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Local government revenue mobilisation in Anglophone Africa

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Abstract

This paper examines opportunities and constraints facing local revenue mobilization in Anglophone Africa with an emphasis on urban settings. Specific revenue instruments and their effects on economic efficiency, income distribution and accountability are discussed. In particular, political and administrative constraints facing various revenue instruments and factors affecting citizens' compliance behaviour are addressed. The analysis is exemplified by cases from across Anglophone Africa. A general conclusion emerging from the study is that local revenues mobilised in most local government authorities in Africa are necessary but not sufficient to develop and supply adequate services for the fast-growing population. On this basis areas for further research on local government revenue mobilisation in Africa are identified.

1. Introduction

A sound revenue system for local governments is an essential pre-condition for the success of fiscal decentralization (Bird 2010; Martinez-Vázques and Smoke 2010a; Olowu and Wunsch 2003). In addition to raising revenues, local revenue mobilization has the potential to foster political and administrative accountability by empowering communities (Shah 1998; Oates 1998). However, prescriptions deriving from the theory and from good international practice impose huge constraints on the choice of revenue instruments for local governments.

The growth of Africa's population has outpaced local authority capacity for service delivery in terms of management, infrastructure, and financing (McCluskey *et al.* 2003: 3; McCluskey and Franzen 2005: 43-44). Firstly, the urban municipal authorities, many of which were originally instituted as colonial administrative institutions, have not been restructured to cope with the fast-growing population (Beall 2000). Secondly, a growing number of residents live in informal settlements characterized by deficient basic services such as housing, clean water, electricity, sanitation, refuse collection, roads, and transport (Devas 2003). Thirdly, many local government authorities are financially weak and rely on financial transfers and assistance from the central government (Brosio 2000). Moreover, local government tax administrations are often inefficient and not able to properly account for revenues collected (Fjeldstad 2006).

As a result, many African local governments are facing a governance crisis and poor service delivery capability. Fiscal decentralization – the devolution of revenue mobilization and spending powers to lower levels of government – has become a main theme of local governance in recent years. The purpose of this paper is to examine opportunities and constraints facing local revenue mobilization in Anglophone Africa, with a focus on urban settings.[1] It discusses various revenue instruments available, their revenue potential, and how they affect economic efficiency, income distribution and accountability. Further, political and administrative constraints facing local revenue mobilization and factors impacting on citizens' compliance behaviour are addressed. The emphasis is on local government 'own revenues', but fiscal transfers from the central level are also covered. The paper argues that local governments need to be given access to adequate resources to do the job with which they are entrusted. However, the revenues mobilized by most local authorities in Africa are generally not sufficient to develop and supply adequate services for the fast-growing population. Hence, a general conclusion that emerges from the study is that local own revenues are a necessary but not a sufficient condition for fiscal decentralization.

The remaining part of the paper is organized as follows: The next section provides a brief review of the established rules of tax assignment between levels of government and key features of the intergovernmental fiscal transfer systems in Anglophone Africa. Challenges facing the reform of local government revenue systems in Africa are discussed in Section 3. Thereafter, Section 4 focuses on the strengths and weaknesses of the major local 'own revenues' instruments. Measures to strengthening the property tax, business license and user fee regimes are emphasized. Methods for revenue collection are addressed in Section 5. Section 6 concludes by outlining some policy implications. On the basis of the previous analysis, areas for further research are identified in the final section 7.

[1] A separate paper covering both Francophone and Anglophone countries in Africa was produced for the ICTD during the inception phase (Brun *et al.* 2012). The purpose of that paper was to identify areas for comparative research on local government taxation in Africa.

2. Tax assignment rules and fiscal transfers

In general, there are two main categories of current revenue for local government authorities (LGAs) in Africa: (i) 'own revenue', which includes taxes, user fees, and various licences (Bahl and Bird 2008), and (ii) transfers from the central or regional levels, usually in the form of grants and revenue sharing (Bahl *et al.* 2003: 71). In some countries municipalities are given the right to borrow to finance investments in local capital infrastructure (Yatta and Vaillancourt 2010: 42; Bahl and Smoke 2003: 8).[2] This section briefly reviews some general principles for revenue assignment between different levels of government, and discusses challenges to securing fiscal responsibility at sub-national levels with respect to intergovernmental transfer systems.

Although other revenue sources may exist at sub-national levels, these are not covered by this study. For instance, external financial contributions provide considerable funding to the constituencies at village and local level in some countries. These sources are dominated by aid projects or programmes funded by a mix of international non-governmental organisations, bilateral and multilateral donors (Yatta and Vaillancourt 2010; Fjeldstad 2001). Often, the local government has little or no knowledge of such projects both in terms of planning and execution phases. In many rural areas, various forms of self-help activities contribute to the maintenance of public services such as village roads, primary schools and health facilities. Although data on the extent of self-help activities is not available, studies from Tanzania in the 1990s indicate that these contributions are significant (Cooksey and Mmuya 1997; Semboja and Therkildsen 1995). Recently, constituency development funds and social action funds, operating outside the local government budgets, have become important funding sources of social and economic development projects at the local level in some countries, for instance, in Ghana, Kenya, Malawi, Tanzania, and Uganda (Baskin 2010).

2.1 Who levies what taxes?

There is no ideal assignment of revenue sources between central and lower levels of government. Still, a set of 'tax-assignment rules' has been developed in the traditional fiscal federalism theory (Oates 2005, 1972; Musgrave 2000; Bird 2010). These principles relate to the respective responsibilities of central and lower tiers of government in macroeconomic stabilisation, income redistribution, and resource allocation (Boadway *et al.* 2000). Furthermore, in developing countries the administrative capabilities of local governments in revenue design (that is, deciding on revenue bases and setting rates) must be taken into consideration (Bird 1990). In large and diverse countries it is also important to address the issue of revenue harmonization between jurisdictions when assigning taxing powers.

The stabilization objective of the fiscal system calls for central control over the revenue instruments that may substantially influence central budget deficits or inflation. Thus, taxes on international transactions (customs duties) and a considerable share of income and general sales taxes (such as VAT) should be assigned to central government. If there are wide disparities in income and wealth across regions, as there are in many African countries, then local taxing powers may exacerbate these differences. Hence, the distributive function of government is an argument for centralized, progressive corporate income and wealth taxes. Since the central government can borrow money to make up for shortfalls, it can live with the more unstable revenue sources, such as customs duties and income

[2] In some countries, such as Kenya, the amount of the loan is restricted. In other countries, such as Malawi, debt service levels are taken into account (Yatta and Vaillancourt 2010). This implies that the supervisory authority cannot approve a loan beyond a given debt service threshold. In most countries, supervisory authorities use the criteria of a threshold of local governments own resources to ensure that they can pay back loans. Generally, such borrowing is heavily constrained and contributes limited financial resources to the local government level. In Tanzania, for instance borrowing contributes less than 0.1% of local government finances (URT 2008).

taxes. Local governments, by contrast, require relatively stable sources of revenue. Thus, lower-level governments should tax revenue bases with low mobility between jurisdictions. Property tax is therefore often labelled as the 'ideal' local tax (see Section 4.1). Moreover, if properly designed, user charges on trading services such as electricity, water, sanitation, and solid waste collection may be attractive local revenue instruments. The same applies to benefit taxes such as road and port tolls, and to various licenses, which also may have regulatory functions (see section 4.2 - 4.3).

While the general principles and theoretical discussions of revenue assignments summarised above are useful reference points, in practice, country-specific factors play a crucial role when considering optimal ways to dividing revenue responsibility between central and lower tiers of government. (Bird 2010; Tanzi 2000). The case for centralization is usually built around macroeconomic considerations and equalization, and the case for local government taxing powers on efficiency considerations and increased accountability. The 'optimal' way to do things, however, depends on how the government weighs these considerations (Martinez-Vázques and Smoke 2010; Boex 2009; Bahl and Wallich 1992). Furthermore, the capacity to administer revenue instruments is always an important constraint to the assignment of 'taxing powers' to lower levels of government in developing countries. Finally, but not least important, local revenue sources must be politically acceptable (Bahl *et al.* 2003: 75). As a rule of thumb, less visible revenue instruments tend to be more acceptable to taxpayers.

Such assessments of tax assignment almost always favour central over subnational taxation. Although the literature generally emphasizes that each level of government should be assigned taxes that are as closely related as possible to the benefits derived from spending them, it often also notes that "if fiscal decentralization is to be a reality, subnational governments must control their own sources of revenue" (Martinez-Vazquez et al 2006: 21). However, as argued by Bird (2010: 5), it is not easy to satisfy both of these conditions: "the standard model of tax assignment in a multi-tier governmental structure essentially assigns no productive taxes to subnational governments". Local governments are commonly left with little but property tax, business licenses, user charges and market fees, although, as discussed in section 4, a wide range of low productive revenue instruments often are in place.

2.2 Transfers from the central government

Almost without exception, governments across the world assign more expenditure functions to local authorities than can be financed from their own revenue sources. This is also the case across Anglophone Africa. The result of this mismatching of functions and finances – usually referred to as *vertical imbalances* – is that local governments are generally dependent on transfers from higher levels of government (Bird 2010; Boadway and Shah 2009; Boex and Martinez-Vazquez 2006; Bird and Smart 2002). In addition, differences in local revenue bases and administrative capacities may create problems of equalization (*horizontal imbalance)* between local government authorities, in particular between rural and urban areas. The presence of such imbalances means that one cannot design an appropriate system of local government taxation without simultaneously designing an appropriate system of intergovernmental transfers (Bird 2010: 1).

There are a number of methods to close the fiscal imbalances of sub-national governments, some of which also reduce imbalances between jurisdictions (Ahmad 1997: 6). In practice, transfers may be in the form of surcharges or revenue sharing whereby a local government receives a share of the revenues from particular taxes collected by the central government within its jurisdiction (McLure 1999: 12). The main mechanism for intergovernmental transfers in Anglophone Africa, however, is

conditional and/or unconditional grants from central to local governments (Box 1).[3] There are commonly four such funding flows from the central to local government (Fjeldstad *et al.* 2010a):

- Recurrent block grants: personal emoluments (PE) component
- Recurrent block grants: other charges (OC) component
- Recurrent subventions and basket funds
- Development (investment) grants and development funds

Of these, the recurrent block grant system generally provides major funding for LGAs. In Tanzania, for instance, it supplied 65% of all local government funds in fiscal year 2006/07, of which the PE component constitute the lion's share while the OC component accounted for less than 25% of the recurrent block grant allocations.

BOX 1: INTERGOVERNMENTAL TRANSFERS IN SOUTH AFRICA

The equitable division of revenue raised nationally among the national, provincial and local spheres of government is a principle laid down in the South African Constitution. Intergovernmental transfers are therefore an important instrument within the South African fiscal system. The national revenue, less a contingency reserve and interest payments on state debts, is divided between the three spheres of government (vertical division).

Vertical transfers from the national sphere are mainly carried out via two instruments: unconditional shares and conditional grants. The *Division of Revenue Act* annually allocates national revenue to the different levels of government (including projections concerning the following two years to assure a certain degree of stability).

The decision on the allocation is based on previous consultations with provincial governments and organised local government as well as on the recommendations of the Financial and Fiscal Commission (www.ffc.co.za/). A baseline allocation, reflecting the three year allocations from the last budget, is used as a starting point for consultations.

The Constitution provides that a nonpartisan Financial and Fiscal Commission (FFC) should advise parliament and subnational governments on a variety of issues in intergovernmental fiscal relations. These include taxing powers, the allocation of revenue between tiers of government, the grants system and borrowing powers.

Source: Chitembo (2009) based on Derichs and Einfeldt (2006)

Several countries have adopted a formula-based recurrent grant system to determine block grant ceilings for priority sectors, including primary education, healthcare, rural water supply, agricultural extension services and local road maintenance (ibid). The formula-based system designed for allocating grants to LGAs commonly has the following factors: (i) size of population; (ii) number of school aged children; (iii) poverty count; (iv) infant mortality rate; and (v) distance from council headquarters to service outlets as proxy for land area. In Uganda, for instance, the Constitution establishes a formula for determining the minimum unconditional grant paid to local governments to

[3] See Ahmad (1997) for a more detailed discussion of intergovernmental fiscal transfers. Ajam (2001) provides a detailed presentation of intergovernmental fiscal relations in South Africa. Boex (2003) and Boex and Martinez-Vazquez (2006) examine the formula-based grant system applied in Tanzania.

run decentralized services (see Box 2). Besides the unconditional grant, local governments receive conditional and equalization grants (Mugabi 2004: 3; Steffensen and Tidemand 2004).

BOX 2: UNCONDITIONAL GRANTS TO LOCAL GOVERNMENTS IN GHANA AND UGANDA

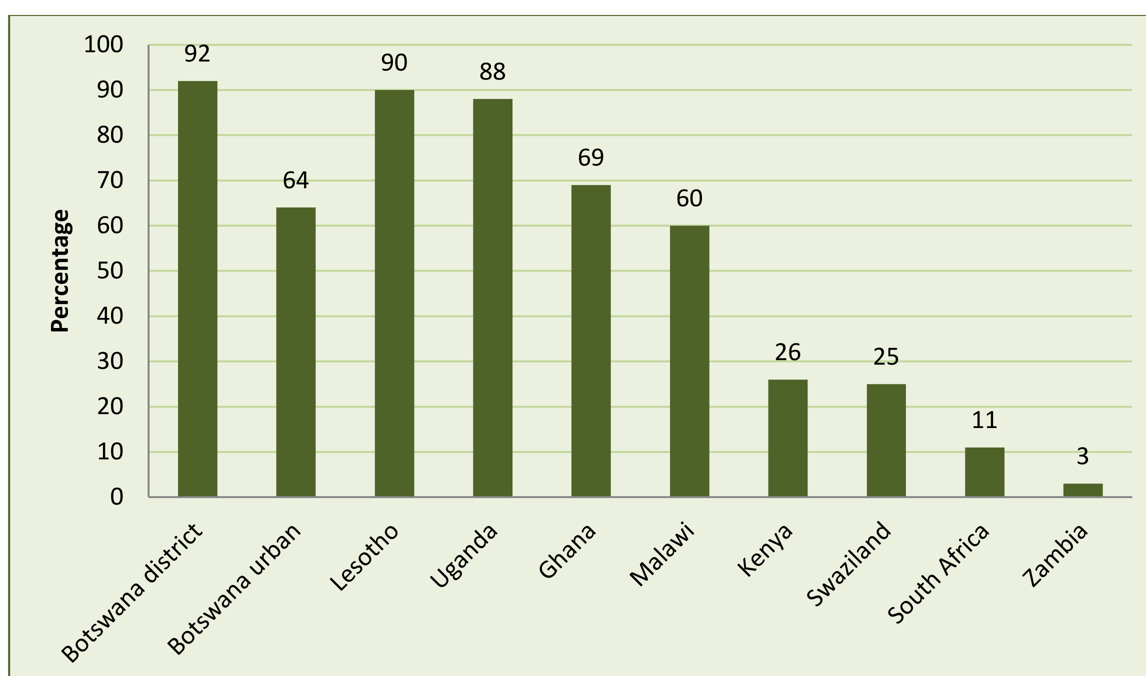
Ghana uses a system where no less than 5% of the total revenues collected by the central government are allocated to a 'Common Fund' for the disposal of sub-national governments.

In Uganda, unconditional grants are determined annually with reference to the reassignment of tasks between the national and sub-national governments. According to the Ugandan Constitution, the total amount is calculated using a formula that includes the unconditional grant of the previous year, corrected by the increase in the general price level, plus the net change in the budgeted costs of running newly devolved or subtracted services. Thus, the Ugandan formula takes into account the actual devolution of functions and its budgetary implications.

Source: Brosio (2000) and Mugabi (2004).

The level of intergovernmental transfers varies widely between countries and also between rural and urban councils within individual countries in East and Southern Africa (Chitembo 2009). Figure 1 illustrates the share of total local government revenues that stems from central government grants. In Botswana, for instance, rural councils receive 92% of their total revenues from the central level, compared to 62% for urban areas. In Uganda, local governments are heavily dependent on transfers from the central government (on average, 88% of total revenues in 2007), while local governments in South Africa, on average, generate the bulk of the revenues from 'own' sources (89% in 2007).

Figure 1: Intergovernmental transfers in percent of total local revenues in some East and Southern African countries (2007)



Source: Adapted from Chitembo (2009:11) citing Commonwealth Handbook 2007.

Transfers and grants also constitute the biggest share of total receipts to the local councils in Anglophone West-Africa. According to Jibao (2009: 43), local councils in Nigeria received on

average almost 78% of their revenue from transfers, in Sierra Leone they received 74% of their revenue from transfers, in Ghana 69%, and in The Gambia 65%. In Liberia local councils rely 100% on transfers from the central government since revenue collection is centralised.

In the process of fiscal decentralization it is important to be aware of the risks for macroeconomic management and fiscal discipline. Substantial devolution of revenues and spending responsibilities to sub-national jurisdictions can affect the central government's ability to carry out stabilization and macroeconomic adjustment through the budget. The destabilizing potential of sub-national governments is greatest when they face no hard budget constraint (Bird 2010; World Bank 2000; Ter-Minassian 1999). Expectations of bail out in case of financial trouble weaken the incentives to economise on costs, and may generate resource waste and rigidity within local authorities. These inefficiencies, in turn, may spill over into macroeconomic imbalances. In particular, concern for macroeconomic imbalance lies behind the common recommendation that strict limits should be imposed on the borrowing ability of sub-national jurisdictions (Bird and Vaillancourt 1998). It is feared that sub-national governments that are highly dependent on national transfers may increase their current expenditures above their capacity to fund them out of current revenues and then close the gap through borrowing. Thus, in Kenya the government has conditioned local government access to the Local Authorities Transfer Fund (LATF) on progressive debt reduction (Yatta and Vaillancourt 2010: 44).[4]

A common pattern is that this dependency on central government transfers affects the local councils' potential to implement their development plans. The transfers are often highly volatile and delayed. In Tanzania, for instance, the national guidelines and budget ceilings, including information on grants, developed by the Ministry of Finance are often not received by the local government authorities until very late in the budgeting process (Fjeldstad *et al* 2010b). Consequently, to initiate the planning process, some LGAs use indicative budget figures from the previous fiscal year. Jibao (2009) reports that there are cases when District Assemblies in Ghana receive their first quarter allocation of the Common Fund in the third or fourth quarter of the year, with the rest of the three quarters overlapping into the following fiscal year and so on.

Perverse incentives, such as offering equal lump sum transfers to all local governments regardless of size, create incentives for jurisdictional fragmentation. In Uganda, for instance, new local governments are being constantly created, diluting the capacity of local governments that were only recently empowered (Martinez-Vázques and Smoke 2010b:340).

However, a major challenge in many Anglophone African countries is the implementation of a stable and transparent system of transfers, geared to filling gaps between the assigned spending and revenue-raising responsibilities of lower-level governments (Boadway and Shah 2009; Ter-Minassian 1999). The definition of such a system is far from easy, especially given the need to preserve adequate incentives for tax effort and cost effectiveness in spending by the sub-national governments.

[4] According to Yatta and Vaillancourt (2010), around 980 local governments in Algeria were in deficit in 2007. This number increased to nearly 1,200 in 2008. In Mexico in the mid-1990s provincial borrowing contributed to a situation where some states were defined as 'bankrupt' (Tanzi 2000).

3. Features of local government tax systems

Many local tax systems in Anglophone Africa are characterized by high levels of arbitrariness, coercion and corruption (Bahiigwa *et al.* 2004; Fjeldstad and Therkildsen 2008; Juul 2006; Prichard 2010; Pimhidzai and Fox 2012). Further, a widely found feature is the huge number of revenue instruments used by local authorities (Brosio 2000; Fjeldstad and Semboja 2000). Local governments seem to raise whatever taxes, fees, and charges they are capable of raising, often without worrying excessively about the economic distortions and distribution effects that these instruments may create.

A complicated and non-transparent local government revenue system is costly to administer and it facilitates corruption and mismanagement (Bardhan and Mookherjee 2002). Moreover, many local taxes have a distorting effect on resource allocation decisions, and, thus, an inhibiting effect on the start-up of new enterprises and the achievement of economic growth (Bahiigwa *et al.* 2004; Devas and Kelly 2001; Sander 2003). These effects occur when effective rates vary greatly between different goods that are traded, or when license fees are set too high for start-up small-scale enterprises to survive. In a study of small and medium sized enterprises in Zambia, Misch *et al* (2011) find that the effective tax burden varies substantially between firms. Enterprises face a range of different taxes, fees and licenses, and the types of taxes that firms are subject to differ - not only between sectors, but also between firms within the same sector. Even among marketers in the same municipality the type of fees and levies differ substantially.

In addition, the levels and types of local revenue instruments by themselves can result in the tax burden falling more on the poor than on the relatively better off in local communities. A recent study from Uganda shows that small informal non-farm enterprises pay local taxes in a regressive way (Pimhidzai and Fox 2011). While the majority of the micro enterprises in the Ugandan sample were poor enough to be exempted from the national business taxes (i.e. the small business tax and VAT) they ended up paying a large share of their profits to local authorities - with the poorest paying the highest share of profits. This is mainly due to the basic design of the local revenue system and the way revenues are collected. Thus, a top-down drive toward more tax revenue from this sector through formalisation could be counterproductive, and would increase the vulnerability of this segment of informal enterprises.

Consultations and cooperation between the central government revenue administration and local government authorities are generally limited. In Ghana, for example, national tax officials report that local tax officials sometimes urge citizens to pay local taxes *instead* of national taxes (Prichard 2010). Meanwhile, local officials complain that the national government has monopolized virtually all available tax bases and offers little if any administrative support. This lack of coordination has allowed the emergence of a high degree of arbitrariness and abuse in local tax systems, while little attention is paid to economic efficiency. Due to lack of capacity and poor co-ordination between the central and local government only limited questions are raised at the central level on local governments' tax proposals. Therefore, the local revenue systems often have developed without much interference from the centre. Furthermore, lack of co-ordination between the central and local levels has led to duplication of taxes, and inconsistencies between taxes imposed by local authorities (e.g., high taxes on export crops) and the national government's policy to encourage export production.

Firms often have to negotiate and provide similar information on their operations to several government bodies, imposing high compliance costs on the private sector (Fjeldstad and Heggstad 2011). For instance, in Tanzania the City Service Levy, a major local revenue source in urban councils, is levied as a fixed percentage on the firm's turnover (0.1% of turnover for the bank/financial sector, and 0.3% for the other sectors), requires the same data for tax assessment that the central government tax administration requires for corporate income tax. The duplication of databases also implies higher administrative costs on the public sector.

A recent study of the tax systems in Mozambique, Tanzania and Zambia, finds that local taxation is still a major constraint on the commercialization of smallholder agriculture and formalization of the small and micro enterprises (ibid). Specifically, multiple taxes (including fees and charges) make it difficult to enter new businesses and markets. Levies are perceived as exorbitant, often charged up-front irrespective of the size and type of business (Misch *et al.* 2011). New local taxes, fees and charges are introduced replacing taxes abolished by the government in recent years. This contributes to undermining the legitimacy of the local tax system, encourages tax evasion and delays the formalization of micro- and small scale enterprises. Furthermore, it undermines compliance enhancing initiatives such as community outreach and taxpayer education.

Arbitrariness, corruption and regressivity have made local taxes generally unpopular and ineffective (Prichard 2010). Despite the many comprehensive central government tax reforms during the last two decades, local government revenue systems in sub-Saharan Africa have remained largely unchanged until recently, though with some exceptions. For instance, in 2003/04, Tanzania conducted a comprehensive reform of its local revenue system (see Box 3). The main elements of this reform were (i) abolition of unsatisfactory local revenue instruments, which were costly to collect from administrative and political perspectives (including the poll tax), and (ii) improvements to remaining revenue bases by simplifying rate structures and collection procedures. The Tanzanian reform demonstrates that radical changes of the local revenue system are possible. The longer-term impact of this reform on local government revenues, however, has been reduced fiscal autonomy and increased dependency on central government transfers (Fjeldstad *et al* 2010a).[5] Uganda abolished the similar graduated personal tax in 2005 in response to its growing unpopularity and politicisation, with a similar impact on local revenues (Fjeldstad and Therkildsen 2008).

Generally, a fundamental requirement when redesigning local revenue systems is greater emphasis on the cost-effectiveness of revenue collection, taking into account not only the direct costs of revenue administration, but also the overall costs to the economy, including the compliance costs to taxpayers. In addition, losses through corruption and evasion need to be reduced. Clearly, improved revenue administration cannot compensate for bad revenue design. Thus, reforming the revenue structure should precede the reform of revenue administration since there is not much merit in making a bad revenue system work somewhat better.

Nevertheless, surveys in both Tanzania and Uganda indicate that citizens have a general appreciation of the necessity of taxation to support local service provision, but chose non-compliance due to lack of confidence in local government (Bahiigwa *et al.* 2004; Fjeldstad *et al.* 2009a). Moreover, studies from Tanzania suggest that peoples' views on local taxation may change over time with implications for policy design. Based on survey data from 2003 and 2006, Fjeldstad *et al* (2009a) found that people were much more positive towards the tax system in 2006 compared to three years earlier. This, the authors' suggest, was partly due to improvements in service delivery, particularly education, health, and law and order, and partly due to reforms which led to less oppressive revenue collection. Corruption, however, was perceived by citizens to be a major problem in both surveys, with implications for their trust in government and government officials and, thus, their willingness to pay

[5] For instance, a sample of rural councils in Tanzania generated on average only 2% of total revenues in 2005 (after the reform) from own sources, compared to 13% in 2002 (before the reform). This drop in own revenue generation is partly due to the abolishment of many local revenue sources in 2003, including the head tax 'development levy', and partly due to the sharp increase in central government grants to local government authorities. The larger Ilala Municipal Council and Mwanza City Council also experienced a drop in their own contributions to total revenues, partly due to the abolishment of business licenses in 2004. Ilala MC generated 45% of its total revenues in 2005 compared to 64% in 2002, while Mwanza CC saw a reduction from 48% in 2002 to 22% in 2005 (Fjeldstad *et al* 2010a). Business licenses were reintroduced in 2011.

taxes and fees. There was also an increasing demand by citizens for more information on revenues collected and how the revenues are spent.

BOX 3: REFORMING THE LOCAL GOVERNMENT REVENUE SYSTEM IN TANZANIA

Until mid-2003, it was common that local authorities in Tanzania had more than 70 different taxes, fees, and charges. In addition, there were many sub-groups of specific revenue instruments. There were also large variations of the rates imposed by councils on similar revenue bases, which led to smuggling of tradable goods across council borders within the country.

In June 2003, a comprehensive reform of the local government revenue system was carried out. A large number of so-called nuisance taxes, which were costly to administrate and generated limited revenues, were rationalized. Thereafter, in June 2004, local business licenses were abolished based on the argument that they provided disincentives for the development of local enterprises. The Tanzanian reform demonstrates that radical changes of the local revenue system are possible. The longer-term impact of this reform on local government revenues, however, has been reduced fiscal autonomy and increased dependency on central government transfers.

Work initiated by the ministry responsible for local authorities focuses on reforming the current local revenue system and to identifying new revenue options. Among the proposals discussed are reforms of the property tax system and introduction of a unified business tax. As part of this work, business licences were reintroduced in July 2011 (URT 2011: 41). Moreover, many councils have started to explore methods to reduce the financial gap caused by the rationalisation by:

1. outsourcing revenue collection to private collectors to increase revenues from existing sources;
2. reducing costs (for example, by limiting the number of meetings and workshops and by retrenching surplus staff); and
3. imposing more cost-effective spending (for example, on electricity and stationery).

Current attempts for economic diversification may also help to expand the local revenue base in the longer term. Furthermore, co-production of services by councils and local communities is on the rise. For instance, an increasing number of primary schools are maintained and expanded via self-help schemes combined with technical support from the local government authorities.

Source: Fjeldstad et al. (2004).

4. Local government 'own revenue' instruments

As noted above, the local government 'own revenue' systems across Anglophone Africa are often characterized by a huge number of revenue instruments. However, the main sources of 'own revenues' are usually property rates in urban councils, business licenses, market fees and various uses charges, often in the form of surcharges for services provided by or on behalf of the local government authority. Nevertheless, experiences from a number of African countries show that these revenue instruments have serious shortfalls. For instance, property taxes can be very costly to administer (Brosio 2000: 20; McCluskey and Franzsen 2005), and the enforcement of user fees has resulted in widespread resistance to pay from the poorer segments of the urban population in some countries (Fjeldstad 2004; Fjeldstad *et al* 2005). Moreover, complex business licensing systems have proved to be major impediments for the start-up and expansion of especially micro and small enterprises (Devas and Kelly 2001; Sander 2003; Pimhidzai and Fox 2011). However, experiences from other regions shows that when well administered, these revenue instruments can provide substantial and reliable revenues for urban municipalities.

4.1 Property tax

Textbooks on revenue assignments between various levels of government generally argue that few fiscally significant taxes are more appropriate to local administration than property tax. This is due to the fact that real property is visible, immobile, and a clear indicator of one form of wealth. Hence, in principle, property tax is difficult to avoid and, if well administered, it can represent a non-distortional and highly efficient fiscal tool.

Property tax as an annual tax on real property is levied in all Anglophone countries in Africa except in the Seychelles (McCluskey and Franzsen 2005). Commonly it is a local government tax, levied mainly in urban areas (Table 1). Only in Liberia the property tax is a national tax. Rural properties are often not taxed, although property taxation is being extended to rural properties in South Africa under the terms of the *Local Government: Municipal Property Rates Act 6 of 2004* (Franzsen 2007: 12). Namibia introduced a land tax on commercial farmers in 2004 as a measure to fund a land reform program.

‘

Table 1: Types of property tax in Anglophone Africa

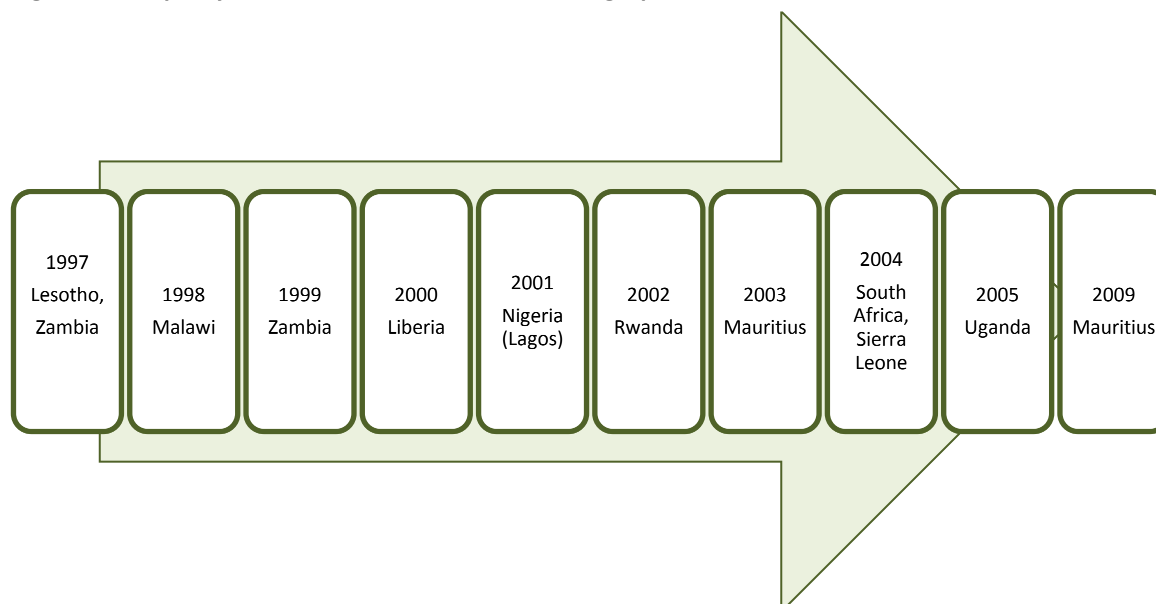
	Property transfer tax	Urban property tax	Value added tax	Rural property tax
Namibia	Yes	Yes	Yes	Yes
South Africa	Yes	Yes	Yes	Yes
Kenya	Yes	Yes	Yes	In principle
Mauritius	Yes	Yes	Yes	
Nigeria	Yes	Yes	Yes	
Botswana	Yes	Yes	Yes	
Ghana	Yes	Yes	Yes	
Lesotho	Yes	Yes	Yes	
Malawi	Yes	Yes	Yes	
Sierra Leone	Yes	Yes	Yes	
Tanzania	Yes	Yes	Yes	
Uganda	Yes	Yes	Yes	
Zambia	Yes	Yes	Yes	
The Gambia	Yes	Yes		
Swaziland	Yes	Yes		
Seychelles	Yes			

Note: ‘Yes’ indicates that property taxes are in place, while the empty boxes indicate that the tax is not levied in the respective country.

Source: Franzsen (2007:10).

Property tax reforms have taken place in most Anglophone African countries for more than a decade. Figure 2 gives an overview of when property tax reforms were initiated in selected countries since 1997.

Figure 2: Property tax reform in a selection of Anglophone African countries



Source: Franzsen and Youngman (2009:10).

Property tax revenue accounts for less than 0.5% of GDP in many African countries. In the 1990s, property taxes accounted for 40% of all sub-national taxes in developing countries (Bird and Slack 2002: 6), but less in most African countries. For instance, property tax accounted for 10–30% of 'own' revenues in urban councils in Tanzania (Fjeldstad *et al.* 2004), and around 20% in metropolitan councils in South Africa (Bahl and Smoke 2003). In Ghana property tax accounts for about 14% of the total revenues of local assemblies, an average of 6.1% in local councils in Sierra Leone, and less than 10% in The Gambia (average for the period 2006 -2008). In Liberia, where local councils are not allowed to collect revenue, property tax accounts for about 1% of total revenues of the central government (Jibao 2009).

Why is property tax not more heavily exploited as a local revenue source in Africa? There are a number of constraints that can explain why (Bell and Bowman, 2006): (a) With the exceptions of Botswana, Namibia and South Africa, property markets are not well developed; (b) property registers and valuation rolls are often outdated or not in place; (c) administrative capacity and equipment are often limited; (d) the tax base is generally narrowed by extensive legal exemptions; and (e) lack of political support to enforce the property tax and political interference in revenue collection. Mikesell (2002: 22) argues that the reasons are considerably more political than economic (see Box 4). First, the difficulty and cost of administering an equitable property tax is exaggerated by those more familiar with income and consumption taxes than with property taxation. Second, in many countries, the property tax has powerful political enemies. The tax strikes people with wealth accumulations quite directly, the real properties to be taxed are obvious to all, and the levy itself is visible. People with considerable property wealth usually have considerable political power and use that power to thwart taxes that aim directly at their holdings. As Burgess and Stern (1993: 802) suggest, low utilization of property and land taxation "reflects the success of the resistance of the rich and powerful to measures which harm their interests." The result is that taxes are paid on a base that often bears little resemblance to the true level of property values (Franzsen, 2007: 8-9).

BOX 4: PROPERTY TAXATION AND POLITICAL ENGAGEMENT IN KENYA

During the 1980s members of the Karen and Langata District Association (KLDA) in Kenya became increasingly frustrated with high municipal property taxes and the absence of effective service provision and fiscal transparency. In response the KLDA went to court to demand that the city council improved transparency before collecting additional taxes. The KLDA won the case, though the City Council refused to comply. Consequently, property taxes were placed by KLDA-members into an untouched bank account for over a decade.

In recent years the KLDA has offered to release the funds if the City Council will grant them greater control over local planning and public spending. Although the lack of progress is discouraging, there is some hope that the initial tax conflict may lead to a more constructive partnership between the district association and the government.

Source: Prichard (2010: 40).

When local governments administer the tax, they are responsible for maintaining property and ownership records, determining taxable property values, calculating and distributing property tax bills, managing receipt payment, and applying tax enforcement against non-payers (Mikesell 2002: 22). In other cases, local governments have a say in the choice of the tax rate, while the administration of the tax are performed by the national revenue authority. In some countries, for instance in Malawi, property valuation is done by the central government, while local authorities set rates and handle collection (ibid: 28). West African French-speaking countries in general rely on the traditional French model, in which the property tax is designed and administered by the central government, whereas Anglophone African countries, with the exception of Liberia, rely on local administration (Brosio 2000; Jibao 2009). This is usually recommended in the literature that stresses that taxes should be administered by the government that is entitled to their revenue. However, mixed results prevail in both Anglophone and Francophone Africa.

Property value is the most common form of property tax in all Anglophone countries, even though their capacity to implement accurate valuation practices often is modest. Availability of relevant property registers and data is generally limited, except in South Africa. Valuation rolls, if they exist, are normally out of date. Lack of qualified valuers to prepare or maintain valuation rolls is also a challenge, again with South Africa as an exception (Franzsen 2007). Efforts to address these shortfalls are reflected in a noticeable move away from relying on central government valuation offices to prepare valuation rolls (e.g. in Lesotho, Malawi, Mauritius, Swaziland, South Africa, Uganda, and Zambia). Some countries, for instance South Africa and Uganda, have introduced ‘mass valuation’ as an alternative to discrete valuations of individual properties or are considering this (e.g. Kenya). However, external quality control with regard to valuation rolls is practically non-existent. Only the new South African legislation provides for ministerial oversight regarding the effectiveness, consistency, uniformity, and application of municipal valuations.

Most countries apply different tax rates to different types of property (Franzsen 2007). Rates are generally determined annually (e.g. Botswana, Namibia, South Africa, and Swaziland), but in some instances are fixed by central government or municipal by-laws for a determined or undetermined period so rates may remain static for years (e.g., Ghana and Tanzania). Where differential rates apply, the tax rates for residential properties tend to be significantly lower than the rates for commercial, industrial, and government properties, where these are taxable (e.g., Lesotho, Swaziland and Zambia).

BOX 5: THE PROPERTY TAX BASE IN ANGLOPHONE WEST-AFRICA

In Sierra Leone, property tax (known as City Rate in Freetown and Town Rate in other urban towns) is levied on buildings whether occupied or unoccupied. Although the tax base includes government buildings (whether owned or occupied), government has not been paying property tax over the years for buildings it owns. Ideally, councils agree not to levy tax on Government owned buildings in return for councils not having to pay whatever they may owe to the central government.

In Ghana, property tax is levied on premises comprising buildings or structures or similar development (Local Government Act 1993). Vacant lands do not attract tax. However, with effect from January 2008, different (flat) rates are assigned to undeveloped plots located in different areas in the Accra Metropolitan.

In The Gambia, property tax (known as Compound Rate) is levied on premises which include: any building together with all lands occupied therewith which is a distinct or separate holding or tenancy; any land whether developed or underdeveloped; or any wharf pier or ramp (Section 2, General Rate Act 1992). The rates are levied on the basis of an assessment in respect of the capital value of property in the rating areas.

Source: Jibao (2009).

There is generally a distinction between imposing tax on land or buildings. Since land in many African countries is owned by the state, often only buildings are included in the property tax base. This applies to Tanzania, Ghana, Mozambique and Sierra Leone. Kenya is the only African country with a land value tax, while South Africa has a uniform, capital value tax. Nigeria is unique by having formally delegated the authority for property tax legislation to the 36 state governments, leaving the various areas in Nigeria with different approaches to estimating property tax (Franzsen and Youngman, 2009:12). The property tax base in some countries in Anglophone West Africa is summarised in Box 5.

In theory, assessment of property value and revenue collection are straightforward: conduct a cadastral survey that assesses the market or site value of each plot of land or property, and send a tax bill to each owner. In practice, however, cadastral surveys are expensive and time-consuming (Bahl *et al.* 2003: 79). The task is often beyond the financial and technical capability of many local governments (see Box 6). Tax offices in many sub-Saharan African countries, except in South Africa, are short on assessors, if they have any at all (Farvacque-Vitkovic and Godin 1998). In Uganda, for instance, there were eleven certified land and property valuators responsible for valuing three million parcels in 2002 (McCluskey *et al.* 2003). The corresponding figures for Tanzania were approximately 100 certified valuators and five million parcels. Thus, it is difficult to conduct and maintain assessments, which commonly also are eroded by inflation. Particularly when property prices are changing rapidly, it is difficult to administer. Accordingly, the property tax base is inelastic, despite growth in the physical size or value of property, because old valuations are not updated and new properties not identified. In most cases, the system has been inherited from the colonial era and is poorly suited to present conditions.

BOX 6: DEFICIENT PROPERTY TAX ADMINISTRATION IN KAMPALA

The seriously deficient administration of the property tax in Uganda exemplifies the difficulties this tax has in providing substantial revenues to local governments in Africa. Although any local authority has the legal right to levy property taxes, in practice they are levied only by municipalities and town councils. Undeveloped land is not taxed, which inhibits the efficient use thereof.

The property tax is based on seriously outdated valuations, which are very low, although the law requires that valuations be carried out every five years. Many valuable properties are not taxed at all, and many newly refurbished buildings have not been re-valued. Systems of recording and valuing properties are seriously deficient. This is partly because the skilled technical staff needed to organize and supervise valuation work is in short supply.

The city of Kampala also shows a phenomenon that is taking place in many other metropolitan areas in Africa. Its urbanized area has expanded beyond its municipal boundaries, but neighbouring districts are either not allowed to levy property tax on residential properties, or abstain from doing so because they still have to provide the basic urban services to these areas. Low revenue is also attributable to poor collections, huge delays in payments, or simply to non-payments. Non-payments also derive from the high mobility of persons, frequent property sales/exchanges, and the inadequate registration of titles.

Source: McCluskey et al. (2003).

Property registers and valuation rolls (cadastral systems) may work in areas with regular street patterns, named streets, and numbered houses. In the absence of street addresses, tax bills are not deliverable, and penalties are unenforceable. Although revenue collection may also prove to be problematic in areas where the property matrix is in place, the absence or scarcity of clear ownership titles is a serious challenge facing this form of taxation. Collection is often poor and many bills go unpaid because taxpayers are not identified or they resist payment because their housing conditions are too poor or urban basic services are not provided to their areas. In principle, non-compliance of property tax can be enforced by confiscation and sale of the owner's personal effects in the building initially, and ultimately through the collateral of the real estate itself. However, experience shows that courts are often swamped by appeals from angry property owners and landowners (Skinner 1993: 364). Moreover, harsh enforcement mechanisms may result in intervention from politicians facing complaints from their constituents (Enemuo 2000: 193). Thus, high administrative and political costs are the crucial problems of property taxation.

Expert opinion diverges on how to improve property taxation in developing countries.[6] Some blame the excessive centralization of property tax policy, which bars setting higher tax rates. Others blame what they consider the almost total anarchy deriving from local government freedom in this field. There is also dispute over tax administration. Certainly, property taxes have many attractions as local bases, but they also have obvious weaknesses that need to be taken into consideration before heavy reliance is placed on them. Often the capability and capacity of the municipality are inadequate to administrate the property tax at a low cost (McCluskey *et al.* 2003: 23). As noted above, these administrative weaknesses are manifested in problems of valuation and arbitrariness in tax assessment and enforcement.

[6] Dillinger (1991) provides an insightful summary of these challenges, which still is valid.

Foreign donors have funded many projects aiming to reform the property tax system and build local administrative capacity, but with mixed results. However, if property tax is to play a greater role in municipal finances it is required that administrative and technical features of the system do not become obstacles. Hence, technical assistance should prioritize appropriate training of property valuators and to upgrade relevant skills of municipal staff. Moreover, current legislation is often a major obstacle in many countries (for example, in Tanzania and Uganda) and need to be revised (McCluskey *et al.* 2003). The *Municipal Property Rates Act of 2004* in South Africa shows that it is feasible to address some of these problems by stipulating nationally uniform mechanisms of assessment and a monitoring process to ensure assessment quality. Clearly, property tax has to be simplified to adapt it to the reality of many African countries. Ambitious cadastral projects were undertaken in the 1980s, but many of them failed or were abandoned halfway as in Cameroon, Mali, and Senegal. Today, advisors therefore recommend the use of very simple parametric methods for the evaluation of property values. Parameters could include the number of rooms, the quality of the building materials, and the area of the city where the building is located. Such parameters are transparent and, in general, easy to apply. Such methods have been used in a number of countries (also in Western Europe) with satisfactory results. Administration could be left local, but the legal framework should be centrally provided. Nevertheless, research undertaken by the Africa Tax Institute[7] argues that many African countries face major challenges if the property tax is to provide a reliable and adequate source of revenue for municipalities. In some countries even the rationality and administrative feasibility of property tax policies and current legislation must be questioned.

4.2 Business licenses

In Anglophone Africa, the standard mechanisms for mobilizing revenues from businesses have been through licensing. Although the original intent was regulatory, local business licensing has increasingly become simply a revenue source in most places. Typically, business licences generate between 5% and 30% of local government own revenues in urban councils. In many countries, however, the system has been quite unsatisfactory, often quite inequitable, and has imposed huge costs on business, while generating relatively little money. In Uganda, for instance, a common complaint from small and medium-sized enterprises has been that 'they do not know what to pay, where and to whom'. The regulatory aspects of the licence system have been largely abandoned. In addition, poor policy design and weak administration mean that licence coverage, assessment, collection, and enforcement rates are low, leading to poor revenue generation.

Local business taxes are generally levied in one of two ways (Devas and Kelly 2001: 384): (a) either as a fixed amount, which usually varies by type, size, or location of the business, or (b) as a percentage of turnover or profits. Assessing turnover or profitability, however, is difficult both in relation to small businesses, which often do not maintain proper records, and to large businesses with multiple premises across various jurisdictions. Thus, local business taxes often use proxies for turnover or profitability, such as the size of premises, type of business, number of employees, installed electricity power, etc.

Obtaining a licence typically involve multiple visits to various offices, sometimes over several days, with associated travel costs. Failure to provide the correct licence receipts may result in closure of the premises. Consequently, the system is often riddled with rent seeking and corruption. Moreover, poor administration often means that many businesses are not included in the licence system due to lack of proper business registers (Arajou-Bonjean and Chambas 2003; Brun *et al* 2012). Furthermore, weak financial management will often imply that collection and enforcement provisions are rarely enforced. This erodes the tax base and introduces inequities into the system. Thus, many existing business licence systems across Africa contain serious defects. These include (Devas and Kelly 2001: 385):

[7] Africa Tax Institute web page: www.ATI.up.ac.za [last accessed 15.09.2012]

- high compliance costs to businesses, due to multiple licensing and complex procedures;
- tariff structures that are complicated and do not reflect ability to pay;
- a process loaded with ineffective regulatory requirements, which provide opportunities for rent seeking;
- poor administration and evasion, which reduce the tax base and generate inequities; and
- a revenue source that generates relatively little income for local governments.

Several African countries have reformed (Kenya, Tanzania and Uganda) or are in the process of reforming their local business licence systems, to make them simpler, more transparent, and effective (Sander 2003; URT 2005; USAID 2005).[8] The main objectives of these reforms are to (a) enable local authorities to collect significantly more revenues, and (b) to reduce the compliance burden on the businesses. In the late 1990s, Kenya pioneered a single business permit (SBP) system, which has since become a model for other countries in the region (see Box 7).

The Kenyan SBP system was introduced on an optional basis in 1999, with all the local authorities being required to adopt it from January 2000. According to Devas and Kelly (2001: 387), the initial reports were positive. However, a major problem experienced during implementation was the lack of effective dialogue and communication with the local business community in the early stages, leading to misunderstandings and some initial resistance to the reform. Moreover, some local authorities chose inappropriate tariff sets – usually too high. This led to tax resistance from local traders. There were also cases of business misclassification (that is, over-assessment) leading to calls for improved administration, transparency, and accountability (Devas and Kelly 2001). On the positive side, however, most local governments experienced substantial increases in revenues – some councils more than doubled their revenue from this source in one year. In some cases, this was due to improvements in coverage of the revenue base, but in most cases the increase was due to choosing higher tariff sets (ibid.: 388).

[8] Business licenses were abolished in Tanzania in 2004. Before the abolishment, business licenses accounted for between 20% and 30% of the total 'own' revenue in municipalities (Fjeldstad *et al* 2010a). In 2011, the Government reintroduced business licenses as a local government revenue base (URT 2011).

BOX 7: THE SINGLE BUSINESS PERMIT (SBP) IN KENYA

The Kenyan business license reform has the following components:

1. Local business licensing is decoupled from regulatory requirements, since these are usually ineffective and create opportunities for rent seeking.

2. All economic activities within the local jurisdiction are, in principle, included in the base. The law was amended to broaden the base to include all businesses and trades, including professionals such as lawyers, doctors, and private consultants. This aimed to widen the revenue base and to improve equity, while at the same time minimizing the economic distortions of the license system. To avoid double taxation, the central government abolished its registration fees on professionals.

3. Businesses are only required to have one business permit per premise regardless of the range of activities carried out there, hence the name Single Business Permit (SBP).

4. Local authorities are required to establish 'one-stop-shops', at which permits will be issued on the spot in exchange for the appropriate fee. The philosophy is a more customer-oriented approach to business licensing.

5. A standardized rate structure is established. Businesses are classified into eight sectors, which are subdivided into broad categories reflecting the scale of profitability of the business. These size categories are based on easily identifiable and objective criteria. The system is based on self-declaration, but with the opportunity for official checking.

6. The tariff structure is designed to be progressive, with smaller businesses paying less than larger ones. The system provides a standard tariff structure for all local authorities, but still allows local government discretion over the actual tariff rates.

7. Measures are taken to improve the local administration of the system. This includes the design of simplified SBP registration forms. Training is provided to encourage local authorities to work with the local business community in choosing the SBP tariff schedule.

Source: Devas and Kelly (2001).

In both Kenya and Uganda, the time required to obtain business permits has been substantially reduced due to the introduction of one-stop-kiosks (Box 8). This has cut the compliance costs of the enterprises, though not necessarily the total costs since the tariffs have been raised. In general, however, collection performance remains a problem and there is a need for improved financial management. However, the early evidence is fairly positive (Gamser 2003). The new system seems to enable local authorities to enhance revenues. At the same time, compliance costs on businesses are lowered and the opportunities for rent seeking and corruption are reduced.

BOX 8: STREAMLINING BUSINESS REGISTRATION IN ENTEBBE MUNICIPALITY, UGANDA

Until recently, the business registration and licensing system in Uganda was very complicated and time-consuming. On average, it took 36 days to register a business. Hence, many small and micro-enterprises avoided the registration process and remained informal.

A one-stop simplified business registration and licensing system was piloted in Entebbe in 2002–2003. The results of the pilot include:

- The licensing process became cheaper and shorter. Overall, the compliance costs for enterprises were reduced by 75% (for example, registration time was reduced to 30 minutes).
- Compliance levels for registration improved by 43%.
- Total revenue collection increased by 40%.
- Administrative costs for the council were reduced. Administrative savings were 25% in staff time and 10% in financial resources.
- There were reduced opportunities for bribery.
- Relations between local authority staff and businesses were improved.

Source: Sander (2003).

In Francophone Africa, local governments levy a tax called the *Patente*, which was originally based on the French *Taxe Professionelle* (Devas and Kelly 2001). In Cote D'Ivoire, the *Patente* was the largest single local revenue source in the 1990s, financing about 17% of the local government budget, and more in the commercial capital Abidjan. The calculation of this tax, however, is quite complex, involving the value of the premises, number of employees, turnover, machinery employed, installed energy capacity, and other size proxies. Moreover, within this formula, rental value of premises is by far the largest factor, so that the tax starts to resemble a property tax.

Atypical for Anglophone Africa, urban councils in Tanzania levy a local business tax named 'City Service Levy'. The City Service Levy (CSL) is levied as a fixed percentage on the firm's turnover (0.1% of turnover for the bank/financial sector, and 0.3% for the other sectors). It is a major local tax in municipalities. For instance, in Ilala Municipality, Dar es Salaam, the CSL generated in 2006/07 more than 47% of the total revenues from the municipal's own sources (Fjeldstad *et al* 2010a). For the large VAT-registered taxpayers, CSL-billing is levied quarterly, while it is paid annually for the majority of small taxpayers who are not registered for VAT (URT 2003: 34). The amount billed is in essence a provisional tax based on 30% of the firm's presumed annual turnover. Monitoring the turnover of large numbers of small businesses has proved to be costly and time-consuming. This also applies to data collection and maintenance of tax registers. Information sharing and professional working relations between the municipalities and relevant central government bodies for the purposes of the CSL are only utilised to a limited extent. Hence, on various occasions the issue has been raised whether CSL should rather be collected as part of Corporate Income Tax by the central government's tax agency, the Tanzania Revenue Authority (TRA). However, municipalities have expressed concern that if the City Service Levy is to be collected by the TRA, central government may too easily retain the revenue or merely seize taxing powers for this source of revenue (ibid: 35).

4.3 User fees – linking payment and service delivery

Taxes are not the best mechanism for matching demand and supply of public services. Better links can be achieved through cost-recovery charging systems, which tie the amount paid directly to the amount

consumed. By providing a more direct link between citizens' contributions and service delivery, such mechanisms may become effective means to recover the costs of service provision, and to promote efficiency in the consumption of the service. Hence, most observers argue that user fees should play a prominent role in local government finance (Bahl *et al*. 2003: 76; Bird 2001).

The main economic rationale for user charges is not to produce revenue, but to encourage the efficient use of resources within the public sector. When properly designed, user charges provide information to public sector suppliers on how much clients are willing to pay for particular services and by ensuring that the public sector supplies are valued by citizens. Free or subsidized services may result in over-consumption of such services. Moreover, it may prove difficult to target the beneficiaries of free services (Box 9). Yet, experiences from several countries, including Namibia and South Africa, show that user charges can impose a heavy burden on lower-income service users, and exclude the poorer segments of the urban population for the services (Fjeldstad *et al* 2005; McDonald and Pape 2002). Adjustments can, however, be made to offset such effects. For instance, user charges can also reflect differences in ability to pay by incorporating sliding scales for the type of user or the amount of usage (Rondinelli *et al.* 1989: 71), although this will require adequate administrative capacity.

BOX 9: FREE SERVICES TO THE POOR IN SOUTH AFRICA

Improved service delivery to the poor is a priority for most African governments. In South Africa, for instance, the two pillars of this policy are to enable local governments to:

- make basic municipal services accessible to all citizens, and
- provide free basic services for poor citizens who cannot pay.

The challenge with respect to service delivery is foremost to ensure that poor households are the primary beneficiaries of the free services policy and associated resources. Since July 2001, every municipality in South Africa is supposed to provide at least the minimum free 'lifeline' supply to households of 6000 litres of water and 50kW of electricity per month.

Some observers have raised concerns with the manner in which this 'lifeline' policy has been designed and implemented. Firstly, it is argued that the quantity of the free services provided is too small. Secondly, since households are not means tested to see if they qualify for the free services, some middle- and upper-income households are benefiting more from the provision than poor households. Finally, there is the problem of delivering free services across the country, particularly in rural area. Therefore, many municipalities have developed indigent registers to ensure that free basic services are provided to the poor.

Source: Fjeldstad (2004).

User charges for 'trading services', including water, electricity, sewage, and solid waste removal, are major sources of revenue in urban municipalities in Southern Africa, especially in Namibia and South Africa (Fjeldstad *et al* 2005; Bahl and Smoke 2003). In particular, service charges on water and electricity supply are important. This revenue is generated by a surcharge added to the cost of the utilities that the local authorities typically buy from the utility companies, or, if the authority itself produces the utility, added to the cost of producing it.

According to Bahl *et al* (2003: 77), around a quarter of the electricity-distributing authorities in South Africa raise substantial revenues from the surpluses earned from their sales. A large share of these revenues is used to cover the cost of providing the service. However, in some municipalities a substantial surplus is left for general local government purposes. Hence, the tax component of the user fee is hidden for ratepayers, and the 'true level' of local government taxation is not transparent for

citizens. The accountability capability of the local revenue system is therefore undermined. Moreover, since the consumer price of the service (for example, electricity) is overstated by the amount of the implicit tax, this may have negative impacts on economic efficiency.

In Namibia, the majority of town councils are not determining their tariffs in accordance with an approved tariff policy of cost recovery (Fjeldstad *et al* 2005). Hence, several trading services, including water distribution, are operated with significant losses in a number of local authorities. This is also the situation for around a quarter of the municipalities in South Africa (Bahl and Smoke 2003). The situation is worsened by an increasing number of outstanding debtors in many local authorities, that is, consumers who do not pay for basic services due to various reasons, including affordability.

Experiences from South Africa and Namibia show that there are a number of obvious constraints on user charges and other means of cost recovery. These arise from equity considerations (i.e. ability to pay), collection and billing methods (Box 10), the quality of the services provided, and persistent resistance to pay. These lessons point to the fact that dealing with the policy problem of revenue enhancement requires some understanding of the factors underlying the individual's decision whether to pay or evade paying service charges (and taxes).

BOX 10: IMPROVING COMPLIANCE THROUGH SHARED PRIVATE WATER TAPS IN ONDANGWA, NAMIBIA

Residents in the poor informal settlements in Ondangwa Town Council, Northern Namibia, generally prefer a pre-paid water system, since it offers the opportunity to economize water consumption and to control expenses, thus avoiding situations where bills cannot be paid and supplies are cut. However, communal taps frequently break down, often on account of misuse. Repair work is slow, often requiring spare parts that are not available in the country. In January 2004, for instance, Ondangwa Town Council ran twenty-five communal taps with pre-paid cards, of which ten did not work due to damages caused by vandalism. Residents relying on communal taps complained that vandals are usually non-residents.

In order to avoid heavy reliance on unreliable communal taps, residents of the informal settlements have been calling for private taps with the pre-paid system, which by then was only available in the formal settlements. Lacking this option, many residents of the informal settlements instead chose to pool resources and shared a private tap connection, even though it was not pre-paid. In this system, three, four or more households shared one private tap connection, located in and ascribed to one of the participating household. Sharing the bill, that is paying equal shares of the connection fees and the expenses related to water usage, reduced the average costs for each household. More importantly, it decreased the risk of disconnection due to non-payment, since all parties had an interest in keeping the supply running. Members in the arrangement who repeatedly failed to contribute to the water bills were eventually excluded. The concomitant loss of an assured water-source represented an effective regulatory and enforcing mechanism.

Source: Fjeldstad et al (2005).

An increasing amount of evidence suggests that the rate of contribution to a public good is affected by factors such as citizens' trust in others and the trustworthiness of the government (Slemrod 2003). Without trust there is little basis for social co-operation and voluntary compliance with laws and regulations that could potentially benefit everyone. In particular, three dimensions of trust seem to affect citizens' compliance: (1) trust in the local government to use revenues to provide expected services, (2) trust in local governments to establish fair procedures for revenue collection, and (3) trust in other citizens to pay their share. The larger the fraction of the local population that is observed not paying the lower is the perceived risk of being prosecuted. This impact the individual ratepayer's perception of the credibility and trustworthiness of the revenue administration. Moreover, the attitude of local political leaders with respect to payment seems to be important, for example, by legitimizing

non-payment through their own behaviour. This suggests that there are reasons and scope for innovation.

The problems of non-payment should therefore be attacked on several fronts, including service delivery, better administration and payment schemes, and community involvement (Fjeldstad 2004). To achieve this, in-depth knowledge and data are required on payment levels for each ward, the proportion of municipal accounts delivered, the number and type of complaints received, living conditions for the poorest segments of the population, including the elderly and unemployed, etc. Moreover, customer care must show that complaining will bring results. Citizens should be encouraged to report defaults such as leaking taps or streetlights not functioning. The prompt redress of such complaints may help convince people that the municipality means business. Furthermore, citizens' involvement in identifying problems and setting priorities may motivate a greater sense of community involvement. Initially, it might be advisable to link payment directly to visible improvements in services. Finally, the co-operation between local government officials, councillors, and community leaders in setting common goals might be a crucial trust-enhancing device.

5. Local government tax collection practises

Local government authorities commonly experience difficulties in collecting taxes, fees and charges. Thus, there are many experiments being carried out to find solutions to make tax collection more revenue productive. Practices for collection of local taxes range from cases where local government authorities collect the taxes themselves to cases where tax collection is outsourced to private agents, semi-private partners and the central government. Market cooperatives and private companies collecting tax on behalf of the local government are examples.

Some taxes and fees are collected by the government and channelled back to the local government. In Malawi the non-tax revenue is intended to be collected by the central government, before the resources are redistributed to District Assemblies using a formula approved by the Cabinet (Malawi Government 1998). A less typical example is from Tanzania where the collection of property tax in Dar es Salaam is assigned to the Tanzania Revenue Authority (Fjeldstad *et al* 2011).

In Tanzania, collection of a large number of local government revenue sources has been outsourced in recent years (Fjeldstad *et al.* 2009b). They include private collection of property taxes in some urban councils; market fees in both rural and urban councils; forestry levies (until 2005) mainly in rural councils; cess on certain agricultural products in rural councils; bus stand; and parking fees. In Mwanza City Council, for instance, more than one-third of the council's own revenues in 2006 were collected by private agents.

Revenue collection is outsourced to a range of different types of agents within and across councils. Another example from Mwanza City Council shows how the collection of fish market fees was outsourced to a fish dealer organisation and the collection of fees at the central market was contracted to a vegetable cooperative operating in the market. In Kilosa District Council the collection of forest levies (until they were abolished in 2005) was outsourced to a private company whose main activity is to run private schools. Iringa District Council contracted villages to collect revenue from village businesses.

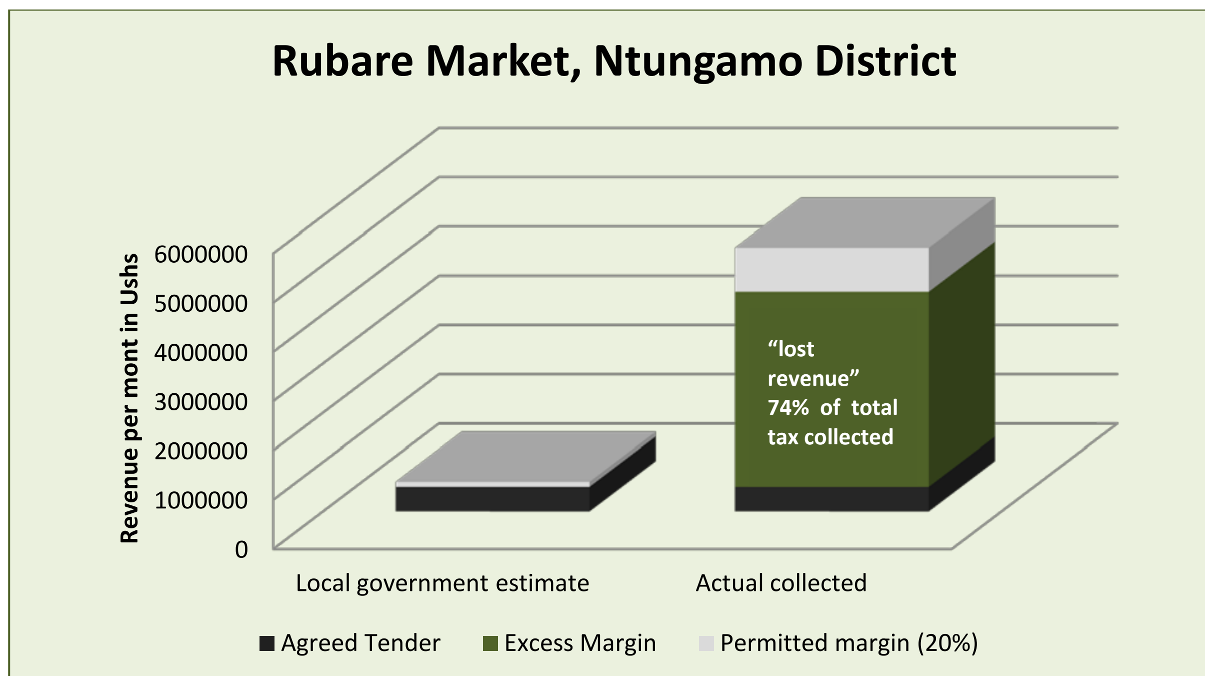
Evidence is inconclusive whether outsourcing has led to better revenue administration performance compared to tax collection remaining a function of local government officials. However, outsourcing can establish a platform from which change can be facilitated, but its initial impact and longer-term successful performance depend on:

- the strength and quality of the management of the local government authority;
- political commitment to support the reform; and
- transparency reflected in the provision of accessible and updated information to the general public on the tendering process and bids received, as well as data on the revenue potential and actual collection (Fjeldstad *et al* 2010a).

A major challenge facing privatised revenue collection in local government authorities is to assess the revenue potential for various tax bases. Commonly, revenue assessment is conducted on an *ad hoc* basis, often based on the previous year's reported collection. Substantial underestimation of the revenue potential may imply that actual collection by the agent is substantially higher than what is reflected in the contract. Consequently, there is a risk of ending up in a situation where the agent keeps the substantial portion of the revenues collected, which already seems to be the case in some councils. In a study from Uganda, Iversen *et al* (2006) found substantial gaps between the local government estimates of the revenue yields from local markets with the actual revenue yield collected by private agents (see Figure 3). In six markets studied, the gaps ('lost revenues') amounted to between 25% and 74% of total revenue collected in each market. Moreover, the actual gross margins realised by private agents caused by this undervaluation of market yields varied between 71% and 970%. Thus, it seems

evident that rather than enhancing local revenue, the private tax collection system in Uganda transfers money from ordinary and often poor rural taxpayers and into the pockets of private tax agents and their various associates. On average, 53% of all revenue collected from vendors in the markets could be interpreted as pure redistributive transfers to members of the local elite.

Figure 3: Rents in tendering contracts for a rural market in Uganda



Source: Iversen et al. (2006: 324).

There are examples suggesting that public officials are more effective as revenue collectors than their private alternatives. For instance, over a two-year period Temeke municipal staff in Dar es Salaam added about 80 000 properties to the municipality's flat tax property register at the cost of less than one US dollar per property. During the same period private consultants who were engaged by the municipality added only 5000 properties at a cost of USD 17 per property (Franzsen 2007:10-11).

6. Concluding remarks and tentative implications for policy

Despite major reforms of the central government tax system during the last two decades, local government tax systems remains largely neglected. This study shows that the local tax systems often are distortive, costly to administer, and exacerbate inequity. Generally, little or no co-ordination with respect to taxation is observed between various levels of government. This has partly to do with lack of capacity at all levels. This has led to double-taxation of the same revenue base, as well as inconsistencies between local and central government tax policies. In some countries some local governments impose high taxes on export crops, inconsistent with the national government's policy to encourage export production. Furthermore, while central government taxes affect only relatively few people directly, local government taxation affects many more. To the extent that state-citizens relations are influenced by taxation, local government taxation is therefore central to a better understanding of state-citizen relations.

While the current potential for most rural councils to raising substantial own revenues is limited, the potential for revenue enhancement in urban councils is better. However, one major administrative problem today for many urban councils in Anglophone Africa is their inability to collect the revenue due to them fully. Particularly in many municipalities, there are huge gaps between reported and projected revenues. This is due to: (1) poor administrative capacity to assess the revenue base; (2) poor administrative capacity to enforce the payment of taxes; (3) explicit and intentional tax evasion and resistance from taxpayers; (4) corruption, including embezzlement of revenues; (5) external pressure on the local finance department to provide optimistic projections; and (6) political pressure on the local tax administration to relax on revenue collection, especially during election periods. In this setting, fundamental issues to be addressed in the context of local government fiscal reforms are to redesign the current revenue structure and to strengthen financial management. In addition, measures are required to enhance taxpayers' compliance and to improve the accountability of revenue collectors and elected councillors. This cannot be achieved without substantial and consistent political support from the central government.

Improved information supplied to the public on budgets and accounts may improve the opportunities for citizens to exercise their voice and demand accountability from local authorities. This is among the lessons we can draw from decentralization reform in Uganda (Reinikka and Svensson 2002). It is, however, important to stress that encouraging citizens and civil society to engage in fiscal and financial monitoring at the local level does not imply that such measures should replace formal auditing and accounting mechanisms. Nor does it imply that such measures will weaken the formal accountability mechanisms. On the contrary, it can strengthen the legitimacy and standing of local government authorities in the communities by contributing with complementary measures to improve the control of revenue collection and expenditures.

A fundamental requirement when further redesigning the local revenue system is greater emphasis on the cost-effectiveness of revenue collection, taking into account not only the direct costs of tax administration, but also the overall costs to the economy, including the compliance costs to the taxpayers. In addition, losses through corruption and tax evasion need to be reduced. To achieve these aims, there is a need further to simplify the business license and fee structures by reducing the number of rates and coverage. Moreover, local taxes and licences should be harmonized with central government tax bases, to avoid double taxation and conflicts with national development policies, such as job creation and private sector development (Pimhidzai and Fox 2011). The experiences from Kenya with the one-stop-shop Single Business Permit systems are promising for future reforms.

More realism is also required when it comes to the implementation of a well-functioning property tax system. An important element of the fiscal decentralization process in many countries has been to give

municipalities the power to value, asses, bill, collect, and enforce property taxes. Property tax has many attractions as a local revenue base since it is imposed on immobile assets and therefore is difficult to avoid – at least in principle. However, it has some obvious weaknesses that need to be taken into consideration before heavy reliance is placed on it. In particular, problems of valuation and tax enforcement often occur due to political interventions and administrative weaknesses. The municipalities' capacity and capability to administer the property tax have in general proved to be inadequate. Hence, it has been difficult for many municipalities across Africa to maintain the current property valuation registers, let alone to continue the property valuation initiatives. It is therefore a need to reassess the basis of the property tax in urban councils and to implement a simpler and more coherent approach to the valuation provision, which takes into consideration administrative capacity and capability constraints facing the urban councils. A pragmatic policy approach is required, which may imply centralization of certain issues, such as management of property titles, valuation assessments, etc.

Local own revenues are a necessary but not a sufficient condition for fiscal decentralisation. In most local government authorities in Africa, local sources are generally not sufficient to develop and supply adequate services for the fast-growing population. The reality is that most local government authorities in Anglophone Africa for a long time will continue to be heavily dependent on fiscal transfers from the central government. Only a few large urban governments located in rich areas are able to finance a substantial share of their total expenditure with their own revenue sources. Transfer systems based upon revenue sharing between the central and sub-national levels of government and grants from the central level should therefore be considered important components of the fiscal decentralization programmes.

7. Issues for further research

Based on the knowledge gaps identified in this study, we will suggest areas for further research on local government taxation in Anglophone Africa. Both technical and political-economy questions are under explored in the literature. Combining research on the technical administrative framework for local taxation with the political and economic realities at the local and central level have the potential to identify constraints and practices that can guide policy work and be used as benchmarks to assess actual policy implementation.

Financial transfers from the central level are typically important components of local government revenues. How does this impact on local government fiscal autonomy, which typically is formulated as a key objective of local tax reforms? A series of research questions related to ***reform*** is therefore suggested for further research:

- How should effective revenue raising systems for sub-national governments be designed and implemented? This issue, and the distinction between urban and rural councils in particular, has received limited attention in the literature.
- What are the actual fees, levies and taxes imposed locally compared to those officially stated in policy documents and in reform plans?
- How do local government revenue reforms affect taxpayers? Should be investigated using time series with surveys immediately after, one year and three years after the reform.

Some research finds that taxpayers perceive local governments to be more trustworthy and accountable than higher levels of government, while other findings point at the frail links between local revenue raising and the responsiveness of African local governments. Existing research is neither conclusive nor extensive. We have therefore identified the following questions addressing ***local government accountability***:

- Is there a connection between local tax payment and service delivery? Is there any evidence on how partnerships (private, public, donor and local government) can result in more effective and sustainable local revenue mobilization?
- Where do we find examples that prove a link between local taxation and expanded responsiveness and accountability?
- Are there good practices from private tax collection concerning taxpayer education, accountability and revenue raising?

An entry point to assess these questions will be through case studies of fiscal reforms in selected municipalities in Africa.

Local government ***own revenues*** primarily come from property tax, business licenses and user fees. Currently the Lincoln Institute of Land Policy and the Africa Tax Institute (ATI) are conducting a comprehensive research programme that aims to collect and systematise data on the present status and future prospects of property-related taxes in all 54 African countries, with a primary focus on land and building taxes and real property transfer taxes. Since the political economy analysis of land and property taxes is not explicitly addressed in this programme, we will explore the possibility to partner with the Lincoln Institute and ATI to conduct complementary research on property taxation. In-depth political economy analysis of business licences may contribute to gain valuable insights on entrepreneurship, incentives and the rights of small business owners. The World Bank's *Doing Business* (2010a, b) reports have some data on this, but they only cover a limited number of countries and provide little background details on the data. Finally, research suggests that citizens will be more willing to pay tax when there is a direct link between payment and service provision (quid-pro-quo).

More research is needed to better understand the earmarking of taxes for specific purposes and whether (and under what conditions) user fees/service charges can become efficient local revenue sources.

Collection methods vary substantially between local government authorities within and across Anglophone Africa. In some countries, e.g. in Tanzania and Uganda, local governments have outsourced revenue collection of some taxes to private agents. Evidence is inconclusive on what collection methods work under what conditions and how local governments best can manage the different collection methods. Some suggestions for further research will focus on private revenue collection:

- Which revenue bases are outsourced and why these?
- Which allowances and incentive systems exist for private collectors?
- What are the revenue trends from different sources after outsourcing compared to the pre-outsourcing period?

Future research should focus on building a more extensive empirical knowledge on the technical, economic and political dimensions of local government taxation. More broadly, the suggestions for further research in this paper focus on the politics of successful tax reform, new insights about taxation and growth, and on the connection between tax governance and state building at the local level. Donors will potentially benefit from the research topics suggested here, by getting policy relevant advice on how to support local government taxation more effectively.

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INDEXING TERMS
Local government
Taxes
User fees
Decentralization
Business licenses
Africa

This paper examines opportunities and constraints facing local revenue mobilization in Anglophone Africa with an emphasis on urban settings. Specific revenue instruments and their effects on economic efficiency, income distribution and accountability are discussed. In particular, political and administrative constraints facing various revenue instruments and factors affecting citizens' compliance behaviour are addressed. The analysis is exemplified by cases from across Anglophone Africa. A general conclusion emerging from the study is that local revenues mobilised in most local government authorities in Africa are necessary but not sufficient to develop and supply adequate services for the fast-growing population. On this basis areas for further research on local government revenue mobilisation in Africa are identified.

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