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PRIVATE TAX COLLECTION—REMNANT OF THE PAST OR A WAY FORWARD? EVIDENCE FROM RURAL UGANDA

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SUMMARY

This article examines the growing role and impacts of private tax collection under fiscal decentralisation in Uganda. Based on evidence from six rural councils, three aspects of privatised tax collection are examined: (i) the impact on the nature of fiscal corruption; (ii) the problem of overzealous collection; and (iii) the challenge of assessing revenue potentials. While possibly meeting short-term demands for local revenue growth and stability, the present form of private tax collection appears to transform the nature of fiscal corruption by reducing corruption at collection point and transferring the problem into the district administration. Moreover, while the charge of overzealousness permeates historical and theoretical work on privatised tax collection, the Ugandan experience casts doubt on its general validity. Instead, perverse distributional effects are the most likely cause of deteriorating state-citizen relations in rural Uganda. Finally, the article considers the merit of the prediction of private collection as a preferred contractual choice for certain indirect taxes, suggesting that problems of asymmetric information in assessing the revenue yields of most rural markets are exaggerated. Copyright © 2006 John Wiley & Sons, Ltd.

KEY WORDS — decentralisation; private tax collection; corruption; Sub-Saharan Africa; Uganda

INTRODUCTION

Decentralisation has featured among Uganda's foremost objectives since the country embarked on its ambitious economic and institutional reform programme in 1986. Quite early in its establishment of a decentralised local government system, Uganda put in place a radical approach to local revenue generation in the form of privatised tax collection. Private collection of taxes, such as market dues, fees at fish landing sites and so forth were central to fiscal policy discussions already in the early 1990s (Livingstone and Charlton, 2001).

Other key features of local government finance in Uganda is the strong dependence on transfers from the centre and, until recently, the predominance of the poll tax, locally known as the Graduated Tax (G-Tax), in revenues generated by local councils.[1] On average almost 90% of total expenditures in local authorities are funded by the central government, but the extent of this reliance has tended to vary across districts. On average, the G-tax contributed to 67% of locally generated revenues in 1999–00 (Local Government Finance Commission, 2003b). However, since 2000–01 and until it was abolished in July 2005, G-tax contributions dropped to around 40% of total own revenues in rural councils. This dramatic fall was

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[1]The fifth section of the 1997 Local Government Act strengthened the role and responsibilities of district councils in revenue generation. The Act provides the legal framework for managing the graduated tax and other local revenue sources including indirect taxes, such as market dues, fees from fish landing sites, business and other licenses, property taxes etc.

prompted by political interventions during the 2001 Presidential Election Campaign,[2] which left local governments across the country in financial crises and made the risks associated with a too narrow revenue base abundantly clear.[3]

Following this drop in revenues, district councils have displayed an increasing appetite for tax base expansions and outsourcing of tax collection. This surge in privatisation has been justified on the grounds of improving both the yield and efficiency of tax collection (Francis and James, 2003). For district administrations reeling from the G-tax shock, the combination of more predictable revenue flows and fewer administrative concerns has evident appeal.

The present enthusiasm for private tax collection among bureaucrats, donors and other participants in the policy debate on local government finance in Uganda, is echoed in the recently published inventory of best practices in revenue mobilisation:

> '*All Local Governments [LGs] that have not yet contracted out collection of other sources of revenue should be encouraged to do so as soon as possible. However, contractors must be sensitised to their obligations, both to the LGs and the taxpayer* (Local Government Finance Commission, 2003a, p. 71)'.

Historically, private tax collection or tax farming[4] presented administratively weak governments with two main advantages. Firstly, the opportunity to save on costs of tax administration by shifting the costs of collection onto the private sector (Webber and Wildavsky, 1986). Secondly, tax farming is also likely to remedy corruption at collection point, by offering superior mechanisms for penalising poor collector performance (Kiser and Baker, 1994). The main disadvantage is the risk of overzealous collection which may result in a deterioration of state-citizen relations (Stella, 1993).

This article examines the growing role and impacts of private tax collection under fiscal decentralisation in Uganda. What are the relative merits of bureaucratic and private tax collection? What are the major institutional and political benefits and constraints facing tax farming in present day Uganda? In particular, how can the problems of corruption and overzealousness in revenue collection be resolved?

This empirical study is based on primary and secondary data from Arua, Kamuli, Masaka, Mbale, Mubende and Ntungamo districts in Uganda and combines different methods for data collection. While information on tendering practices were obtained from district level secondary data sources, we also interviewed key informants in district administrations, existing tender holders and other interested parties. The empirical assessment of market yields was based on field-team visits to six rural markets of different size and structure. During the first visit in July/August 2003, complete censuses of market vendors and of transactions in key commodities such as livestock and *matooke*,[5] were undertaken. The census data were later complemented by data on seasonal fluctuations and labour costs of tax collection during a second field visit in January 2005.

The rest of the article is organised as follows: Section 2 reviews historical and theoretical perspectives on tax farming and corruption. The theoretical literature reviewed provides predictions about the division of labour between bureaucratic and private collection driven by underlying informational asymmetries. Tendering practices in rural districts are discussed in section 3, which also presents empirical estimates of the revenue potential (yields) of the six rural markets. Thereafter, section 4 examines the impacts of seasonal variations on revenue

[2]During the campaign, the opposition candidate, Kizza Besigye, campaigned for abolishing the G-tax, while President Museveni promised to reduce the minimum level of G-tax from USh 11,000 per year to USh 3,000 per year. This caused confusion among taxpayers about the legitimacy of the G-tax. After the 2001-election, the President's promise was implemented and the minimum G-tax rate reduced to USh 3,000. This led many taxpayers to pay only the minimum rate arguing that the president 'assessed them all in 2001' (Bahiigwa *et al*., 2004, p. 2).

[3]In July 2005, a large majority of Ugandans voted for the return to multiparty democracy in a national referendum. This result was foreseen. In his budget speech in June 2005, the Minister of Finance simply announced—against the advice of the local government association and the government's own finance commission—that the GPT would be abolished by 1 July 2005 (Fjeldstad and Therkildsen, 2006). The Government was clearly preparing for the 2006 presidential, national and local elections and trying to prevent the poll tax from becoming an election issue, as it had been in 2001.

[4]In the literature, terms like 'tax farming' and 'tax farm' are used synonymously with private tax collection.

[5]Cooking bananas that are staple diet foods for most Ugandans (Ellis and Bahiigwa, 2003).

collection and the administrative costs of tax collection. The gap between revenue potential and contract prices gives rise to considerable rent-seeking opportunities for tax farmers and their associates. The issue of overzealous collection is examined in section 5. Section 6 concludes.

HISTORICAL AND THEORETICAL PERSPECTIVES ON TAX FARMING AND CORRUPTION[6]

Tax farming, understood as a system wherein '*the right to collect certain taxes owed the state is auctioned off to the highest bidder*' (Stella, 1993, p. 217), was practised in Mesopotamia around 1750 B.C., in England from the late Tudor period until the Civil War, by the Mughals in Northern India in the early 18th century and by France, China, Russia and Spain at other historical junctures. While tax farming's popularity typically faded with time and modernisation, its trajectory and ultimate demise was rarely linear and often involved switching between bureaucratic and private systems of collection (Kiser, 1994; Kiser and Schneider, 1994). Indeed the typical division of labour would be to outsource collection of indirect taxes, while government bureaucrats retained control over collection of direct taxes.

This underpins the claim that contract theory provides a promising avenue for explaining the historical trajectories of tax collection systems (Kiser, 1994). Indeed, contractual perspectives illustrate the two core problems in bureaucratic collection, namely corruption at collection point and the scope for ascertaining the tax base of activity-sensitive taxes (Azabou and Nugent, 1988; Toma and Toma, 1993; Kiser and Baker, 1994). Using a principal-agent approach to the relationship between the (local) government and the collection agent, the principal's challenge is to design a mechanism (contract) that reconciles the conflicts of interest between the two parties. In tax collection, the contractual choice may be interpreted as a function of the control or monitoring capacity of district administrations with a) bureaucratic, b) a mixture and c) full-fledged tax farming as the main contractual alternatives (Kiser, 1994). Contractual shifts would then result from a change in the underlying monitoring problem.

Uncertainty about the size of the tax base represents a key aspect of this monitoring problem. Stable revenue bases reduce the difficulty of the monitoring problem and enable the principal to more accurately predict revenue flows. This makes the verification of the performance of a government-employed tax collector easier. Many and often indirect tax bases in poor countries are, however, distinctly sensitive to economic fluctuations. This applies, in particular, to agricultural-based revenue bases where the principal will need to distinguish (i) poor performance by the bureaucrat from (ii) collusion and corruption between bureaucrat and taxpayers, and (iii) a poor collection result due to a local recession. It follows that tax farmers not only have a greater personal stake in controlling collectors, but may also more effectively penalise underperforming collectors. Government jobs in Uganda are usually permanent and frequently provide insufficient performance-related incentives. The latter provide the key arguments for outsourcing the collection of market fees and other activity-sensitive taxes.

However, whereas asymmetric information in judging revenue potentials and market fluctuations may be crucial for understanding the use of outsourcing within a centralised system of government, it may not convincingly explain the widespread preference for outsourcing among local councils in Uganda. Firstly, there may be doubts about whether the conventional view overstates the bureaucrat's information problem. Secondly, apart from broadening the tax base to enhance and stabilise local revenue flows, other and more covert motives may underpin local councils' enthusiasm for tax farming. These issues are explored in depth below.

To meet its official objectives, the system of private tax collection needs to meet procedural criteria that ensure that private contractors (tenderers) accomplish a reasonable return on the resources deployed. Moreover, the tendering process should be transparent, competitive and fair. Whether this is the case in rural Uganda forms an important part of our empirical inquiry.

[6]Vulnerability to corruption and tax evasion are common features of tax systems in developing countries (Ghura, 1998; Fjeldstad and Tungodden, 2003; Svensson, 2003). The main empirical foci have been on problems of accountability and leakages within central agencies such as the Uganda Revenue Authority (Svensson, 2003), and the massive corruption uncovered in the administration of import duties in Tanzania (Fjeldstad, 2003).

Similarly, the widespread claim that privatisation leads to overzealous collection will be empirically tested.[7] Historical records are repleted with evidence of overzealousness (Stella, 1993). In some instances, such as in the Dutch Republic, the excesses of private collection led to '*the most significant riots in the Republic's history*'. In France it prompted the execution of the so-called Farmers-general during the Revolution. While providing timely caveats about the potential damage private tax collection may cause to state-citizen relations, these historical excesses are insufficient for dismissing private collection altogether. Indeed, the main problem in France may not have been private collection *per se*, but the concentration of economic power in the hands of a few tax farmers due to a gradual consolidation of small units into a large and more efficient entity in 1723 (Kiser, 1994, p. 299). The biggest collector, 'the general tax farm', controlled more than 45% of total revenue in 1768 (ibid, p. 300). The evidence from France and the Netherlands thus suggests that monopolisation of private collection will need to be guarded against. In section 5, we revisit the hypothesis of overzealous collection, asking whether Stella and others may have overlooked the scope for accidental or deliberately designed mechanisms that effectively curtail excesses. Finally, the factors that fuelled sentiments that led to the demise of private tax collection will have varied across historical junctures and contexts. Some of the most potent charges against the French Farmers-general were those of widespread favouritism and high profits in the system for awarding tax contracts.

TENDERING PRACTICES IN RURAL DISTRICTS

Practices in tendering for the right to collect taxes vary in a number of dimensions across district administrations in Uganda (LGFC, 2003b; Wilson, 2002). A widespread feature is that market places, fish landing sites, car parks and other sites are tendered out on the basis of a 'reserve price', derived from an estimate of the revenue potential of individual markets or sites. Using data from 11 districts, Wilson (2002) found that a combination of previous tender prices and an assessment by the District Market or Finance Officer was a common approach for determining the reserve price. In Mubende district, we found that the revenue potential of rural markets were assessed by one district officer working in tandem with sub-county and parish officials. In Ntungamo district, the district revenue officer would estimate the reserve price after collecting the counter foil receipts for previous market seasons from the incumbent tax contractor. The officer would then compute the amounts collected and determine the reserve price without much concern for the incumbent's vested interest in retaining a low reserve price.

In determining the minimum acceptable bid, the tenderer will usually be allowed a gross margin in the range of 20% above the reserve price. Hence, for a revenue potential of USh 960,000, the reserve price would be USh 800,000. All tenders are made public, and sealed bids are invited. In Mbale district, for example, bidders for a market are required to (i) pay a non-refundable application fee of USh 25,000, (ii) possess a G-tax certificate, and (iii) have no outstanding debts. The latter condition is, of course, hard to ascertain. Similar criteria are deployed elsewhere. The content and duration of contracts vary across districts. In Mubende district, the duration is 12 months, in Kamuli and Ntungamo the tender period is 6 months, while in Mbale it is only 3 months.

The sealed bids are usually opened and read in public immediately after the deadline, which ensures some procedural transparency. In general, all applications will be vetted by the Technical Evaluation Committee (TEC) which ranks bids and in turn advises the District Tender Board (DTB).[8] While some councils exclude non-residents of the district, the Local Government Act permits the DTB to give preference to local bidders.[9] Practice also varies

[7]Stella (1993) interprets overzealousness as 'revolting harshness' in collection. Tax collection regimes in East-Africa are often harsh in this sense (Fjeldstad, 2001; Fjeldstad and Semboja, 2001). Most district administrations in rural Uganda operate with a myriad of official tax rates. For market dues these vary across commodities and quantities. In the latter context, overzealous collection may also be interpreted as over-collecting, that is collecting above these official rates. It is even possible to think of overzealousness as resulting from the generation of excess profits. As sections 4 and 5 will show, the present system allows for substantial profits and yet involves 'undercharging' compared to official tax rates.

[8]In Mubende district, for instance, the DTB has seven members of whom two should be women and one disabled. The TEC is chaired by the District Chief Administrative Officer who nominates officers from seven departments (Education, Health, Planning, Finance, Production, Engineering, Community Development) who will serve on the TEC for one financial year.

[9]Azabou and Nugent (1988) report that tax farmers in Algeria recruited assistants on short-term wage contracts who were selected for being aggressive, being from outside the region and with loyalty to the tax farmer. The preference to local bidders noted above may offer several important advantages; including a softer approach to tax collection. That the tenderer may have to interact with members of the local community in the future may help to dilute overzealousness.

Table 1. Structure of rural markets surveyed

Market name and category	District	Tender price (in USh)	Main revenue source	% of revenue generated by main revenue source
Ejupalo (A)	Arua	710,000	Millett, Sim-sim, cassava	47.5%
Kidera (A)	Kamuli	230,000	Clothes vendors	25.0%
Butayunja (B)	Masaka	60,000	Clothes vendors	49.4%
Buwaya (B)	Mbale	276,000	Matooke	36.2%
Butawaata (A)	Mubende	1,400,000	Livestock transactions	59.8%
Rubare (B)	Ntungamo	500,000	Matooke	80.7%

with respect to rules for paying the contracted amount to the local council. Both Mbale and Ntungamo districts require advance payments, thus eliminating the risk of subsequent, and potentially costly, defaults.[10]

An underlying principle is that only bids above the reserve price will be considered. In practice, the winning bids are seldom significantly higher than the reserve price and some districts eliminate bids outside of $\pm 10\%$ of the reserve price (Wilson, 2002). In Mubende, for instance, the DTB view is that bids outside the $+10\%$ range are unrealistic, and, hence, likely to increase the risk of default and therefore administrative costs. For fish landing sites, Wilson (2002) recommends that bids exceeding the reserve price by more than 20 per cent should be eliminated. This could be a sensible policy if reserve prices were realistically assessed. However, the substantive gaps between reserve prices and revenue potentials of rural markets revealed below make such a recommendation deeply problematic.

As noted, the TEC evaluates bids and makes recommendations to the DTB. In awarding the contract, the DTB has considerable discretionary power. Thus, the principles deployed in arriving at a final ranking of candidates may be arbitrary and subject to political interference (LGFC, 2003b). Wilson (2002) found the DTB to overturn the TEC's recommendations in 70 % or more of the cases observed. The gravity of conflicts between the TEC and DTB do, however, vary. Our evidence, from Ntungamo, Masaka, Kamuli and Mbale districts suggests that such conflicts were less severe and that the working relationships between the TEC and DTB could be described as reasonably constructive.

The value of the bid is weighted alongside other criteria in assessing bidders. These often include the past performance of an incumbent tenderer. In Kamuli district, the bidder's past experience is assessed (on a scale from 1 to 3) and given the same weight as the bid price (also pointed from 1 to 3). Each applicant is therefore rated on several criteria and the bidder with the highest overall score should in principle be awarded the contract. However, according to Wilson (2002) '*it was in practice impossible to win a tender if the applicant was from a less favoured political party and should the applicant not have contacts at DTB*'. Another study found that in Bugiri, a poor district in Eastern Uganda, the popular view was that contracts are awarded to LG staff, their relatives and to politicians (Ministry of Finance Planning and Economic Development, 2002).

Two of the markets covered by our study provide further insights into the scramble for control over tax contracts through manipulation of the bidding process. The incumbent tender holder for Butawaata public and livestock market in Mubende district is a company controlled by the LC3 Chairperson of Kasambya sub-county where the market itself is located. In 2002/03 this tender attracted four bidders. The company won the contract after having submitted the second highest bid. Following a campaign to intimidate rival bidders, others have subsequently withdrawn from bidding for this the biggest and most lucrative market in the area. In Rubare Weekly Market in Ntungamo, in contrast, tenderers have established an informal cartel to control the submission of bids, keep bids low and share contracts among themselves.

[10]In Kamuli district defaults by tax farmers were reported in 13 of 22 sub-counties in 2001–02.

Table 2. Tax types, Kamuli District, March 2003

Formal revenue sources	No of different rates applied
Market dues	136
Business licences	81
Graduated tax bands	22

Official rates vary by commodity traded or business description, with the second column showing the number of listed types.

An important presumption, both in the taxation literature discussed above and in the debate on fiscal reform in Uganda, is that assessment of the revenue potential of a market poses a formidable challenge, and that capacity building to make assessments more accurate should be a high priority. This is an exaggeration, as anyone who has visited a real market and observed the tax collection system at work would be able to ascertain.

The six rural markets surveyed by the present study are all fairly well-organised. Part of the space is assigned to vendors selling agricultural produce, part to livestock, part to clothing and part to household goods and other items. As Table 1 suggests, these markets vary in terms of specialisation and predominance of certain commodities and by their revenue potentials as indicated by the tender prices. Three grade A[11] and three grade B rural markets were covered, with estimated reserve prices[12] ranging from USh 60,000 to USh 1,400,000. These are all weekly markets that operate throughout the year. Table 1 also indicates the principal revenue source in each market and the estimated percentage of collected revenue generated by this source at the time of our market censuses.

Livestock transactions, in particular cattle, represent the predominant revenue source in Butawaata, while *matooke* transactions provide the main revenue source in Rubare (Table 1). In this market, about 7,200 bunches of *matooke* were sold during one market day in August 2003, amounting to somewhere in the order of 215 tonnes of bananas. In Butawaata, 215 heads of cattle were sold on the day of the field-team's visit in August 2003.

Officially, a large number of tax rates are usually imposed on the various tax bases, as illustrated by data from Kamuli district reported in Table 2. For market dues, the rates are specified by commodity and quantity and essentially designed as taxes on transactions (i.e. sales taxes).

The nature of rural markets, usually weekly events rather than permanent institutions, makes this large number of official rates hard to implement in practice. Indeed, a detailed system of sales taxes, such as that illustrated for market dues in Table 2, is likely to be implementable only in permanent (usually urban) markets, where goods are transported into the market, the market vendors pay a tax per quantity unit upon entry and the goods leave the market only after a sale has been completed. Operating a similar system in a weekly rural market would be very costly since a vendor would have to pay on entry and be reimbursed for unsold quantities after finalising the day of trading. In the typical rural market a complex official tax system has therefore been replaced by a pragmatic and less administratively costly solution. Apart from bulky and easy to monitor commodities, such as livestock and *matooke*, for which piece rates are implemented, vendors are charged a daily fee for market space. This reduces the monitoring problem confronting market tenderers. Thus, a count of the number of traders belonging to each category will suffice to estimate revenue. For bulky and important commodities like *matooke* and livestock, taxes are levied per bunch or animal sold. In the present sample of rural markets, it was mostly a minor chore to post assistants to count bunches of *matooke* entering (or leaving) the market during a day of trading. For livestock, the assistants would also need to record transactions, a simple task in markets where the total volume of livestock transactions is modest, but more demanding as the volume of livestock transactions increases. In general, however, arriving at reasonable estimates of the revenue yield of a given market on a given market day is not a critical factor preventing the proper working of the private collection system.

The estimated revenue potentials of the six rural markets covered by our study are presented in Table 3 below. Two graphical examples are presented in Figures 1 and 2. The discrepancy between agreed bids and the estimated

[11]The grading is somewhat arbitrary, but should in principle reflect market size measured by turnover.
[12]Converted into monthly equivalents to facilitate comparisons.

Table 3. Operation in practice of market tender system in 6 districts

Category	Data based on sample markets					
	Mbale	Kamuli	Mubende	Masaka	Ntungamo	Arua
1. Agreed tender value (= reserve price)	276,900	230,000	1,400,000	60,000	500,000	710,000
2. Estimated total collection	473,400	1,169,200	4,180,400	394,500	5,350,650	1,463,800
3. Fixed 20% margin for cost recovery	78,900	194,867	696,733	65,750	891,775	243,967
4. Estimated 'lost revenue' (= 2 − 1 − 3)	117,600	744,333	2,083,667	268,750	3,958,875	509,833
5. Estimated 'lost revenue' as % of estimated total collection (= (4/2)*100)	24.8%	63.7%	49.8%	68.1%	74.0%	34.8%
6. Estimated total margin (= 2 − 1)	196,500	939,200	2,780,400	334,500	4,850,650	753,800
7. Estimated % Gross Margin (= ((2 − 1)/1)*100)	71.0%	408.3%	198.6%	557.5%	970.1%	106.2%

revenue potentials is striking, and comparison of the agreed bids and market revenue yields illustrates the poor performance of the private tax collection system in Uganda.

The gap between total revenue collected and agreed tender can be divided between two categories: (i) the 20% margin private tenderers are permitted to realise on their collections in some districts, and (ii) an amount representing the 'lost revenue' to councils, that is the additional revenue the councils would have obtained if the revenue potential of each market had been correctly assessed. The graphs clarify this deficit and compare the LG estimate of the revenue yield of the market with actual revenue yield showing clearly the 'lost revenue' that is involved. In these six markets, the 'lost revenue' amounted to between 25% and 74% of total revenue collected in each market. Moreover, the actual gross margins realised by private tenderers caused by this undervaluation of market yields

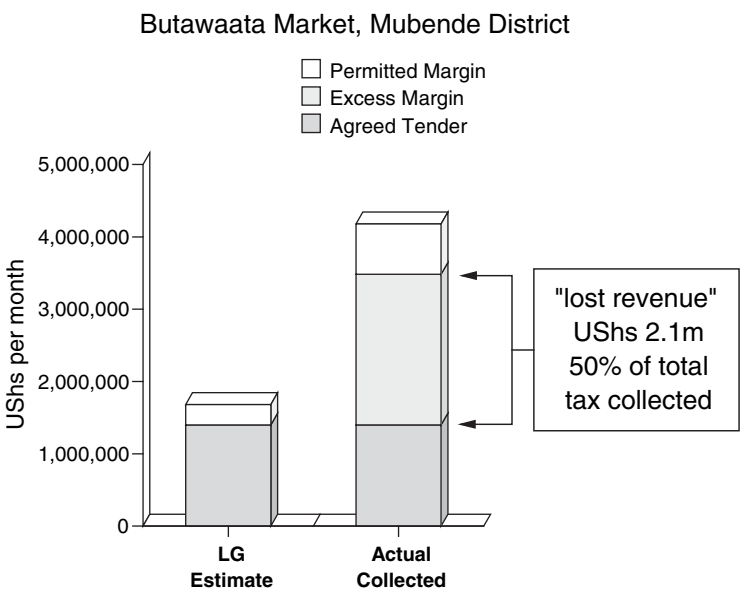

Figure 1. Working of the tender system in Butawaata Market, Mubende District.

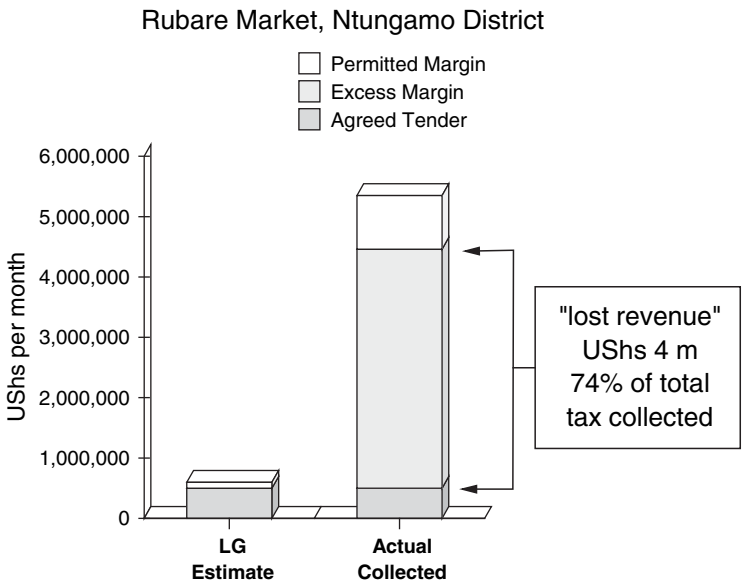

Figure 2. Working of the tender system in Rubare market, Ntungamo District.

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 tax payers 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. The distributional effects of the system of private tax collection, as it currently operates, are therefore highly questionable.

ACCOUNTING FOR SEASONALITY AND THE LABOUR COSTS OF TAX COLLECTION

To what extent do seasonal fluctuations and collection costs influence the above estimates and conclusions? Starting with the latter, the 20% margin leaves room for covering some labour costs of collection, but is this margin sufficient to cover all labour costs? Interviews with collectors in each of the six markets revealed that remuneration varied somewhat with market activity, but that earnings would typically fall in the USh 2,000–3,000 range.[13] Table 4 strengthens the above estimates by presenting the costs of collection based on upper end estimates of remuneration of collectors for each of the six markets. As the numbers clearly demonstrate, the collection costs fall well within the permitted 20% margin, suggesting that the above conclusions are insensitive to costs of collection.

A second important question is whether and to what extent seasonal fluctuations impact on the preceding conclusions.[14] For three of the six markets, that is Rubare, Buwaya and Ejupalo, the timing of the census (i.e. July/August) coincided with medium activity levels suggesting that our estimates would be robust to seasonal fluctuations as long as these fluctuations are evenly distributed around the medium activity level. For each of the remaining three markets, a separate commentary is necessary. For Kidera market in Kamuli, the census point

[13]The only exception is Butawaata market, where remuneration is reported to be around USh 5,000.

[14]During the second visit to the case councils in January 2005, market vendors and others with intimate knowledge of each of the six markets were used as key informants for developing an activity calendar for each market throughout a normal year with H, M and L indicating high, medium and low activity levels.

Table 4. Costs of hiring tax collectors in the six markets*

Category	Mbale	Kamuli	Mubende	Masaka	Ntungamo	Arua
Number of collectors	4	6	15	1 assistant plus the tender holder	5	6
Total monthly costs (in USh)	48,000	72,000	300,000	12,000	60,000	72,000
The 20% margin (in USh)	78,900	194,867	696,733	65,750	891,775	243,967
July/August	L–M	H	M	M–H	M	M

*The number for tax collectors in each market refers to the number at the time of the census, that is July/August.

occurred during the peak season, implying that our initial estimates are likely to overstate the attractiveness of the contractual terms for the 6 months period covering the lean season. For Butayunja market in Masaka, where market activity is low during November-February, a similar point can be made. In short, for the two smallest (measured by revenue potential) of the six markets, the current problems of lost revenues due to the gap between revenues collected and the agreed tender are thus less severe. What about Butawaata market in Mubende? At the time of the second visit in January 2005, livestock transactions had been suspended due to an outbreak of anthrax. This suspension was still in place at the end of March due to risks of further outbreaks. Given the 12 months tenure of the tender contract for this market, the above estimate is robust for a normal year, but who shoulders the burden of the present suspension? As indicated in Table 1 above, revenues from livestock transactions amount to around 60% of the tax revenue in Butawaata. At present, the tenderer's payments to the DTB have been adjusted downwards to compensate for the revenue shortfall caused by the suspension of trading in the livestock part of the market.

The flaws in the private tender system, especially for the larger markets, are starkly exposed by the foregoing evidence. A bureaucrat keen to maximise local revenue from a tax base balancing growth and poverty alleviation objectives would opt for an optimal reserve price. However, such motives seem to be absent from the observations in Table 3. Since assessing the revenue yield of markets during normal years is not difficult, it appears that reserve prices and therefore agreed tenders are set deliberately low. However, the mechanisms that generate these low reserve prices vary across councils.

At present, the low reserve prices provide scope for collusion between members of the tender board, local politicians and the winning bidder over the division of the generous margins allowed for the larger markets. The more generous these margins, the better the prospects for local bureaucrats and politicians of extracting bribes from bidders.[15] *Individual* bureaucrats, local politicians and others therefore have a strong vested interest in ensuring that tax contracts remain valuable commodities. These individual incentives starkly conflict with official objectives of local revenue enhancement.

Even when TEC and DTB members behave impeccably, the routines for reserve price assessment may provide incumbent tenderers with opportunities to influence the reserve price by controlling the supply of foil tax receipts (e.g. Butawaata). As noted, the present margins also encourage collusion among tenderers and intimidation of potential bidders so as to retain the status quo.

Figures 1 and 2 also indicate a sharp deterioration in the 'terms of trade' between tax payment and service delivery. While privatisation as it currently operates may satisfy the narrow goal of stable and predictable local revenue flows, the resources made available for service improvement as proportion of the taxes collected, are much below their potential. The medium to long-term implications for state-citizen relations of this dramatic imbalance are potentially severe.

[15]The above estimates of the tenderers' profits overestimate true profits since they do not account for side-payments required to win contracts.

These observations provide stern warnings to donors and others who often see problems with privatisation as symptoms of low administrative capacity or as reflecting absence of sensitivity that can be repaired by programmes of sensitisation. In particular, there is a need to focus on incentive mechanisms for repairing existing loopholes in tax collection, in contractual designs and in procedures for reserve price assessment. This need is particularly acute for the larger markets. Below, we take a closer look at the monitoring problem confronting district level administrations, comment on the performance of the prediction of overzealous collection and discuss incentive mechanisms that may help to diffuse some of the problems identified above.

A MARKET CASE STUDY: BUWAYA WEEKLY MARKET IN MBALE DISTRICT

Buwaya is a lively weekly rural market in the interior of Butiru sub-county in Mbale District. Various types of agricultural produce, such as vegetables, grains, flour and matooke (cooking bananas), livestock, other foodstuffs such as fish, clothes and other household items change hands. The market is organised into separate sections: On the weekly market day of the field-team's visit, 34 vendors selling vegetables, grains and flour were clustered in one part of the market while 39 textile sellers occupied its upper area. *Matooke* and livestock trading took place in clearly separated sections at opposite ends of the market.

The tender for Buwaya market is awarded for 3-month periods and the incumbent tenderer has held the contract for 3 years. In line with other local governments, Mbale District has issued an official list of market dues, specified by commodity and volume. Apart from transactions and movements of the easily trackable commodities, that is livestock and *matooke*, piece rates on transactions are not implemented. Instead vendors are charged a fee for the day of trading. A refusal to pay will typically result in commodities being confiscated.

The argument for privatising tax collection hinges on the problem of verifying the reasons behind a poor collection result. How persuasive is this argument? District authorities, that is the Market Officer and his assistants, will have assessed the revenue potential of Buwaya, but will also have surveyed other weekly markets in Butiru and adjacent sub-counties. An interesting and important characteristic of Butiru is the presence of a cluster of rural, weekly markets (on alternating days) within a relatively short distance of each other, placing the district administration in an ideal position to register local, economic fluctuations.

The incumbent tenderer resolves his monitoring problem by employing four separate collectors responsible for *matooke* trade, livestock transactions and dues from market stalls/vendors. On a given market day, estimating revenues from vendors within a reasonable margin of error is therefore an easy task. What about trading in livestock and *matooke*? In Buwaya, *matooke* transactions involve suppliers (local farmers, men and women) entering the market in the morning, followed by bargaining between sellers and buyers (mainly bicycle vendors who purchase bunches from separate sellers) as the day unfolds. In the early afternoon, as business draws to a close, bunches of *matooke* are transported by bicycle to the next point of sale. A tax of USh 100 is levied on each bunch leaving the market. A volume of around 500 bunches (10–15 tonnes) of *matooke* was sold on the day of the field-team's visit in July 2003. For a trained eye this poses a straightforward challenge. Regarding livestock, 18 adult goats and 2 heads of cattle were sold on the same day. Triangulation of the volume and value of livestock transactions was much easier than expected.

Under decentralised tax administration, it would appear that Kiser (1994) overstates the complexity of the monitoring problem. Indeed, with limited resources and skills, a local bureaucrat with a couple of assistants should have few problems with estimating the revenue potential of four of the six markets covered by the present study. In the two remaining markets, where the volume of livestock and *matooke* transactions are higher, accurate assessment is more challenging, but hardly insurmountable. At the same time, the suspension of livestock trading in Butawaata provides a reminder of the importance of effective mechanisms that insure tenderers against such events.

What about overzealousness? Historical evidence indicates that overzealous collection was particularly grave when the monopoly of the state was replaced by large monopolistic tax farms (Webber and Wildavsky, 1986). As noted, Butiru sub-county has a number of weekly, local markets within a relatively short distance of each other.

This coincidence creates an interesting self-regulatory mechanism since overzealous behaviour may be penalised by market traders deciding to exit markets where tax extraction is more onerous. Vendors will, on a weekly basis, have to make decisions about which weekly market(s) to attend. In July 2003, the incumbent tender holder in Buwaya described the impacts on business as a distinct issue he had to consider in deciding which rates to charge. A striking observation relates to the implemented rates on *matooke*, which were equivalent to 50% of the official tax rate for this commodity that constitutes the main revenue source, accounting for 36% of the tenderer's total revenue. This self-regulatory effect of competing for 'customers' is important. Indeed, the contrast to the large-scale monopolistic tax farms in medieval France could hardly be more striking (ibid.). Concerns about overzealous collection would thus suggest that a structure of smaller markets is conducive to a more benign tax regime. It is also worth pointing out that with the present generous margins, there is no need for tenderers to adopt draconian measures to maximise revenues. This means that a narrowing of margins caused by better mechanisms for reserve price assessment could accentuate the pressure on tax payers.[16]

CONCLUSION

Present initiatives for local revenue enhancement in Uganda advocate a larger role of the private sector in tax collection. This article questions the narrow remit of this policy debate, and the absence of careful analysis of how local government systems for private tax collection actually work. The present version of privatisation, we demonstrate, appears to transform the nature of fiscal corruption by reducing the problem of corruption at collection point and transferring it into the district administration.

Empirical observations of low reserve prices were consistent across the six markets surveyed and reinforce less rigorous observations made by others (Wilson, 2002). This conclusion is not sensitive to the labour costs of tax collection. As we have shown, however, seasonal fluctuations make the adverse distributional effects a more acute problem in larger markets. Indeed, the conflict of interest between the official objective of local revenue enhancement and the individual incentives of strategically situated district level bureaucrats and politicians poses a serious challenge for decentralised local governments in Uganda. Under present routines for assessing markets and procedures for tendering rights to collect taxes, the prospects for local bureaucrats to extract bribes are positively correlated with the value (i.e. the profit or rent) generated by a contract. The rent or contract value, in turn, is inversely related to the tender price, that is the local council's share of the total revenue from a particular tax item such as a market. This is the core of the incentive problem.

At present, private tax collection involves redistributive transfers from rural and often poor taxpayers and into the pockets of the local elite. We cannot, on the basis of this evidence, make claims about the exact distribution of these generous profits within the local elite itself, that is among tenderers, local bureaucrats and politicians. What is clear, though, is that there are strong vested interests favouring the status quo.

Sensitisation or capacity building, a high priority among donors and others, is unlikely to resolve this problem. A more effective solution could be to move the responsibility for market assessment out of district administrations by establishing an independent body responsible for such assessments.[17] As clean bidding processes are unlikely in the short-to medium-term, a properly assessed reserve price provides an important check in the presence of expected bid rigging. It is also possible to consider more fine-tuned incentive mechanisms that link remuneration of local bureaucrats to revenue enhancement goals.

Alongside improvements in reserve price assessments, the case of Butawaata illustrates that risks confronting tenderers need to be carefully integrated into local council policy. The conditions under which payments will be suspended or compensations made must be part of this overall policy. Combining a broader tax base with a more extensive private sector role in collection may reduce fluctuations in local revenue flows in the short-term. But the

[16]An interesting observation made by a tax collector in Rubare market was that the risk of overzealous collection was particularly acute when job insecurity peaks as the expiry of a tender draws closer. According to him, some tax collectors grab as much as they can because of considerable insecurity about future employment.

[17]If more competitive bidding processes were realistic, one could consider removing the reserve price altogether and simply resort to the highest bid.

present system is unlikely to be sustainable. If the 'terms of trade' between taxes paid and local service delivery reasonably predicts the quality of state-citizen relations, these relations would, unless reforms are implemented further deteriorate.

The prediction of overzealous collection does not, in general, hold in rural Uganda. Accidental circumstances (the structure of local markets) and the generous profits observed contribute to explain this observation. More general mechanisms for curtailing overzealous behaviour may include awarding tax contracts to market associations or establishing systems for dealing with complaints from market vendors. While harsh collection may be resolved by an effective complaint system, the present complexity of rural tax systems would make it hard to address over-collection through this route.

Finally, how do theoretical perspectives perform in explaining the strong preference for private collection among policymakers in Uganda? For principal-agent theory, the verdict that estimation and monitoring of market yields represent a difficult task does not survive closer scrutiny.

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