsibility in 1988, totalling K22.8 million. These data also provide an indication of the magnitude of underfunding of transferred activities by the MUG for provincial governments with full financial responsibility, especially those four which have been limited to MUG funding levels since 1978.

A second factor that has reduced available funding for provincial governments with full financial responsibility is the deduction of teachers' and public servants' salaries from the adjusted base year amounts. This is because capital works (the only activity funded by the MUG for provincial governments without full financial responsibility) does not have a salary component. Thus, for those provincial governments the cost of increase in salaries has been completely assumed by the national government. Table 3 shows the effect of the more rapidly increasing salary bill and the more slowly increasing MUG on the proportion of this funding that is absorbed by salaries. From 1978 to 1988 salaries increased from just under one-half to nearly three-fourths of the total adjusted base year amounts for provincial governments with full financial responsibility.

Table 1
Comparison of annual changes in the CPI,
public expenditure and gross MUG
1983-1988 (percent)

	1983	1984	1985	1986	1987	1988	1983-1988
Consumer price index	7.9	7.5	3.7	5.5	3.3	4.5	36.9
Total public expenditure	2.4	7.6	6.5	3.3	3.9	3.8	30.8
Gross MUG adjustments	2.0	6.9	7.8	-3.0	5.8	2.2	23.2

Note: The CPI is the weighted urban average at year end taken from National Statistical Office Consumer Price Indexes, December Quarter 1983, (24/2/1984), Table 1, p. 7. and Consumer Price Indexes, March Quarter 1988 (23/05/88), Table 1, p. 7. Total public expenditure is calculated from Planning and Budgetary Strategy 1988-1992, Budget Document No. 1 (1988 Budget Year), Table 2.8, p. 24. Gross MUG adjustments are the annual adjustments in the adjusted base year amounts as provided by the Department of Finance and Planning.

Table 2
Funds paid to provincial governments without full financial responsibility in 1988 over and above amounts prescribed by the MUG

Province	Amount paid in excess of MUG
Western	4,570,217
Gulf	1,322,122
Central	431,627
Milne Bay	1,717,077
Oro	776,215
Southern Highlands	3,083,329
Enga	3,131,572
Western Highlands	1,824,992
Simbu	1,557,604
Sandaun	3,374,223
Manus	1,002,039
Total	**22,791,016**

Note: These figures represent the difference between the funding for ten transferred activities under Divisions 271-286 of the national budget in 1988, and the amount of funding prescribed by the MUG for these activities in 1988.
Source: MUG calculated from figures provided by the Department of Finance and Planning. Actual funding taken from Estimates of Revenue and Expenditure for the year ending 31st December 1988, Divisions 271-286.

Table 3
Salaries of teachers and public servants as a proportion of gross MUG for provincial governments with full financial responsibility 1978-1988 (percent)

Province	1978	1982	1984	1986	1987	1988
Eastern Highlands	47.7	64.4	61.5	73.4	75.9	78.7
Morobe	46.8	53.0	53.8	62.0	66.6	65.7
Madang	47.5	52.3	65.2	70.2	79.9	79.6
East Sepik	54.3	61.8	75.6	91.1	81.8	82.9
New Ireland	34.0	43.8	46.7	52.0	51.0	51.7
East New Britain	49.4	65.3	67.4	74.8	76.0	79.8
West New Britain	54.4 4	54.8	73.7	80.6	83.9	80.3
North Solomons	39.7	49.6	57.8	55.1	55.2	60.4
Mean Percentage	**46.7**	**55.6**	**62.7**	**69.9**	**71.3**	**72.4**

Source: Figures for 1978-1987 taken from Planning and Budgetary Strategy 1988-1982, Budget Document No. 1, 1988 Budget, Table 3.1, p. 34. Figures for 1988 calculated from Estimates of Revenue and Expenditure for the year ending 31st September, 1988, Table 3, p. 552.

Additional unconditional grants

Additional unconditional grants were originally conceived to be the single most important alternative source of funding for transferred activities, becoming increasingly important as the MUG declined in real terms. This conception never materialized as NFC grants (as they came to be called) remained relatively modest (K7 million being the highest amount paid in 1980) and declined to K3 million before being abolished in 1984. As a response to the decline in these sources of funding provincial governments relied more on their own resources to fill the gap.

Provincially-raised revenue

Provincially-raised revenue has become a more important source of funding for provincial governments than was originally envisaged. What was originally conceived to be a relatively unimportant source of financing, the provincial retail sales tax, has become the most important source of provincially-raised revenue.

This revenue comes from a variety of sources, provincial retail taxes being the most important, amounting to more than K20 million in 1988. Table 4 shows that in 1988 provincially-raised revenue ranged from 1.6 percent of total funding for Southern Highlands to 22.9 percent of total funding for North Solomons Provincial Government, and on an average accounted for just over 10 percent of total funding for all provincial governments. The importance of provincial taxes (both the general retail sales tax and other taxes) has increased from K11.9 million in 1982 to K26.1 million in 1988 with its proportion of provincially-raised revenue increasing from 71.8 percent to 80.7 percent of an increased level of total funding over that period.

Provincially-raised revenue has provided some provincial governments with a source of funding to compensate for the declining MUG and discontinued NFC grants. The retail sales tax is the most important, followed by the land tax as the second most important single source of provincially-raised revenue. By using the land tax to fund the shortfall in transferred funding, provincial governments are removing from urban local governments a source of revenue that has traditionally been their major source of self-raised finance. In this way the trends in provincial government funding have had a definite negative impact on the potential for urban local governments to develop fiscal viability.

The way the financial arrangements for provincial governments have been implemented has had a perverse effect whereby the mechanism for funding the recurrent costs of services has been used to pursue a policy of redistribution, contrary to its original purpose. Although authority over the activities which have been designated as provincial has been transferred to provincial governments, financial control over all these activities has not been transferred to all provincial governments. It is this perverse effect of implementation that has allowed equalisation to take place at the expense of decentralisation rather than **vice-versa.**

For provincial governments without full financial responsibility the national government was able to finance the seven activities at whatever level it wished though the national budget. Department of Finance officials have consulted provincial governments on the determination of these budget items, providing some provincial input into the budgeting of Divisions 271-290 through which these activities are funded. This procedure has allowed national government officials to take into account the actual increases in costs to these provincial governments, to provide funding for the transferred activities at a sufficiently high rate to meet these costs, and to direct higher levels of funding toward the less well off provinces.

Table 4
Provincially-raised revenue as a proportion of total funding of provincial governments 1982, 1984, 1988 estimates (percent)

	1982	1984	1988
Western	4.1	4.0	2.0
Gulf	14.0	3.8	4.9
Central	5.5	0.9	9.3
Milne Bay	8.1	4.2	4.9
Oro	10.1	5.8	10.5
Southern Highlands	0.8	1.1	1.6
Enga	7.2	1.8	3.3
Western Highlands	1.9	2.3	16.3
Simbu	8.4	4.5	12.2
Eastern Highlands	11.2	12.2	15.5
Morobe	26.1	15.9	20.5
Madang	3.5	2.8	15.4
East Sepik	10.9	8.2	10.8
Sandaun	0.0	0.2	2.4
Manus	7.5	4.7	6.5
New Ireland	3.7	5.6	7.5
East New Britain	12.1	10.8	16.0
West New Britain	1.0	4.8	13.8
North Solomons	12.5	18.6	22.9
Mean	**7.8**	**5.9**	**10.3**

Source: Transfers from the national government taken from Estimates of Revenue and Expenditure, 1982,1984, 1988. Provincially-raised revenue taken from estimates of revenue and expenditure of the provinces.

One of the effects of this pattern of funding is provided in Table 5, which shows the evolution of per capita levels of transfers from the national government for funding provincial activities from 1976/77 to 1988. Since the activities funded by these transfers have increased over the period (1976/77 figures being the base year amounts for transferred activities and the 1988 figures including all transferred grants, taxes, and items included in Divisions 271-290 of the national budget) the comparisons of total amounts over time are not meaningful. The significance lies in the differences among provinces and their positions relative to each other. The last two columns of Table 5 compare the rank order of the size of increases in per capita transfers over the period to a summary indicator of the level of development of each province.

Where there is a large difference in the relative position of a given province on the two rankings (i.e. a high position in increased funding and a low position on level of development, or vice-versa) the overall evolution of the funding has tended toward redistribution in favour of the less well-off provinces. Clear examples of this emerge in the case of Enga, which ranks last on the development indicator and which has seen the second highest increase in per capita transfers, and in the case of East New Britain, highest on the development indicator and fourth from last in increases in per capita transfers.

The increased levels of funding of provincial governments with full financial responsibility has not, however, provided them with higher levels of funding for capital works projects, since the capital works activities for all provincial governments have been adjusted according to the MUG formula. This means that in the absence of additional resources from royalties, derivation grants, or significant amounts of provincially-raised revenue, increased funds for investment in urban infrastructure will not be available from provincial governments.

The two major trends of declining resources in face of increasing demands on provincial government activities on the one hand, and the redistribution of national government funding toward less well off provinces on the other hand, provide the context for local government funding. Because of the complexities of the funding arrangements total levels of funding at the provincial level are not directly translatable into levels of funding of local-level government. Funding at the local level will also depend on the relative importance of different sources of funding, the conditions under which that funding is received by the provincial government, and provincial government policy decisions regarding the allocation of scarce resources to competing needs, inter alia.

Table 5
Transfers from the national government to provincial governments
per capita amounts and rank order compared to level of development
(Kina)

	1976/77 Amount	1976/77 Rank	1982 Amount	1982 Rank	1984 Amount	1984 Rank	1988 Amount	1988 Rank	Percent increase 1976/77-88	Rank	Rank level of Dev.
Western	42.13	8	69.79	7	92.72	5	187.25	1	344.5	1	10
Gulf	47.51	6	77.57	6	98.76	4	112.52	4	136.9	4	9
Central	48.91	3	78.33	4	92.10	6	83.00	8	69.7	17	6
Milne Bay	37.08	10	57.99	11	71.63	11	72.49	12	95.5	14	8
Oro	40.71	9	62.10	9	80.71	8	82.17	9	101.8	13	7
S. Highlands	28.97	15	45.53	15	53.70	15	64.17	14	121.5	5	18
Enga	29.21	14	47.21	12	55.76	14	75.35	11	158.0	2	19
W. Highlands	25.62	18	40.26	18	49.49	17	56.33	16	119.9	7	13
Simbu	30.39	12	47.08	13	59.48	12	67.01	13	120.5	6	12
E. Highlands	23.27	19	35.98	19	43.97	19	49.68	19	113.5	10	16
Morobe	30.04	13	46.62	14	56.37	13	50.51	18	68.1	18	17
Madang	26.64	17	41.94	16	51.86	16	54.49	17	104.5	12	15
E. Sepik	26.93	16	41.27	17	48.80	18	57.70	15	114.2	9	11
Sandaun	34.70	11	60.55	10	75.64	10	87.60	6	152.5	3	14
Manus	84.88	1	126.61	1	162.31	1	179.37	2	111.3	11	3
New Ireland	75.93	2	107.64	2	123.64	2	121.28	3	59.7	19	4
E. New Britain	48.65	5	77.82	5	91.51	7	83.88	7	72.4	16	1
W. New Britain	42.38	7	68.09	8	78.88	9	79.30	10	87.1	15	5
N. Solomons	48.88	4	100.24	3	115.14	3	106.78	5	118.4	8	2
Mean	40.68		64.87		79.08		87.94		119.5		

Note: Transfers from the national government include the MUG and other unconditional and conditional grants, the derivation grant, royalties, transferred taxes, and items paid to the departments of the provinces through Divisions 271 to 290 of the national budget. Amounts for Western Province include funding for transferred activities in the Kiunga-Lake Murray Districts financed through Division 246 of the national budget. NPEP grants, PIP grants and provincially-raised revenue are not included.

Source: Estimates of Revenue and Expenditure, 1982, 1984, 1988. Base Year Figures provided by the Dept. of Finance and Planning. Population figures provided by the National Statistical Office. Level of development ranking from Klaus de Albuquerque and Eddie D'Sa, Spatial Inequalities in Papua New Guinea: A District Level Analysis, IASER Discussion Paper, No. 49, 1986, Table 11, p. 52.

Chapter 4

THE PRESENT STATE OF URBAN LOCAL GOVERNMENT FINANCE

It is useful to begin a discussion of the present situation with respect to urban local government finance in Papua New Guinea with a set of principles which describe the philosophy, goals, and means of financing local government. It is then possible to examine the extent to which the present arrangements are able to satisfy these criteria. Ultimately, suggestions will be made as to how the present state of urban local government finance might be amended to satisfy more fully these goals.

A. The Criteria of Local Government Finance

In October 1972 the Report of the Committee of Enquiry into Local Government Finance and Borrowing (Port Moresby: Post Printing Service, October 1972) was submitted. It was the report of an enquiry into local government finance and borrowing which provided an exhaustive analysis of the philosophy behind local government and set the general policy for local government financing in Papua New Guinea. For the most part the principles expounded in this report remain the premises which still underlie the general policy behind local-level government. However, the establishment of nineteen provincial governments since then has changed the circumstances under which local governments operate. This has had a drastic impact on the ability of urban local governments to fulfill the role foreseen for them. The central element of this policy is that local government should be self-sufficient, or as it was more often expressed, fiscally viable.

The report laid out in detail the rationale for the establishment of local government:

- Local government provides a relatively direct avenue for the ordinary citizen to participate in the affairs of the community.
- Government in small units is more likely to adapt its actions to the differing circumstances and preferences of the local communities. This is particularly true in Papua New Guinea.
- Local government provides a means of maintaining the diversity of society in Papua New Guinea.
- Local government is likely to provide the freedom of local communities to promote progress in satisfying the desires of the people.
- Local government is a means of decentralising the powers of the government.

From these basic principles the committee developed the concept of local fiscal viability in order to develop some general principles for the financing of local government in Papua New Guinea (Report 1972, 19). The committee argued that if local government is to play an important role in the economic, social and political advancement of the country, it must be made fiscally viable (Ibid. 20).

Underlying the concept of fiscal viability was the argument that unless there are particular grounds for redistributing income in their favour, the people who benefit from local government services should meet the cost of the resources required to satisfy their demands. This satisfies the principles of equity and efficiency. Unless there is a desire to redistribute income by requiring some people to pay for services to others, the incidence of the local tax system as a whole should be geared to the benefits that the individual taxpayers receive (Ibid. 22).

The Committee of Enquiry did not consider that the main source of revenue for local governments should be grants. Grants from the central government could be justified under three conditions. One is where revenue resources of local government in general are insufficient to meet its expenditure responsibilities. A second is for support for less well off areas which require special support. The third is where there are potential local expenditures which will give rise to significant benefits on a regional or national scale.

The committee set out criteria (listed below) for judging the appropriateness of different sources of local government revenue and detailed the various sources of local government revenue with the emphasis on a package that could provide for self-sufficiency for most councils, and almost certainly for all urban local councils. The first five criteria relate primarily to the local government tax system as a whole, and are based partly on the requirements for fiscal viability which were set out earlier in the report. The remaining five bear more directly on the choice and use of particular taxes (Ibid. 26).

(i) The sources of taxation available to local government authorities should be sufficient to enable them to discharge their responsibilities by their own efforts, except where the central government wishes to provide special support.

(ii) Local government tax revenue should respond to the growth of production, incomes and expenditure in the local economy, but should not be greatly affected by short-term economic fluctuations.

(iii) Local government authorities should have considerable flexibility in their sources of taxation and in the amount of revenue that they raise, so that they can adjust to local needs and preferences and to the changes that occur with economic development.

(iv) Local government taxation should not seriously impair the efficiency of economic activity by distorting the pattern of production and consumption.

(v) Except where it is designed to finance redistributional expenditures, local government taxation should be levied in accordance with the benefit principle.

(vi) As far as possible, each local government tax should be levied in such a way as to make clear the relationship between contributions to the revenue and the provision of local government services.

(vii) The base of each local government tax should be clearly identified with the local area, so as to avoid conflicts of jurisdiction, uncertainty as to liability, and overlapping tax demands.

(viii) The bases of local government taxation should be as distinct as possible from those of central government taxation, and there should be no appearance of competing claims between the different levels of government for tax revenue from the same source.

(ix) Each local government taxing measure should be inexpensive to administer and to comply with, and the base of each tax should be simple and objectively measurable and should conform to local customs and ways of doing business.

(x) Local government taxation should encourage rather than discourage gainful work and the division of labour, and should be conducive to the use of local resources for the economic development of the area.

The committee argued that local taxes are better assessed on the benefit principle, which relates the burden on each taxpayer to the benefits that he derives from publicly provided goods and services, rather than the ability principle, which relates the contributions of taxpayers to their means, and would thus distribute the burden in accordance with their income and assets, with due allowance for family responsibilities and other indicators of the need for personal expenditure (Ibid. 24).

Since taxes imposed on the ability principle are a more appropriate basis for redistribution of income, it is better reserved to the central government, or to provincial governments, as they now have a role in addressing questions of intra-provincial spatial inequalities. The Committee of Enquiry identified four general fields of taxation that could be made to satisfy most of the criteria moderately well: resident taxes, such as the local government personal (head) tax; taxes levied on urban and rural property; licence fees on business activity and personal assets; and selective sales and transaction taxes.

The head tax was thought to be an important source of local government revenue in the future in spite of difficulties of collection resulting from greater mobility of the population. Its advantages lie in its simplicity compared to other taxes, and its close association with the delivery of local services.

Real property taxes were seen as an important source of local government revenue in spite of a number of formidable problems to be overcome. They included the prevalence of leasehold from the central government, especially in the larger towns, the existence of unregistered and conventional tenure, and of communal ownership or occupancy in which there is no formal record of the shares or even the participation of individuals, and finally problems of establishing values for rating purposes in an economy where skilled manpower is scarce and development is proceeding rapidly (Ibid. 32).

There were fewer problems with property taxes in the urban areas where the Local Government Ordinance already provided for the taxing of unimproved capital value of urban land in registered private ownership or leased from the central government without government buildings, and for an approximately equivalent tax on buildings where land was occupied under customary or permissive nature. For the most part urban areas are more likely to be able to overcome these difficulties and taxes or rates on land could be a central source of urban local government revenue.

Taxes based on the granting of licences also satisfy the criteria for local government taxation. They are relatively cheap and easy to administer, and can produce considerable revenue. Unless the rates are heavy, the fees are unlikely to have much effect on the location of economic activity; and where such an effect is desired, the rates can be pitched accordingly. Under the Local Government Ordinance councils were allowed, with prior approval, to impose fees for the registration of dogs, pigs and other prescribed animals, and bicycles and other prescribed vehicles using public roads in the council area. The committee saw some scope for graduating the fee in accordance with the scale of operations of the business, and for extending this form of taxation to a far wider range of businesses, including wholesaling, manufacturing and the supply of professional and other services (Ibid. 37).

The retail sales tax was rejected as a source of local government revenue as it would be too difficult and costly to administer, could lead to the creation of local tax havens, and would impede the development of a general consumption tax through the central government tax system (Ibid. 39).

Local government authorities have traditionally received fees for various specific services which they provide. The finances of local authorities are affected by the extent to which they charge directly for services provided. If charges are high enough to provide a surplus after meeting costs, including interest and depreciation, the surplus may be regarded as a form of taxation imposed on the users of the services. Fees or prices charged for services also influence the demand for those services, thereby helping to prevent wasteful use of resources and easing pressures on council budgets.

It is useful to make a distinction between social services, community services, and business activities. Social services are those which, for humanitarian or social reasons, are either not charged for directly at all or are provided substantially below cost, such as primary education and clinical health services. Community services involve activities which councils normally provide for the benefit of their local communities, usually with the intention that the costs of the services (including interest and depreciation) will be fully recovered from householders and others receiving the services. Examples are water supply, sewerage, garbage collection and sanitation. Business activities may be regarded as those activities that are normally provided by the private sector but which, for reasons of social or economic policy, councils have decided to undertake. Examples are sawmills, hostels, retail stores and transport services, where the intention is usually to make a profit (Ibid. 45).

Borrowing was another source of funds for local government authorities which provided councils with a means of financing lumpy expenditures. For local governments borrowing is a means to gain present access to goods and services while placing the burden of repayment on future generations of local residents. For the most part this will imply that borrowing will be used for major capital projects which cannot be financed through recurrent expenditure. The committee argued that the use of loan funds to finance expenditures can only be justified in equity to the extent that assets are created which will yield net benefits to the future taxpayers who will be responsible for servicing the debt (Ibid. 49).

Under the principle of fiscal viability or self-sufficiency of local urban governments the overriding need is to ensure that the financial resources available to local councils are sufficient in the aggregate to meet their expenditure requirements. However, to the extent that there is unavoidable lack of balance between the revenue resources of local councils on the one hand and their expenditure needs on the other, it is possible to redress the balance through grants from the central government. From the perspective of self-sufficiency, grants from the national government or provincial governments are a secondary or supplemental source of financing, rather than being a central element of the financial package. The committee believed that, if its recommendations regarding taxation, other recurrent revenue and loan finance were adopted, most local councils should be able to find sufficient funds for all essential council purposes. It should therefore be unnecessary for central government to make general financial assistance grants to councils (Ibid. 60). While this may not have been feasible for all rural councils, it is not unrealistic to believe that many urban councils would have the means to achieve this level of fiscal viability. It was also believed that there would be a continuing need for specific purpose grants to local councils for roads, public health and welfare, education and other fields which were covered by RIP Grants. These might include grants for road construction, village water supplies, local aid posts, area health services, and primary and vocational schools (Ibid. 60).

While the principles of local government finance set out in the 1972 report are still relevant today, the conditions under which they can be realised have changed. No longer is the national government responsible for local government activities, with laws governing local government having been adopted in nearly every province. Questions of intra-provincial distribution among urban and rural sectors are now the responsibility of provincial government, and financing for that purpose will come primarily from provincial sources of funding. In addition to this, local governments no longer possess control over the sources of funding discussed above, and proceeds from those resources are determined by provincial policy.

B. Patterns of Urban Local Government Finance

As a result of the transfer of responsibility and financing of local government to provincial governments, problems associated with local government funding and the solutions to these problems must be approached from the level of provincial governments. There are three main considerations that will influence the funding of urban local governments. First, the capacity of the provincial government to provide adequate funding at the local-level will depend on the availability of resources for that funding. This will be a function of the total funding available to the provincial government in relation to the demands on those resources. Second, the composition of provincial government revenue will have an impact on policy decisions that designate certain sources of funding for local government purposes. Third, the policy decision to provide adequate funding for local government will depend on the outcome of a competition for the allocation resources between different development priorities, one of which is local government. This is in turn conditioned by the total level of funding available to the provincial government, and is partially influenced by the particular sources of that funding, inter alia.

Provincial funding and local government finance

The previous analysis indicates that the funding arrangements for provincial governments, which were designed to operate as an overall integrated package of measures, have failed to satisfy their original objectives. The result of this has been a decline in the amounts which were to provide the means to maintain the funding of provincial activities at a constant level. Provincial governments have had to make adjustments both on the side of revenue and on the side of expenditure. They have had to rely on other revenue sources and they have had to reduce expenditure on new activities to compensate for this shortcoming. Both of these approaches have an impact on the financing of local-level government.

On the expenditure side, provincial governments now control the level of funding of local-level governments, an activity for which not all funding was included in the MUG although RIP grants and kiaps' salaries were as part of the costs of provincial works and provincial affairs. One means of resolving the budgetary pressures is to reduce provincial funding to local government.

With respect to the revenue side, significant sources of income, which are not "committed" to a particular purpose are mineral royalties, the retail sales tax, and the land tax. The first is a transferred tax from the national government, the second is a new source of revenue raised by provincial governments, and the third is a provincial tax which previously was collected by urban local governments in the form of land rates. Significant amounts of revenue from royalties and retail sales tax may allow a provincial government to fund new and ongoing activities at higher levels than if these sources were not available, but local government may not be successful in competing with other priorities for these funds. On the other hand, the transfer of land taxes to provincial government represents a loss of the most significant source of urban local revenue, and even if significant amounts of income are generated there is no guarantee that they will be remitted to the urban authority, particularly if the provincial government has no other major sources of new revenue.

Total provincial funding for 1988 amounted to K281.8 million including internal revenue raised by provincial governments. Salaries paid to public servants and teachers accounted for by far the largest component of this total, amounting to K120.5 million, nearly half of all transfers from the national government and 42.8 percent of all funding for provincial governments. Total transfers from the national government amounted to K249.5 million, or 88.5 percent of total funding, with internally raised revenue at K32.3 million still accounting for only 11.5 percent of total funding in 1988 (Axline 1988b).

Most of the other sources of funding are based on the level of economic activity in the province (timber royalties, mineral royalties, derivation grant, motor vehicle registration and drivers' licence fees, and other transferred taxes) and therefore vary greatly from province to province. Western and North Solomons provincial governments received about K5 million each in mineral royalties for 1988, and several other provincial governments will begin to receive significant royalties when new mining production begins in the next few years. Timber royalties are more evenly distributed, with all provincial governments receiving some revenue from this source. Derivation grants are less evenly distributed, with seven provincial governments receiving no grant at all in 1988.

Financial resources of urban local governments

The impact of decentralisation on local government finance can be revealed through examination of the situation in several different urban centres. At the level of the local government budget it is possible to see the constraints imposed by the increasing demands on urban services and infrastructure along with the loss of important sources of revenue.

With economic development, population growth, and a tendency of the population to migrate to urban areas, demands on urban services and the urban infrastructure are likely to increase significantly over the next ten years. It is not possible to analyse here the specific level of future needs, but it is obvious that urban growth is likely to be a main feature of demographic trends in the country in the near and medium future.

Planning for all forms of public and private enterprise activities, from the provision of power, water, sewerage, health and education to the establishment of new commercial and industrial ventures will be affected by the future demand for these services. Future demand is likely to be closely correlated with future urban population growth. It is difficult to predict accurately urban population growth, but some projections have been made taking into account fertility, mortality and migration trends (Harding, 1983). The provisional mid-year citizen population based on estimates using data from the the 1980 census, and growth rates for the major towns in Papua New Guinea are shown in Table 6.

Table 6
Population and projected growth rate of the eleven largest urban centres in Papua New Guinea

	Growth rate (percent)	1980	1990	2000
National Capital District	4.5	111,700	173,500	269,500
Lae	5.0	56,600	92,200	150,200
Madang	2.9	20,200	26,900	35,800
Wewak	2.8	19,100	25,200	33,200
Goroka	3.3	17,400	24,100	33,300
Rabaul	1.5	13,300	15,400	17,900
Mt. Hagen	6.2	12,400	22,600	41,300
Arawa	5.0	10,700	17,400	28,400
Daru	3.5	7,000	9,900	13,900
Popondetta	3.8	6,200	9,000	13,100
Kimbe	5.0	4,400	7,200	11,700

Source: National Statistical Office, Port Moresby, March 1983.

This study covers five major urban centres in Papua New Guinea: the National Capital District in Port Moresby, Lae in Morobe Province, Goroka in Eastern Highlands Province, Rabaul in East New Britain Province, and the Arawa-Kieta-Toniva area in North Solomons Province. They are the first, second, fifth, sixth, and eighth largest urban centres in the country.

Although there are examples from all of the four regions of the country, New Guinea Islands, Mamose, Highlands and Southern, they are not representative in any sense, with each having its own particular characteristics, and being typical only in demonstrating the uniqueness of the different urban areas. Understanding of the particular situation of the remainder of the ten largest centres, Madang (3), Wewak (4), Mount Hagen (7), Daru (9) and Popondetta (10) would require specific examination of their present financial situation. The choice of cases included in this study was dictated by constraints of time and transportation.

<u>National Capital District (Port Moresby)</u>

The situation of urban government in Port Moresby is unique in Papua New Guinea. Not only is it the site of the national capital and the largest urban centre in the country, with a population projected to be more than 170,000 in 1990 and growing to nearly 270,000 by the end of the century, but it is also the only urban area that does not come under the jurisdiction of a provincial government. Thus there is no middle level of government between the urban authority and the national government. The Constitution of Papua New Guinea establishes the National Capital

District and states that it shall be the seat of government (Section 4). Although the constitution appears to permit some form of government other than provincial government, it does not exclude the possibility of a provincial government.

In 1980 the Port Moresby Local Government Council was suspended by the Minister of Decentralisation in his capacity as minister responsible for local government. In 1981 a commission of enquiry was established to investigate and report on a system of government for the National Capital District, largely in response to pressure by Motu and Koitabu villagers who were traditional owners of land in the National Capital District. Following the receipt of this report the national government adopted the National Capital District (Preparatory Arrangements) Act, 1982, which established the National Capital District Interim Commission (NCDIC) with responsibility for the National Capital District except those areas under the Motu-Koita Interim Assembly which has responsibility for the ten Motu-Koita customary villages in the National Capital District. An Organic Law was to be adopted within three years which would provide for a future permanent National Capital District Government.

Subsequently a number of draft policy submissions were made concerning the future of the local urban authority. There were some suggestions that it should not be a statutory body, but rather a separate department or part of a national government department because of the various functions of health, education, etc. that it was to carry out in the National Capital District. In effect the functions carried out by the urban authority are more akin to those carried out by provincial governments than to those carried out by other urban authorities in the country. The ultimate determination of the form of government to be adopted for the National Capital District is still to be made, and the functions of local government continue to be carried out by the NCDIC, which is responsible to the national minister responsible for provincial affairs, to which all budgets and annual reports are submitted.

The legislative powers of the NCDIC include virtually the same powers that were transferred to provincial governments under the OLPG. It also exercises all those powers and functions previously exercised under the Local Government Act 1963 by the former Port Moresby City Council. Funding for the services of education and health that were transferred to provincial governments is provided through the national budget (Division 246, Department of Provincial Affairs) until 1988, and in line department budget divisions in 1989. The national government also provides an annual K1 million grant for carrying out maintenance on national roads in the National Capital District, and the NCDIC has the power to legislate and impose taxation that is accorded to provincial governments, including retail sales taxes, land taxes, the head tax, and other licence and service fees (National Capital District Interim Commission, 1982 Annual Report 13-15). The rate schedule imposed by the NCDIC for land use tax and retail sales tax in 1989 is as follows:

Land use		Rate (kina)
Low covenant properties		40.00 per unit
Medium covenant, high covenant, industrial		
(a)	Rate on all properties per kina of unimproved capital value	00.167
(b)	Where there is more than one residential building on each site, an additional	100.00 per unit
(c)	Where there is a shop and more than one residential building on each site, an additional	100.00 per unit

Retail Sales Tax

Product	Rate (percent)
New and used vehicles	3.0
Tyres	3.0
Beer, wine, spirits	7.5
Motor fuel/distillate	3.0
Tobacco and cigarette manufacture	2.0
All other goods	1.0

Details of the estimated revenue for 1989 of the NCDIC are provided in Table 7. With estimates of revenue for 1989 surpassing K23 million, the budget of this urban authority is comparable to the largest provincial government budget in Papua New Guinea.

The 1989 budget of the NCDIC reveals the importance of the retail sales tax as a source of urban local government revenue, with estimates that it will generate K6.4 million in 1989. The introduction of this tax with the National Capital District Retail Sales Act 1986, represented a decision on the part of the NCDIC based on recommendations of a report on the reform of financing measures commissioned in 1986. In 1986, before the introduction of a general retail sales tax, the land tax accounted for nearly 90 percent of total revenue (Grynberg, Kurer, and Vermuri, 1986). The tax on land in the National Capital District is estimated to generate K4.5 million in 1989, with another K500,000 being paid by the national government as a grant in lieu of rates. The large amounts of self-raised revenue allow for the NCDIC to budget for a capital works program totalling K7.7 million in 1989, with another K6.4 million in supplementary capital works projects identified for possible funding through foreign aid loans or government grants.

Table 7
National Capital District Interim Commission
total revenue estimates 1989

Source	Amount (kina)
Land tax	4,500,000
Land tax penalty	100,000
Garbage and sanitation	530,000
Swimming pool fee	91,000
Retail sales tax	6,400,000
Interest	20,000
Trade licence	50,000
Building fees	120,000
Market fees	420,000
Burial fees	21,000
Liquor licensing	450,000
Dog Pound fees	10,000
Margin rec. works	40,000
Sale of plants	5,000
Sale of assets	10,000
National government grants	1,000,000
Lottery	150,000
Housing	15,000
Miscellaneous	100,000
Village Court fines	6,000
Rental income	38,000
Stadium	10,000
Service station fees	12,000
Sale of houses	450,000
Sale of vehicles	300,000
Loan proceeds	1,300,000
Water & sewerage fees	7,289,000
Total	**23,437,000**

Source: National Capital District Interim Commission. 1989 Budget.

The breakdown of NCDIC revenue into broad categories as presented in Table 8 shows the extraordinary degree to which the urban authority raises its own revenue. In 1989 more than K20 million, or 85 percent of total estimated revenue is raised through taxes and fees, with taxes alone, which amount to K11.65 million accounting for 50 percent of total revenue. The degree of self-sufficiency that this represents is also reflected in the fact that grants account for less than 5 percent of total revenue, and that the NCDIC plans to raise substantial amounts through loans.

Table 8
Sources of funding for the NCDIC by category 1989

Category	Amount (kina)	Share (percent)
Taxes	11,650,000	49.7
Fees	8,549,000	36.5
Grants	1,000,000	4.3
Other	938,000	4.0
Loans	1,300,000	5.5
Total	**23,437,000**	**100.0**

Source: Table 7.

When the final form of government in the National Capital District is determined, it is possible that funding for all education and health services will become part of the NCDIC budget. In this eventuality there would also likely be an annual grant made to the National Capital District urban authority like the MUG provided to provincial government to cover the costs of these transferred activities. In this situation the ability of the urban authority to fund its services and provide adequate investment in infrastructure will be subject to the same constraints as provincial governments presently are. It would be likely that, by virtue of possessing all the revenue-raising powers of a provincial government, the National Capital District will be able to attain a degree of self-sufficiency that is not available to other urban local governments in Papua New Guinea.

Lae

The city of Lae has a population projected to be in excess of 90,000 in 1990. It is one of the fastest-growing urban areas in Papua New Guinea and is projected to reach 150,000 by the end of the century. The administration of Lae is carried out by the Lae City Authority, which was established by the Lae City Authority Act 1987. Other local governments in Morobe operate under a community government act. The Act is based on model draft legislation that has been adopted by a number of provincial governments in setting up urban authorities. Under Section 17 of the Act the Authority has the power to impose rates, charges and fees under rules adopted according to Section 14 and Schedule 1 of the Act. Section 14 of the Act broadly defines the powers of the Authority and Schedule 1 lists specific functions related to the administration of the city.

Section 17 also provides that the Lae City Authority may receive grants from the provincial government and from the national government (with the approval of the provincial government), may make investments, and raise money through other means under provincial laws. The Authority may borrow (but not exceeding the borrowing power of the provincial government) up to the lesser of K50,000 or 20 percent of the previous year's recurrent revenue without prior approval, and larger amounts with the approval of the provincial government. Section 19 provides that the provincial government shall pay a grant to the Lae City Authority in lieu of any fines or penalties incurred under rules adopted by the Authority, those fines being paid to the provincial government. The grant is to be the estimated amounts of the fines in the previous fiscal year.

Details of the estimates of revenue in the 1989 Lae City Authority Budget as presented in Table 9 indicate that gross revenue raised for 1989, exclusive of loans, is expected to amount to about K3.1 million. (N.B. The budget document provides figures for net revenue for all activities which generate service fees. This table has disaggregated those totals to provide an indication of gross revenue estimates.)

Table 9
Lae City Authority - total gross revenue estimates 1989

Source	Amount (kina)
Garbage and sanitation	850,000
Building fees	30,000
Trees removal	10,000
Refuse dump	85,000
Cemetery and burials	63,000
Petrol sales	91,000
Vehicle maintenance	132,500
Nursery sales	8,000
Property income	117,000
School bus hire	3,600
Market	167,800
Dog registration	2,800
Trading licences	31,000
Court fines	1,500
Hotel tax	140,000
Video hire tax	30,700
Dividend income	5,000
Interest on IBDs	200,000
Miscellaneous	16,000
Provincial government grant	300,000
Grant in lieu	400,000
Road maintenance grant	450,000
Total	**3,134,900**

Source: Lae City Authority. 1989 Budget.

The largest item in self-raised revenue is garbage and sanitation fees at K850,000, with other revenue coming from building authority fees, trees removal, the refuse dump, cemetery and burials, vehicle maintenance and inspection, farm and nursery sales, property income, school bus hire and market fees. Trading licences, dog registration fees, court fines, taxes on hotel accommodation, video tape hire and interest income provide additional revenue. Morobe Provincial Government provided a grant for road maintenance services of K450,000 and K300,000 to cover the cost of obligatory services in 1989, and the national government paid the Lae City Authority a grant of K400,000 in lieu of rates.

Lae presents a clear example of the difficult situation faced by urban local governments in Papua New Guinea following the creation of provincial governments. Sources of financing previously available under the Local Government Act of 1963 (principally the imposition of rates on urban land) were taken over by the provincial government. It appears that there was no corresponding reduction in the activities for which the urban authority was responsible. The total amount of provincially-raised revenue is estimated to be amount to more than K7.0 million, representing 52 percent of the total revenue of Morobe Provincial Government. In 1989 the Morobe Provincial Government expects to collect approximately K2.1 million from land taxes. There is no established proportion of this transferred to the Lae City Authority, as the provincial government is consciously pursuing a policy of using urban-raised revenue as a means of financing rural development. Other taxes which had been originated by the city of Lae, a tyre tax and a fuel tax, are now also collected by the provincial government.

Table 10 provides a breakdown of the different sources of income raised by the Lae City Authority in 1989. Self-raised revenue from fees and specific taxes on hotel rooms and video hire provided K1.65 million, or more than 50 percent of the gross revenue in 1989, with K1.5 million, or 46 percent of this being provided by fees for services. Garbage and sanitation fees provided a net surplus of K525,000 based on gross collections of K850,000. Total tax revenue amounted to only K200,000, or 6.4 percent of total gross revenue, with about 47 percent of revenue coming from grants and other sources.

Table 10
Sources of funding for the Lae City Authority
by category 1989

Category	Amount (kina)	Share (percent)
Taxes	201,700	6.4
Fees	1,445,200	46.1
Grants	1,150,000	36.7
Other	338,000	10.8
Total	**3,134,900**	**100.0**

Source: Table 9.

Rapid increases in population, exacerbated by the drift of population to urban areas, are placing a mounting burden on town services. Lae, as the main entry point for commercial activity and entrepôt for traffic to the Highlands has suffered a decline of its road infrastructure (built in the 1950s) as heavy traffic, which it was not designed to support, has taken its toll. It is generally felt that the decline in revenue and increase in demands have led to a deterioration in urban infrastructure and services.

The Lae City Authority has proposed several additional sources of revenue, based either on a new type of charge or on a form of revenue sharing with the provincial government. The urban authority has proposed that a rate be charged against all householders, institutional users and businesses which occupy land and/or have access to urban services which are provided in Lae city, but for which a specific fee is not levied. The rate would be called a community service rate and would be levied by the Lae City Authority under its enabling legislation. The imposition of this rate would have to be approved, as are all local government laws, by the Provincial Executive Council. It would be variable according to the nature of the activity on a land area and the availability of urban services to the land, according to a series of factors: the zoned land use; the infrastructure and physical services available to the user; the social and community services available to the user; and the general income range or "affordability" of the user. The community service rate is similar to the one presently being imposed by the the North Solomons Capital Authority, which is discussed below. The total projected income to the Lae City Authority is estimated to amount to K1.9 million per annum (Lae City Authority 1989, Appendix 2).

The Lae City Authority has also proposed that a portion of land taxes be remitted and that motor vehicle licensing fees be transferred to the urban authority, neither of which has been accepted by the Morobe Provincial Government. Suggestions have also been made that the water supply be transferred to the Lae City Authority, which would provide a significant source of revenue. The city is presently responsible for installing pipeline. Another proposal is to designate the Lae City Authority as the sole agent of vehicle inspection in Lae, which could generate K60,000 of revenue through annual inspections. The urban authority is planning major investments in town houses and office complexes. (This investment is not included in the budget figures presented here.)

The Lae City Authority is conscious of the likelihood of increasing future demands for infrastructure investment, and that significant grants from the national and provincial governments will be required. At the same time it is pursuing various means to become as self-sufficient as possible. The large amount of provincially generated revenue raised by the Morobe Provincial Government (estimated to total more than K7.0 million in 1989), and the large portion of that which is generated in the Lae urban area suggest that some of this revenue might be used to provide the Lae City Authority with a stronger financial base to face future demands on urban infrastructure and services. The discussion of this possibility must take into consideration Morobe Provincial Government's expressed policy of developing rural areas using revenue generated in urban areas, and the impact of this policy on reducing the rate of migration from rural to urban areas.

Goroka

Goroka, the site of Eastern Highlands Provincial Government, is estimated to have a population of about 24,000 in 1990, with a projected increase to 33,000 by the end of the century, based on an estimated rate of increase of 3.3 percent per year. These figures refer only to the population of the central town area, not the immediately surrounding peri-urban area which is growing at a much faster rate, and which will also have an effect on the urban infrastructure. In 1988 The Eastern Highlands Provincial Government enacted the Eastern Highlands Capital Authority Act 1988 creating the Eastern Highlands Capital Authority for the town of Goroka. Until 1989 the town of Goroka had been under the Goroka Local Government Council, the first one created in 1968 when urban centres were brought under local government. At that time it replaced three separate councils which corresponded to the three language group areas of Lower Asaro, Unggai, and Bena Bena. Goroka is unique in that it was the only local government council which brought together separate councils for rural and urban areas. The 1989 Act creates a new authority for the urban area of Goroka town, while the Goroka Local Government Council remains the local government for the rural areas in the Goroka district.

The Act is based on the same model draft legislation that has been adopted by a number of provincial governments in setting up urban authorities. Under Section 17 of the Act the Authority has the power to impose rates, charges and fees under rules adopted according to Section 14 and Schedule 1 of the Act. Section 14 of the Act broadly defines the powers of the Authority and Schedule 1 lists specific functions related to the administration of the city. Section 17 also provides that the Eastern Highlands Capital Authority may receive grants from the provincial government and from the national government (with the approval of the provincial government), may make investments, and raise money through other means under provincial laws.

The Authority may borrow up to the lesser of K50,000 or 20 percent of the previous year's recurrent revenue without prior approval, and larger amounts with the approval of the provincial government. Section 19 provides that the provincial government shall pay a grant to the Eastern Highlands Capital Authority in lieu of any fines or penalties incurred under rules adopted by the Authority, those fines being paid to the provincial government. The grant is to be the estimated amounts of the fines in the previous fiscal year.

Table 11 indicates the amount of revenue to be raised by the Eastern Highlands Capital Authority in 1989. The 1989 budget is the first one adopted under the new act, and total expenditures are estimated at K737,000. The principal items of revenue are grants from the provincial and national governments. The largest is a grant of K300,000 from the Eastern Highlands Provincial Government under the RIP programme for maintenance of town roads, and the second largest is the grant in lieu of land rates paid by the national government. Among items of self-raised revenue, fees from sanitation and garbage collection generate the greatest amount of revenue at K100,000. An entertainment tax, court fines, trading licences and other sundry fees provide a small amount of revenue. In addition to this the Capital Authority receives a 5 percent commission for the land rates that it collects on behalf of the provincial government, amounting to K80,000, and interest on bank deposits of K25,000.

Table 11
Eastern Highlands Capital Authority
total revenue estimates 1989

Source	Amount (kina)
Sanitation and garbage	100,000
Licences	8,000
Entertainment tax	1,000
Court fines	1,000
Cemetery	1,000
Sundry	1,000
Grant in lieu	220,000
Provincial government grant	300,000
Urban road grant	80,000
Commission	25,000
Total	**737,000**

Source: Eastern Highlands Capital Authority. 1989 Budget.

Table 12 presents a breakdown of the sources of revenue for the Eastern Highlands Capital Authority for 1989. The situation is dramatically different from that of the two major urban areas of Lae and the National Capital District where a majority of the revenue was self-raised. In Goroka 80 percent of total revenue, amounting to K600,000 is provided by grants. Taxes and fees together account for less than 20 percent of estimated revenue for 1989. Although the relative size of urban areas and the different demands on urban services and infrastructure must be taken into account, it is clear from these figures that under the present funding arrangements the Eastern Highlands Capital Authority does not have the means to be self-financing.

Table 12
Sources of funding for the Eastern Highlands
Capital Authority by category 1989

Category	Amount (kina)	Share (percent)
Taxes	9,000	1.2
Fees	127,000	17.2
Grants	600,000	81.4
Other	1,000	0.1
Total	**737,000**	**100.0**

Source: Table 11

The Eastern Highlands Provincial Government retains the proceeds from land rates which are imposed on all alienated land in the township of Kainantu and Goroka and on all other land in the province for the first time in 1989. The 1989 Eastern Highlands Provincial budget estimates that about K1.2 million will be raised through land rates, of which K400,000 to K500,000 will come from Goroka (Eastern Highlands Provincial Government 1988). In 1988 the Goroka Local Government Council collected about K400,000 in land rates. The K300,000 unconditional grant is considered to be a transfer of a portion of the 1989 proceeds back to the Eastern Highlands Capital Authority. The provincial estimate of proceeds to be received from land rates may not be very accurate since this is the first time that rates have been imposed on rural land, the levels of the rates have been changed for this year, and a new valuation is in effect. The Eastern Highlands Land Tax Rates of 1989 replaces a general 5 percent rate with a scale of rates that ranges from one percent to 10 percent. The following rates are in effect in 1989.

Description of Land	**Rate (percent)**
Agricultural land in the town of Goroka and Kainantu	4
Business land in the town of Goroka and Kainantu	7
Residential land in the town of Goroka and Kainantu	2
Combined residential and business land in the town of Goroka and Kainantu	5
Undeveloped urban land in the town of Goroka and Kainantu	10
Other land in the town of Goroka and Kainantu	1
Business land not in the town of Goroka and Kainantu	3
Residential land not in the town of Goroka and Kainantu	1
Combined residential and business land not in the town of Goroka and Kainantu	3
Other land not in the town of Goroka and Kainantu	1
Agricultural land not in the town of Goroka and Kainantu	2
Unimproved land not in the town of Goroka and Kainantu	7

The proceeds for 1989 may be less than expected since most of the town area is residential land which has been reduced from a 5 percent rate to a 2 percent rate. At the same time, the increase to 7 percent for business land may result in small businesses finding it difficult to pay the rates. For 1989 the accounts sent out for Goroka town totalled around K650,000, of which K500,000 is likely to be collected. The Eastern Highlands Capital Authority is requesting the Eastern Highlands Provincial Government to transfer to it the right to collect and keep the rates from Goroka town starting in 1990, but the policy to be adopted by the provincial government is uncertain. The central issue will involve weighing the desire of the Capital Authority to have the power to raise sufficient funds to cover the cost of providing its services against the desire of the provincial government to use the proceeds of rates from the urban area to promote development in the rural areas.

Another issue to be resolved in relation to the establishment of the new Capital Authority is the transfer of assets from the Goroka Local Government Council. The refusal of the Council to negotiate the transfer of assets to the Capital Authority necessitated an act of the provincial legislature, the Eastern Highlands Capital (Amendment) Act of 1989, providing that all assets be transferred by the Local Government Council to the new authority. Some assets have been transferred, but the Goroka Council wants to retain the water supply (a source of revenue) and the swimming pool. Transfer of the water supply to the urban authority would not only provide an additional source of revenue, but would also give the urban authority a sanction against defaulters on payment of other fees. The issue will have to be resolved politically by the provincial government. The Eastern Highlands Capital Authority considers that the assets are necessary to carry out its activities and to provide the backing for eventual loans for major infrastructure investments.

Rabaul

Rabaul, the site of East New Britain Provincial Government has a projected population of about 15,000 in 1990, and is expected to increase to nearly 18,000 by the end of the century. Rabaul has a town community government established, like other community governments in East New Britain, under the East New Britain Community Government Act 1979. It collects revenue under its own bylaws adopted under the Community Government Act with the approval of the provincial government. It still collects the head tax, although the amounts collected (estimated at about K21,000 for 1989) are small, difficult to collect and probably do not pay the costs of its administration. It also collects a variety of fees for specific services, the most important ones being garbage and sanitation. Rabaul also collects an entertainment tax, a video tape tax, undertaking fees, court fines (including village courts), mobile traders' licence fees, dog registration fees, and commercial revenue.

East New Britain Provincial Government provides a grant for capital works and maintenance and a conditional grant through the provincial RIP programme, and application has been made to the transport sectoral programme at the national level. Land tax is collected for the Rabaul town by the provincial government under provincial legislation. Half of this revenue is retained by the provincial government and the other half is paid to the Rabaul Town Community Government. In 1989 Rabaul received a grant in lieu of rates from the national government of K200,000. The provincial government also transfers the proceeds of the bookmakers' tax to the urban local government.

The funding available to the Rabaul Town Community Government is adequate to meet its present requirements, but any major renewal or expansion of the urban infrastructure would require additional revenue. With urban growth resulting from immigration to the town and natural population growth, increased demands are likely to quickly outstrip present financing. The eventual relocation of the town at Kokopo as a result of volcanic activity will also engender significant infrastructure costs.

In the case of Rabaul, there are two revenue sources directly linked to the urban area that are presently retained by the provincial government. The first is half of the proceeds from land tax in Rabaul. The second is proceeds from the licensing of liquor sales in Rabaul, which are collected and retained by the provincial government. The actual services associated with licensing, such as health inspection is carried out by the Rabaul Town Community Government, and a case could be made that the urban authority should receive this revenue.

Table 13 provides details of the different sources of revenue estimates for the 1989 Rabaul Town Community Government, which total just under K1 million. Proceeds from the head tax is estimated to generate about K21,000 in 1989, with another K5,500 to be collected in back tax. The East New Britain Provincial Government transfers 50 percent of the land tax back to the urban authority, amounting to K157,000 for 1989. A variety of other taxes and licences bring a smaller amount of revenue. Among the fees charged for services, the garbage and sanitation fees provide the largest amount of revenue, amounting to nearly K350,000. Among the grants received by the Rabaul Town Community Government, the largest is the grant in lieu of rates from the national government, amounting to K200,000. Other grants include a conditional grant from the provincial government of K64,000, a road maintenance grant of K78,700, and a grant from the Japanese Government to maintain the Japanese Memorial.

Table 13
Rabaul Town Community Government
total revenue estimates 1989

Source	Amount (kina)
Head tax	20,883
Back tax	5,500
Provincial government grant (land tax)	157,000
Entertainment tax	10,500
Undertaking fees	13,950
Service fees	750
Court fines	3,500
Village Court	5,000
Traders licence	10,500
Rent accommodation	9,000
Garbage fees	279,293
Sanitation fees	67,600
Water fees 1987	4,500
Sewerage fees 1987	2,800
Rent foreshores	5,400
Dog registration	1,020
On-spot fines	1,500
Video tax	20,550
Miscellaneous	4,000
Tree cutting	15,750
Bookmakers' tax	3,000
Japanese grant	7,000
Provincial government conditional grant	64,000
Road maintenance grant	78,700
Grant in lieu	200,000
Total	**991,696**

Source: Rabaul Town Community Government. 1989 Budget.

The breakdown of revenue sources for the Rabaul Town Community Government for 1989 in Table 14 indicates that 50 percent of total revenue is obtained through grants, with another 40 percent generated by fees for services. Although grants account for half of revenue, if the Rabaul Town Community Government were to collect and retain the land rates for the town area, it would be significantly closer to self-sufficiency than it is at present. If the grant from the East New Britain Provincial Government that represents a transfer of approximately half of the land tax were treated as a town tax, nearly 50 percent of the total revenue of the urban authority would be self-raised.

Table 14
Sources of funding for the Rabaul Town Community Government by category 1989

Category	Amount (kina)	Share (percent)
Taxes	70,933	7.2
Fees	395,663	39.9
Grants	506,700	51.1
Other	18,400	1.9
Total	**991,696**	**100.0**

Source: Table 13.

These data indicate that there is some potential for the Rabaul Town Community Government to achieve a greater degree of self-sufficiency through adoption of bylaws to raise its own land taxes, or through a guarantee that the tax be transferred to the town authority. If additional locally-raised taxes, such as liquor licensing fees from the Rabaul town were transferred to the urban authority it would create an even stronger base for fiscal viability.

Arawa-Kieta-Toniva

Arawa, the site of the North Solomons Provincial Government, is projected to have a population of about 17,000 in 1990, increasing to 28,000 by the end of the century. The Arawa Town Council was established as an elected body in 1972 under the Local Government Act. It replaced the Arawa Municipal Commission, an appointed body which dated from 1970. The town council was suspended for alleged mismanagement in 1979 and a board of management was appointed to manage its affairs. The Arawa Town Authority (Interim Provisions) Act, 1980 was adopted by the provincial legislative assembly, thus putting to an end the Local Government Council system in North Solomons Province. With the adoption of this legislation, responsibility for local government in the urban area of Arawa was transferred from the national government to the provincial government. As was the case in most other provinces, the Arawa Town Authority lost virtually all autonomy, including control over the raising of funds to be used to finance the delivery of services in the township.

The largest source of funding in the 1985 budget was the grant in lieu of land rates paid by the national government at the level of 5 percent of the unimproved value of national government land in Arawa. The North Solomons Provincial Government paid a grant to the town council equal to 60 percent of the land tax and all of the head tax collected in the Arawa region. Other major sources of revenue came from fees for garbage and sanitation and water and sewerage services. The Arawa Town Authority also provided various health and sanitation services to Kieta and Toniva towns, for which a service was levied.

In 1987 the North Solomons Provincial Government established an appointed urban authority for the provincial capital area of North Solomons Province under the Provincial Capital Government Arrangements Act, 1987. The North Solomons Provincial Capital area encompasses the towns of Arawa, Kieta, and Toniva. The finances of the Capital Authority are outlined in part V of the 1987 Act and include taxation under rules it makes with the approval of the provincial government, grants from the provincial and national governments, fees for goods and services, borrowing, and investment.

Table 15
North Solomons Capital Authority
total revenue estimates 1989

Source	Amount (kina)
Trading licence fees	11,500
Building permit fees	9,500
House/hostel rental	37,000
Interest and dividend	12,000
Arawa house rent	158,000
Equipment sales	36,000
Miscellaneous	5,000
Provincial Government grant	620,000
Grant in lieu	600,000
Litter court fines	1,000
Vehicle equipment hire	15,000
Vehicle inspection fee	51,000
Coffin sales	10,000
Sand/gravel royalties	10,000
Nursery sales	5,000
Dump fees	11,000
Community service rate	583,000
Head tax	285,000
Total	**2,460,000**

Source: North Solomons Capital Authority. 1989 Budget.

Revenue estimates in the 1989 budget of the North Solomons Capital Authority Budget amount to approximately K2.5 million, as indicated in Table 15. The largest sources of income are from grants of K620,000 from the provincial government, representing 60 percent of the land tax collected by the North Solomons Provincial Government, and K600,000 from the national government as a grant in lieu of land rates. Among self-raised revenue sources the North Solomons Capital Authority still collects the head tax, and estimates that K285,000 will be raised from this source in 1989.

The largest source of self-raised revenue, amounting to K583,000, is the new community service rate, imposed for the first time in 1989. The North Solomons Capital Authority introduced this new service rate under the Community Rate Rule No. 1, 1989, and it coincides with the phasing out of the previous charges for garbage and sanitation services.

The community service rate places a "price tag" on all services supplied by the North Solomons Capital Authority, including those general services for which no specific charge was being levied, such as street lighting, street cleaning, etc. The community services rate is paid by all property owners at a kina rate which is determined on the basis of the cost of services (K70 for 1989). The amount paid by a particular ratepayer is determined by applying a "factor" for each type of service determined by access to the services according to the type and location of a property, e.g. a low covenant house, high covenant house, or business located in Arawa, Kieta, or Toniva (North Solomons Capital Authority, 1988). The new fees will result in greater revenue than the specific fees for services previously applied as a result of including an economic cost for general services which were not calculated in the past.

There are several advantages to the concept of a community services rate. As mentioned above, it allows the local government to recoup a market value based cost of general services. In addition to this it partially compensates for the loss of revenue occasioned by the retention of a portion of land tax by the provincial government. It also raises the question of its application to government-owned land, and the existing grant in lieu of rates by the national government, as well as the question of an increased total tax burden on local ratepayers who also pay the land tax which formerly covered the cost of providing general services.

The breakdown of sources of revenue for North Solomons Capital Authority for 1989 is presented in Table 16. Half of total estimated revenue is accounted for by grants, and half of this is represented by the transfer from the North Solomons Provincial Government of 60 percent of land rates collected in the urban area. The other half is the grant in lieu of rates from the national government. When taken together with the fees raised by the North Solomons Capital Authority, the total revenue "generated" in the urban area accounts for about half of total revenue. If the urban authority were to receive the proceeds from these sources, it would achieve a greater degree of self-sufficiency.

Table 16
Sources of funding for the North Solomons Capital Authority
by category 1989

Category	Amount (kina)	Share (percent)
Taxes	285,000	11.6
Fees	707,000	28.7
Grants	1,220,000	49.6
Other	248,000	10.1
Total	**2,460,000**	**100.0**

Source: Table 15.

The previous analysis of five of the major urban centres with respect to amounts and sources of revenue raised by the local urban government gives a general idea of the potential that urban authorities in centres of different sizes have for attaining a degree of self-sufficiency. Before discussing specific policy steps that might be taken to realise a degree of self-sufficiency, a brief analysis of the relationship between self-sufficiency and investment in urban infrastructure is in order.

Self-sufficiency and investment in urban infrastructure

Although the principal purpose of this study is to provide a general picture of the major sources of finance of urban local government, and to arrive at some judgment as to their potential for self-sufficiency, it is important to have some idea of the extent to which the urban authorities are presently investing in the urban infrastructure. A more extensive and detailed study is required to reveal the overall infrastructure investment needs and present levels of funding, but from the present data it is possible to get a general idea of the extent to which urban authorities are likely to be self-sufficient in funding investment in urban infrastructure.

A comparison of the proportion of total expenditure of urban authorities devoted to urban infrastructure in 1989 is given in Table 17. For the purposes of this study, investment in infrastructure is defined as funds budgeted for capital works activities devoted to major capital expenditure on infrastructure items such as roads, water supply, sewers, footpaths, drainage, buildings and heavy equipment, as well as upgrading and maintenance on this infrastructure. An attempt has been made to eliminate other items which often appear in the category of capital expenditure, such as office furniture and motor vehicles. Because of inconsistencies in the way different items are treated in different budgets, these data should be interpreted with caution, and treated only as indicating the broad patterns of investment in infrastructure by urban authorities.

Table 17
Investment in infrastructure as a proportion of total expenditure of selected urban authorities, 1989

	Total expenditure	Infrastructure investment	Proportion
NCDIC	24,167,000	8,472,000	35.1
Lae	3,205,000	1,680,000	52.4
Goroka	737,000	102,000	13.8
Rabaul	757,375	123,775	16.3
Arawa	2,460,000	506,400	20.6
Mean			**35.1**

Source: Budgets of the various urban authorities.

Table 17 shows that more than half the budgeted expenditure of the Lae City Authority is devoted to expenditure on infrastructure, and that more than a third of the NCDIC total expenditure is devoted to this purpose. One should keep in mind the relative magnitude of the two cities, with the budget of the NCDIC being nearly eight times as large as that of Lae. For the purposes of this analysis the investment in town houses and office complexes which are to be funded through borrowing has not been included in the data on the budget of the Lae City Authority. The NCDIC budget treats revenue and expenditure for water and sewerage as separate accounts. They have been aggregated with other expenditure for purposes of this study.

The budgets of the three middle-sized towns reflect the difference between themselves and the two major cities, with none of them devoting more than about 20 percent of total expenditure on investment in urban infrastructure, ranging from 13.8 percent for The Eastern Highlands Capital Authority to 20.68 percent for North Solomons Capital Authority. These results reflect the relative lower level of revenue generated in relation to the demand on urban services in the smaller centres, along with the relative lower demand for investment infrastructure. It is also likely that the data for the Eastern Highlands Capital Authority reflect the recent creation of the new urban authority along with the uncertain basis of its financing and the retention of the water supply by the Goroka Town Council as discussed above.

The data in Table 18 compares the revenue derived from grants from the national government and provincial governments by the five urban authorities with the total expenditure on items identified as investment in infrastructure. The figures in column three are obtained by subtracting grant revenue from infrastructure expenditure, giving an indication of the extent to which self-raised revenue has been able to provide resources for investment in infrastructure beyond the amounts provided from grants. Broadly speaking, the larger the figure in column three the greater the degree of self-sufficiency of the urban authority. A negative figure indicates that self-raised revenue has not been sufficient to cover non-capital expenditure, and that the remainder available for investment in infrastructure after urban services have been budgeted for is less than the amount provided from grants.

Table 18
Comparison of revenue from grants and investment in infrastructure of selected urban authorities, 1989

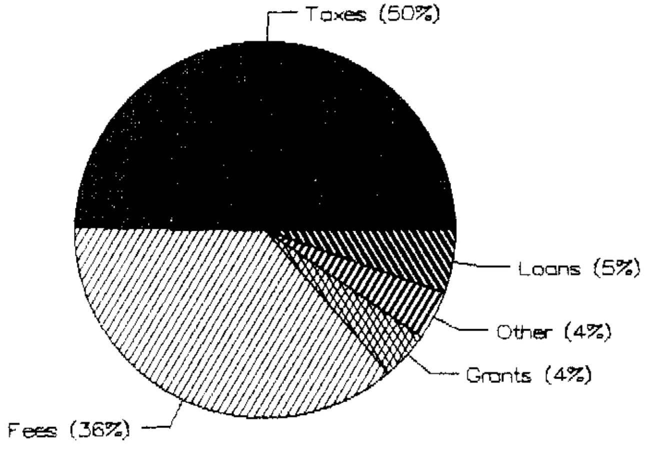
	Infrastructure investment	Grants	Difference
NCDIC	8,472,000	1,000,000	7,472,000
Lae	1,680,000	1,150,000	530,000
Goroka	102,000	600,000	-498,000
Rabaul	123,775	506,700	-382,925
Arawa	506,400	1,220,000	-713,600

Source: Budgets of the various urban authorities.

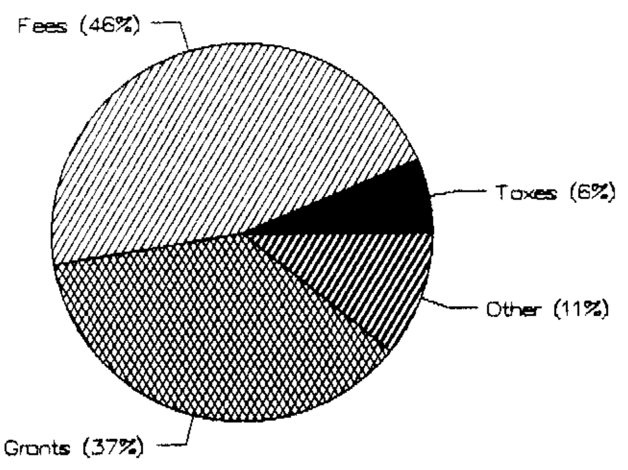
Again the unique position of the NCDIC is apparent. It should be kept in mind that the national government is responsible for a large amount of infrastructure development and maintenance in the National Capital District, which is not reflected in these figures. Lae City Authority also budgeted amounts for investment in infrastructure that exceeded revenue from grants, while the three medium-sized urban authorities all devoted part of their grant revenue to fund non-capital expenditures.

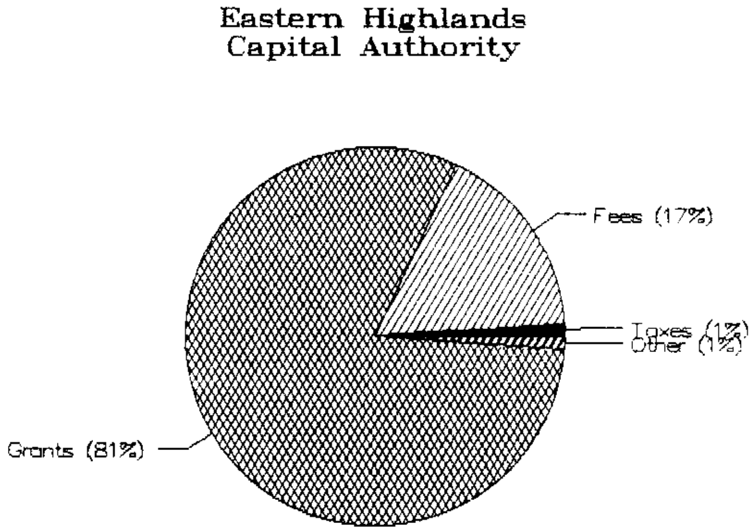
A final caveat is required with respect to the interpretation of these data. As indicated above they only represent an approximation of the broad lines of expenditure on investment in infrastructure. In addition to that it must be recognised that decisions on allocation of expenditure depend on relative demands on resources and political decisions with respect to those demands, as well as access to sources of revenue. This study has been able to examine only one part of the equation, and before more definitive conclusions can be drawn other factors must be included in a much more detailed study. In light of the previous analysis, however, it is possible to draw some general conclusions concerning the potential for self-sufficiency of urban local government in Papua New Guinea.

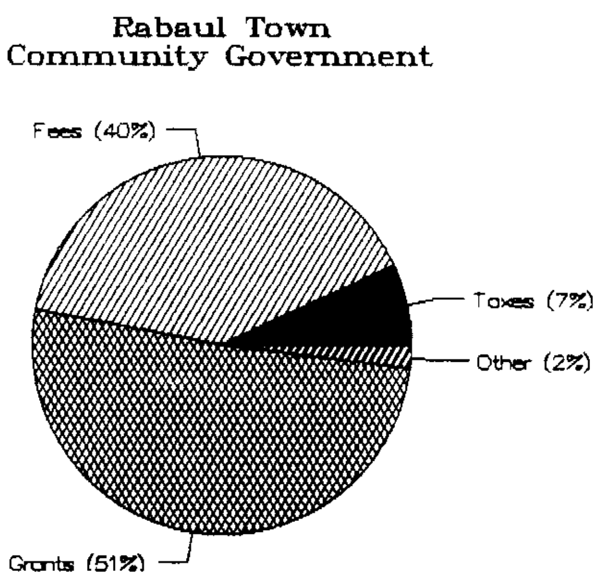
National Capital District Interim Commission



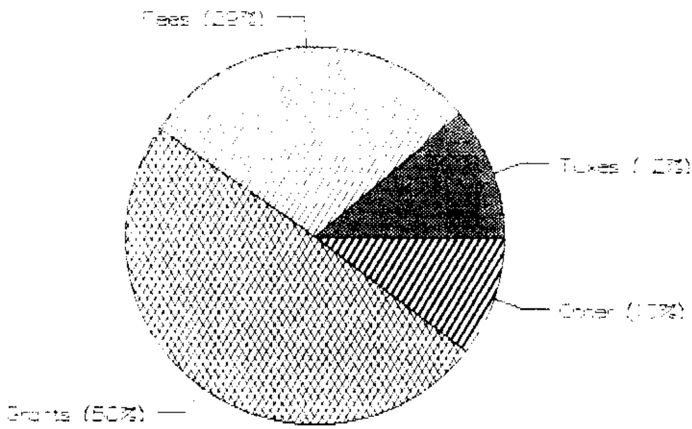
Lae City Authority




Eastern Highlands
Capital Authority
Fees (17%)
Taxes (1%)
Other (1%)
Grants (81%)

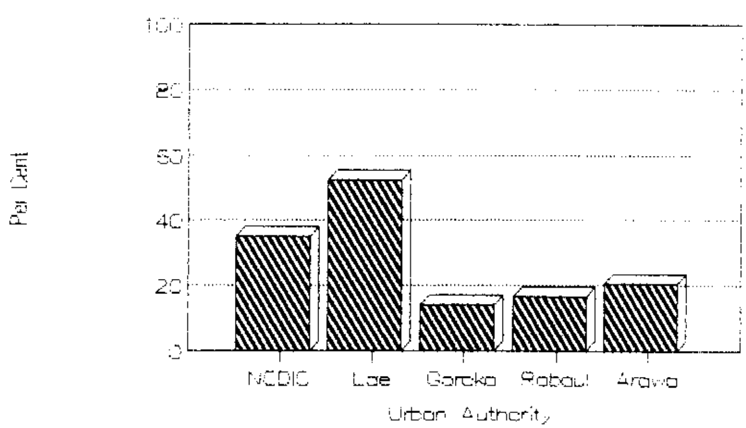

Rabaul Town
Community Government
Fees (40%)
Taxes (7%)
Other (2%)
Grants (51%)

North Solomons
Capital Authority



Infrastructure Investment as Per Cent

of Total Expenditure



Chapter 5

THE POTENTIAL FOR SELF-SUFFICIENT URBAN LOCAL GOVERNMENTS

Although the decline of local government in Papua New Guinea and the associated decline in urban services and deterioration of infrastructure had been evident for a number of years, few concrete steps have been taken to ameliorate the situation. In 1984, as part of its comprehensive study of provincial government funding, the Specialist Committee offered a number of observations on local-level government, but provided few specific recommendations for reform.

The committee reported that there was a generally accepted belief among many politicians and public servants at national, provincial and local levels that the performance of local-level government in many parts of Papua New Guinea had deteriorated, and that insufficient personnel and financial resources were being allocated to that level of government. In the massive reorganisation of financial, legal, and personnel structures required by the decentralisation process, insufficient attention had been given to the needs of local-level government. The Specialist Committee noted that there was an urgent need to assess the performance and needs of local government in the areas of legislative matter, support staff, and revenue.

Provincial legislation on local-level government was generally prepared in haste, resulting in many defects and inconsistencies in the laws. The Specialist Committee noted that in some provinces the Acts do not have the necessary electoral and other regulations. Powers of local government councils under national legislation had not been transferred to local-level bodies under provincial laws. The result was that local-level bodies under these laws had few powers and functions. This was not generally understood, and many continued to "illegally" exercise functions under national laws. The committee called for a full review of the existing legislation, to remedy these and other shortcomings. Since then a number of provincial governments have developed new legislation dealing with local government.

With respect to staffing, the Specialist Committee indicated that a major source of the problems with local-level government was the shortage of experienced and competent support staff. It supported steps by the national government to provide technical support and assistance in consultation with provincial governments to ensure their views and needs are taken into account. It also recommended the implementation of a 1980 Premiers' Council resolution calling for the absorption of local and community government clerks into the public service structure, and that existing kiaps be involved as advisers and assistants to local governments to help lessen the present lack of competent support staff.

The Specialist Committee also identified a number of problems related to the revenue of local-level government. It has already been pointed out that the problems of local government bodies in major urban areas have always been quite different from those of bodies in rural and small urban areas. There has been a general trend in Papua New Guinea in recent years towards establishment of appointed local administrative bodies in major urban areas. The committee saw the removal of land rates from urban authorities as a radical change in the financing of these bodies, and while it recognised there may be reasons for redistribution of expenditure from urban to rural areas, it also saw that there were good reasons for services provided by larger urban authorities to continue to be financed largely by service charges. When land rates were used as a service charge, urban councils, could, if needed, raise their rates to meet rising costs of providing services. The committee recommended that provincial governments consider allowing their urban authorities to impose rates as a means of funding services. This could be done in conjunction with provincial land tax (as a means of simplifying administrative arrangements). It also might involve reducing land tax rates so that a share of that revenue would be collected, by means of rates, as service charges.

The Specialist Committee drew attention to the need for certainty in the revenue of local governments, without which they cannot plan properly. It also argued in favour of some degree of financial autonomy, to encourage responsible decisions, and to provide financial accountability to their electors. The declining importance of the head tax since 1970 meant that other tax sources would be needed. The committee recommended that provincial governments be encouraged to allocate an adequate and predictable proportion of their revenue to local-level governments, together with some taxing powers, and indicated that the allocations made by North Solomons, Morobe, and East New Britain could be used as an indication of the minimum levels to be provided.

The ideas expressed by the Specialist Committee clearly point toward the realisation of the principle of self-sufficiency as expressed by the Committee of Enquiry into Local Government Finance and Borrowing. It is further possible to identify the means and the potential for attainment of self-sufficient urban local government in Papua New Guinea.

The potential for urban local governments in Papua New Guinea to become self-sufficient depends on a complex set of factors at the national, provincial and local levels. From the previous discussion it should be obvious that the most crucial element is related to provincial government. Nearly all local urban governments now operate under provincial legislation, and their funding arrangements are governed by this legislation and provincial government policy. Through law or through policy the provincial government will determine the sources of local government funding, and the level at which this funding is provided. Based on the criteria for local government finance used in this study, it is possible to make a number of observations about possible sources of revenue for urban local government in Papua New Guinea. The major actual and potential sources of revenue are taxes (including licences), fees, borrowings and grants.

A. Taxes

Possible tax sources from which urban local government might derive revenue are the head tax, land tax, retail sales tax, licences, and transferred taxes.

Personal tax (head tax)

Although the head tax was at one time a central element in the funding of local government in Papua New Guinea, more recently it has fallen into disfavour. Some larger urban areas have dropped it altogether and some smaller centres report that it is difficult to collect and results in a great deal of resentment. As a local tax it is perhaps more appropriate in smaller rural centres, as in larger towns, greater mobility makes it harder to collect. On the other hand, larger concentrations of population should make collections more efficient. Among the five urban authorities examined here only the two smallest, Rabaul and Arawa, show revenue from the head tax for 1989. Estimates of the amounts to be raised by this source are markedly different, with the North Solomons Capital Authority estimating to collect more than ten times the K20,000 estimated by the Rabaul Community Government Authority. The North Solomons case merits further examination in order to determine if the head tax might provide a useful source of revenue for other urban centres, as it satisfies the benefit principle of taxation, as well as being clearly identified with the local urban authority as provider of services. Since the head tax may be imposed on legal persons, a corporate head tax at a higher rate that the personal tax could provide greater revenue and be relatively easy to collect.

Tax on land

Taxes, or rates, on land has traditionally been a centrepiece of urban local government finance in Papua New Guinea; although land taxation powers were available to all councils from the very inception of the 1963 Act until they were taken away from rural councils by the Local Government (Rates and Taxes) Ordinance 1970 (No. 11 of 1971). Although it is a more complicated and difficult tax to administer than taxes through licensing, urban authorities have developed relatively efficient ways to collect land rates. Land tax also satisfies the benefit principle and the criterion of identification with the local area, as well as being relatively independent of short-term economic fluctuations. Through judicious use of rating scales the land tax can also be made to be more progressive than the head tax, since ownership of property is a measure of relative wealth.

The importance of the land tax for urban local government lies mainly in its potential to raise relatively large amounts of revenue. In 1989 the amount of land tax raised in the urban areas studied here amounted to nearly K1.5 million in North Solomons Capital District, K320,000 in Rabaul and K4.5 million in the National Capital District. In Morobe Province and Eastern Highlands Province, tax is imposed on land throughout the province, with nearly all the K2 million raised by Morobe Provincial Government coming from the city of Lae and with estimates of about K500,000 to K600,000 of the K1.15 million raised by Eastern Highlands Provincial Government coming from Goroka. (Discussions with officials of the provincial governments and urban authorities.)

With the advent of provincial government, the land tax ceased to provide a stable and predictable source of urban local government finance as it, along with other former local-level taxes, became a provincial source of revenue. Among the cases studied here, only in the National Capital District does the urban authority retain the power to tax land. In Arawa and Rabaul a fixed percentage of the proceeds (60 percent and 50 percent respectively) is transferred to the urban authority as a provincial government grant. In Goroka and Lae there is no specific identification of provincial government grants being based on land tax, although this source does, of course, comprise part of the provincial consolidated revenue from which provincial expenditures, including these grants, are funded. In introducing the new measure of imposing land tax on all alienated land in Goroka and Kainantu and on all other land in rural areas in the 1989 provincial budget, the Eastern Highlands Provincial Government announced that "A fair portion of this amount [K1 million] will be ploughed back into the town of Goroka through its newly established Town Authority" (Eastern Highlands Provincial Government 1988). The Eastern Highlands Capital Authority has made a policy submission to the provincial government requesting that the Authority collect and retain proceeds from land tax in Goroka town, but at present no policy has been adopted on this question.

Among the provinces which contain the eleven largest urban centres, 1988 revenue estimates of provincial governments of all but four, Madang (Madang town), Western (Daru), Oro (Popondetta), and West New Britain (Kimbe), show that land rates are collected as a provincial tax. In these urban centres, the land tax may still provide a source of local government revenue.

Because of the close identification of land rates with the provision of local government services, serious consideration could be given to authorising urban local government to collect and retain proceeds from these taxes. This could best be done through a bylaw of the urban authority enacted under their provincial enabling legislation. The decline of provincial government funding, and the responsibility of provincial governments to carry out policies of redistribution have been the two major factors influencing provincial governments to retain land taxes for themselves. The greatest obstacle to the transfer of this source of finance to urban local governments is likely to be political, with the provincial government wanting to retain control over this relatively important tax source.

Table 19 shows the proportion of total provincial revenue accounted for by the land tax in five urban areas. Again, the National Capital District stands out, with land tax accounting for 18 percent of total revenue. Estimates of the proportion of land tax collected by the Morobe Provincial Government from Lae city indicate that it ranks second among urban areas, with this source accounting for at least three-fourths of total land tax collections and more than 10 percent of the total provincial budget. The amounts collected in Goroka, Rabaul, and the Arawa area all account for less than 5 percent of the total provincial budget, with the smallest proportion coming from Rabaul.

Where provincial governments are not willing to give urban authorities the power to collect the land tax, an alternative would be to establish a fixed percentage of the taxes collected in the urban area to be paid to the urban authority as a grant, as is presently done in East New Britain and North Solomons. This would provide a more stable and predictable basis for urban finance based on revenue produced in the urban area.

Table 19
Land tax collected in main urban areas as a share of total provincial revenue 1989

	Total provincial revenue	Urban Land tax	Urban share (percent)
National Capital District (NCD)	23,437,000	4,500,000	19.2
Morobe	13,515,000	1,500,000	11.1
Eastern Highlands	9,625,258	500,000	5.2
East New Britain	16,848,500	320,000	1.9
North Solomons	23,928,226	1,000,000	4.2
Mean			**8.3**
Non-NCD Mean			**5.6**

Source: Tables 7, 9, 11, 13, 15, provincial budgets and interviews.

Retail sales taxes

The retail sales tax is not an appropriate tax for urban local government in Papua New Guinea. It has never been a source of revenue for local government, and in fact, did not exist before decentralisation, when it was introduced as part of the overall provincial funding package. In 1988 provincial governments estimated that they would raise K12.4 million from the general retail sales tax, and another K8 million from sales taxes on other specific items such as petroleum, alcohol, etc. (Axline 1988). The retail sales tax has become an important source of revenue for provincial governments, making a significant contribution to revenue, and being used as part of their consolidated revenue to be allocated to provincial priorities.

Retail sales taxes are not directly associated with the derivation principle relating them to their place of collection, nor are they directly connected with the delivery of urban services. This is especially the case in Papua New Guinea, where most sales take place in the urban centres, including some by rural people who travel there, and where the tax is actually collected at the wholesale level rather than at the final point of sale. Thus there is no strong case for transferring a specified portion of retail sales tax to urban authorities.

In some cases it might be appropriate to consider designating the imposition of sales taxes on specific items as a local government taxing power, or to transfer this tax revenue to urban authorities. This would be feasible where the activity in question is clearly tied to the urban area, such as a tax on hotel accommodation, and where the amounts do not reduce provincial taxes by a significant amount, or where there is presently no such tax in existence. For the medium-sized urban areas such as Goroka or Rabaul, the amount of revenue raised this way could prove to be a valuable addition to existing sources of finance.

Licences

Licence fees can be viewed as a tax on a particular type of business or activity as distinguished from a fee for services provided. Trading licences are now also a source of provincial revenue, but one that has been traditionally associated with local government, and for the most part they are still collected by the urban authority. The level of trading licence fees is set under a national act, but several urban authorities have provided a scale of fees for different sizes or types of business, and have added various administrative charges to the basic licence fee, providing additional revenue. Although this study has not been able to look in detail at the question of licence fees, it is felt that there is scope to increase revenue from this source.

A major source of revenue for provincial government is licensing the sale of beer and liquor. In Rabaul, and perhaps other areas as well, the actual inspection and administration of the licensing activity is carried out by the urban authority. In other urban areas it is not difficult to identify the location of licence fees. To the extent that the service is provided by the urban authority, or that the activity can be identified with the urban area, provincial governments might consider transferring a proportion of proceeds from liquor licensing to the urban authority in the form of a grant. This could be provided on a relatively stable basis by designating a fixed percentage of proceeds or by actual calculation of the amounts generated in the urban area. In 1989 the East New Britain Provincial Government budget estimates income from liquor licences to amount to K120,000, most of it from Rabaul. This amount represents more than 10 percent of the total revenue of the Rabaul Town Community Government. There may also be other activities subject to regulation and licence, such as certain services, which could provide new revenue sources to urban local governments.

Transferred taxes

There are some national taxes, whose proceeds are presently transferred to provincial governments as part of their funding package, and which could conceivably be passed on to local urban authorities. The most appropriate would be those which are associated with the urban area. Rabaul Town Community Government receives the proceeds of the bookmakers' tax, and the tobacco tax could also be handled this way.

B. Fees

Fees for services represent an important source of revenue for urban local governments, and for the smaller and medium-sized ones it is often the largest single source of revenue. It is useful to make a distinction between fees for specific services and fees for community services.

Fees for specific services

A wide range of services are provided by urban local governments, for which they charge a fee. Garbage and sanitation service, rubbish dump, water and sewerage fees, tree removal, cemetery and burials, market services, and vehicle inspections are a few of the types of fees that are collected by local governments. In terms of revenue generation, garbage and sanitation, and water and sewerage fees are the most important. These services can be charged for on a "user pays" principle, and in most cases the costs of providing the service are covered by the revenue collected.

One issue that came up a number of times in the course of this study was the question of water supply. There is no uniform situation among urban governments, and changes are presently taking place in a number of areas. In Rabaul, where the Rabaul Town Community Government previously was responsible for the water supply, this function has now been taken over by the Waterboard, a national body. In Goroka, the Goroka Local Government Council, which is now responsible for Goroka District, the peri-urban area surrounding the town of Goroka, has retained control of the water supply, and is resisting transferring it and other assets to the Eastern Highlands Capital Authority. In Lae, the City Authority installs water pipe, but does not receive the fees from water supply. The whole question of water resources policy in Papua New Guinea is in a situation of flux, and the possibility of water fees as a source of urban local government revenue will be a function of the outcome of this policy. The power to collect fees for water supply can also have an effect on the ability to collect other fees for services, such as garbage collection, where interruption of water supply has traditionally been an effective sanction on defaulting consumers.

Community service fees

The community service fee is a new source of urban local government revenue in Papua New Guinea, being implemented by the North Solomons Capital Authority for the first time in 1989, and being proposed for adoption by the Lae City Authority. The details of this fee are discussed in the sections dealing with those two urban authorities.

The community service fee responds to two specific needs. The first is to be able to charge for the non specific public services provided by the town authority, which cannot be attributed to particular users (a public good), and the second is the loss of land rates as their principal source of self-raised revenue. Land rates provided the revenue from which the costs of these services were met. With the takeover of the land tax by provincial governments the urban local governments were left with the costs of the services, but without the financing that traditionally funded these services.

The community service fee attributes a cost to the provision of such services as street lighting, cleaning, parks, kerbing, etc., determines the total amount of funding needed to provide the service, and then establishes a fee based on that amount to be paid by all property owners who benefit from the service. By identifying a cost related to the provision of a particular service, the charge can more accurately be considered a fee rather than a tax, from which the national government, provincial government, churches, and schools might be exempt. The community service fee is designed to recover the cost of services previously funded from land rates, and to place the burden of cost on the users.

The community service fee is an appropriate source of urban local government finance, as it satisfies well the principle of benefit, and criterion of association with local services. It also places an economic value on services provided and is flexible enough to respond to changes in cost over time, while not being subject to short-term economic fluctuations.

One important consideration must be taken into account in adopting the community service fee, the question of the total tax burden on property owners. Even though the local urban government may not now be collecting the land rates it previously collected, the taxpayer is still paying those rates to the provincial government in the form of land taxes. From the point of view of the taxpayers, they have continued to pay taxes and to receive urban services, even though the urban authority may not have been receiving the proceeds of those taxes. With the new community services rate, taxpayers may feel that they are being charged for something they are already paying for. In the case of the North Solomons Capital Authority the community services fee will incorporate the former specific charges for garbage and sanitation, so that there will be a reduction in other service fees, but the scope of this study does not permit a detailed analysis of the effect on the total tax burden.

C. Borrowing

Borrowing is one means of funding for lumpy expenditures which will be amortized from future revenue. This implies that it will be most likely used for infrastructure whose cost will be recovered through future charges, or for investments which will yield future profits. As we have seen there are limits on the level of borrowing which local governments can undertake without the approval of provincial governments, and the level of these limits makes it unlikely that borrowing will be used for major investments in infrastructure by most local governments on their own. This does not mean that borrowing of larger amounts will not take place, but rather that they will depend more on provincial government policy than local government policy.

The two largest urban centres of the National Capital District and Lae are perhaps more likely to be involved in borrowing. As we have seen the NCDIC foresees borrowings of K1.3 for 1989 and the Lae City Authority also proposes a borrowing of K5.2 million for investment in town houses and office complexes.

D. Grants

One finding that emerges from this study is the importance of grants as a source of urban local government revenue along with a relatively lower degree of reliance on self-raised revenue. As already indicated this is principally the result of the transfer of previously local sources of finance to provincial governments.

Minor grants

For a number of years there has been a town services grant from the national to local governments to cover the cost of providing services in gazetted towns without land rates. In 1984 the Specialist Committee noted that some provincial governments were not paying the town service grants to their local-level governments that used to carry out either the town services or handle the tendering process for town services contracts. It also indicated that there was some evidence that this was resulting in higher costs as well as in under-utilisation of existing local government capacity. The committee suggested that provincial governments should not take over local government activities such as town services unless there is demonstrable incapacity in particular local government bodies.

In 1983 another national government grant emerged out of the National Development Fund, which allowed each Member of National Parliament to allocate certain funds to local government councils, under the rubric of direct tied grants to local governments. In 1989 these two sources together amounted to K902,000 for all local governments, of which K830,000 was accounted for by the direct tied grant. Although handled through the provincial Bureau of Management Services, local governments often do not control the funds, and in some cases are not even aware of what they are being used for. While they may provide for a number of useful small-scale projects at the local level, they do not figure as an important source of urban local government funding.

Grant in lieu of land rates

When urban local governments were given the power to impose land rates under the Local Government Act they could not impose rates on government land. The national government paid these councils a grant in lieu of rates at the general rate imposed by the council. The national government continued to pay this grant until 1986, even though the passage of provincial legislation on local government superseded the national Local Government Act, and under the OLPG provincial governments were given the power to collect land rates. For the 1987 budget year the national government announced that it would not pay the grant in lieu of rates, which caused serious hardship on a number of urban government councils. The grant was reinstated in 1989, and the previous analysis indicates that it provides a significant amount of revenue to the urban authorities studied here.

There are some questions as to the future of the grant in lieu of rates as a source of stable and predictable income for local urban governments, particularly as the conditions under which it was established have changed fundamentally. First of all, as the decision to discontinue the grant indicates, it is by no means a stable source of revenue, since it depends on the policy of the national government in any given year. Secondly, the national law under which the national government was exempt is no longer in effect in most provinces, although a case could be made for the general exemption of the state from taxes imposed by other governments. Thirdly, if the grant is to be paid, it is logical for it to be paid to provincial governments since they now collect the land tax. Finally, with decentralisation, much of the property of the national government was transferred to provincial governments, implying that if local governments were still collecting land rates the provincial government rather than the national government should be paying the grant. The original logic for the grant in lieu of rates clearly no longer holds. For these reasons it would be wise to find a way of replacing the funds presently provided from this source.

The community services fee may be one way of achieving this, and as indicated, it is a fee for a service rather than a tax, allowing it to be imposed on state property. Payment of this fee by the national and provincial governments with respect to their property in the urban areas could compensate for the loss of the grant in lieu of rates. Again, the total tax burden must be carefully considered, and the ultimate resolution of the question will depend on cooperation between the national government and provincial governments.

Conditional and unconditional grants

Among the grants that have assumed a larger role in the financing of urban authorities are unconditional and conditional grants from the national government and provincial governments. As we have seen, provincial unconditional grants often represent a remittance of part of revenue collected in the urban area, either as a specified proportion of the urban land tax, or as an amount determined as part of the annual provincial budget exercise. Where self-raised revenue is insufficient to provide for the recurrent costs of local government the funds may be applied to this purpose. Where they are in excess of recurrent expenditure needs they may be applied to capital works. Conditional grants are usually provided for a specific project, and may be applied for under the provincial RIP programme, or be included in national capital works projects. These grants are more likely to be the source of funding for more important capital works projects.

In 1984 the Specialist Committee recommended that national government grants to local governments be made as conditional grants to provincial governments which then would allocate adequate proportions of funds to local-level governments. The proportions to be aimed at would be determined after more detailed information was obtained on spending, on and by local-level governments, and would take into consideration the need to equalise spending levels between provinces. The committee felt that as local-level government is primarily a provincial area of responsibility it was inappropriate for the national government to make direct grants to local-level governments, and that any grants for local government purposes should be made as conditional grants to provincial governments.

For the kinds of capital works projects that are implied by major investments in the urban infrastructure likely to be needed in the future urban local governments will be dependent on grants from the national government and provincial governments. The sources of revenue available to them at present are unlikely to be sufficient to provide levels of funding adequate to the task. Since the major urban areas are of central importance to the development concerns of both national and provincial governments it is appropriate that they play a role in the upgrading of this infrastructure, which will require close cooperation among all three levels of government.

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