

Decentralization of Taxation in Africa

Policy Choices

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* Presentation based on a research program supported by the Ministry of Foreign and European Affairs (Chambas *et al.*, “Mobilizing local resources in sub-Saharan Africa,” *Economica*, Paris, 2010)



Conference on Revenue Mobilization and Developing Countries, IMF, April 17-19 2011

Decentralization of taxation = mobilization of own local resources

- Context
 - There are various approaches to decentralization in the developing countries
 - Local institutions vary (federal/unitary states, variable number of levels of local government)
- Own local resources consist primarily of:
 - Property and residence taxes, taxes on economic activity (business licenses)
 - Local taxes on utilities (water, electricity)
 - Non-tax revenues (payments for market stalls, license fees, etc.)
- Own local resources: specific characteristics
 - Accountability (direct link between taxation and the supply of public goods)
 - Proximity to local needs



Decentralization of taxation and the challenges facing African governments

Two crucial challenges face African governments:

- Mobilizing an adequate level of public resources, particularly for the Millennium Development Goals
- Promoting good governance to achieve an efficient supply of public goods



Own local resources as one way of meeting the challenges

- Mobilization of additional public resources (e.g., urban property tax)
- Financing of a supply of public goods tailored to the needs of the population (proximity)
- Promotion of competition between central and local governments leading to better governance (comparison of performance)
- Increased accountability through broad-based local direct taxes and levies: a factor in the efficiency of the supply of public goods
- Greater accountability of elected officials leading to better governance



... but with risks

- Fragmentation of the overall tax system and confusion in the administration of taxes
 - ⇒ Lack of consistency in the overall tax system (re-establishment of pseudo-taxes on exports)
 - ⇒ Economic distortions (e.g., cascading local taxes on the circulation of goods)
 - ⇒ Lack of control (misappropriations, corruption)
- Excessive taxation (vertical tax competition)



Finding: weak and unequal mobilization of local resources

- Own local resources: generally less than 1% of GDP
- Concentration of own local resources in large cities
- Impoverished rural communities
- Result: increased inequalities through the concentration of the supply of public goods in large cities



Lack of coordination between local and central taxation

- Legislation on own local resources
 - Blurred and complex borderlines between local and central taxation (shared taxation)
 - Lack of oversight on the initiatives of local communities in the area of local tax legislation
- Administration of own local resources
 - Local communities excluded from the mobilization of own local resources
 - Role of local communities and governments often poorly defined (practice often based on non-formal agreements)
 - Conflicting actions by various institutions or governments vis-à-vis the same tax base



Inappropriate local tax legislation

- Excessive and counterproductive number of own local resources
- Local taxes not suited to diverse tax bases and poor populations (property tax)
- Complex legislation that is out of step with the challenges: e.g., property taxes based on rental values in public housing neighborhoods
- Little innovation in taxation; frequent anomalies



Administration of own local resources: the risks

- Own local resources: broad-based direct taxation with low returns on a large number of assessments: high collection costs
- Own local resources: diversion of central government resources for small stakes, substantial opportunity costs
- Lack of oversight and control of own local resources

Consequences :

- Frequent arbitrariness in the application of local taxes
- Local tax burden can be excessive and unequal, to the detriment of the poor
- Risk of cronyism that favors the more well-to-do



Approaches to the decentralization of taxation

- Need for wide-ranging reforms similar to the reforms of central taxation
- Reforms should cover both the legislation and administration of own local resources
- Fundamental principles for the decentralization of taxation:
 - Base decentralization on the principles applied successfully in central taxation
 - Seek optimization of the supply of public goods



What should be the link between local and central taxation?

■ Legislation

- The central tax system should constitute the main reference (aim of preserving the achievements of the reforms)
- Construction of a coherent overall system (central + local) for the mobilization of public resources
- Avoid dispersion of own local resources among a multitude of revenue sources

■ Administration

- Key role for local communities in the mobilization of own local resources
- Support for local communities from the government network with the greatest capacity



Operating Principles of Legislation

- Construct coherent arrangements for the mobilization of own local resources using systems that are segmented on the basis of the characteristics of the tax base.
- Example of segmented arrangement:
 - Property tax on rental value (high-value building),
 - Indicator-based residence tax (lower-value building)
 - Lump-sum residence tax (shanty towns)



Operating Principles of Legislation

- Simplification in proportion to the stakes and pragmatism.
 - E.g., application of a simple indicator-based business license that is entirely local and that fully discharges a micro-business's tax liability
 - For other business that are subject to taxation on the basis of actual profits, application of the traditional business license
- Effective central oversight of the system of taxes and levies
 - Exhaustive lists of local taxes and levies
 - Applicable tax brackets
 - Publication of tax codes



What is the best system for administering own local resources?

- No single framework for the mobilization of own local resources given the diversity of contexts
- However, there are some fundamental principles
 - Reserve a key role for the local communities (accountability of elected officials and avoidance of free-rider behaviors)
 - Use the government network that is best placed to support the local governments
 - Respect the principle of a single manager for each own local resource stream (assessment and collection)



What is the best system for administering own local resources?

Link between tax administration and local governments

- For local taxation of companies subject to assessment on the basis of actual profits and for highly technical taxes: principle of one tax administration:
 - to preserve the principle of one contact for tax issues
 - to avoid competing actions by tax administrations and local communities
 - to take account of technical competencies
- For simple local taxes (majority of cases): collection by local communities with support from the best placed government network



Conclusion

A crucial step for governments

- Mobilization of own local resources constitutes an essential tool in promoting a more efficient supply of public goods that is likely to better respond to the needs of the people, especially the very poor.
- In Africa, decentralization of taxation is growing but faces major constraints.
- A sustained effort to design and implement reforms must be initiated to ensure that the decentralization of taxation contributes to the development of appropriate overall systems for the mobilization of public resources.

