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Strengthening Local Taxation Through Decentralized Development Cooperation

Delphine Scheerens & Jan Van Ongevalle

KU Leuven

HIVA RESEARCH INSTITUTE FOR WORK AND SOCIETY



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Delphine Scheerens & Jan Van Ongevalle

Research commissioned by the Belgian Policy Research Group on Financing for
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Abstract

This research report provides an overview of existing practices and lessons learned from decentralized development cooperation support to subnational taxation initiatives in low and middle income countries. The focus is on programmes funded by local government donors from a selection of Western European countries: Belgium, the Netherlands, Germany and France. Three main working areas of donor support are identified: (1) improving tax policy and design, (2) strengthening the tax administration, and (3) encouraging constructive state-society engagement around taxes. Based on a review of the literature and case study analysis, potential mechanisms that can support and expand local taxation are identified for each of these working areas. The support modalities and the instruments used by donors are also critically assessed. The results of this study suggest a need to broaden the focus of donor support in order to include all three working areas where possible, avoiding a too limited focus on only strengthening the tax administration. Furthermore, locally elected politicians seem central to the success or failure of taxation efforts, so they should ideally be targeted in donor support programmes. It is also important for donors to deepen their understanding of the particularities of subnational taxation in the partner country and the partner local government. As to the support modalities used by donors, such as peer-to-peer exchange, financial support or a programmatic approach, they all have pros and cons so the choice should be made according to the goals of the programme. Using a mix of modalities could equally be an interesting approach. Finally, donors should strengthen their monitoring and evaluation systems in order to get a clearer idea on 'what works' in relation to donor funded support programmes for local taxation.

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List of abbreviations

AAAA	Addis Ababa Action Agenda
AIMF	Association Internationale des Maires Francophones (International Association of French Mayors)
ANCB	Association National des Communes du Bénin (National Association of local governments in Benin)
ATI	Addis Tax Initiative
GDP	Gross domestic product
GIS	Geo-information system
IMF	International Monetary Fund
M&E	Monitoring and evaluation
NGO	Non-governmental organization
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
RFU	Registre foncier urbain
SNG	Subnational government
TREE	Tax Revenue for Economic Enhancement
UCLG	United Cities and Local Governments
UN DESA	United Nations Department of Economic and Social Affairs
UVCW	Union des Villes et Communes de Wallonie
VAT	Value added tax
VNG	Vereniging van Nederlandse Gemeenten (Association of Dutch Municipalities)
VVSG	Vereniging van Vlaamse Steden en Gemeenten (Association of Flemish cities and municipalities)
WB	World Bank

Introduction

With the adoption of the sustainable development goals, the discussions on how to broaden financing of development have become of great importance. At the third international conference on financing for development (F4D), held in Addis Ababa (Ethiopia) in July 2015, world leaders agreed upon the Addis Ababa Action Agenda (AAAA) which includes a specific action area on domestic public resources¹, indicating that it is the main source of development finance. Furthermore, donor countries subscribing to the Addis Tax Initiative (ATI), which was created during the conference, expressed their commitment to double the technical cooperation efforts in the area of domestic revenue mobilization/taxation by 2020.

This increased donor effort towards domestic revenue mobilization goes hand in hand with decentralization processes in low and middle income countries all over the world. More autonomy is given to subnational governments, also concerning taxation. However, while the AAAA recognizes that expenditures and investments in sustainable development are increasingly being devolved to the subnational level, the subnational governments “often lack adequate technical and technological capacity, financing and support” (UN DESA, 2015: paragraph 34). The AAAA calls for greater international cooperation “to support local governments in their efforts to mobilize revenues as appropriate” (UN DESA, 2015: paragraph 34).

It is true that, when it comes to donor support for taxation issues, efforts have been mainly concentrated on central level tax reforms in partner countries, promoting a quite uniform ‘global reform program’, which seems not appropriate for poor countries nor for decentralized governments (Fjeldstad & Moore, 2008). However, increased donor efforts aiming at strengthening subnational taxation are to be expected in the following years both because of international agreements (the AAAA for example) and the need for a more comprehensive global reform program which includes the specific needs of subnational governments.

Designing a subnational taxation system has to be done with care, taking into account the particular situation of each local government. No ‘one size fits all’ solution exists. Nevertheless, some taxes have been identified as of particular interest for subnational governments in general. The property-based tax is probably the most well-known example.

This working paper provides an overview of the existing literature on subnational taxation in low and middle income countries, focusing on (1) the rationale for subnational taxation, compared to centralized taxation, (2) the state of affairs in low and middle income countries, (3) the dynamics of subnational taxation, (4) the main challenges for improved subnational taxation in developing countries and (5) the policy options for the design of subnational taxation systems.

Furthermore, approaches of donor support for subnational taxation and the instruments used will be assessed, with a particular focus on subnational donors. Through case studies of decentralized cooperation efforts by donors from a selection of Western European countries, this paper contributes to a better understanding of how this support is organized. Also, successful mechanisms that seem to support and expand local taxation activities are identified, both related to programme strategies

¹ Six other action areas are included in the Addis Ababa Action Agenda: domestic and international private business and finance; international development cooperation; international trade as an engine for development; debt and debt sustainability; addressing systemic issues; science, technology, innovation and capacity-building.

and to donor instruments. These findings can inspire policy makers and development practitioners involved in support programmes for subnational taxation.

1 | Methodology

The research methodology consists of three main elements. First, a desk-review of the existing literature on subnational taxation in low and middle income countries was carried out in order to get a deep understanding of the rationale for fiscal decentralization, the current state of affairs of subnational taxation, the dynamics of subnational taxation, the challenges for improved subnational taxation, and the principles and options for the design of subnational taxation systems. Also, research on donor support to (local) taxation was reviewed, with a particular focus on decentralized cooperation.

Second, seven case studies of decentralized cooperation support to local taxation initiatives were selected, representing a mix of cooperation modalities (i.e. local traction, coordination and exchange, and programme-based) from four Western European donor countries (Belgium, France, Germany and the Netherlands). The beneficiaries of the selected programmes are subnational governments in low and middle income countries (Benin, Ghana, Zimbabwe and Peru). Semi-structured interviews² were carried out with staff responsible for development cooperation from all the donor institutions and from a selection of partner institutions (i.e. the local governments of Dogbo, Bohicon, Za'Kpota and Djidja in Benin; and the intercommunal Gi-Mono in Benin). Additionally, the responsible for domestic resource mobilization of the National Association of Local Governments of Benin (ANCB) was also interviewed as a resource person. Where project/programme documents were available these were also taken into account.

Limitations

The case-studies had only limited documentation on the impact and results of the interventions. Therefore 'strong' evidence is sometimes missing on what works or not in support programmes for local taxation. The lack of documentation was mainly due to:

- The complexity to measure impact of programmes that goes beyond measuring the increase in tax revenue of the partner government.
- The lack of sound monitoring and evaluation systems in many decentralized cooperation programmes.
- The recent start-up of the programmes, whereby information on progress could not yet be collected and analyzed.

² See annex 1: interview guideline; and annex 2: list of interviewees.

2 | Subnational taxation in low and middle income countries

2.1 Fiscal decentralization versus centralized taxation

The pros and cons of subnational taxation

Taxation is a responsibility of the central level government in all countries in the world. Nevertheless, the world has experienced a progressive tendency of decentralization, whereby subnational governments, that is local (cities or villages) or regional (provinces, states, etc.) governments, increasingly gain responsibility over the delivery of a set of public services to the citizens, for example related to transportation infrastructure, education, environmental issues, health, social and cultural affairs, commercial issues, etc. As a consequence, subnational government expenditure increases, with a corresponding demand for more financial resources in order to provide the services delegated to them. Also, subnational governments often need to finance their own bureaucratic structure, such as salaries of the municipal staff and the municipal infrastructure.

The financial resources at the disposal of subnational governments are in most cases a mix of income through fees and taxes, intergovernmental transfers (usually from the central government level; these could be earmarked or not), loans and international cooperation.

Decentralization processes are also often accompanied by fiscal decentralization processes in order to give subnational governments broader responsibilities related to taxation. The literature on this issue draws the attention to some advantages and disadvantages of fiscal decentralization compared to a highly centralized taxation system.

Some of the positive aspects of fiscal decentralization can be summarized as follows:

- *Improve the fiscal balance*³. Local authorities perceive more pressure to provide more public goods with limited resources than central governments. Their geographical closeness to the citizens fosters stronger accountability, which leads to a search for the production and provision of public goods at lower costs. This reduces expenditures and has a positive effect on the fiscal balance (Sow & Razafimahefa, 2017: 13)⁴.
- *Increase revenue mobilization*. In parallel, fiscal decentralization can further improve the fiscal balance, as it can increase revenue mobilization. This argument is made by assuming that subnational governments have more potential and – if the intergovernmental transfer system is well designed⁵ – incentives to reach the income, consumption and wealth tax bases compared to the central government. Also, with an increase of subnational revenue

3 The fiscal balance is “the difference between general government revenues and expenditures showing how much in a given year government spending is financed by the revenues collected. a surplus occurs if, in a given year, government collects more revenues than it spends. conversely, when the government spends more than it receives in revenues, there is a deficit.” (OECD, 2017: 56).

4 Sow & Razafimahefa (2017) explored the impact of fiscal decentralization on fiscal policy performance in a large sample of advanced and developing economies. They provide statistical evidence for their findings.

5 The literature on intergovernmental transfers (financial transfers from the central government level to the subnational governments, such as grants, shared taxes, subsidies, or subventions) (Bahl & Bird, 2008; Prud’Homme, 2003) suggests that when transfers are too generous, incentives for local governments to strengthen local taxation efforts drop. But also, too limited transfers can undermine taxation efforts at the local level. Thus, in order to benefit from fiscal decentralization, an adequate intergovernmental transfer system should be in place.

mobilization, the need for intergovernmental transfers from central revenues reduces (Bahl & Bird, 2008).

- *Create welfare gains.* Subnational governments can respond to specific needs of people in their jurisdiction, which will be perceived by these people and will create gains in welfare (downward accountability)⁶. Important conditions are that subnational governments must have controlling power over their employees, and residents over their governments, normally through elections. Also, there must be an availability of information to voters in order to evaluate the fiscal decisions of their subnational governments (Bahl & Bird, 2008).
- *Increase political efficiency.* Fiscal decentralization is found to have political efficiency gains in three ways: 1) increased local participation in political decision-making; 2) democracy strengthening, both for the electorate and the politicians which in a decentralized system are more likely to discuss social issues; 3) subnational government functions as a counter-power to the central government and a protection against authoritarianism (Prud'homme, 2003).
- *Improve government accountability.* By taking revenue and expenditure decisions to the local level, and thus making them more visible, it is expected that the connections between what people pay and what they get in return are strengthened (Prichard, 2010).

Research has also pointed out some of the problems of fiscal decentralization:

- The central government can collect most taxes more efficiently than can subnational governments, causing a vertical imbalance. This could be solved to some extent by introducing surcharges on central taxes (Bahl & Bird, 2008).
- The potential tax bases available to subnational governments vary widely from jurisdiction to jurisdiction, causing a horizontal imbalance between subnational governments (inter-regional disparities; regional inequality) (Prud'homme, 2003; Bahl&Bird, 2008). Fiscal decentralization thus tends to perpetuate and increase intra-regional disparities (Prud'homme, 2003). In order to reduce this imbalance there is a need for more balancing transfers to poorer regions (intergovernmental transfers) (Bahl & Bird, 2008; Prud'homme, 2003)
- Fiscal decentralization is expected to weaken the macro-economic⁷ stability and control (Sow & Razafimahefa (2017)).⁸

These elements can make governments wary to implement fiscal decentralization measures. Additionally, fear of losing control over key infrastructure development, of a possible shift in the composition of public capital investments, of duplication of services and of an increase in corruption are common reasons for resistance (Bahl & Bird, 2008).

A continuum of subnational taxation modalities

The traditional theory of fiscal federalism sees a very limited role for subnational taxation (Bahl & Bird, 2008). The only tax that should be levied at the local level (municipalities and cities) is the property tax, the so-called 'property tax only policy' (Bahl & Bird, 2008; Bird, 2010), while at the regional level a retail (final-stage) sales tax and a few excises are permitted, as well as surcharges on centrally-imposed personal income or payroll taxes (Bird, 2010). "Subnational governments are essentially viewed [...] as little more than decentralized service providers with the strictly allocative role of providing sub-central public goods" (Bird, 2010: 4). Or also, "spending is 'deconcentrated' or 'delegated' by the centre to the subnational governments (SNGs), rather than 'decentralised', and SNGs act as an 'agent' of the centre, with limited or no policy-making autonomy" (OECD/UCLG, 2016: 10).

⁶ In a centralized system in contrast, there is upward accountability.

⁷ Macro-economic policies are intended to avoid economic recession, monetary inflation, and public finance crisis.

⁸ Sow & Razafimahefa (2017) found evidence that fiscal decentralization can limit the ability of the central government to conduct macroeconomic stabilization policies. As local authorities' objectives are primarily related to the provision of public goods, they tend to conduct pro-cyclical policies which do not take into account outcomes of macroeconomic stabilization.

However, as decentralization processes imply greater expenditure responsibilities for SNGs, Bird (2010) argues that tax assignment should be linked to expenditure responsibilities, i.e. the bigger the expenditure, the more tax revenue and tax autonomy a subnational government should have.

Indeed, in theory, a *completely local tax* has the following characteristics (Bahl & Bird, 2008):

- local governments can decide whether to levy the tax or not;
- they can determine the precise base of the tax and set the tax rate;
- in the case of “direct” taxes, they assess the tax imposed on any particular taxpayer; and
- they administer the tax and get to keep all the revenue they collect.

However, in practice, local taxes often only possess some of these characteristics. Therefore, it is possible to think of a local tax which is collected at the central government, while the tax base and tax rate are set by the local government and all revenues are kept by the local level (e.g. provincial personal income tax in Canada). In other cases, tax rates can be set at the central level, while subnational governments impose and collect the taxes (e.g. VAT taxes collected by states in Brazil). In the interests of transparency and accountability however, subnational governments should have the power to set the nominal (politically visible) tax rate (Bird, 2010).

What follows is an overview of the modalities for subnational taxation (Junquera et al., 2017). Often SNGs get revenue from a mix of these types of subnational taxes:

1. *Independent subnational taxes*: corresponds to what was mentioned before, a completely local tax. Thus, legislation, administration, and revenue are under the control of subnational governments, often under broad guidelines from the central government. This is often the case with the property tax.
2. *Centrally assisted subnational taxes (co-administration)*: legislation and revenue are under the control of subnational governments; the administration could be shared with the central government, for example, a property tax with central valuation.
3. *Surcharges (piggy-backing)*: administration is under central control, while policy discretion is given to subnational governments to set a rate on the nationally determined tax base. Revenue is given back to the subnational governments on the basis of the tax rate, origin of revenues, residence of taxpayers, or some formula. This structure is sometimes used with income taxes and VAT.
4. *Tax sharing (transfer)*: all policy and administration are under central government control. A portion of revenue is given to subnational governments on the basis of origin, residence, or some formula. For VAT this model is sometimes used, e.g. in China.
5. *Revenue sharing (transfers and grants)*: policy, administration, and revenue are all under central government control. Revenue can then be given back to the subnational governments through revenue sharing based on a formula.

Subnational governments can also rely – and often do so – on *non-tax revenue sources*, such as *user charges and fees*. Some examples are service charges (for example, for water, sewerage and parking), administrative fees (for example, building permits, certificates) and business license fees. Service charges are typically defined per unit of consumption. The challenge in weak institutional contexts, which is the reality in many low and middle income countries, is to get the prices right. Often there is a lack of necessary infrastructure and capacity to set prices, to measure usage, and to collect fees (UN DESA, 2017).

Another challenge related to user charges and fees is that many of the users live in extreme poverty. To overcome this, the use of cross-subsidies, where richer groups of the population subsidize access to services for the poor, has been suggested and has shown success in some countries (UN DESA, 2017). Cross-subsidies between different sectors, where profits from one sector subsidize the service delivery of another sector, are often used in order to reduce or eliminate user charges for health

⁹ Direct taxes are levied directly by the government (e.g. income taxes) and the tax payer cannot shift the burden of tax to others while in the case of indirect taxes the possibility to shift the tax burden to others exists, e.g. in the case of sales tax, which is paid by a retailer, who then shifts the burden to the customer by charging sales tax on goods.

services, which helps to overcome the detrimental effect of such charges on the poor. This has led to an increase in the health utilization rates (Lagarde and Palmer, 2008, as cited in UN DESA, 2017).

2.2 Current state of affairs of subnational taxation in low and middle income countries

Most countries in the world are moving towards more decentralization. Sub-Saharan African countries, however, generally remain rather centralized (Prud'homme, 2003).

Decentralized countries can be categorized as being single-tiered, two-tiered or three-tiered countries (OECD/UCLG, 2016), that is, SNGs can be distributed across one, two or three levels of government. Every decentralized system assigns certain responsibilities to the subnational levels. This differs naturally from country to country but a general scheme is provided in table 1 (OECD/UCLG, 2016: 16).

Table 1 Breakdown of responsibilities across subnational government levels: a general scheme

Municipal level	Intermediary level	Regional level
<p>A wide range of responsibilities:</p> <ul style="list-style-type: none"> -General clause of competence -Eventually, additional allocations by the law <p>Community services:</p> <ul style="list-style-type: none"> -Education (nursery schools, pre-elementary and primary education) -Urban planning and management -Local utility networks (water, sewerage, waste, hygiene, etc.) -Local roads and city public transport -Social affairs (support for families and children, elderly, disabled, poverty, social benefits, etc.) -Recreation (sport) and culture -Public order and safety (municipal police, fire brigades) -Local economic development, tourism, trade fairs -Environment (green areas) -Social housing -Administrative and permit services 	<p>Specialized and more limited responsibilities of supra-municipal interest</p> <p>An important role of assistance towards small municipalities</p> <p>May exercise responsibilities delegated by the regions and central government</p> <p>Responsibilities determined by the functional level and the geographic area:</p> <ul style="list-style-type: none"> -Secondary or specialized education -Supra-municipal social and youth welfare -Secondary hospitals -Waste collection and treatment -Secondary roads and public transport -Environment 	<p>Heterogeneous and more or less extensive responsibilities depending on countries (in particular, federal vs unitary)</p> <p>Services of regional interest:</p> <ul style="list-style-type: none"> -Secondary/higher education and professional training -Spatial planning -Regional economic development and innovation -Health (secondary care and hospitals) -Social affairs, e.g. employment services, training, inclusion, support to special groups, etc. -Regional roads and public transport -Culture, heritage and tourism -Environmental protection -Social housing -Public order and safety (e.g. regional police, civil protection) -Local government supervision (in federal countries)

Source OECD/UCLG (2016: 16).

In order to comply with these responsibilities subnational governments need financial resources. It is not unusual, however, that a mismatch occurs between expenditure responsibilities and revenue sources, resulting in an underperformance of subnational governments.

Expenditure

The spending ratio of local governments is often used as an indicator for decentralization. In highly centralised countries where local authorities have limited spending responsibilities, subnational government expenditure accounts for less than 8% of GDP and 20% of public spending (OECD/UCLG, 2016). 85% of the 26 African countries in the sample of the OECD/UCLG study (2016) on local finances are in this situation. Exceptions are South-Africa (over 35% of public spending and between 15% and 25% of GDP) and Ghana (between 15% and 35% of public spending and between 8% and 15% of GDP) (OECD/UCLG, 2016).

Using the spending ratio indicator, the OECD/UCLG study on local finances (2016) also found that the higher the income of a country, the more decentralized the country is. This is reflected in their high subnational expenditure percentages as part of GDP and as part of public spending, as shown in table 2 (OECD/UCLG, 2016: 22).

Table 2 Subnational expenditure and income country groups (2013)

Subnational government expenditure	Low income	Lower middle income	Upper middle income	High income
% of GDP	1.7	6.3	8.3	13.2
% of public expenditure	7.5	20.3	25.1	29.7

Source OECD/UCLG (2016: 22).

However, care must be taken when using the spending ratio as an indicator of decentralization, as it does not reflect the autonomy of the subnational government in policy making or the power devolved from the central level to the subnational level (OECD/UCLG, 2016).

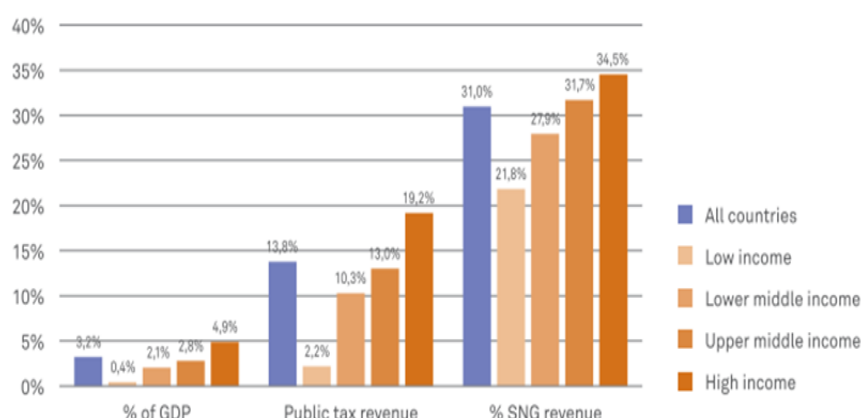
Subnational tax revenue

In parallel to the high expenditure rates of SNGs in upper middle income and high income countries, these countries also have the tendency to assign significant taxing powers to SNGs. In contrast, in low and lower middle income countries central governments have been more reluctant to give more taxing power to SNGs. Most expenditure at the subnational level in these countries is financed through transfers from the central level (Bahl & Bird, 2008).

In low income countries subnational tax revenue represents 0.4% of GDP, 2.2% of public tax revenue and 21.8% of the total subnational government revenue. In comparison, in high income countries subnational tax revenue represents 4.9% of GDP, 19.2% of public tax revenue and 34.5% of subnational revenue (figure 2.1).

Subnational tax revenue as part of total subnational revenue according to the country income level is more homogenous than the other indicators, ranging from 21.8% in low income countries to 34.5% in high income countries, with those countries belonging to the upper middle group being close to the high income group (figure 1). However, it remains that the subnational funding models of high income countries rely more on tax revenue (shared and own) than countries in other groups, especially compared to low income countries.

Figure 1 Subnational government revenue as a % of GDP, public tax revenue and subnational government revenue and income groups



Source OECD/UCLG (2016: 50).

Subnational tax systems

The subnational tax systems that are currently in place in Sub-Saharan Africa have their origins in the former colonial powers. While there have been major reforms in central government tax systems, there have not been big changes in subnational tax systems in many African countries since their independence. Some exceptions can be seen in East-Africa, which have led to the abolishment of the so-called nuisance taxes, such as the poll (head) taxes in Tanzania and Uganda, and to a simplification of the local government tax legislation and administration (Fjeldstad, Chambas & Brun, 2014).

Municipalities in former French colonies, such as Benin, Côte d'Ivoire, Mali, and Senegal essentially apply the 'old four' traditional taxes: tax on buildings, land tax, business license and liquor license. (Fjeldstad et al., 2014).

In Anglophone Africa, at the local level, it is common to find property taxes (on residence and commercial buildings), business licenses and user charges on locally provided services (e.g. water, sewage, garbage, etc.). In rural councils, poll taxes and various taxes and fees on agricultural production and marketing are widespread practices (Fjeldstad et al., 2014).

Table 3 provides an overview of a selection of African least developed countries and the taxes assigned to/levied by the local government levels.

Table 3 Taxes assigned to/levied by local governments in least developed countries

Country	Tax authority at local level
Burundi	Vehicle tax, real estate taxes
Mali	Regional and local development tax, income tax from local civil servants, property tax, other taxes
Rwanda	Property tax, rental income tax, and trading licenses
Tanzania	Development levy, property tax, service levy, business license, fee on trade, crop and livestock cess, other fees and user charges
Uganda	Rents, rates, royalties, stamp duties, crop and livestock cess, fees on registration and licensing and other fees and taxes that parliament may prescribe (property taxes, license and user charges)

Source UN DESA (2017: 55).

2.3 Understanding the dynamics of subnational taxation

Link subnational level – central level – global level

Subnational taxation systems cannot be seen as independent systems. The central level government and the legal framework determine the degree of autonomy of subnational governments over the subnational tax system in designing the system, in setting tax rates, in collection efforts, etc. Thus, the overall tax design of a particular country has a major influence on the policy options that subnational governments have at their disposal.

Also, revenues from subnational taxes and fees are often accompanied by intergovernmental transfers. The establishment of an adequate intergovernmental fiscal transfer system serves three main purposes: it covers for local government fiscal imbalances; it contributes to meet national redistribution objectives; and it helps to offset fiscal capacity differences among governments (reduce inter-regional disparities) (Smoke, 2001). Transfers can be conditional or unconditional. While unconditional grants serve the income redistribution goal best, conditional grants are a way of encouraging expenditures at local government levels on particular types of target services (Smoke, 2001).

The motivation to increase local taxes decreases with the magnitude of intergovernmental transfers: small transfers provide an incentive for significant local taxes, while increased transfers trigger a reduced importance of local taxes. Prud'homme (2003) even found that there exist threshold levels for transfers beyond which local taxation collapses.

Further, global dynamics of taxation and trade liberalization can have an effect at the subnational level. For example, tax havens can provide incentives for companies to not pay taxes domestically. Also, the reduction of trade taxes (promoted by international agencies) through bilateral trade agreements can have as a consequence less tax revenue and the need for searching new tax sources.

Political economy of (subnational) taxation

Designing a subnational taxation system doesn't only require a technical analysis of what would work best for a specific subnational government but also has to take into account political economy issues related to taxation at local and regional levels.

Research on political economy of taxation recognizes that “deeply embedded historical factors, the nature of political systems, and the relationship between the state and citizens condition how much and which revenues can be raised” (Smoke, 2013: 8). The most influential theorists on these issues adhere to (one of) the following approaches (Smoke, 2013):

- *public finance approach*: minimizing the impacts of taxation on economic development and other national goals;
- *taxpayer-focused approach*: considers how ideology, value and culture influence taxpayer willingness to pay and comply;
- *political institutions approach*: explains the development of state capacity and tax systems through historical analysis;
- *crisis-based approach*: how conflict drives tax expansion and modernization;
- *fiscal contract approach*: revenue maximizing governments use state-provided benefits to ‘negotiate’ with payment minimizing taxpayers.

National politics influence “which functions and revenues are decentralized, the degree to which the center is willing to grant subnational autonomy, and the process and support structures that enable subnational governments to assume new responsibilities” (Smoke, 2013: 9). It is then particularly relevant for the subnational level is to know why, under what conditions, and how decentralization was undertaken, and the implications of these decisions for the durability of ‘political will’ at the central level to genuinely empower subnational governments (Smoke, 2013). For example, in a crisis situation, decentralization can be done in a too fast way resulting in a shallow consensus on the shape and process of reform (Smoke, 2013). Also, processes of decentralization could be

suddenly reverted because of changes in the political environment, resulting in a course shift by recentralizing (Smoke, 2013).

Political economy also plays at the very local level. Local elections, for example, are particularly critical moments for tax collection at local levels. It can lead to the politicization of decisions and revenue generation, and therefore patronage, clientelism and non-democratic behavior can prevail (Smoke, 2013). Also, “weak (poorly understood by the general population) civic engagement processes and dominance of civil society by interest groups, local elites or external actors” (Smoke, 2013: 13), often constitute major challenges for subnational taxation. The design of the local electoral system itself may also have its effects on accountability and revenue generation (Smoke, 2013).¹⁰

Good governance and state building

The literature on taxation and governance suggests a positive relation between taxation and state-building¹¹ (Bräutigam et al., 2008). Mobilizing domestic financial resources through the tax system would lead to improved governance through three main mechanisms (Prichard, 2010; Fjeldstad, 2013):

1. *Common interest processes*: governments that are dependent on taxes have stronger incentives to promote economic growth, as they want to increase the prosperity of taxpayers.
2. *State capacity processes*: states that depend on taxes have to develop a bureaucratic apparatus for tax collection. This would also lead to broader improvements in public administration.
3. *Accountability and responsiveness processes*: negotiation and fiscal bargaining over taxes by taxpayers (social fiscal contract). Taxpayers expect something in return for the taxes paid, and are more likely to hold their government accountable if it underperforms.

At the subnational level the latter two are particularly relevant:

- *State capacity processes*: when local governments are attributed greater autonomy and responsibility for tax levying and collection, they are forced to expand and strengthen the bureaucratic apparatus that will help them to successfully complete this task. This, however, is still one of the main challenges for the optimization of taxation processes at the local levels.
- *Accountability and responsiveness processes*: the decentralization process should bring the government closer to the people. This, in theory, should enhance transparency and accountability (Bräutigam, 2000). By taking revenue and expenditure decisions to the local level, which makes them more visible for the people, decentralization is expected to strengthen the connection between what people pay and what they get in return (Prichard, 2010). However, at the subnational level many lines of accountability and funding channels for service delivery come together, making it less clear for citizens what to expect from elected local governments. In Kenya for example, constituency development funds were awarded to parliamentary constituencies, which overlap subnational government jurisdictions, to finance community driven development programmes, providing services to local actors. These can compete with nascent subnational governments, generating confusion among tax payers, which in turn can have a negative influence on tax compliance rates as accountability lines are not clear (Smoke, 2013).

What makes that people pay taxes?

Tax compliance. An important concern for local governments is to ensure a high degree of voluntary tax compliance by their citizens. But what makes that people voluntarily pay their taxes? First of all, voluntary compliance by tax payers is closely linked to the legitimacy of the local government. Indeed, the extent to which tax is collected through quasi-voluntary compliance is a sign that the tax regime has at least a broad passive legitimacy among the population (Levi, in DiJohn, 2010).

¹⁰ More research is needed to understand the fiscal effects of subnational electoral practices and outcomes in developing countries.

¹¹ State-building can be defined broadly as ‘the process of increasing the administrative, fiscal and institutional capacity of governments to interact constructively with their societies and to pursue public goals more effectively’ (Bräutigam et al., 2008: 2).

Also, research indicates that when citizens feel fairly treated, i.e. when they perceive they receive benefits for revenues paid and the payments made are similar to other local residents, they will be inclined to make local tax payments demanded of them (Smoke, 2013).

One of the advantages of fiscal decentralization is the potential for strengthening bargaining between the citizens and the government around taxation (Prichard, 2010). For example, some local governments have successfully experimented with participatory mechanisms in order to improve tax payer compliance. The city of Porto Alegre (Brazil), for example, is a pioneer in the field of participatory budgeting, which has proven to increase tax payer compliance (Schneider and Baquero, in Smoke, 2013).

A case study on a local poll tax in two district councils in Tanzania (Fjeldstad & Semboja, 2001) found support for the hypothesis that tax compliance is higher:

- the higher income a taxpayer has;
- the higher the (perceived) probability of prosecution is¹²; and
- the fewer tax evaders the tax payer personally knows.

This research also found that the majority of respondents (90%) was willing to pay more taxes if services were improved. However, some of them added that this would also depend on their ability to pay.

The link between improved service delivery and increased tax compliance was confirmed in other research. Using attitude and perception data on taxation from the fifth round of the Afrobarometer surveys (2011–2012), Ali, Fjeldstad and Sjursen (2014) found that tax-compliance attitude is positively correlated with the provision of public services in Kenya, Tanzania, Uganda and South-Africa. However, differences were found between countries and between the specific services in question: “[w]hile access to infrastructure such as roads and electricity encourage tax compliant attitude in Kenya, respondents in Tanzania and Uganda refer to education and health services as key to their tax compliance. In South Africa, the government’s provision of services such as police services and issuing identity cards are likely to increase tax compliant attitude.” (Ali et al., 2014: 837). Tax knowledge and awareness are also found to be positively correlated with tax-compliance attitude (Ali et al., 2014).

Research has also tried to identify factors that can create resistance to tax compliance. These include the perception of inequities in taxation, i.e. that certain groups are perceived of being taxed unequally compared to others, or uncertainty about how tax proceeds are used by the local government (Smoke, 2013). This also undermines citizen trust in their subnational government (Smoke, 2013).

Also, the same case study as cited above on a local poll tax in two district councils in Tanzania brought to light that oppressive tax enforcement, harassment of taxpayers and discontent with public service delivery seem to increase tax resistance (Fjeldstad & Semboja, 2001).

The case of Senegal, studied by Juul (2006), provides further insight in the complex nature of the lack of tax compliance at local levels. Indeed, in Senegal, tax compliance decreased after collection was devolved to local councilors. Different reasons were found for this decrease, such as poor service delivery and weak confidence in local authorities. Also, local governments could not use police services anymore to enforce tax levying: when coercion drops, tax compliance drops too. Interestingly, the small amounts of taxes that were collected, came mostly from newcomers (with this group presenting the highest compliance rates), which was a way for them to be recognized as citizens with rights and obligations. Also, non-state actors seemed to have taken over some of the public service provision functions and managed to mobilize large amounts of revenue outside the formal tax system (Juul, 2006).

¹² This is explained by the visibility of tax evasion at local levels, i.e. taxpayers cannot hide their liability except by hiding their existence or migrating to another council where the tax is inexistent or is imposed at a lower rate (Fjeldstad & Semboja, 2001). “[T]axpayers’ perceptions concerning the likelihood of being prosecuted and the severity of penalties affect their choice to pay or not” (Fjeldstad & Semboja, 2001).

In sum, no clear-cut conclusions can be drawn on the issue of tax compliance due to its complex nature and the existence of mostly case-study research. The case-studies also suggest that the factors contributing or not to tax compliance are context-specific and cannot always be generalized.

However, consensus is growing on the fact that the lack of trust in the fiscal relation between citizens and the government is the key element which is blocking voluntary tax compliance (Fjeldstad & Rakner, 2003). “In particular, three dimensions of trust seem to influence compliance: (1) trust in the local government to use revenues to provide expected services; (2) trust in the authorities to establish fair procedures for revenue enforcement and distribution of services; and (3) trust in other citizens to pay their share of service charges” (Slemrod, 2002, in Fjeldstad & Rakner, 2003: 29; Levi, 1998, in Fjeldstad & Rakner, 2003: 29). One way to enhance trust is to establish better links between the demand and supply side of services. This is further evidenced by observations of high compliance and less free rider problems in many self-help activities (SHA) in local communities, which coexist with high rates of tax evasion and resistance in the official tax system (Fjeldstad & Rakner, 2003).

In the subnational system tax compliance is also related to taxpayer perceptions of fairness and value for money. In order to promote that, it is suggested that citizens should be informed and actively engaged around the mobilization and use of taxes. “The potential benefits of greater transparency in publicizing tax information appears substantial, particularly when linked to efforts at broader community mobilization” (Prichard, 2010: 30).

Enforcement and coercion. Tax enforcement is an important part of any taxation system. At local levels, the tax collection and enforcement process could be seen as a bargaining process between different stakeholders that all have their specific interests. The administration or the management of the local authority wants to collect enough taxes to pay the wages of the local staff. The local politicians want to be re-elected so their interest lies in raising taxes just up to the level that people start to complain. Interestingly, during election years, there is often a downfall of tax revenues at local levels. The position of the central government is vague. However, the central level usually considers the local tax collection efforts as a means of keeping the state machinery active at local levels (Fjeldstad, 2000).

Correspondingly, these different stakeholders in the tax collection process with their different bargaining powers, also have different views on tax enforcement (Fjeldstad, 2000). Fjeldstad (2000) found that the level of coercion, i.e. the practice of forcing taxpayers to pay by use of threat or force¹³, depends on these bargaining powers. He found that coercive tax enforcement becomes more likely when the local government administration has more power over tax collection relative to elected councilors (Fjeldstad & Therkildsen, 2008). It was also found that this ‘balance of power’ between the administration and the elected, could be influenced, in favor of the local administration, by the presence of donors in a local authority (Fjeldstad, 2000).

2.4 Challenges for subnational taxation

Research on local tax systems in low and middle income countries documented some of the recurring challenges for strengthening subnational taxation. In general, most local tax systems are characterized by high levels of arbitrariness, coercion and corruption, an anti-poor bias and the creation of major economic distortions (Prichard, 2010; Fjeldstad & Therkildsen, 2008; Juul, 2006).

More specifically, the following challenges were identified in the recent literature on the issue.

Limited fiscal autonomy

Decentralization and fiscal decentralization is a relatively recent development in low and middle income countries. Additionally, in many countries the political will of the central government level

¹³ For example, there is evidence of tax raids involving the military or the police in the 1990s in Uganda (Fjeldstad, in Dijkohn, 2010).

for these processes is lacking (Smoke, 2013). In Sub-Saharan African countries, the central government's control over the local revenue system is therefore still very strong, and more so in the Francophone countries in West Africa than in Anglophone East Africa (Fjeldstad, Chambas & Brun, 2014).

In addition to this lack of fiscal autonomy at local levels, there is also a lack of coordination between the different levels of government (local – central) on taxation issues (Fjeldstad & Semboja, 2000). For example, in Lesotho, municipalities are legally empowered to raise revenues and borrow through the Lesotho Local Government Act (1997). However, political inertia stands in the way of effective fiscal decentralization, as the Minister has not yet published the list of items from which local councils may collect revenues by way of tax or levy of charge, constraining the implementation of the 1997 Act (UN DESA, 2017).

Weak social fiscal contract

Tax compliance at local levels is often low in low and middle income countries. As already mentioned, important factors that may contribute to an increased tax compliance are good service delivery by the local government, access to information by citizens and a high degree of trust in the local government. A general absence of these factors, however, leads to a weak social fiscal contract between taxpayer and local government. Technical improvements of local taxation systems are then only likely to have a positive effect when they are also committed to strengthening this social fiscal contract.

As Smoke puts it: “subnational revenue specific arrangements, mechanisms to appeal property tax assessments or local business license fees, for example, will not be effective if people do not know about them or face barriers in using them, such as the lack of appropriate knowledge, poor access to advice, or even outright intimidation” (Smoke, 2013: 16).

Also, civil society has a role to play in strengthening the social fiscal contract. A more engaged and capacitated citizenry can be a key success factor of decentralization and could substantially increase the willingness to pay (Smoke, 2013).

Weak capacity of the local administration

“[In]capacity is often cited as a key factor in limiting the access of subnational governments to revenue” (Smoke, 2013: 7). The already mentioned lack of coordination between various levels of government on taxation issues has partly to do with a lack of capacity at any level. At the local level, the serious shortage of qualified staff at the treasury and planning departments is particularly critical (Fjeldstad, 2013).

However, capacity building often constitutes a large share of resources for fiscal decentralization. The key point is *how* capacity building is done. Smoke (2013) argues that many low- and middle-income countries continue to focus on a supply driven (by the central government) classroom training model, while growing consensus is rising on the fact that “on the job” training demanded by local governments for tasks they are currently implementing is more effective (Smoke, 2013).

Limited revenue base and the informal sector

A constant concern of local authorities is on how to broaden the tax base, as this would allow them to increase revenue from taxation.

While intermediate and metropolitan governments often have the possibility to raise substantial revenues, the situation for rural areas where poverty rates are high, can be rather different. With a lack of revenue base in these situations, it is much harder to strengthen subnational revenue generation (Smoke, 2013).

Additionally, many local authorities in low and middle income countries are faced with big informal sectors that are not taxed. Although a large share of the economic activity is located within the informal sector, taxing this sector is often not the priority of the local authority. Returns to effort

may be low in terms of cash, and collection is likely to be a difficult and unpleasant task (Fjeldstad & Moore, 2008). From a state building perspective however, broadening the revenue base by increasing efforts to tax the informal sector, is vital to building the social fiscal contract (Fjeldstad, 2013). It is also a central element for an equitable tax regime.

Subnational political dynamics

Even when policies and systems that are consistent with key fiscal principles and the most favorable national political conditions are in place, local revenue generation can face important subnational political challenges:

How subnational governments use revenue powers depends in great part on where local political power really lies—economic elites, certain ethnic/religious groups, members of particular political parties, labor unions, civil society movements, etc.-- and the resulting incentives faced by local politicians. (Smoke, 2013: 13).

For example, local councilors may impose a too heavy or too light tax on businesses relative to certain individuals or certain sectors, causing behavioral distortions and inequities.

Corruption may also be more or less likely under decentralization depending on the nature of social and political relationships. This could be tackled by improved accountability and citizen trust. On the other hand, corruption could intensify when relationships between the electorate and their representatives are personalized (Smoke, 2013).

2.5 Designing subnational taxation systems

Design principles

“There is much to be thought about before determining what taxes subnational governments in any particular country should have access to and with what degree of freedom” (Bahl & Bird, 2008: 1). Designing a subnational taxation system cannot be done in a vacuum. In the decentralization process, it is important that first clear expenditure assignments are established to the different levels of government. Further, there is need to think about an intergovernmental transfers system to offset at least some of the ‘inequality generating’ effects of fiscal decentralization. Also, the differences related to scale and scope of operations of the subnational governments should be taken into account before making decisions on the packages of tax choices that they would dispose of.

Bahl & Bird (2008) did an attempt to formulate a series of basic principles to take into consideration while designing a subnational taxation system:

- no unnecessary distortion of the allocation of resources;
- accountability: governments should be responsible at the margin for financing the expenditures for which they are politically responsible;
- own-source revenues should be sufficient to finance all locally provided services that primarily benefit local residents, in order to reduce the vertical fiscal imbalance (so the need for intergovernmental transfers reduces);
- subnational revenues should burden only local residents, for accountability reasons.

Depending on the level of fiscal autonomy that decentralized governments dispose of, they have more or less discretion to impose one or another tax at subnational level, to set the tax rates and to structure the collection process. In order to make these choices many factors must be taken into consideration, such as the level of economic development, the demographic composition, the geographic size and the population size of the local authority (UN DESA, 2017).

The attempts to assess the potential and political adequacy of specific local revenue sources are numerous. Based on a literature review, Smoke (2013) provides an overview of ten key principles to assess local revenue sources. These could provide guidance during the design process of subnational taxation systems and could inform policy decisions. Such principles include the following:

1. *Revenue adequacy*: is the set of taxes adequately covering the local government's budgetary needs?
2. *Revenue buoyancy*: are revenues increasing in proportion to the economy and expenditure needs?
3. *Stability*: is the revenue source stable, i.e. doesn't have large fluctuations in revenue yields, which would undermine the ability of subnational governments to provide services?
4. *Correspondence between payments and benefits* (including limiting tax exporting, i.e. the taxation of citizens who are not under jurisdiction of the local government): do taxpayers perceive that they receive a tangible benefit through the way tax incomes are spent by the local government?
5. *Distortionary impact*: are revenue sources designed to minimize distortions of economic decisions made by individuals and firms (e.g. which could result from differentiated base assessment and rates)?
6. *Autonomy*: does the revenue source allow subnational governments to make independent decisions (discretion), creating a link between revenue generation and service delivery?
7. *Administrative feasibility*: are revenue sources not too complex or expensive to implement?
8. *Political feasibility*: is the revenue source politically feasible, in order to maximize the acceptance and compliance degrees of the local citizens? Do the tax payers see value for money, fair treatment, and find the practical implementation of the revenue source acceptable (e.g., through small payments over time versus large lump sums)?
9. *Equity*: does the revenue source ensure fair treatment among equals (horizontal) and across different groups?
10. *Integration/consistency*: does the logic of the full set of subnational revenues is ensured? Is there consistency with the rest of the national fiscal system?

However, even when the subnational revenue system is designed in the best way, taking into account all these principles, important constraints, such as the challenges described in the previous chapter, can still limit positive outcomes.

Pros and cons of different revenue sources

Common subnational taxes in low and middle income countries are asset taxes, including taxes on immovable property (land and building), machinery and equipment, motor and other vehicles, and natural resource taxes and charges; user fees and charges for specific services; consumption taxes, including excises, sales taxes, and VAT; income taxes on individuals and businesses and payroll taxes on employers; and local business taxes, including business permit or regulatory fees and licenses (Junquera-Varela et al., 2017; Smoke, 2013).

In a brief overview of a selection of these taxes, mainly based on the work of Bahl & Bird (2008), the advantages and disadvantages of each tax are summed up.

Property tax (on land and buildings)

Subnational governments in low and middle income countries have often been told that the only appropriate tax for them was the property tax. Many local governments indeed try to increase the subnational revenue by strengthening their property tax system.

Some of the advantages of the property tax include (Bahl & Bird, 2008):

- buildings cannot 'run away' or 'hide' from tax officials;
- it confronts the people with the cost of government (people have to make periodic large payments), which contributes to political accountability;
- it is an adequate tax in order to finance local services such as roads and garbage collection: the quality and quantity of these services (or their absence) is directly linked to the property tax.

Research has also drawn attention to some of the disadvantages of the property tax, such as (Bahl & Bird, 2008; Byamugisha, in UN DESA, 2017):

- in many cases, especially in big cities or at the regional level, the tax doesn't yield enough revenue;
- valuation of property is a complex task with much room for discretion and argument with respect to the determination of the base of the tax;
- taxpayers can easily compare their property taxes with those of similar properties in the neighborhood; discrepancies between assessed values and market values within classes of property, and across municipalities can then lead to costly appeals by taxpayers and to pressure for tax relief;
- there is no automatic increase of the base of the property tax, so periodic nominal rate increases are necessary in order to maintain real revenue levels;
- there is a general lack of land registration titles;
- there is no continuous assessment of rising land values due to the lack of qualified staff and resources for local governments; this leads to important revenue shortfalls;
- increases in property taxes are often focused on nonresidential properties, i.e. businesses, that most lend themselves to tax exporting;
- it is a very visible tax, which tends to increase tax payer resistance, especially when tax burden increases, even in the case of nominal increases; it is thus also sensitive to political resistance.

From the assessment of advantages and disadvantages a list of criteria or guiding principles for a successful local property tax was also presented by Bahl & Bird (2008).

- First, local governments must have the autonomy to set their own tax rates. Few developing countries currently allow much freedom to local governments to do so. On the other hand, where greater autonomy is given to local governments, this power is often not fully used because of generous intergovernmental transfers.
- Second, the tax base must be maintained in an adequate way. In countries with inflation concerns, it may be advisable to implement a kind of index adjustment of assessments.
- Third, in the case of centrally coordinated systems, assessment agencies must be provided with direct financial incentives to keep local tax bases up to date.
- Fourth, the reform of property transfer taxes¹⁴ should be carefully assessed. In developing countries transfer tax rates are usually high. This encourages an under-declaration of sales values and compromises the database which is used to do the valuation for the property tax.
- Finally, to improve efficiency in tax collection, valuation accuracy, and the coverage of the potential tax base, procedural reforms are often needed.

Research on the property tax suggest two possible approaches to local property tax reform, favoring a collection-led approach over a valuation-pushed reform, especially in weak institutional contexts (McCluskey, 2015, in UN DESA, 2017; Smoke, 2001). It is argued that in these contexts efforts should focus on improving tax collection and ensuring practical enforcement of tax legislation instead of registration and valuation of properties¹⁵. Especially in smaller urban and rural jurisdictions with limited local administrative capacities and no central administrative support, a collection-based reform could be more successful (UN DESA, 2017).

Excise taxes

Excises are a kind of indirect tax and is considered as an appropriate tax for the subnational level, especially the regional level and to a lesser extent the municipal, local level.

Among the advantages of these taxes research has found the following (Bahl & Bird, 2008):

- it is a tax that can have differentiated rate determination among regions;

¹⁴ This is a tax related to changes to a property's title, for example, on the purchase of property or the interest gains from property.

¹⁵ Examples of valuation efforts are: set up fiscal cadasters (such as, comprehensive and perpetual inventories that describe and assess the value of landholdings) or street addressing (that is, giving streets names and/or numbers).

- it is an efficient tax and there is little distortionary effect;
- positive outcomes or benefits are mainly seen when the excise tax is linked to the expenditure responsibility of the subnational government, for example excises on alcohol and tobacco when the subnational government is responsible for health expenditures, or excises on vehicles and fuel when the subnational government is responsible for roads.

Some disadvantages of excises have also been put forward (Bahl & Bird, 2008):

- it does not seem very desirable to link regional finances in a substantial way to the inelastic levies¹⁶ through excises when the pressure on those finances comes largely from elastic expenditure demands¹⁷ for health and education;
- the benefit case for ‘sin’ taxes, i.e. taxes on ‘sinful’ goods and services such as tobacco and alcohol, is weak.

User fees and user charges

User fees and user charges are similar to excises. They are charged on the specific users of a service.¹⁸ In research they have been mentioned as a potentially important revenue source for subnational governments (Smoke, 2001). Among the advantages are the close connection between consumption and cost, an easy collection process because of the direct nature of the charges, and the possibility for excluding nonpayers (Smoke, 2001).

Challenges are related to problems with increasing user fees and user charges for public services, such as the political sensitivity of increasing fees/charges, a reluctance to raise charges/fees over time, resulting in a shortfall of revenue in times of increased costs due to inflation, and, for equity reasons, concerns about the effects of user charges on people with limited financial capacity (Smoke, 2001).

Smoke (2001) identified five principles that should be taken into consideration when applying user fees/charges at the subnational level:

- it is best to charge for services that have some private characteristics, especially where benefits vary among individuals and nonpayers can be excluded from consumption (for example, bridge tolls, user fees for the use of municipal facilities, a market fee for the use of the market storage place);
- for more ‘public’ goods, user fees or charges could be useful to establish a link between consumption and costs; research increasingly shows that people are willing to pay for services in exchange for adequate quality and reliability;
- equity must guide decisions on setting charges or fees; cross-subsidization of certain target groups can be implemented to overcome price discrimination across users, and could allow for cost recovery (for example, some local governments use a pricing system for electricity, whereby the price per unit of consuming this municipal service increases as more of it is consumed and is free up to a designated level);
- efforts should be done for public education and consultation schemes, in order to get people to accept new and increased user charges;
- finally, user fees and charges “need to be phased in over time to prevent harsh equity effects, undesirable changes in patterns of service use, administrative and political resistance and so on” (Smoke, 2001: 25).

¹⁶ Inelastic levies such as excises on goods such as cigarettes or alcohol, do not affect the demand for these goods. So when demand for these goods stays to a great extent the same, income for the local government from an excise tax on these goods, will remain the same.

¹⁷ Elastic expenditure demands mean that when, for example, the price of health and education drops, demand will increase for these services and expenditure for the government to provide them will also rise. So, when this expenditure is linked to inelastic levies such as excises, these won't follow the same dynamics of the elastic expenditure needs at the risk of not being able to finance properly these services.

¹⁸ The discussion on the differences between taxes and fees is ongoing. In general, it is assumed that fees are charged on a specific group of users of a service and that there exists a direct link between the fee and the service that the payer receives. Taxes don't have this direct link between the individual payer and the service delivery.

Personal income taxes

Personal income taxes are usually levied at the central government level. However, through piggybacking (surcharges) subnational governments could also get revenue from this tax (Bahl & Bird, 2008). They are especially interesting for regional governments or large urbanized areas, and less for the local, municipal level. An advantage of personal income taxes is that they can be levied on a destination (resident) basis instead of on an origin (employment) basis and in that way, they would improve political accountability (Bahl & Bird, 2008).

Among the reasons against the use of this tax at subnational level research has highlighted that central governments highly rely on this source of revenue (Bahl & Bird, 2008), making it unlikely that they will share this with other government levels. Also, it is a tax that is hard to collect, even with central governments facing important challenges with personal income tax collection (Bahl & Bird, 2008). Finally, it also has several administrative and political weaknesses, such as a very narrow set of taxpayers, a poor capacity to expand the tax base to self-employed people, and resistance from wealthy individuals to pay this tax (through concealing their income) (Fjeldstad, 2013).

Consumption taxes (general sales tax)

The value added tax (VAT) is the most widely known sales tax, that is often levied at the central government level. However, with a good tax administration it is surely feasible to operate a VAT at the subnational level on a destination basis, especially for relatively large regional subnational governments (Bahl & Bird, 2008). The downsides of this tax are the high administrative and compliance costs, the possible loss of macroeconomic control, the reluctance of central governments to share VAT with subnational governments and the possible problems with cross-border (interstate) trade (Bahl & Bird, 2008).

Business taxes

Corporate income taxes, capital taxes, nonresidential property taxes, and such ancient levies as *octroi*, *patente*, and various forms of 'industry and commerce' tax are found in many developing countries (Bahl & Bird, 2008).

Business taxes have actually been an important means for local governments of expanding revenue, especially when confronted with the restrictions (and unpopularity of) residential property taxes and the lack of reliability of central transfers (Bahl & Bird, 2008).

Some of the advantages of this tax are listed by Bahl & Bird (2008):

- they produce substantial revenue and tend to be more elastic than, for example, property taxes;
- people don't have a clear view on the incidence of such tax, which makes it easy to assume for local residents that these taxes are paid by someone other than themselves.

Researchers Bahl & Bird(2008) make a specific case for a business value tax at local levels, which is a VAT levied on the basis of income (production, origin) instead of on consumption (destination), like a usual VAT. It is considered less distorting for investments than other business taxes and it is less susceptible to evasion and base erosion, and less volatile over business cycles. However, risks related to the business value tax is tax competition and tax exporting.

3 | Donor support to local taxation

3.1 Historical evolution

Focus of donors on taxation issues has traditionally been on central governments. However, in recent years the promotion of decentralization has become more apparent, as well as direct aid flows to decentralized governments. The International Monetary Fund (IMF) and the World Bank (WB) have traditionally supported tax reform in low and middle income countries. More recently other donors have taken an interest in the topic, such as bilateral donors, development banks and international agencies (Fjeldstad, 2013).

Also, the content of the tax agenda has broadened over time: in early times, reform focused strongly on the reduction of trade taxes, their replacement with VAT, and the lowering of direct tax rates, while contemporary reform efforts focus increasingly on improving the tax administration, and an emerging interest in the links between taxation, accountability and broader state-building goals (Fjeldstad, 2013).

The dimension of donor support to local taxation is rather small. As of 2015, of all ODA assistance to domestic resource mobilization only 4% had a subnational focus (Oxfam, 2017). In general, (trustworthy) data on the dimension of support streams to local taxation initiatives is however not readily available.

In 2015 the donor community agreed upon the Addis Abba Action Agenda (AAAA) on Financing for Development and the Addis Tax Initiative (ATT), which includes a goal to double donor support for technical cooperation on taxation issues by 2020. In a context of a tendency towards deepened decentralization in low and middle income countries, donor programmes will likely have – at least a minor – focus on strengthening local taxation initiatives.

3.2 Approaches of donor support to taxation

Few scholars have looked into specific donor interventions on local taxation in low and middle income countries. The focus is generally on programmes aiming at supporting taxation at the level of the central government.

Main working areas of donor support

Fjeldstad (2013) identified three broad working areas of general donor support to taxation¹⁹: (1) improving tax policy and design, mainly for revenue increasing purposes; (2) creating more effective tax administrations; and (3) encouraging constructive state-society engagement around taxes.

Improving tax policy and design, mainly for revenue increasing purposes

The first working area includes discussions on different types of taxes, tax systems reform, and tax law. The overall interest is generally on revenue increase. Early donor efforts focused for example on the implementation of a progressive personal income tax system, which failed in low- and middle-income countries. In the 80s the international community aligned to a set of recommendations for low- and

¹⁹ In this case it is not about the specific support offered to subnational governments.

middle-income countries, which included “(a) simplification of tax structures and procedures; (b) the elimination of export taxes; (c) reduced tariffs and less reliance on trade taxes; (d) a dual income tax system with a simplified progressive tax on labour and a simple, often flat, and fairly low corporate tax; and (e) expanded reliance on goods and services taxes, in particular the VAT” (Fjeldstad, 2013: 4). The suggested shift from trade taxes to VAT didn’t live up to expectations in many countries for a series of reasons, such as, difficulties to collect VAT, lack of organizational capacity of the government, and weak bookkeeping capacities (Fjeldstad, 2013). Also, according to Fjeldstad (2013), focus has been too predominantly on overall revenue increase targets (mainly measured as tax-to-GDP-ratio), which in some cases, can have negative influences on taxpayer’s rights, as enforcement becomes more coercive, and on accountability, by empowering the bureaucracy at the expense of the elected politicians. Further, most donor effort on tax reform has focused on the central government level, leaving subnational levels largely unchanged since independence (Fjeldstad, 2013).

Strengthening the tax administration

A second working area focusses on creating more effective tax administrations. Donor interventions include a wide variety of actions, such as “exploiting new information and communication technologies; moving from a system organized around different taxes to one organized around localities and/or industries so that individual taxpayers have to deal with fewer tax officers; introduction of unique taxpayer identification numbers; establishing different offices and procedures for different categories of taxpayers, typically starting with focus on big companies; trying to make the collection process more ‘user-friendly’; in some countries using commercial banks as collection agents; using audit units more selectively and strategically to check on the performance of tax collectors; and, creation of revenue authorities²⁰ across much of Latin America and anglophone Africa” (Kloeden, in Fjeldstad, 2013: 6-7; Keen, in Fjeldstad, 2013: 6-7).

Encouraging constructive state-society engagement around taxes

While the first two working areas have been of major interest to donors, the third has often been left behind. As argued in the paragraph on the relation between taxation and governance in chapter 3.3., “[t]ax systems can potentially contribute to shaping accountability relationships between the state and citizens, and strengthening state capacities” (Fjeldstad, 2013: 10). Presenting tax reform as a merely technical issue, as many donors currently do, without addressing state-building issues such as citizen engagement over taxation and (local) politics, will therefore have only limited results (Fjeldstad & Moore, 2008).

Academic literature seems to favor a tax reform agenda which includes efforts to strengthening all three dimensions of taxation: (i) tax policy design; (ii) tax administrative capacity; and (iii) governance, including fairness, predictability, transparency and accountability (Fjeldstad: 2013). However, as to donor support to local taxation specifically, an OECD (2004) report mentions that overall, support has been fragmented and badly coordinated, with some donors working on improving property taxes while others on income taxes, without a clear view on the overall tax potential and capacity.

²⁰ One example are the semi-autonomous revenue authorities (SARAs), which were implemented in Peru for example. Evidence on (S)ARAs success is mixed (Fjeldstad, 2013). A study on local tax collection in Peru found that local governments with semi-autonomous revenue agencies (SARAs) collect more revenue than those with conventional tax administrations (von Haldenwang, von Schiller & Garcia, 2014). The research also indicates that local revenue is more stable in municipalities with SARAs, which is good for budget policy and planning. However, while some have made impressive advances, other revenue authorities have seen little progress, or initial progress stagnated. This is attributable to (S)ARAs being quite diverse in terms of revenue authority model; being mostly new and evolving; and having been introduced in part at the urging of aid donors and international financial institutions (Fjeldstad, 2013).

3.3 The complex relationship between aid and taxation

Besides development programmes that directly support the taxation systems in low and middle income countries, financial flows in the framework of development cooperation have also been identified as having an indirect effect on taxation, and more specifically on tax effort. However, research is not conclusive on the question if these flows create incentives for recipient governments to reduce tax collection efforts or not.²¹ Bräutigam (2000: 48), for example, finds that “[h]igh levels of aid provide no incentive at all to boost domestic revenue generation”. However, the way in which ‘aid’ is delivered plays an important role and could possibly revert this negative side-effect. Solutions such as using a matching funds system, substantial debt forgiveness and cutting back on the number of donor-funded projects are suggested (Bräutigam, 2000).

Dijohn (2010) does not find sufficient evidence to claim that ‘aid’ would negatively affect domestic tax collection efforts, pointing out three main arguments:

- Great amounts of aid remain ‘off-budget’²², that is they are not reported to the central finance ministry and thus not visible for political leaders as available resources, so providing no incentive to reduce domestic tax collection efforts.
- Even when aid levels are high, the high volatility and unpredictability of these aid flows will hold back political leaders from reducing domestic tax collection.
- Increased domestic revenue collection equals reduced aid dependency, which may be a priority for political leaders as this will give them more policy space and less dependence on donors’ conditionalities. For example, the Ghana Tree Program, aimed at improving domestic resource mobilization at the decentralized level, is part of the exit strategy of the Dutch development cooperation and constitutes an important pillar of the ‘Ghana Beyond Aid’ programme of the government of Ghana.

At the local level specifically, donor presence has also been identified as a factor that could negatively influence taxation. In order to overcome problems of free riding by local councils, some donors have adopted a matching scheme, providing aid only on the basis of matching funds from the own revenue mobilization of the local government. This is believed to provide important incentives for revenue collection (Catterson & Lindahl, in Fjeldstad & Therkildsen, 2008). Also, it is acknowledged that donor support to local governments may soften the effect of possible taxpayers’ opposition (Fjeldstad & Therkildsen, 2008).

Fjeldstad (2000) further found that donor support to local governments may change the ‘balance of power’ between the local administration and the locally elected councilors. Cooperation between donors and the local government partner is often concretized in a direct contact with the council administrators and staff, more than with the locally elected. Following Fjeldstad (2000), this increases their influence and power, at the expense of the local political system. So, external donor interventions may have the dis-empowerment of the political organs of local authorities as an impact, failing to strengthen state-citizen relations, which, as stated before, are central to a successful local taxation system (Fjeldstad, 2000).

3.4 Decentralized cooperation and taxation

This study focusses on decentralized development cooperation in the field of local taxation. In this modality, local governments are the lead actors of the cooperation effort. The overarching goal is sustainable local development and the focus is on activities such as exchanges and financial, technical

²¹ See Prichard, Brun & Morrissey (2012) for an overview of this debate.

²² However, high degrees of off-budget aid is often problematic for recipient governments. From interviews with finance ministry officials across African countries with high degrees of off-budget aid it was found that this creates problems of macroeconomic planning and the general coordination of aid (Dijohn, 2010: 23).

and strategic support (Haftack, 2003). Many of decentralized cooperation projects are implemented in the framework of municipal twinning arrangements between a local government from a high income country and a local government from a low or middle income country, but other modalities are also possible, which involve local government associations or other development actors.

A distinguishing feature of this cooperation modality between local governments is that its intervention strategy is focused on learning in pairs and on exchanging good practices (UCLG, 2013).

It is also acknowledged that decentralized cooperation between local governments has several advantages or strengths:

- It works through existing structures, i.e. local governments, as opposed to bilateral, multilateral and NGO interventions that often require the set-up of parallel structures (UCLG, 2013; Dijohn, 2010).
- Local governments have in depth knowledge of the responsibilities as providers of concrete basic services to enhance local quality of life; of being accountable institutions towards citizens; and of implementing and advocating for decentralization and devolution policies (UCLG, 2013).
- Local governments are best placed to build linkages between the partners' local civil societies (UCLG, 2013).
- There is a high potential for peer-to-peer learning (UCLG, 2013).

Some of the weaknesses and challenges of decentralized cooperation between local governments have also been documented (UCLG, 2013):

- The lack of a systematic approach and coordination in the choice of partnerships with local governments: there is often a concentration of partners in a certain local government, while others lack support.
- Lack of ownership of programmes: the priorities of the local government in the partner country are not always met.
- Lack of continuity due to political changes.
- Lack of professionalism: too little focus on strategic results and insufficient monitoring and evaluation.
- Many partnerships do not benefit from citizen support.

Following the classification used by the UCLG (2013), three main models of funding for decentralized development cooperation can be distinguished which define the way decentralized cooperation is organized:

- *Local traction (e.g. France, Spain, Italy, United Kingdom, Denmark, Germany):*
 - A significant amount of funds come from the donor municipality or region's own local budget (e.g. France, Spain, Italy) or local governments mainly rely on the funds made available at national level and contribute small amounts from their own local resources (e.g. the United Kingdom, Denmark, Germany).
 - Partnerships are created freely and priorities of cooperation are established by both partners.
 - Broad-based support of the civil society.
 - Often a weak performance in relation to the coordination with other partners.
- *Coordination and exchange of practices (e.g. Belgium, Finland, Sweden):*
 - The local government association in the donor country coordinates a broader programme of local government development cooperation, funded by the national government.
 - The local government association channels funds for city-to-city cooperation to the domestic municipalities involved and ensures that partners at both ends of the partnerships are trained to achieve tangible results.
 - The local governments may provide co-financing.
- *Programme-based: alignment and focus (e.g. the Netherlands, Canada):*

- The national government has tasked the local governments association to implement activities on behalf of the municipalities.
- Municipal expertise is used, while the association coordinates, implements and manages the programme.
- A more integrated development approach is used, with a clear focus on priorities and expected outcomes and impact.

4 | Case studies of decentralized cooperation on local taxation

4.1 Brief description of the case studies

Case studies for this report were selected (table 4) in order to represent a mix of decentralized cooperation modalities from the categories described in the previous chapter.

Table 4 Decentralized cooperation modalities and selected case studies

Modalities	Selected case studies
Local traction - With a significant amount of funds coming from the donor municipality or region's own local budget. - Donor government mainly relying on the funds made available at the national level, and contributing small amounts from their own local resources.	Decentralized cooperation between the department of Yvelines (France) and the intercommunal Gi-Mono (Benin).
	City twinning and decentralized cooperation between Munich (Germany) and Harare (Zimbabwe).
Coordination and exchange of practices The local government association in the donor country coordinates a broader programme of local government development cooperation, funded by the national government.	Decentralized cooperation programme of the Union des Villes et Communes de Wallonie – UVCW (Belgium) and 12 municipalities in Benin which all have a twinning arrangement with a local government in Wallonia. From the city twinings, the partnership between Tintigny (Belgium) and Djidja (Benin) has been looked at in more detail.
	Twinning arrangements and decentralized cooperation programmes from Flemish local governments with their counterparts: <ul style="list-style-type: none"> ▪ Hoogstraten (Belgium) and Za'Kpota (Benin) ▪ Zoersel (Belgium) – Bohicon (Benin) ▪ Edegem (Belgium) – San Jeronimo (Peru)
Programme-based approach: alignment and focus The national government has tasked the local governments association to implement activities on behalf of the municipalities.	Tax Revenue for Economic Enhancement (TREE) programme: partnership between the Vereniging van Nederlandse Gemeenten - VNG (the Netherlands), the Ministry of Finance in Ghana, 32 local governments in Ghana and Maple Consult.

In the framework of the case-studies, interviews were conducted with the responsible staff for decentralized cooperation of the respective donors (March-April 2018) and with representatives, mostly the person responsible for decentralized cooperation²³, of a selection of local governments in Benin (Bohicon, Za'Kpota and Djidja²⁴) and the intercommunal Gi-Mono in Benin (September 2018). Also, one additional local government official was interviewed in Benin, i.e. Dogbo, because of their experience with the 'guichet unique', which is considered a *good practice* of local resource mobilization in Benin. A representative of the local government association of Benin, *Association Nationale des Communes de Benin*, was also interviewed as a resource person.

What follows is a brief description of the projects and programmes of the case-studies.

²³ See attachment 1 for the complete list of interviewees.

²⁴ Djidja is one of the 12 municipalities that is part of the UVCW decentralized cooperation programme.

Decentralized cooperation between the department of Yvelines (France) and the intercommunal Gi-Mono (Benin)

The department of Yvelines in France and the inter-communal Gi-Mono started their cooperation in 2008 and signed a framework Convention that formalizes their partnership.

The current project 'Project to improve the financial resources of the Mono inter-communal group (GI-Mono) through a better control of the property-based taxes of the municipalities and the payment of the garbage collection tax' aims at strengthening local resource mobilization of the six municipalities that constitute the Gi-Mono intercommunal in Benin. The long term goal is to ensure that Gi-Mono has the necessary financial resources for its functioning and for the activities corresponding to the responsibilities delegated to the Gi-Mono, being waste management the most important. By strengthening taxation of the six local governments it is expected that the contributions from these governments to the intercommunal will increase and become more stable. Also, by introducing the garbage collection tax at the level of the six local governments, this extra revenue will be transferred directly to the intercommunal in order to guarantee a sustainable financing of the garbage collection service provided by the Gi-Mono.

This programme is co-funded by the department of Yvelines (25%), the *Association Internationale des Maires Francophones – AIMF* (60%) and the Gi-Mono (through the six local governments that constitute the intercommunal) and runs from 2017 until 2020. The budget is centralized at the AIMF and transferred to the Gi-Mono.

The main strategies to achieve the anticipated results are summarized in table 5.

Table 5 Programme strategies and donor support strategies of the decentralized cooperation programme between the department of Yvelines and the intercommunal Gi-Mono

Programme strategies*	<ul style="list-style-type: none"> ▪ Provide technical support to the six local governments on strengthening their taxation systems, with a main focus on property-based taxes. ▪ Provide technical support to the six local governments on the implementation and optimization of the garbage collection tax. ▪ Set up sensitization activities for the population on the importance of paying taxes. ▪ Strengthen the decentralized tax services²⁵ and facilitate the use of performance-agreements between them and the six local governments.
Donor support strategies**	<ul style="list-style-type: none"> ▪ Exchange activities with the department of Yvelines in France. ▪ Co-financing of the programme by the department of Yvelines. ▪ Limited technical support by a local volunteer of the department of Yvelines who is located in Togo.

* Strategies implemented by the partner subnational government in the framework of the support programme.

** Strategies used by donors to support their partners in implementing the programme and achieving the goals.

City twinning and decentralized cooperation between Munich (Germany) and Harare (Zimbabwe).

The city of Munich (Germany) and Harare (Zimbabwe) started a twinning arrangement in 1996. However, it is only since 2009 that their partnership is focused on more structural work.

The current project 'A geo-information system (GIS) to improve the public services in Harare' runs from 2015 until 2018. The goal is to strengthen the tax administration (improved rate-setting and financial management).

This project was preceded by the project 'IT solution for local resource mobilisation' (2012-2016), which focused on the set-up of a robust and sustainable infrastructure for the Harare city administration that can be operated sustainably by the employees of the city administration of Harare, focusing on four working areas: 1) the organizational and technical conditions are in place in order to improve the effectiveness of the financial administration; 2) greater transparency in the management of funds; 3) citizen information and public participation in budget matters is supported;

²⁵ These are services that depend from the central level government but that are in charge of collecting the property-based local taxes for the local governments in Benin.

and 4) the city council and the administration have acquired knowledge and skills in IT, finance, including controlling and governance.

The programmes are funded by the German Ministry of Development Cooperation. The city of Munich does not support the programme financially but brings its expertise to the table.

The main strategies to achieve the anticipated results are summarized in table 6.

Table 6 Programme strategies and donor support strategies of the city-twinning and decentralized cooperation between Munich and Harare

Programme strategies	<ul style="list-style-type: none"> ▪ Implement software and hardware for the digitalization of the city administration of Harare. ▪ Implement a sustainable strategy for the implementation of a GIS system in the city of Harare. ▪ Implement a GIS system for data collection (for example, internet maps to get a better registration of water meters, streets, properties), which would allow the city to have a more reliable base to levy taxes.
Donor support strategies	<ul style="list-style-type: none"> ▪ Peer-to-peer exchange between the IT departments of both cities. ▪ Technical support on the implementation of a GIS system. ▪ Establish a regional know-how network together with the cities of Bulawayo (Zimbabwe) and Durban (South Africa). ▪ Exchange on the experiences with taxation of the city of Munich.

Decentralized cooperation programme of the Union des Villes et Communes de Wallonie – UVCW (Belgium) and twelve municipalities in Benin that have a twinning arrangement with a local government in Wallonia.

Since 2008 UVCW coordinates the decentralized cooperation programme of twelve Belgian municipalities of Wallonia with their twinning partners in Benin. UVCW takes up the role of the coordinator and provider of technical support on the country level to both the Walloon and the Beninese local governments, while each twinning arrangement is working in parallel on the implementation of their specific programme with their partner local governments in Benin.

The goal of the current programme, which runs from 2017 to 2021, is described as follows: by 2021 the Beninese municipalities will have made their structures and organizational capacities more dynamic and safer for the management of their financial means and the improvement of the management of their territory and the basic services delivered to the citizens.

The programme is funded by the Directorate-general Development Cooperation and Humanitarian Aid of the Belgian government.

The main strategies to achieve the anticipated results are summarized in table 7.

Table 7 Programme strategies and donor support strategies of the decentralized cooperation programme of the Union des Villes et Communes de Wallonie – UVCW and twelve municipalities in Benin that have a twinning arrangement with a local government in Wallonia

Programme strategies	<ul style="list-style-type: none"> ▪ Implement improvements to the registration and valuation of taxable units: territories/land (cartography and cadaster), people (registration and digitalization of civil status certificates) and economic activities (update database, study on the economic and fiscal potential). ▪ Policy influencing work by the National Association of Local Governments in Benin in order to create better conditions for local taxation. ▪ Organize sensitization campaigns on the rights and obligations of citizens related to taxation (second phase of the programme).
Donor support strategies	<ul style="list-style-type: none"> ▪ Exchange of expertise between Belgian and Beninese local governments. ▪ Exchange of expertise among the Beninese local governments. ▪ Capacity-building of the tax units of the partner local governments. ▪ Finance software for the <i>guichet unique</i> and development of a specific software for the digitalization of the civil status certificates and management of the related database.

Twinning arrangements and decentralized cooperation programmes between Flemish local governments and their counterparts

Hoogstraten (Belgium) – Za’Kpota (Benin)

Hoogstraten and Za’Kpota have a twinning arrangement since 2014. In the current programme of decentralized cooperation (2017-2021) the focus is on increasing the municipal income of Za’Kpota (with 10% by 2019 and with 20% by 2021) by strengthening the capacity of the local government to collect taxes and by strengthening the local economy (focus on the orange industry) so that this sector can provide increased income for the municipality through taxation. An important focus is also on mobilizing resources from the municipal market.

The programme is funded by the Directorate-general Development Cooperation and Humanitarian Aid of the Belgian government, through the joint programme of the Vereniging van Vlaamse Steden en Gemeenten (VVSG) for Benin.

The main strategies to achieve the anticipated results are summarized in table 8.

Table 8 Programme strategies and donor support strategies of the twinning arrangement and decentralized cooperation programme of Hoogstraten and Za’Kpota

Programme strategies	<ul style="list-style-type: none"> ▪ Intensify the engagement from the local authority with the orange industry in Za’Kpota: set up an association of intermediaries, make agreements with the orange industry on the implementation of taxes, etc. ▪ Put in place a digital <i>guichet unique</i>, a system of securing and mobilizing financial resources.
Donor support strategies	<ul style="list-style-type: none"> ▪ Peer-to-peer exchange between programme coordinators. ▪ Exchange on good practices with other partner cities of the VVSG decentralized cooperation programme in Benin. ▪ Finance software for the <i>guichet unique</i> and for infrastructure on the market. ▪ Finance staff and extra tax collectors. ▪ Political dialogue between locally elected from both cities. ▪ Monitoring visits.

Zoersel (Belgium) - Bohicon (Benin)

Zoersel and Bohicon have a twinning arrangement since 2011. In their current programme of decentralized cooperation (2017-2021) the focus is on increasing the revenue of the city of Bohicon, by increased efficiency in tax collection processes and the strengthening of the local economy, with a focus on the market.

The programme is funded by the Directorate-general Development Cooperation and Humanitarian Aid of the Belgian government, through the joint programme of the Vereniging van Vlaamse Steden en Gemeenten (VVSG) for Benin.

The main strategies to achieve the anticipated results are summarized in table 9.

Table 9 Programme strategies and donor support strategies of the twinning arrangement and decentralized cooperation programme of Zoersel and Bohicon

Programme strategies	<ul style="list-style-type: none"> ▪ Improve the collection process of market fees. ▪ Create more opportunities and incentives for increasing revenue, for example by creating more market places, improving the infrastructure of the bus terminal and truck station. ▪ Strengthen the working of the existing cadaster. ▪ Sensitize the population on the purpose of taxation. ▪ Put in place a system of securing and mobilizing financial resources (digital <i>guichet unique</i>).
Donor support strategies	<ul style="list-style-type: none"> ▪ Peer-to-peer exchange between programme coordinators. ▪ Technical peer-to-peer exchange between the fiscal departments of both cities, between the staff responsible for the cadaster of both cities. ▪ Finance software for the <i>guichet unique</i> and for infrastructure for the market. ▪ Finance extra tax collectors. ▪ Monitoring visits.

Edegem (Belgium) - San Jeronimo (Peru)

Edegem and San Jeronimo have a twinning arrangement since 2004. In their current programme of decentralized cooperation (2017-2019)²⁶ the focus is on strengthening the administrative capacity of San Jeronimo. Specific goals include improved municipal waste management, following the ‘the polluter pays’ principle, and improved spatial planning (building licenses, cadaster). This programme does not aim directly at strengthening local taxation but indirectly, mainly through overall strengthening of the local government administration and the focus on improved spatial planning.

The programme is funded by the Directorate-general Development Cooperation and Humanitarian Aid of the Belgian government, through a joint programme of the Vereniging van Vlaamse Steden en Gemeenten (VVSG).

The main strategies to achieve the anticipated results are summarized in table 10.

Table 10 Programme strategies and donor support strategies of the twinning arrangement and decentralized cooperation programme of Edegem and San Jeronimo

Programme strategies	<ul style="list-style-type: none"> ▪ Optimize the process of the issuing of building licenses. ▪ Improve communication between the local government and the citizens. ▪ Set up a cadaster in order to be able to tax property.
Donor support strategies	<ul style="list-style-type: none"> ▪ Peer-to-peer exchange between the programme coordinators. ▪ Technical support by the team spatial planning and environment of Edegem on the set up of a cadaster in San Jeronimo. ▪ Finance the local coordinator for the twinning arrangement in San Jeronimo. ▪ Monitoring visits.

Tax Revenue for Economic Enhancement (TREE) programme

After a pilot project with a selection of municipalities, VNG and the Ministry of Local Government and Rural Development and the Local Government Service of Ghana, decided on a joint programme, ‘TREE’ (Tax Revenue for Economic Enhancement), that runs from 2017 to 2021. The goal is to bridge the tax gap and to increase efficiency in service delivery in 32 municipalities in Ghana, by focusing on a revenue collection-led strategy (the expected increase in revenue is 10-20% per year).

The programme is funded by the Dutch embassy in Ghana. A local project team in Ghana is responsible for the implementation of the project activities, supported by their peers of the project team at VNG.

²⁶ The Belgian government has decided to stop the bilateral development programmes in Peru, Bolivia and Ecuador in 2019. Therefore, Edegem, together with the Vereniging van Vlaamse Steden en Gemeenten (VVSG) decided to present their decentralized cooperation programme for the period 2017-2019 only. However, Edegem and San Jeronimo are very likely to be continuing their partnership beyond 2019 but it is not clear yet under what conditions and with the support of which type of funding.

The programme uses a modular approach, which includes the following modules:

- *Analysis and strategy development*: through an analysis of all the aspects of the tax administration and process (registration, valuation, billing, levying, collection and enforcement), a national strategy was developed for improvement, focusing both on strategies for improved tax processes and on defining what should be done with the extra income through taxes (service delivery to citizens). All stakeholders were involved in this process: the fiscal decentralization unit in the ministry of Finance, the ministry of local government, the local government service, and the representatives of the regions where the programme is implemented. Then, the strategy is presented to the local governments and a joint action plan is set up.
- *Improved and modernized tax processes*: capacity building of the staff of the local tax administration and improved tax processes, with a particular focus on improved tax collection processes (using innovative ways, such as mobile money and incentives for paying taxes).
- *Implementation software*: an IT-solution that is ‘fit for purpose’ and that supports all tax processes, which is easy to use and easy to understand.
- *Taxpayer communication*: improved communication and transparency on revenues and investments between local governments and citizens, and taxpayer education, for example on the improved tax processes.
- *Program and project management*: the local tax department of the local government is set up as a project unit, which will guarantee sustainability after the end of the programme.

The donor support strategies are the following:

- Finance software and hardware for the local governments.
- Capacity building by the local project team and the VNG team, for example on organizational changes and on basic notions of taxation, accountancy, tax collection and efficiency.
- Set up and facilitate learning trajectories of groups of local governments (4 groups of 8 local governments).

4.2 Findings on what appears to work

The analysis of the case-studies allowed to identify what appears to work (or not) related to mechanisms or strategies implemented by SNGs to strengthen local taxation, in the framework of decentralized cooperation.

The chapter is built up around the three broad working areas of taxation support that were put forward in the literature review: (1) improving tax policy and design; (2) strengthening tax administration; and (3) encouraging constructive state-society engagement around taxes (Fjeldstad, 2013).

4.2.1 Improving tax policy and design

Improving tax policy and design is in general not specifically mentioned as an outcome in the case-studies. Interviews revealed that this is often because of a lack of knowledge of the donors on the legal framework in the partner countries and on technical issues related to the choice for one or another revenue source. Donors also suggested that policy choices, for example on which taxes to levy or on how to redesign the local taxation system, should be made by the local government itself. Further, in order to implement changes in tax policy at local levels, often the central level government has to be involved, which goes beyond the reach of most decentralized cooperation programmes, especially the city twinnings.

Some programmes however, do engage in (small) actions related to tax policy and design. In the case of city twinnings, possible exploitations of new sources of revenue sometimes constitute the

topic of (informal) discussions between both partner governments, for example in the case of Munich – Harare. Also, in the framework of the the Yvelines – Gi-Mono programme a new tax is being implemented, i.e. the garbage collection tax. Finally, the UVCW programme has defined activities with the National Association of Local Governments of Benin (ANCB) to do lobby work with the central level government in order to improve the capacity of local governments to register taxable units and to collect taxes.

Local government – central government relation

The level of fiscal decentralization of a country determines the level of autonomy of the subnational governments to set tax rates and to collect taxes, compared to the central level government. This often creates tension between subnational and central government levels.

The case-studies allowed to get a deeper insight in the situation of Benin, showing that although decentralization has been a reality since 2003, fiscal decentralization remains very limited. For example, local property-based taxes are not collected by the local governments but by decentralized tax services of the central government. This tax income is then not directly transferred to the local governments but instead local governments have to file a budget request to the decentralized services. Interviewees indicated that this often does not run very smoothly, with services not approving budget requests, or not timely informing on the amount of taxes collected and at the disposal of the local governments. Also, these services lack staff and motivation to prioritize the collection of local taxes. Therefore, many local governments in Benin pay extra staff and material (such as transportation) in order to improve the tax collection of ‘their taxes’.

Also, local governments in Benin depend on the central level’s provision of receipt booklets (*quittanciers*) in order to collect the local development tax (*taxe de développement local*) on products such as cotton and agricultural products. Often the central government does not provide enough of these booklets or not on time, so local governments cannot collect taxes and lose tax income.

Also, in Benin there is a general lack of interest of the central government in property-based taxes because they don’t constitute a very important source of revenue for the central level. However, for the local governments these taxes could actually bring in an important amount of revenue.

In the Munich-Harare partnership it was mentioned that the central and local levels have been political enemies and the central level refuses to provide transfers to municipal levels.

These situations are often the cause of tension between the municipal level demanding more fiscal autonomy and the central level government trying to limit the municipalities’ fiscal autonomy. The case-studies provide some good practices on how to constructively engage with the central level government (see boxes 1 & 2).

Box 1: Performance contracts with decentralized tax services

The national government in Benin promised to design a model agreement of collaboration between the decentralized tax service and the municipalities, but after two years, municipalities were still waiting for this document.

As an alternative, some local governments such as Dogbo and Djidja, have designed their own performance contracts with the decentralized tax services of the central government in order to overcome problems of lack of information exchange and lack of motivation by these services to collect ‘local taxes’. They now sign a ‘results-contract’ or performance contract with these services, which defines the goals for tax collection and provides incentives for the decentralized tax services, i.e. when a certain goal is reached, they receive a bonus from the local government.

Box 2: Actively involve central government ministries

The Gi-Mono programme includes a concertation effort with the fiscal department of the Ministry of Finance in Benin. A focal point for the project was assigned within the ministry. This assures a smooth working relation with the decentralized tax services that depend from the central government. Also, direct support is foreseen in the programme to strengthen these decentralized tax services. If problems would arise with these services in the framework of the project, the focal point can remediate.

The VNG programme includes a partnership with the central government level, i.e. the Ministry of Finance, the Ministry of Local Government and Rural Development and the Local Government Service of Ghana, for the implementation of the programme. They are all part of the steering committee. This was possible thanks to the Dutch embassy, that is financing the programme. This involvement of the central government level allows for a high degree of political will to achieve the programme goals, alignment with central-level tax policies, transparency on the financial flows to the partner country and for possible future upscaling to other local governments in Ghana. Also, coherence among the 32 municipalities that take part in the programme is guaranteed. For the municipalities this is also a clear indication that central government is serious about supporting local taxation.

4.2.2 Strengthening tax administration

The case studies confirm what the literature review highlighted, i.e. that the main focus of donor support is on strengthening the municipal administration in general and the units dealing with taxation specifically, in order to make them more effective and efficient, for example by providing software for digitalization of the administration (all case-studies), the instalment of a digital one-stop shop in order to reduce tax leaks (for example, the *guichet unique* in Benin), the improvement of tax processes (for example, improve the process of issuing building licenses in San Jeronimo, Peru; the VNG-approach to improved tax processes), the set-up of digital databases (civil status, property ownership, land ownership, economic activity, etc.), capacity strengthening of public servants involved in taxation (for example, the Yvelines-Gi Mono project), etc.

This focus on strengthening the tax administration corresponds to specific needs expressed by the local partner governments, related to inefficiency, a lack of capacity and a lack of systematized information and databases.

In what follows, mechanisms for tax administration strengthening are discussed.

Collection-led or valuation-led approach?

Two approaches to local taxation support, especially related to property-based taxes, coexist: a collection-led approach that focuses more on improving the collection processes of taxes and fees, and a valuation-led approach that focuses on the registration and valuation aspects of taxation.

Examples from the case-studies of the collection-led approach are the financing of extra collectors on the market (city twinning Zoersel-Bohicon), the strengthening of tax processes at the local tax administration (VNG programme in Ghana), experimenting with innovative billing strategies, such as e-bill delivery and e-payments using mobile phones (VNG programme in Ghana), or putting in place a digital system of securing and mobilizing financial resources (for example, the *guichet unique* in the framework of the city twinings Zoersel-Bohicon and Hoogstraten-Za’Kpota).

A valuation-led approach focusses on the registration of taxable units and the valuation processes. Examples are the focus on improved and digitalized civil registration (UVCW programme in Benin), taxpayer registration and cadaster set-up (UVCW programme, city twinings Zoersel-Bohicon, Hoogstraten-Za’Kpota and Edegem-San Jeronimo, and Yvelines-Gi Mono partnership).

The idea that taxable units, such as taxpayers, properties, etc., have to be registered first in order to be able to tax them, is challenged by the VNG-approach where the focus on registration and valuation turned out to be inefficient as long as tax collection was not properly organized:

Don't copy things from Europe. For example, GIZ is still focusing on 'street addressing' but this does not work. It is necessary but it is not the thing you have to start with. You can increase the database but if you don't have a system that works with this information it won't help you a lot. (interview with a VNG representative).

While collection-led approaches lead to a more rapid increase of income (thanks to more efficiency), registration/valuation-led approaches are also important in order to complement these efforts. However, more innovative ways could help overcome practical obstacles related to registration and valuation (such as, high cost of cadastral plans, lack of capacity of the local

government to do it, etc.). Zonal cadastral plans for example were mentioned by a respondent as a less expensive and less complex way to do the registration and valuation of properties. Also, VNG provides financial support in the first project year in order to be able to do extra valuations, focusing on the big land owners first. The extra income from these valuations, should be sufficient to pay for future valuation efforts.

As an interviewee from UVCW mentioned, the focus of interventions should, also, be on registration, especially for equity reasons: “if there are people on the territory that are not registered in the database, is the municipality going to tax only the registered taxpayers and the others not? That is not fair.”

Thus, arguments for both a collection-based and a valuation-based approach seem all valid. A combination of both approaches then seems to offer the best chances for a successful intervention. However, each intervention should be designed with due care, taking into account the specificities of the local government. In a context of a badly designed local taxation system, a too rigid focus on improving tax collection could lead, for example, to an unfair tax burden on part of the population. On the other hand, an intervention that predominantly focusses on registration and valuation in the context of a local authority with poor tax collection capacity, risks of not meeting expectations related to revenue increase.

Know your tax base and tax potential

Local governments in low- and middle income countries face enormous challenges when it comes to having updated information on their tax base and tax potential. For property-based taxes in Benin, for example, the costs of mapping the area, setting up a cadaster and a database are often very high. In Ghana, valuation is a responsibility of the central government level but local governments should pay travel costs, accommodation and food for the public servants who do the registration work in the municipalities. This money is often not available.

However, information on the tax base constitutes an important lever to increase the own tax revenues. It allows local governments to know how well they are performing and to identify the so-called tax gap, i.e. the difference between what they manage to collect and their potential income through taxation.

The case-studies provided some examples of how information was collected on the tax potential in order to inform strategic decisions (see box 3).

Box 3: Preparatory study work on tax potential

In the framework of the partnership between the department of Yvelines and the intercommunal Gi-Mono a preparatory study was done in order to assess the potential for increasing income from taxes at the local governments' level. It was then found that most income could be generated through property-based taxes (such as built land, non-built land, patents and licenses). Also, a new property-based tax was identified with a high potential: the garbage removal tax. It was also found in this study that the local governments did not really know their tax potential in relation to these property-based taxes, so also, there was no clear view on how well they were performing. The set-up of a database on land and properties became then an important aspect of the programme.

The UVCW programme financed a diagnostic study on the mobilization of local finance in five municipalities in Benin (Bembereke, Djidja, Natitingou, Savalou and Tchaourou) in order to identify for each of them their tax potential and current performance, to assess their resource mobilization procedures and to formulate recommendations. This allowed every city/municipality to make informed decisions on their strategy for domestic resource mobilization, according to their specific challenges. Based on the recommendations an action plan was set up by each municipality, which they are gradually implementing, with financial support from the UVCW programme. One of the main components is the registration of taxable units in a database.

The focus of the preparatory studies on the *tax potential* of local governments (box 3) is mainly technical, and includes information on the revenue raised and the potential revenue, on the actors involved in the tax collection procedures, on the resource mobilization procedures and on the

revenue collection strategies. An in-depth analysis of citizen-government relations, of the local political situation and of possible resistance from different actors to make improvements to the taxation system (for example, from the population, from locally elected, etc.) is not included however. The inclusion of these aspects related to the governance pillar of local taxation, could enrich the analysis and help design strategies that go beyond the technical aspects of improving tax systems.

Further, local governments need to have updated and reliable information on their *tax base*. That is why many projects have a valuation-based approach, i.e. on improving the registration of the ‘tax base’ (knowing who and what can be taxed, and how much) (see boxes 4, 5 & 6).

Box 4: Fiscal inquiries

The project Yvelines – Gi-Mono finances fiscal inquiries (*enquêtes fiscales*) to collect information on the tax base, i.e. on the tax payers and their properties (land and buildings) and the activities they are doing on these properties. This allows local governments to set up a digital database of property-related information of taxpayers. This database should then be used by the decentralized tax services (from the central government), instead of leaving it up to them to define a list of taxpayers each year. This reduces the risk that staff from the decentralized tax services make a random selection from the list, leaving friends and family out for example. It also allows the local governments to monitor the performance of the decentralized tax services related to tax collection of property-based taxes. Fiscal inquiries are expensive, so urban areas are prioritized, as the population is more concentrated in these areas.

Box 5: Creating a registre foncier urbain (RFU)

The UVCW programme with 12 local governments in Benin focusses on creating a RFU, a *registre foncier urbain (RFU)*, a kind of cadaster. Therefore a cartography of the area should be done, including a division in *quartiers*, *ilôts* and plots, and ideally the addressing (giving names to streets and numbers to houses) of the area. The partner cities from the UVCW project are gradually doing this work, starting with the *arrondissements* which are most populated and that have the most intense economic activities. It is a costly activity but the RFU constitutes a database of information on the taxpayers in these areas, their properties and their activities. This allows to know the tax base and the tax potential, and to charge taxpayers correspondingly. A regular update of this information is needed however, in order to apply the correct rates.

In Djidja, in order to keep the tax base updated, distributors of the tax notices register people who died, who moved to another place, who changed their economic activity on the territory, etc. As financial resources are limited, the focus of the updating process is mainly on identifying new properties. Ideally, a thorough tax inquiry should be done in order to dispose of a reliable update of the tax base.

UVCW and its partner local governments are in continuous dialogue to find a solution to reduce costs of updating the RFUs. They are organizing lobby activities with the central government to influence the policy for updating the cartography and the RFUs, as well as trying to build internal capacity at the level of the local governments to be able to do this update themselves, instead of spending high amounts of money to private contractors.

Box 6: Innovative ways of registration and valuation

The VNG approach is primarily collection-led but also focusses to a lesser extent on the registration and valuation of the tax base. Two important approaches to registration and valuation are used. First, innovative ways of registration and valuation are discussed with the ministry in Ghana, for example, zonal valuation, especially for poor neighborhoods, where every object in the neighborhood is taxed at the same flat rate. Also, very poor neighborhoods get a zero rating but do receive a tax notice. This helps to sensitize the population on taxation issues. When the economic situation of these neighborhoods improves, rates can be increased and taxes can be levied. Second, financial support is given to local governments in the first project year to do extra registration and valuation. The extra income from this effort should be used in the second project year to continue extra registration and valuation efforts, avoiding a dependency on the donor to continue this work.

Separate service delivery from revenue collection

In order to strengthen resource mobilization and to secure non-fiscal revenue, the local governments from the case-studies in Benin have been pushing for the implementation of a *guichet unique*. This mechanism follows the principle that the service delivery (for example, the issuing of a civil status document) should be separated from the service that collects the payment by the citizen

for the provision of this service. In many local governments this is currently not the case. It is often the same person who receives the money, who also provides the service, which leaves much room for leakages. The *guichet unique* is also supported by a software that allows to register all non-fiscal revenue in one single digital system.

From the experiences in Benin the *guichet unique* provides less incentives for corruption, as, for example, civil servants and citizens would not be able to bargain over the price for the provision of a specific service provided by the local government. Also, it allows the mayor and other staff of the municipality to know at any moment the state of affairs of income and expenses and to perform a better control over the revenue income.

A remaining challenge of the *guichet unique* is to find a way to include fiscal revenues, from property-based taxation, in the system. This would allow for an overall view on all the revenue sources of the municipality, which is now often limited to revenues from fees and the issuing of administrative documents, for example. The city of Dogbo has already set up such a comprehensive system.

Box 7: The *guichet unique* in Benin: some results

In Za'Kpota, partner of the city of Hoogstraten, the *guichet unique* was responsible for an increase in the communal revenue by 27,92% in 2017 after one year of implementation²⁷. A key feature of the *guichet unique* was to separate the service of economic affairs (income) and the financial service (expenses) in two separate services of the municipality.

In Bohicon, partner city of Zoersel, there was an increase of 130% of income of the municipality after the installation of the *guichet unique*.²⁸

In Dogbo, the *guichet unique* was created in 2013. All revenues (fees, royalties, market placement fees,...) at the level of commercial infrastructure and sand and gravel quarry exploitation are centralized by the *guichet unique*. The GFPCOM software is used to secure operations. In 2012 the city's annual income was 180 million XOF. In 2016 there was an increase of 200%, with an annual income of 355 million XOF.²⁹

Although there is no 'proof' of a decrease in tax leakages, interviewees from the cities of Za'Kpota, Bohicon and Dogbo confirmed that the *guichet unique* certainly contributed to this outcome.

An interviewee from the National Association of Municipalities in Benin (ANCB), however, warned for a too positive belief in the *guichet unique*, as a mechanism that will solve all problems. In the respondent's opinion, the *guichet unique* can have a positive effect only when the local governments are also willing to make structural adjustments to their taxation systems.

A central role for digital tools

All donors from the case-studies have a strong belief in an approach with a central role for digitalization, as a way to enhance the efficiency of the tax administration. Further, with the aim of an improved registration of taxable units, digital tools are also seen as an important way to improve tax processes, for example for the set-up of reliable databases of taxpayers or taxable units. Finally, digital tools also help to inform policy and expense decisions.

A particular approach of the VNG programme is the link that is made between the software of the local government and the financial system of the central level government. This allows for the central government to dispose of the correct financial data from the local governments. In the framework of the city twinnings this link with the central level government could not be made and different types of software are being implemented in the different cities.

4.2.3 Encouraging constructive state-society engagement around taxes

The working area of 'encouraging constructive state-society engagement around taxes', is strongly related to aspects of good governance, the social fiscal contract, transparency and equity. This aspect

²⁷ Document 'Evaluation du guichet unique janv.2018' (document from the municipality of Zak'pota).

²⁸ Interview with the responsible for decentralized cooperation of the city of Zoersel (13 March 2018).

²⁹ For more information on the good practice of Dogbo: http://www.vng-international.nl/wp-content/uploads/2015/07/Brochure_Bonnes_Pratiques_final_2014_compressed.pdf (pages 10-15).

of taxation is increasingly part of donor support programmes. The case-studies focus mainly on improving tax compliance through intensified communication by the local governments towards the population. Information sessions are organized to explain the importance of paying taxes and the link between taxation and service delivery. A good practice seems to be the presence or participation of locally elected officials in these meetings with the population. Also, local governments from the case-studies are trying to establish a more direct link between the collected taxes and the expenditure.

However, other aspects to strengthen state-society engagement around taxes are less present in the programmes studied, such as improved participation of citizens in discussions on the municipal budget, assessment of the taxation system from an equity perspective, and a focus on improved service delivery by the local governments.

Clear accountability lines

In many cities in low and middle income countries the markets play an important role in local economy. From the case-studies it was learned that these are also interesting places to work on local taxation, as there is a clear negotiator available for the local government, i.e. the market holders, often organized in an association or union. This allows for the local government to assess the needs of the market holders and in return for a timely payment of their fees, implement some of the their demands, such as the improvement of market infrastructure, better hygiene conditions on the market, better security measures, etc. In the case of Bohicon this effort was also accompanied by an investment in extra tax collectors on the market and the modernization of the collection process (see box 8).

The success of these efforts seems to lie in the direct accountability lines between the service delivered by the local government and the people who benefit from it and thus are more willing to pay the fees. Indeed, research has also found that when accountability lines are clear, tax compliance tends to increase (see higher, chapter 3.3. on the link between taxation and governance). At the subnational level this is often a challenge, however, as many lines of accountability and funding channels for service delivery come together, making it less clear for citizens what to expect from elected local governments (Smoke, 2013).

Box 8: The social contract - tax compliance in exchange for improved infrastructure and services

In Bohicon, with support of the decentralized cooperation programme, the city has invested in the modernization of the markets and in an increased capacity of the markets, responding to demands from market holders. Also, users of the bus station and the taxi station are being consulted in order to know their demands for improvement of these places. The municipality then searches for funding in order to improve the infrastructure. With an improved infrastructure, the users are more willing to pay the fees, and fees could even be raised.

In Dogbo a similar process has taken place. The city promoted the creation of an association of market users in order to have a interlocutor to discuss reform plans for the market. Before each reform the representatives of the association are consulted and plans are adapted to their demands.

A pilot project in Kumasi (Ghana) funded by VNG managed to increase market revenues (by 48 percent in one month) by signing a social contract with a group of women known as 'market queens'. In exchange for better lighting and better sanitation facilities, which ensures a safer environment in which to conduct their business, these women help with the collection of market fees.

Organizing the funding cycle

The long term goal of donors that support local taxation initiatives is to optimize the funding cycle at the level of local governments. An increase of revenue should therefore go hand in hand with an adequate spending on public services, and improved service delivery as the ultimate goal.

This would also strengthen the social fiscal contract between taxpayers and the local governments: beneficial expenditures are delivered to taxpayers in return for their tax payments. This belief in the link between financial management, service delivery and tax compliance, has been strongly confirmed in interviews with donor and partner local governments. As the representative of VNG puts it: “a

local government that is underperforming in financial terms will never have the money to deliver good services, which also erodes peoples' trust"³⁰.

Although this long term goal is clearly recognized, clear strategies or activities to actually improve spending on public services and service delivery are less explicit. The VNG programme for example, does not foresee specific support to municipalities on improved service delivery and considers this to be their own responsibility. The UVCW programme also mentions the long term goal of improved service delivery but is not yet working on this, as they find that first revenue has to be increased. It seems that donors are relying heavily on the fact that an increase of own resources will be followed automatically by an improvement of local public services.

The twinning arrangements have been working more on trying to improve local service delivery by partner local governments, also due to the diversity of topics that are included in the framework of a twinning arrangement, transcending the specific programmes related to taxation. For example, Bohicon is making infrastructure improvements on the market; San Jeronimo has improved the process for getting a building license; the intercommunal Gi-Mono has first set up a fully-operational garbage waste system (with donor support) and is now focusing on getting the financing of this system right through improved taxation systems at local levels.

The Munich-Harare partnership specifically focused on improving the financial management of the city of Harare, by implementing an IT solution. This was partially successful. A network was implemented and the staff of Harare is now working with the management system, but there are still problems with their billing system, for example.

An important question in this discussion is where to begin: as only limited revenue is available, local governments find themselves limited in their attempts to provide better services; but also, when service delivery is not satisfying the local population, taxpayers will be reluctant to pay, perpetuating the local government's situation of insufficient financial resources. This often leads to the perception of a vicious circle on what to do first: improve service-delivery or improve tax collection, while the first can be a strategy to achieve the second, and the second could be considered as a prerequisite to do the first. An increased focus on financial management however, could be key to find a way out of this apparent trap: “[a]ppropriate financial management can tap into strategies that improve efficiency of revenue collection, win public support, capitalize on urban and regional economies of scale, curb land speculation and sprawl, incentivize economic activity, and improve urban affordability for the poor. The resulting budgetary improvements can allow municipalities to make strategic investments in their cities, stimulating a virtuous cycle of growth, revenue generation, and prosperity.” (UN Habitat, 2015).

Digital tools

Besides strengthening the tax administration, digitalization of the tax processes at local levels is also believed to enhance transparency on the tax processes and to reduce leakages. This would improve trust of taxpayers towards the local government and increase tax compliance rates.

Sensitize local politicians

In all case-studies staff of local administrations are the most important actor pushing for reform and improvement in the local taxation systems. Local politicians, however, often don't have the same incentives and have to be 'convinced'. Local elections are often a particular difficult time to find political support for taxation measures, although this resistance is not limited to these periods. As an interviewee put it: “politicians have to choose between being unpopular and having high income from taxes, or being popular and having low income from taxes” (interview 1 October 2018). Political commitment around local taxation thus requires a strong will.

³⁰ <https://www.humancities.co/2017/03/importance-municipalities-trust-conversation-human-cities-coalition-partner-vng-international/>

One way of overcoming this is by establishing better linkages between the tax policy and tax administration officials (Smoke, 2001). Public servants often have a clear view on the challenges related to local taxation and have many suggestions for improvements. However, they should engage in a constructive dialogue with the locally elected in order to sensitize them about the importance of taxation and the advantages of increased revenue, i.e. they can provide better services to the population, so the population will be more satisfied about their locally elected (see box 9).

Box 9: Concertation framework between local politicians and staff on domestic resource mobilization

In Za'Kpota a concertation framework between locally elected and civil servants was set up in order to discuss strategies for domestic resource mobilization. During the meetings these strategies are defined and problems related to the local economy are discussed. These meetings take place every three months and include local politicians of all levels. In Benin for example, the municipal level consists of several '*arrondissements*' which all have an elected '*chef d'arrondissement*'. These are important actors in the taxation process, as they can strengthen the tax collection in their *arrondissements*.

Citizen communication and participation

Disinformation on taxation seems a widespread issue. An anecdote shared by a respondent illustrates this: at the market a saleswoman asked why she had to pay the market fee if her husband was already paying taxes for their house?

A lack of trust of the population in their local governments also plays a role in the unwillingness to pay taxes.

That is why many local governments are increasingly working on improved taxpayer – government communication. The case-studies indeed all include to a greater or lesser extent the dimension of improved taxpayer communication as part of their strategy to increase tax compliance, mainly by sensitizing them on the importance of paying taxes and by showing what is being done with the revenue coming from taxes/fees. Sensitization of the population can take many forms, for example, through radio emissions, posters, publicity on television, etc. Also, formal and informal meetings between the municipality and the local population are set up to inform them on the importance of paying taxes and the primary expenditure items of the local government. As described in box 10, the involvement of locally elected in these sensitization efforts has proven to be particularly effective.

Box 10: Increasing trust through meetings with the population

In Bohicon (Benin) the municipality invited a high-ranked tax collector (public servant) of the decentralized tax service (this is a service from the central government that is also responsible for collecting property-based taxes for the local governments) to sensitization meetings with the population. This generated more trust among the population and people showed more interest in what the municipality had to say on what is being done with their tax money.

In Dogbo (Benin) locally elected join sensitization sessions with the population at the market. This allows market users to address their questions and worries directly to their representatives. This is also believed to increase trust. In Za'Kpota a similar method is used, where locally elected are involved in sensitization efforts, for example by joining the control brigades on the market place.

Respondents also indicated that, in general, the population who has more 'contact' with the municipality and knows better what they do, show higher tax compliance rates compared to other groups of the population that are less familiar with the work of their local government.

However, the social fiscal contract between taxpayers and local governments is complex, as described in the first part of this paper. Although improved citizen communication is likely to lead to better service delivery and to citizen willingness to pay taxes, this is not automatically like this. When “participation is token or non-inclusive and advisory rather than influential, broad improvements in service coverage/quality and citizen willingness to pay subnational taxes should not be expected” (Smoke, 2013: 16). Thus, there is still much room for improvement in order to go from communication and information provision, to ‘real’ citizen participation that contributes to a constructive relationship between the local governments and the citizens on taxation issues.

Tax where the money is

Many local governments in low and middle income countries face an extra difficulty related to improving local taxation, i.e. the lack of financial means of the population to pay taxes. From the case-studies, for example, the city of Harare has a 90% unemployment rate, so only 10% of the population has a fixed income.

The guiding principle of ‘tax where the money is’ is often being used by local governments – or pushed by donors – in order to overcome this obstacle. For example, in registration and valuation efforts, focus goes mainly to big properties and big companies.

For some local governments a strategy to increase the revenue base is by strengthening the local economy (see box 11), as intensified economic activity would increase income for the local government through taxation. In Bohicon for example, the co-financing of the market by the German development cooperation, has been very important, as it is now one of the most important revenue sources for the city of Bohicon. More merchant infrastructure could allow the city to increase income through market fees. Also, mining activity is currently left to self-organization by the population but could also constitute an additional income for the municipality. In Dogbo, part of the strategy to increase own revenue is to support women groups in the sector of vegetable production.

When local economic activities are intensified and a robust tax system is in place to tax these activities, local governments can enjoy a positive outcome on their revenue.

This could also be an argument in favor of paying more attention to taxing informal urban economic activity. The informal sector is now often left out of tax efforts by local governments – and in donor support programmes – because of the technical difficulties and the limited revenue base. However, especially from a state-building perspective, taxing the informal sector could bring important political advantages, i.e. broadening the revenue base is central to building the social fiscal contract and to creating an equitable tax regime (Fjeldstad, 2013).

Box 11: Local economy

In Za’Kpota donor support from Hoogstraten is focused on strengthening the orange industry. This is an important industry of the region but income for the local government from this activity is still limited. A study was done to identify the stakeholders in the orange industry and the actual problems, and to formulate a list of recommendations. These recommendations were included in the annual operational plan of the city of Za’Kpota. Some of the executed and planned activities are: a study visit to Hoogstraten to get to know how the strawberry industry is organized; the organization of the sellers and the producers in Za’Kpota in an associations; the design of a tax on the ‘retailers/intermediaries’ (*revendeuses*) of oranges at Za’Kpota (in the past they would only pay taxes in Bohicon, a city nearby). This is considered as a win-win strategy for both the local economic operators and the local government.

Differentiate in actors

A wide range of actors are involved in local taxation: the local administration, the city council, the mayor, the population, central level ministries, the leaders of smaller territorial units, local economic operators, civil society organizations, among others. These can contribute to the success of local revenue mobilization or slow down progress. In most cases the local administration is in favor of extending and strengthening the local taxation system. Other actors can have less incentives to do so. In some of the case-studies these other actors are specifically targeted, besides the local government administration (see boxes 12 and 13). This seems to be an interesting approach, as support to only one or a limited number of the before-mentioned actors is likely to have only limited impact.

Box 12: The intercommunal level

The project of Yvelines and Gi-Mono provides direct support (financial and technical) to the intercommunal level, and as such indirectly to the local governments, without money transfer to that level. This is believed to guarantee long-term effects of the intervention, because the Gi-Mono intercommunal is an intermediary actor that will continue to do its work, even when the project has come to an end. Further, the programme also includes a partnership with the central ministry of finance and with the decentralized tax offices. The latter are also targeted as receivers of support (staff and material) in the framework of the programme, so they can optimize their role as tax collectors for the municipalities.

Box 13: Actor-focused assessment

The partnership between Edegem and San Jeronimo focused in a first stage on improving the building license process. Once this was completed, the city invested time and money in communicating to the local citizens about the updated process and the obligation to get a building license. Despite these efforts, still many buildings were built without license. Further analysis indicated that it was the group of building promoters that was blocking progress. Unlike the population, they had not been invited to an information session and had not been involved at any stage of the updating process. This is now being considered by San Jeronimo as a new strategy in order for the new building license process to work properly.

4.3 Findings on support instruments used by donors

The case-studies for this research give an overview of the instruments used by local government donors to support local taxation initiatives.

Peer-to-peer exchange (North-South & South-South)

In the case of the twinning arrangements, the peer-to-peer exchange of expertise between staff of the local administrations is the most commonly used instrument. This can take many forms and levels of intensity. In the case of Munich-Harare this exchange often is more about exchanging on a specific approach to local resource mobilization, instead of on the technical details of organizing local taxation. Often the most intense exchange is between the coordinators of decentralized cooperation of both local governments, who are not experts in taxation issues nor have responsibility over this topic in their local governments. In the case of Zoersel – Bohicon, however, in parallel to peer-to-peer exchange between the coordinators of decentralized cooperation, a continuous dialogue is also ongoing between staff of the tax departments of both cities, which stimulates technical capacity building.

Donors in the framework of twinning arrangements recognize that they often lack knowledge on the specific local realities of their partners, so peer-to-peer exchange between similar cities within the same country is often found a more useful approach to strengthen local capacity. In Benin, for example, a platform was set up between the partner cities of the Belgian cities from the UVCW programme in order to exchange good practices. A thematic coordinator (from the city of Djidja in Benin) was chosen to do the follow up on the issue of local finances in the different partner cities and also to provide technical support (for example, to do a study on the tax potential of each local government). As part of more ad hoc exchange activities, the city of Za’Kpota visited Dogbo to learn about their experience with the *guichet unique* and visited Toucountouna to learn about their database with tax information.

Financial support

Decentralized cooperation in the framework of city twinings usually includes a direct transfer of money to the local partner governments. An annual plan is jointly set up, that should be roughly respected. However, partners have a high degree of autonomy in spending the money, although this varies among the different cases studied for this paper. Financial resources are mainly used for salaries of staff (for example, in order to hire extra tax/fee collectors), to buy materials (for example, uniforms for tax controlling staff and tax collectors), to buy software and/or hardware (for example, to set up the *guichet unique*), to invest in infrastructure (for example, to improve the market), or for trainings. The coordinator for decentralized cooperation in the partner city is the contact person for the donor city and is responsible for the follow up on the project activities and the expenses made. This is being done continuously at a distance and at least once a year during a meeting between both cities.

The Yvelines-Gi Mono project and the VNG programme don't engage in direct money transfers to local governments. In the case of Yvelines-Gi Mono, the programme is co-funded by the AIMF, the department of Yvelines and to a lesser extent the six local governments constituting the intercommunal. The project money is spent by the local partner, the Gi Mono communal, and no money transfer takes place to the six local governments. T

he VNG programme set up a local project team that implements the project, together with a project team in the Netherlands that does the follow-up. Expenses are made by the local project team without direct transfer of money to the local municipalities.

Thus, an important difference between the city twinning arrangements and both the VNG programme approach and the Yvelines-Gi-Mono project is that the first make direct financial transfers to the local governments, while the latter have an intermediary structure, i.e. a local project team or the intercommunal, and no money transfer is made directly to the local governments.

Programme-approach versus tailor-made approach

In contrast to the twinning arrangements, that are ongoing processes of exchange that surpass the lifetime of the current programmes, VNG has a strict programme approach with a commitment to work with the 32 local governments in Ghana only for the duration of the programme. The strategy to be implemented is set at the national level, and is now trickling down to the 32 local governments. Among the advantages of this programme-approach they consider the following: the presence of the local project team in the Ghana to provide technical assistance to the local governments; a structured implementation of the same approach in 32 municipalities, allowing however for small tailor-made adjustments according to each municipality's reality; the possibilities for upscaling to other municipalities in Ghana; and the development of an exit strategy which ensures sustainability.

Among the downsides or challenges could be mentioned a more top-down approach and the creation of a new structure, i.e. the project team, which is temporary and is not part of the local governments involved in the project.

The other case-studies adopt a more tailor-made approach, where annual work plans can be adjusted during the programme to priorities expressed by the local government partners, without changing the overall goals of course. Besides their specific programmes on local taxation, the city twinnings also constitute a long term partnership that transcends the duration of the current programmes and also includes cooperation in other fields than taxation only, such as waste management (for example, Edegem - San Jeronimo partnership), cultural exchange (for example, Hoogstraten - Za'kpota partnership) and support to social protection (for example, Zoersel - Bohicon partnership).

No extra structure is set up to implement the project, but in some cases staff of the local government is (partially) paid by the funds of the project/programme. Usually, the local partner in the South has a high degree of autonomy and the relationship between the donor city and the local partner is based on mutual support and trust.

Political dialogue

City twinnings also have the particularity of establishing a political dialogue between locally elected, especially between mayors of both cities. The intensity of these exchanges however, differs from case to case and depends mainly on individual will to do so. In the framework of the UVCW programme this is encouraged but with limited success. Especially local politicians in Belgium don't show a lot of interest in this kind of political dialogue with their counterparts. From the partner cities, however, there is actually a demand for more exchange. This could thus be more explored, as sensitive topics, such as corruption, financial management, equity in taxation, and general tax issues, could be discussed in such a political setting. It would not be possible to discuss these issues between a Belgian civil servant and a Beninese mayor. This political dialogue could also help to sensitize local politicians on the importance of taxation.

In the VNG programme this approach of ‘soft influencing’ is not used. A Memorandum of Understanding is signed with the participating local governments before the start-up of the intervention to formalize the political will to collaborate in the programme. When confronted during the project with a lack of political will from the local government the programme establishes the possibility to ‘opt-out’ and to replace the local government with another one. Also, the support from the central level government in Ghana helps to overcome possible political resistance at the local level.

Capacity-building

A challenge that is often mentioned is the lack of local capacity to implement and maintain a sound local taxation system. For example, in Bohicon there are not enough tax collectors; in the framework of the UVCW programme municipalities lack the technical know-how to keep RFUs up to date; when staff of local governments is trained, they then often get a better paid job in a private company, etc.

In other to strengthen capacity, many options are available. However, as found mentioned in the literature review, a demand-driven approach should be a guiding principle in order to satisfy real needs of the partner institution. Also, on-the-job training has shown good results (see box 14).

Box 14: On-the-job training

The VNG approach uses tailor-made, on-the-job training for staff of local governments as an approach to capacity-building, instead of general trainings on taxation issues. This increases the chances that the skills acquired will be put at the service of the local governments, and also reduces the risk that the trained staff will leave the workplace (what often happens when local staff receives general trainings). Also, the programme differentiates between cities that need more capacity building and others, giving more attention to for example smaller cities that face bigger challenges to implement the reforms.

Also, on the donor side there is a lack of capacity. The coordinators of decentralized cooperation in donor cities are not experts in taxation issues and have difficulties to fully grasp the local reality of their partner municipality, for example, the challenges related to the link municipal-central government, the technical issues with taxation at local levels, the local politics, among other things. Also, in some cases, such as in the cities involved in the UVCW programme, staff of these local governments voluntarily take up the responsibility for the follow-up on the twinning arrangement and often prioritize other responsibilities in the municipality.

A way out for donors is to search for capacity building of their own staff. In local governments the tax department could definitely be an important ally that could strengthen the internal capacity building on taxation issues. However, local realities of partner local governments will always remain difficult to fully grasp, when working at a distance.

The VNG-programme used another approach to strengthen internal capacity, as the programme hired specialists from the Finance Ministry of the Netherlands and has established a partnership with the Erasmus university that offered its expertise on local taxation in low and middle income countries during the design phase of the programme. The programme is also based on pilot projects that were closely accompanied by VNG staff, allowing for a deeper understanding of local taxation issues in low and middle income countries.

Finally, capacity building is also necessary in terms of monitoring and evaluation (M&E). M&E systems of city twinnings are often focused on the financial reporting and the follow up on activities. A more outcome- and impact-focused approach to M&E however, as used in the VNG programme, would allow for better learning and management by the actors involved in the partnership.

5 | Conclusions

This paper intended to provide insights in the mechanisms of decentralized cooperation in the field of local taxation in low and middle income countries. Also, successful mechanisms that support and expand local taxation activities were identified, both related to programme strategies and related to donor instruments.

Three broad working areas of donor support to taxation initiatives were identified: improving tax policy and design, strengthening tax administration and encouraging constructive state-society engagement around taxation. Support programmes from the case-studies mainly focus on the second dimension and increasingly on the third.

The first working area, *tax policy and design*, is generally not a central outcome of decentralized cooperation programmes. It is often considered as an internal issue of the partner government. In twinning arrangements, the limited understanding of the local context is an obstacle to provide support to their partners on tax policy or design. Also, exchange mostly happens between staff of the local administrations, and less at the political level, where decisions on tax policy are made. Further, in order to improve or redesign taxation systems at the local level, the central level governments is likely to be involved. This is often beyond the reach of decentralized cooperation.

An exception is the Gi-Mono programme where a new tax will be implemented in some of the six local governments after a study was carried out on the potential of this tax. In another cases, programmes have tried to constructively engage with the central level government, for example by implementing performance contracts with decentralized tax services (that depend from the central government) or by actively involving central ministries, such as the ministry of finance or the ministry of decentralization in the programmes.

The second working area, *strengthening the tax administration*, is the central focus of all support programmes from the case-studies. For the twinning arrangements, this seems to be a logical consequence of the particularities of city-to-city decentralized cooperation, where peer-to-peer exchange between staff of both local administrations is the main instrument. But also the programme approach from VNG is focused almost entirely on improving the local tax administration and tax processes.

Good practices related to this working area include the need for a careful assessment of whether to focus on a data-led approach to improve the property tax, mainly working on improved registration and valuation of taxable units, which is often very expensive and a time-consuming, or a collection-based approach, which often allows for a more rapid increase in tax revenue. Some research suggests a collection-based approach is the most promising. However, the need for improved registration and valuation is also clearly expressed by local governments and can definitely not be left out of reform strategies. A combination of both approaches seems to offer the best chances for a successful strategy, as well as innovative ways to do registration and valuation, such as zonal valuation, in order to overcome financial and time constraints. In any case, strategies should be designed with due care, taking into account factors such as the financial and technical capacities of the local government, the design of the taxation system in place, fairness in tax burden, etc.

Other good practices on tax administration strengthening include the following: the separation of service delivery from revenue collection (for example, the *guichet unique* in Benin) and the use of digital

tools in order to increase transparency (and reduce tax leakages) and efficiency (for example, a digital database of taxable units).

Decentralized cooperation programmes are also increasingly working on the third dimension, *encouraging constructive state-society engagement around taxation*. The case-studies provided more insights in what seems to work:

- Establish *clear accountability lines* between the service delivered by the local government and the people who benefit from it. This would increase tax compliance and willingness to pay fees or taxes.
- The *organization of the funding cycle* seems to be an important guideline for taxation support strategies. This implies improved spending on public services and improved service delivery as the ultimate goal of taxation enhancing efforts.
- *Digital tools* increase transparency on taxation processes and enhance citizens' trust in the local government.
- *Local politicians should be sensitized* on the use and importance of taxation. This can be done through a concertation framework between the staff of the administration and the locally elected officials.
- *Citizen communication on taxation and public expenditure* helps to increase tax compliance, especially when locally elected politicians are involved in sensitization efforts.
- *'Tax where the money is'* is a useful guiding principle for local governments to determine where to focus their taxation efforts on, especially when they are faced with a limited revenue base and a big informal sector, which is hard to tax. In those contexts, focus could be on big businesses and big properties. However, care must be taken for equity reasons. An alternative strategy is to expand the revenue base, by strengthening the local economy.
- *Differentiate in actors* to engage with in the programme. Many actors have a stake in local taxation efforts, blocking or supporting them. Thus, support strategies are likely to have more impact when they take these different stakeholders into account and set up strategies that target a more diverse set of actors.

Several *donor support instruments* are used in the framework of decentralized cooperation which all have both their value and their limitations. The case-studies allowed to formulate the following general reflections on these instruments:

- *North-South peer-to-peer exchange on taxation issues* is often limited because staff responsible for decentralized cooperation are not experts on the topic and a deep understanding of the local context by the donor lacks.
- *South-South peer-to-peer exchange* offers interesting opportunities because good practices from similar contexts can be exchanged and easily be replicated.
- *Financial support*: decentralized cooperation through city twinnings make direct financial transfers to the local governments, while other modalities work with an intermediary structure, a new structure, i.e. a local project team, or an existing structure, i.e. an intercommunal, avoiding direct money transfers to local governments. No definite answer could be given on what works best.
- *Programme approach or tailor-made approach?* The first allows for more coherence, upscaling, and linkages with the central level government, while the second can respond better to local needs and be more flexible.
- In the case of city twinnings, the *political dialogue* between locally elected officials can in some cases be an interesting instrument to discuss taxation issues, especially more sensitive topics, such as local tax policy reform, corruption, and trust-building.
- *Capacity-building* is necessary in many local tax administrations and should be as much as possible demand-driven and 'on-the-job'.

Regarding the decentralized cooperation modalities from the case-studies, i.e. local traction, coordination and exchange, and programme-approach, a general scheme is suggested including the added value and the challenges of each modality (table 11).

Table 11 Decentralized cooperation modalities in support of local taxation initiatives: added value and challenges

	Added value	Challenges
Local traction, with significant amount of funds from the subnational level	<ul style="list-style-type: none"> - No new structures are set up in the partner country. - Flexible partnership. - Tailor-made, based on the needs expressed by the local government (bottom-up). 	<ul style="list-style-type: none"> - Limited knowledge on local taxation dynamics of the partner. - Difficulty to engage with the central level government. - Limited coordination with other support programmes. - Weak monitoring and evaluation.
Local traction, with significant amount of funds from the central level		
Coordination and exchange of practices	<ul style="list-style-type: none"> - No new structures are set up in the partner country. - Tailor-made, based on the needs expressed by the local governments (bottom-up). - Coordination among city twinnings - Exchange of good practices (N-N, N-S, S-S) 	<ul style="list-style-type: none"> - Limited knowledge on local taxation dynamics of the partner. - Difficulty to engage with the central level government. - Weak monitoring and evaluation.
Programme approach: alignment and focus	<ul style="list-style-type: none"> - Strong alignment with the central level government. - Project team can provide continuous follow up on activities and technical support. - Coherence in the approach with all the local governments involved and possibility for upscaling. - Strong monitoring and evaluation system. 	<ul style="list-style-type: none"> - New structure is set up in de partner country (project team). - Top down approach.

Source: own creation

A clear added value of a programme approach on local taxation is the possibility to engage more directly with the central level government. Political support from the central level is guaranteed throughout the programme and interventions are in line with ongoing fiscal decentralization policies and processes developed at the central level. A programme approach also ensures coherence among the different local governments involved, with the possibility for future upscaling.

The added value of city twinning arrangements of both types, local traction, and coordination and exchange, is in the first place that no new structures are set up in the partner entity and the fact that interventions are tailor-made, leaving considerable space for autonomy of the partner government and flexibility to respond to specific needs that may arise.

An additional feature of the ‘coordination and exchange’ modality is that this allows for exchange of good practices at different levels: north-north, north-south and south-south. Also, direct cooperation with the local government association in the partner country is possible, which can be an important stakeholder for lobbying efforts on fiscal decentralization with the national government. Also, coordination takes place between the donor local governments, which ensures a more coherent approach than in the case of city twinning arrangements without coordination structure.

6 | Recommendations

In addition to the good practices mentioned in part 5 of this paper, some general recommendations can be formulated related to the design of support programmes on local taxation, the cooperation modalities and instruments used by donors and a future research agenda.

6.1 The design of support programmes

Integrate the three working areas where possible

Support programmes have focused mainly on strengthening the tax administration, by making it more efficient (for example, through digital tools), by improving the tax processes, by improving the registration and valuation of taxable units, by improving collection strategies, etc. Although this approach clearly responds to needs of local governments in low and middle income countries, support programmes could benefit from a broader reform agenda to local taxation, including all three working areas discussed in this paper, i.e. tax policy and design, the tax administration and governance. Of course, this should be considered from the perspective of each decentralized cooperation modality and more emphasis could still be placed on one or another working area. A minimal attention for the three working areas in every support programme is nevertheless recommended in order to guarantee a more comprehensive approach to local taxation, which transcends a purely technical focus on local taxation.

Engage locally elected officials

From the case-studies it was clear that one of the key factors for improved local taxation is political will. Locally elected officials are key stakeholders in local taxation systems in several ways: they are often reluctant to implement measures for local taxation strengthening because of electoral reasons; they are the local decision-makers on taxation issues; and their participation in sensitization efforts with the population seems to help increase tax compliance. Support programmes could therefore develop specific strategies that target this group. Good practices from the case-studies include a concertation framework between locally elected officials and staff of the administration, or specific sensitization efforts directed at local politicians on the importance of taxation for local development and improved state-society relations.

Understand the dynamics of subnational taxation

Taxation at the subnational level is complex and cannot be reduced to a merely technical issue. It is embedded in a context of interlinkages with the central level government, ongoing processes of (fiscal) decentralization, local political economy elements, and trust- and state-building processes. In such complex contexts donor institutions should have a thorough “understanding of the reasons and mechanisms that lead to deteriorating fiscal situations of local governments” (Fjeldstad & Semboja, 1999). This study found that this is often a challenge for donors in decentralized development cooperation, especially when they are working at a distance. As a consequence, donors often feel

limited in the technical or strategical support they can offer on taxation issues. The following topics could be at the center of efforts to deepen the understanding of local taxation dynamics:

- *The policy context in the partner country*: legal framework for local taxation, the interlinkages between the local and the central level (both technical, for example intergovernmental transfers, and political, for example, possible tension between both levels), the level of fiscal autonomy of local governments, ongoing debate among local governments (for example, demands for more fiscal decentralization or for tax policy reform), etc.
- *Assessment of the local partner government according to the three working areas*. What follows is a non-exhaustive set of questions to guide the assessment:
 - Tax policy: which taxes/fees are collected and why? How is the current tax system at the local level organized? What opportunities exist for tax policy reform? How is the link with the central level government?
 - Tax administration: how are the current tax processes organized? Which actors are involved? Which strategies are used for tax registration, valuation, billing, collection and enforcement? What are the main challenges? What are the opportunities for efficiency gains?
 - Governance: is there political will at local level to implement new strategies for local taxation? Who are the actors that block improvement and why? Why is tax compliance low/high? How transparent are the taxation processes?

6.2 Support modalities and instruments

Which support modalities and instruments work best?

The support modalities and instruments presented in this paper all have their added value and challenges (see Conclusion). The choice for one or another should be based on the needs in a specific context. A programme approach with a local governments association implementing activities on behalf of the municipalities (e.g. the VNG programme) allows for a direct engagement with the central level government of the partner country, which is often not possible in the framework of city twinnings. This is certainly an added value to ensure alignment with central level policies and coherence among the local governments. It also provides a possibility for upscaling.

In order to strengthen constructive state-society engagement around taxation, however, city twinnings or other cooperation modalities that allow for a more tailor-made approach are possibly more useful. Building trust between citizens/taxpayers and the local government is a complex process that requires a flexible set of strategies designed according to the local context. Also, “bringing about accountability should not be expected to occur rapidly—it will typically require a strategic, gradually implemented process for building trust between local government officials and their constituents” (Smoke, 2001: 19). City twinnings are then an interesting approach, as they constitute long-term commitments, transcending the programme or project duration. City twinnings also have the possibility for a political dialogue with locally elected officials to discuss more sensitive issues related to governance.

In view of strengthening the tax administration, the different support modalities could all bring valuable elements to the table. A programme approach, supported by the national government and that includes several local governments, ensures coherence in the reform of tax processes at the local levels. Also, a local project team is able to provide technical support and training. Twinning arrangements can offer peer-to-peer exchange between staff of both local administrations on specific topics and South-South exchange on good practices.

Monitoring and evaluation

In order to have a better idea on what works and what does not work in local taxation support programmes, it is necessary to strengthen monitoring and evaluation (M&E) systems of decentralized cooperation programmes. The focus should shift to outcomes and on a more diverse set of the ‘expected change’ on all three working areas discussed in this paper. Currently, results of programmes are mostly defined as increased revenue for the local government. While this is of course an important goal, a too limited focus on revenue increase only could divert attention from other important outcomes related to local taxation, especially the ones related to the third working area, such as improved trust in the local government and improved equity in taxation. Also, more focus could be on what is considered the final goal of many taxation support initiatives, i.e. to improve service delivery for the citizens. As an interviewee put it:

You can strengthen the tax administration but that alone won't suffice. This is only sustainable if citizens see that their tax money is used to improve public services. Local governments should understand that their role is to provide services to the population. The need for tax money in order to do this, is a condition but not the final goal. (interview with a VNG representative).

6.3 Research agenda

Research on what works (or not) in decentralized donor support programmes to local taxation should be expanded, focusing on the three working areas mentioned in this paper and their integration in support programmes (tax policy and design, tax administration, and especially state-citizen relations) and on the modalities and instruments used by donors. This would enhance further understanding on how donors could best support local governments (and central governments) on local taxation issues.

Also, research should increasingly focus on studying the dynamics of local taxation in low and middle income countries. Research topics could include: taxpayer experiences at local levels, the organization of the social fiscal contract at local levels, how connections between tax payment and broader demands for improved governance take place, and which role central-local government relations play in local taxation (for example, the inter-organisational cooperation in revenue collection³¹).

³¹ Recent research Fjeldstad, Ali & Katera (2018) examines the opportunities and challenges of inter-organisational cooperation between central and local government agencies in a developing country context.

- APPENDICES -

appendix 1 Interview guideline

Description du programme/projet d'appui aux systèmes fiscaux locaux : données généraux sur le(s) programme(s) actuel(s) (période 2016 – 2018) : durée du programme, acteurs impliqués, contexte, ...

Le processus de changement prévu (le 'focus' du programme) :

- Quels sont les objectifs du programme?
- Quels aspects de la fiscalité locale le programme veut appuyer ? (*note: première question ouverte, puis ensuite possiblement questions sur les thématiques spécifiques ci-dessous*)
 - Focus plus sur la politique fiscale et le 'design' du système de fiscalité locale?
 - Focus sur le renforcement de l'administration fiscale ?
 - Focus sur le renforcement de la bonne gouvernance (représentativité, relation citoyens-gouvernement local, transparence, responsabilité, etc.)
 - Autre?
- Stratégies du programme pour atteindre les objectifs (et théorie de changement) ?
- Mécanisme de monitoring et évaluation ?

Modalités d'appui: comment les partenaires locaux sont-ils soutenus?

- Comment le partenaire local est-il soutenu par le programme? (*note: première question ouverte, puis ensuite possiblement questions plus spécifiques*)/ quelle type d'appui est-ce que vous recevez dans le cadre du projet de coopération décentralisée ?
 - Soutien financier? De quelle façon (dons, prêts, etc.)? Exemples?
 - Support technique? De quelle façon? Exemples?
 - Renforcement des capacités / formation? De quelle façon? Exemples?
 - Investissements, par exemple pour l'achat de logiciels / matériels ?
 - Autres?
- Quels sont les acteurs qui reçoivent l'appui ? Le travail est-il fait avec les administrations et/ou plutôt avec les politiciens locaux ? En quoi l'approche diffère selon le groupe cible?
- Comment est-ce que le travail est avec les autres acteurs impliqués dans le programme?

Obstacles et défis

- Quels sont les plus grands obstacles ou défis pour renforcer avec succès les systèmes fiscaux locaux dans les communes? Actions prises par rapport à ça ? Leçons apprises ? *Note: si il n'y pas beaucoup de réponses, donnez quelques exemples :*
 - Obstacles techniques: revenus potentiels limités, coûts de transaction élevés, manque de capacités des autorités fiscales, etc.
 - Obstacles non techniques: perception des citoyens, économie politique, rôle des organisations de la société civile, corruption, etc.

Facteurs de succès

- Résultats du programme jusqu'au moment ?
- Leçons apprises?
- Les facteurs les plus importants qui contribuent à la réussite d'un programme de renforcement des systèmes fiscaux locaux?
- Évolutions/trends sur ce thème (croissance de l'importance ou des efforts, ou pas?)
- Cadres théoriques sur lesquels le programme s'est inspiré pour le travail sur la fiscalité locale?
- Information écrite/publications sur le programme ou dans la littérature académique?

appendix 2 List of interviewees

Name	Organization/ government	Function	Date of interview
Wim De Geest	City of Edegem, Belgium	Responsible for international development cooperation and coordinator of the city twinning with San Jeronimo	28 February 2018
Isabelle Compagnie	UVCW, Belgium	Head of department Europe/International of UVCW	12 March 2018
Erik Fuhlbrügge	City of Zoersel, Belgium	Responsible for international development cooperation and coordinator of the city twinning with Bohicon	13 March 2018
Peter Jongkind	VNG, the Netherlands	Program Director Tax Revenue for Economic Enhancement (TREE)	20 March 2018
Renate Hechenberger	City of München, Germany	Head of unit on international cooperation for developing countries and coordinator of the city twinning with Harare	22 March 2018
Hilt Rigouts	City of Hoogstraten, Belgium	Responsible for international development cooperation and coordinator of the city twinning with Za'Kpota	26 March 2018
Cédric Le Bris	Department of Yvelines, France	Director of GIP « Yvelines coopération internationale et développement »	27 March 2018
Hugues Tchaou	City of Bohicon, Benin	Responsible for decentralized cooperation	3 September 2018
Michée Tchando	City of Za'Kpota, Benin	Responsible for decentralized cooperation	3 September 2018
Cassien Dossouhouan	City of Djidja, Benin	Responsible for decentralized cooperation	3 September 2018
Patriège Agbadja	Intercommunal Gi-Mono, Benin	Executive director of Gi-Mono	4 September 2018
Lambert Sehoubo	City of Dogbo, Benin	Responsible for decentralized cooperation	4 September 2018
Georgette Djenontin-Bada	ANCB, Benin	Local Economic Development and Domestic Resource Mobilization Officer	1 October 2018

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