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## Local taxation and institutional accountability in Rwanda's growing cities

**Conference Item [eg. keynote lecture, etc.]**

**Original citation:**

Originally presented IPAR 1st Annual Research Conference: Improving the Lives of Ordinary Rwandans: Evidence for Policy, 7-9 December 2011, Kigali Institute of Education (KIE), Rwanda.

This version available at: <http://eprints.lse.ac.uk39870/>

Available in LSE Research Online: [January 2012]

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# Local taxation and institutional accountability in Rwanda's growing cities : the case of Kigali

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IPAR Annual Research Conference  
Kigali, 7<sup>th</sup>- 9<sup>th</sup> December 2011

# Structure of presentation

- 1) Taxation, state-building & accountability in theory
- 2) Fiscal decentralisation in Rwanda
- 3) Kigali local revenues in comparative perspective
- 4) Detailed breakdown of local revenues
- 5) Performance of the three decentralised taxes
- 6) Strengths, weaknesses, opportunities and challenges

# Taxation, state-building and accountability : a virtuous circle?

- Taxation is considered central to building state capacity in both theory and historical experience
- Two-way relationship between taxation and accountability
- Importance of ‘fiscal social contract’ (Moore)
- ‘Quasi-voluntary compliance’ (Levi): effective taxation depends on government legitimacy & credibility as well as state capacity

# Taxation can fulfil multiple functions

- Building bureaucratic capacity
  - Building accountability
  - Increasing citizen engagement with public affairs
  - Stabilising the economy
  - Incentivising /discouraging particular types of investment
  - Regulating economic activity
  - Redistributing wealth
  - Discouraging dangerous/undesirable activity
  - Decreasing dependence on aid/increasing autonomy
- Even if the intention of a tax relates to just one of these, it may affect some of the others as well

# Which taxes are suitable for decentralisation?

- Effective decentralisation of service delivery requires *fiscal* decentralisation, not just dependence on transfers
- Taxes relating to stabilisation functions (e.g. tariffs & VAT) are not suitable for local authorities; they are too cyclical
- Most taxes relating to distribution are not considered suitable: can exacerbate regional inequalities if wealth moves to areas with lower taxes
- But distributive taxes relating to *immobile assets* (land & property) are considered highly suitable for decentralisation
- So are business licenses and user fees for services

# Fiscal decentralisation in Rwanda

- 3 taxes were decentralised by Law No. 17/2002 (along with various fees). What are the characteristics of these 3 taxes?
  - **Property Tax:** in theory is non-distortional , efficient & progressive; but also difficult to administer
  - **Rental Income Tax:** linked to immobile assets (property) & potentially very lucrative, but difficult to capture; not often decentralised
  - **Business Licences:** relatively straightforward to collect; tends to also have a regulatory function, which can sometimes conflict with its revenue-raising objectives
- *District authorities in urban areas offer particular potential for raising these taxes, and need to maximise them due to especially large service delivery mandates*

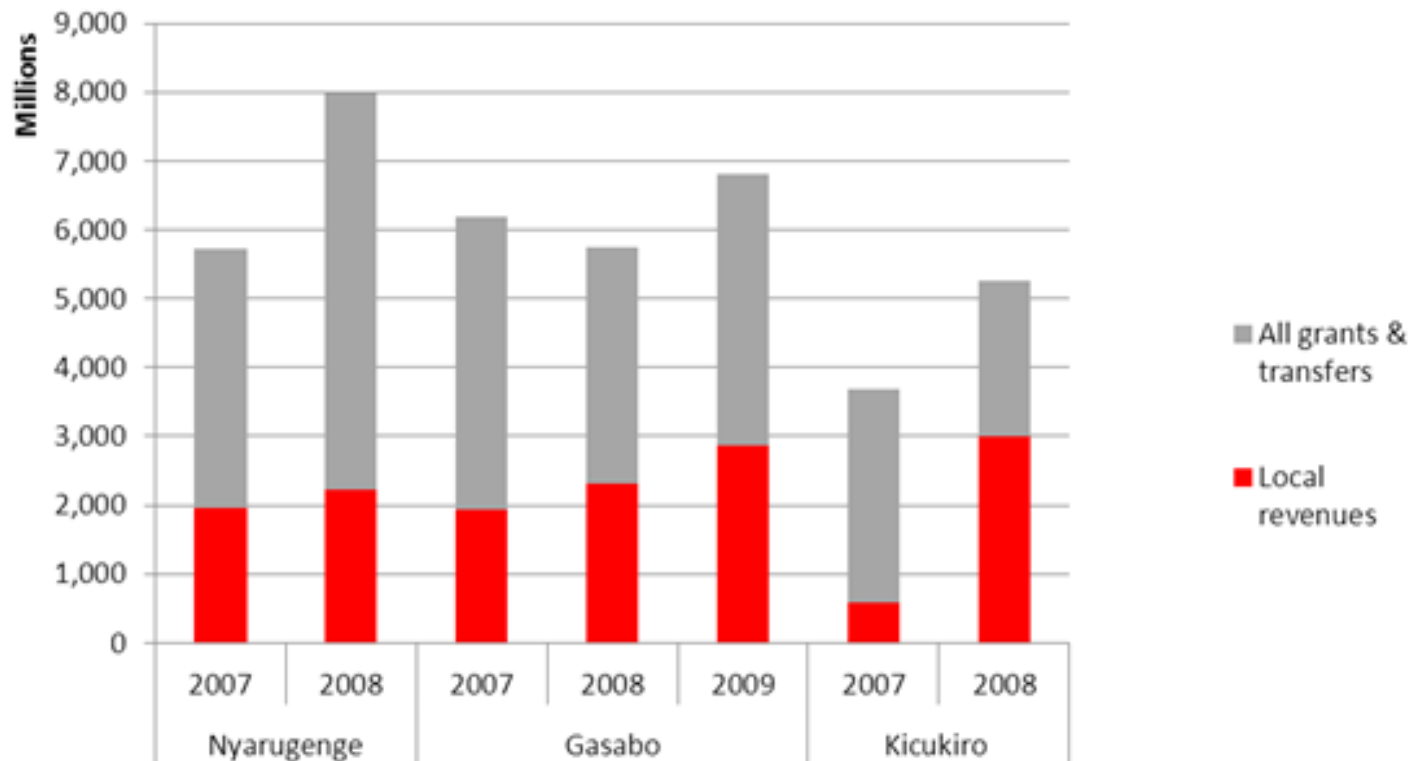
# Rwanda: local taxation in national perspective

- RRA has been very successful: highly motivated and competent; enjoys strong government support
- RRA success reflects its high levels of bureaucratic capacity, but also government legitimacy, motivation & credibility
- How does *local* taxation relate to this national picture?
- RRA is model revenue authority for Africa, and Kigali has been called a 'model city'. Could Kigali also provide a model in terms of effective *local* revenue collection?



# Kigali: local revenues in comparative perspective

- Kigali collects more local taxes per capita (\$14) than Kampala (\$11), & local revenues have grown more steadily

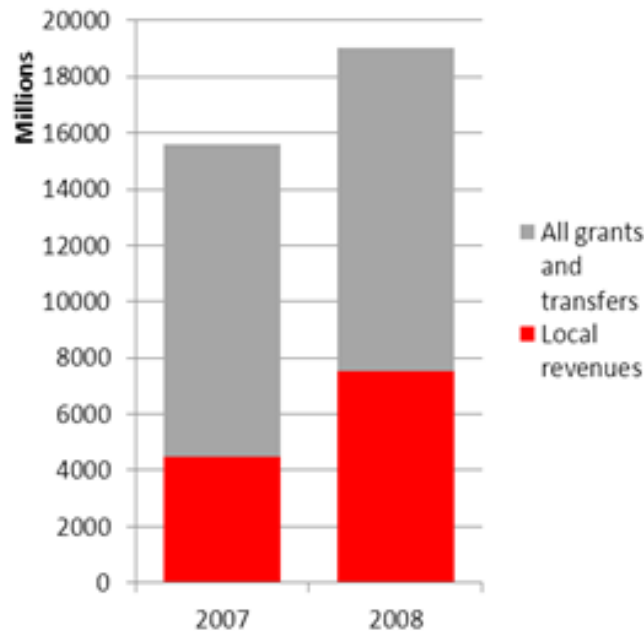


- Local revenues remain under 50% but grew in all 3 districts

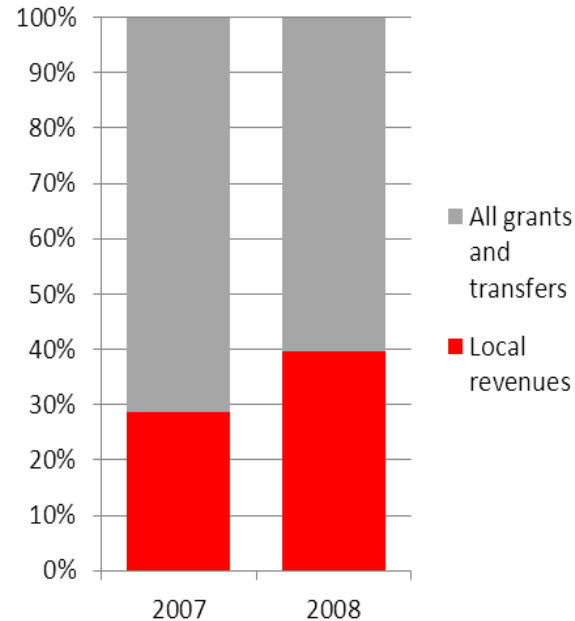
# Kigali: local revenues in comparative perspective

## Local revenues and transfers, Kigali's three districts combined

- *a) Absolute figures (RWF)*



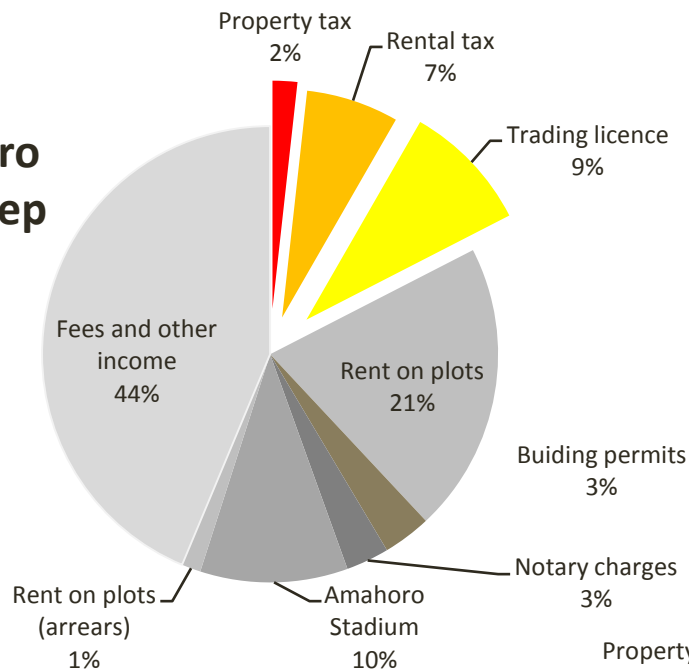
- *b) As a percentage of total*



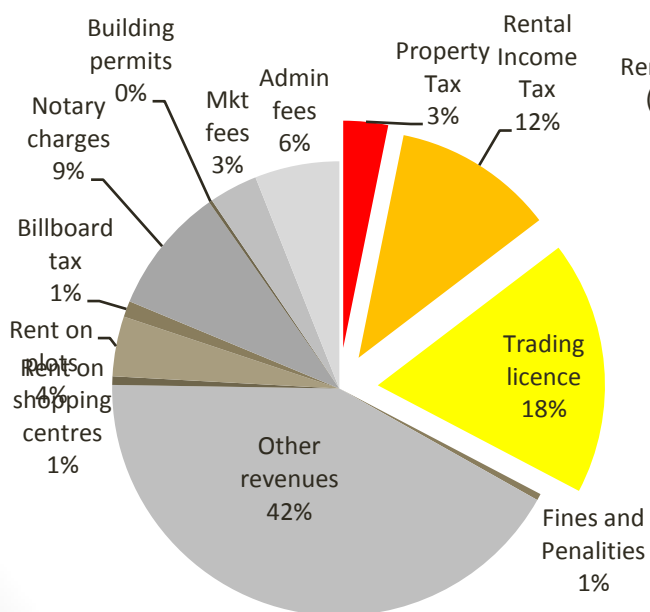
Local taxes grew as % of total city revenues, while in Kampala transfers have grown much faster than local taxes

# Breakdown of Kigali districts' local revenues

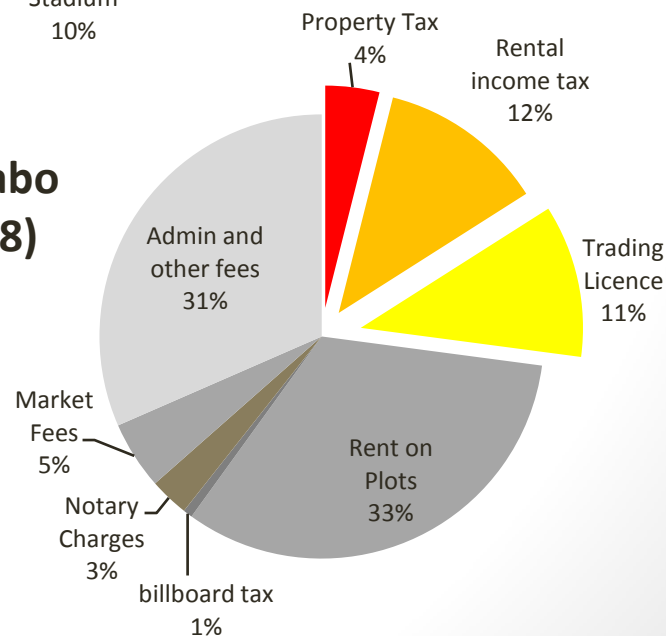
**Kicukiro  
(Jan-Sep  
2009)**



**Nyarugenge (2008)**

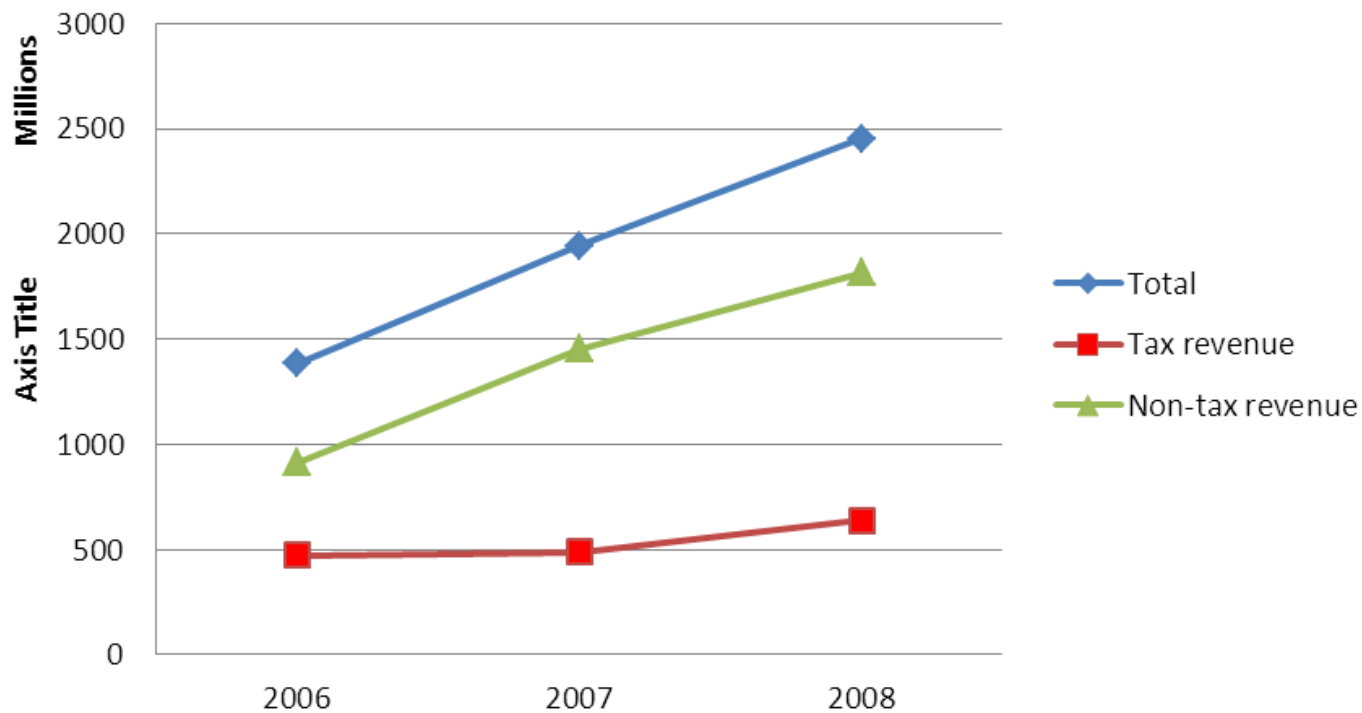


**Gasabo  
(2008)**



# Breakdown of Kigali districts' local revenues

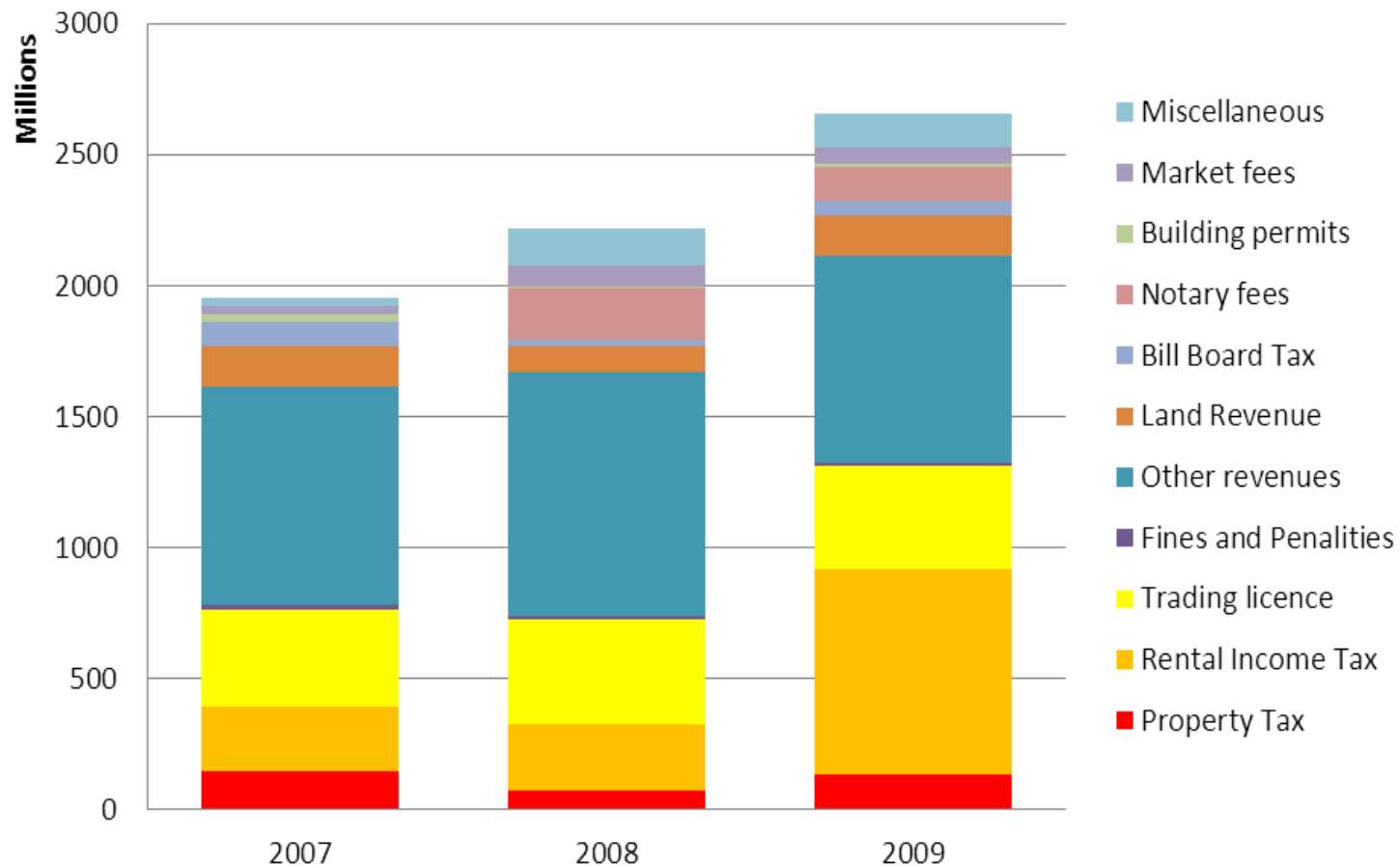
- Much revenue in Kigali's districts comes from various fees, rent on plots, and sale of district assets



*Gasabo District total local revenues, 2006-8*

# Breakdown of Kigali districts' local revenues

- **Nyarugenge District local revenue composition, 2007-2009**



# Performance of the 3 decentralised taxes

## 1) Trading licenses

- These have performed best & most consistently: 85-95% of businesses are registered and pay this tax
- Already almost 'saturated', so potential increase is limited
- Issue of size differentiation within categories of business

## 2) Rental income tax

- Has been increasing fast in all districts (both in terms of registered taxpayers and absolute sums collected)
- Report was inconclusive regarding whether districts or RRA were more effective in collecting this tax
- Potential to increase even more due to large rental market
- May be difficult to distinguish rental from other income

# Performance of the 3 decentralised taxes

## 3) Property tax

- Remains the most limited: amounts to around 12% of the three decentralised taxes, and 3% of all local revenue
- Very small increases each year and sometimes decreases
- Only around 1000 people registered in whole city
- Holds great potential: PT amounts to 20-30 % of revenue in many African countries, and more in many other regions
- Lack of capacity for market-based valuation
- Valuation is expensive ; has to be balanced against benefits
- Given the scale and pace of Kigali property boom, the more time that passes, the harder it will be

# High dependence on non-fiscal revenues: does it matter?

- Around 70-80% of local revenues in Kigali are from sources other than taxes (i.e. non-fiscal)
- Potential reasons why this may be problematic
  - Sustainability of certain sources over time
  - Fluctuations in certain sources may make them unreliable
  - Possible implications for accountability and state-building
- The only way to raise ratio of taxes to other revenues may be through RIT and PT
- User fees?
- To what extent should local taxes be tied to development vs recurrent expenditure?



# Strengths & weaknesses of existing system

- Local revenues already high compared with some countries
- Impressive on business licensing, formalising the economy
- National government is supportive of local authorities
- District revenue systems are becoming streamlined at KCC
- Dependence on transfers still quite high (which may impede local state-building and accountability)
- Some revenue sources may lack sustainability over time
- The most progressive local taxes have a relatively small share

# Opportunities and challenges

- PT and RIT are closely linked & can be improved in concert
- New titling system should increase property tax revenues
- The fact that local revenues are increasing overall may facilitate greater accountability/civic engagement
- Trading licenses may have limits as a local revenue source
- Low/non-market based PT may encourage speculation on property at the expense of other forms of investment
- Districts' capture of rental income tax remains uncertain
- Potential confusion over relationship between property tax & land tax (rent on plots) under new titling system