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## NEW CHALLENGES FOR LOCAL GOVERNMENT REVENUE ENHANCEMENT

*The recent rationalisation of local government taxes and, in particular, the abolishment of the development levy, imply that many district councils, in the short run, will lose 40-50 percent of their own generated revenues. This has raised concern among stakeholders at both the local and central levels that the financial autonomy of local authorities is undermined and that some councils are moving towards bankruptcy. In this Project Brief, Odd-Helge Fjeldstad argues that there are reasons to be concerned about the short-term impacts of the tax rationalisation. However, the reform also represents an opportunity for local governments to implement much needed reforms of their revenue systems and to look at new approaches for revenue enhancement and cost saving.*

Before the rationalisation in June 2003 it was clear that the local tax system was overdue for reform. It was complicated, costly to administrate and exacerbated inequity. Tax evasion was widespread, often reflected in persistent public resistance to pay. Moreover, the linkages between the central and local government tax systems were in general weak leading to double taxation and inconsistencies between tax policies implemented at various levels of government. Already in 1993, the Association of Local Authorities in Tanzania (ALAT) advised the government to abolish development levy. This advice was partly based on considerations of revenue generation, administrative costs, income distribution and economic efficiency. Furthermore, the widespread tax resistance threatened to undermine the legitimacy of local authorities. Although there are reasons to question the speed at which the recent rationalisation of local taxes took place and the limited consultation with local authorities, similar considerations as those taken by ALAT ten years ago seem to have been the foundation for the recent reform.

### Short-term impacts of the local tax rationalisation

Prior to the rationalisation, most district councils generated only 10-20 percent of their total revenues from own sources, of which development levy was the major source. 80-90 percent of total revenues in many rural councils were conditional grants transferred from the central government. Hence, fiscal autonomy in most local authorities was limited both with respect to revenues and expenditures. However, the rationalisation has reduced the already limited local autonomy even further.

The immediate consequences of the rationalisation are that some council activities are scaled down or postponed. In particular, council meetings are postponed to save allowances. The reform will most likely also have impacts on activities at the village level, since some of the development levy collected (20-45 percent) were retained in the villages, mainly as honorarium to village leaders and Village Executive Officers, for stationery and to some extent for development activities, including women and youth development funds. Furthermore, the way the local tax reform was carried out, taking many people both at the local and central levels by surprise, has led to confusion among both collectors and taxpayers on what taxes actually are abolished and which are still in place. Hence, in some councils taxpayers now actively resist paying levies and taxes which have been retained. Tax collection has, therefore, dropped by more in recent months than the revenue shortfall caused by the abolished taxes alone.



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On the other hand, a positive outcome of the local tax reform is that some council staff have been released from low productivity activities and re-oriented for new assignments. For instance, Village and Ward Executive Officers now can perform their main responsibilities better. These tasks include supporting the village governments and ward committees on development issues, planning, among others, as well as to put more effort into local conflict resolution. Previously, most of their time was spent on tax collection and revenue mobilisation.

Not surprisingly, ordinary citizens and many councillors are positive to the tax rationalisation. Moreover, people interviewed during a recent visit to some district councils, argued that the abolishment of local taxes, particularly development levy, would make citizens more able and willing to contribute to self-help activities and to pay user fees for social services. Yet, some councillors expressed concern about the impacts of the tax rationalisation on council activities, including sitting allowances. Both the council management teams and some councillors questioned the sustainability of the tax reform.

## Options for further reforms

One major administrative problem today for many councils is their inability to collect fully the revenues due to them. In most councils there are huge gaps between reported and projected revenues. Recent studies conclude that this is due to: (1) poor administrative capacity to assess the revenue base; (2) poor administrative capacity to enforce the 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. 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. Moreover, measures are required to enhance taxpayers' compliance and to improve the accountability of tax collectors and councillors.

There is undoubtedly room for further improved financial management in most local authorities as well as improved co-ordination between the different levels of government. In particular, there is a need to simplify the licence and fee structures by reducing the number of rates and coverage. Fees and licences that have regulatory functions, such as sand fees, hunting and business licences, should be harmonised with central government taxes, to avoid double taxation and conflicts with national development policies such as employment creation and environmental protection. Furthermore, uniform rates on agricultural taxes, that is, crop cess, are necessary to minimise distortions. In this context it might be worth considering the possibility to centralise the collection of certain local taxes. For instance, cess on export crops could be collected by the Tanzania Revenue Authority (TRA) at their points of export.

Property tax has some 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 also has some obvious weaknesses which need to be taken into consideration before heavy reliance is placed on it. For instance, problems of valuation and tax enforcement often occur due to political interventions and administrative weaknesses. Furthermore, harsh enforcement mechanisms may result in intervention from politicians facing complaints from their constituents. Hence, experience advocates cautiousness when extending property tax to district councils, and when imposing a commercial land tax in local authorities.

A fundamental requirement when further redesigning the local tax 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. Such improvements may take a long time to achieve, although additional simplification of the local revenue system should provide a positive contribution towards these aims.

Some councils have already started to explore methods to reduce the financial gap caused by the tax rationalisation by: (1) outsourcing revenue collection to private collectors to increase revenues from existing sources such as natural resource products, including charcoal, wood and other forest products, and livestock auction fees; (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 stationeries. Current attempts for economic diversification will also help to expand the tax base like, for instance, a longer-term strategy introducing new cash crops. Moreover, co-production of services by councils and local communities is on the rise. For instance, in several councils recently visited the increasing number of primary schools is maintained and expanded via self-help schemes combined with technical support from the council. Such measures are welcome as well as promising for the future sustainability of local authorities.

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