IMPROVING SUBNATIONAL DOMESTIC RESOURCE MOBILIZATION

A Review of Issues and Opportunities for Strategic Donor Support

PHOTO CREDIT: Kendra Helmer/USAID
"Collecting Payment for Electricity, May 2013, Caracol, Haiti"

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EXECUTIVE SUMMARY

Improving subnational resource mobilization – or the process by which subnational governments raise and spend funds on behalf of their constituents – is critical to ensuring sustainable progress towards development goals. In many places, reforms and investments may be needed at the subnational level to ensure governments have the resources and accountability to effectively provide necessary public services, support transparent governance, and nurture a conducive economic environment for private sector growth.

In most developing countries, including those in which USAID works, subnational government revenue is limited: it is about a fifth of general government revenue and a fraction of national GDP (ranging from 3.8 percent in low-income countries to 7 percent in upper middle-income countries). About half of subnational revenue comes from intergovernmental transfers and grants with about a third from taxes and the remainder from fees or other sources.

Subnational governments, including urban local governments, and authorities in cities, city-regions, and peri-urban areas, face several challenges in mobilizing resources, especially raising own-source revenue. Improving subnational domestic resource mobilization (DRM) can be tricky. It requires overcoming political, legal, and administrative challenges and managing a diverse array of stakeholders. This hampers their ability to deliver basic public services and create an enabling environment for the private sector and undermines the social contract between government and citizenry.

Through a review of literature, interviews with subject matter experts, and the authors' analysis, this report offers several takeaways on the challenges and opportunities for improving the mobilization and management of subnational resources:

- **Improving own-source revenue represents an important opportunity for subnational governments to generate needed resources and build trust with citizens**. Own-source revenue is especially important to funding and improving service delivery. There are many, well-established ways to generate own-source revenue, including variants of user fees and property taxes. The relative merits of these revenue streams – including their potential to raise revenue, complexity and costs of managing, equity considerations, and potential distortionary effects – must be carefully weighed by local officials and their partners.

- **Strengthening subnational resource mobilization has the potential to yield important governance dividends**. Improvement in the way subnational governments mobilize resources does not only increase their resource envelopes. It also has the potential to improve transparency, strengthen the business environment, and enhance public accountability. Technical solutions, such as digitizing revenue collection or consolidating and rationalizing tax instruments, can address common administrative challenges and at the same time improve transparency and predictability in revenue collection. Tailoring these solutions to local realities, accounting for incentives and political economy dynamics, as well as sequencing and messaging reforms to build public support, can help address political challenges as well.

- **Resource mobilization is more likely to gain traction if it is situated within larger conversations on subnational public financial management, including expenditure management and accountability for budgetary decisions.** Investments in the broader public financial management (PFM) system, if they place the subnational government on stronger fiscal footing, are critical to ensuring improved resource mobilization is sustainable and translatable into improved outcomes. A key enabling or constraining factor is the degree of subnational fiscal autonomy, particularly whether subnational governments have authority to raise sufficient revenue to meet their expenditure responsibilities (obligations and responsibilities to citizens).

- **Intergovernmental transfers are, and are likely to remain, the most significant revenue stream for most subnational governments.** This reality makes sense given that own-source revenues often fall short of what subnational governments need to meet their expenditure responsibilities. Although service delivery responsibilities are often decentralized, central governments generally retain control over the revenue instruments that generate the most resources and are most efficiently administered at the central level (e.g., Value-Added-Tax, personal and corporate income tax, customs). Although transfers may weaken incentives of subnational authorities to increase own-source revenue, evidence suggests that, if well structured, they can promote equity, strengthen local administrative and financial management capacity, and advance progress towards development goals.

- **Donors can best support these efforts by working with local actors to ensure a thorough understanding of the technical and political economy issues underlying the existing DRM context**. Equipped with such a grounding, and taking a flexible, iterative approach, donors can support reforms by adapting international expertise to local opportunities and needs, aiming for “best fit” solutions rather than an unrealistic, context-free, international “best practice.”

USAID can support improved subnational DRM in several ways:

- Convene stakeholders to identify challenges and build coalitions for reform.

- Tap international best practice to inform locally appropriate policy advice, programming, and technical assistance.

- Lend visible support to local leaders who have made clear, effective revenue improvements, and use these as peer learning opportunities.

- Coordinate with other development partners, including those making large investments to stimulate the local economy, to help subnational governments build PFM and subnational DRM capacity.

We offer the following recommendations to strengthen DRM programming:

- **Ground strategies in the realities of each country, subnational context, and behavioral norms.** Any strategy to improve a subnational revenue system should be based on detailed analysis of incentives for national and local stakeholders and the existing policy and legal framework. Accordingly, subnational reform efforts should focus on areas where there is sufficient local autonomy to act independently.

- **Adopt a flexible, iterative approach based on experimentation, refinement, and scale-up**. Some donor programs prescribe an exact approach, which is incompatible with the messy and gradual nature of subnational DRM reform. Future programs need to depart from this trend; this can be done by implementing pilots that enable continuous learning and help determine whether the program works, and if it should be scaled as-is, scaled with modifications, or shelved.

- **Increase support for subnational DRM by linking with broader programs and funding on decentralization, local governance, urban governance, and public financial management.**

The close, mutually reinforcing relationship between improved, transparent local governance and stronger subnational resource mobilization presents particularly good opportunities for collaboration. Consequently, donors should identify opportunities for aligning DRM objectives with existing or planned programs nominally focused on other, adjacent issues, including decentralization, governance, and PFM.

- **Adopt a realistic and sustainable but ambitious performance measurement framework.** In addition to tracking revenue performance, subnational DRM programming should adopt nuanced performance measurement indicators that shed light on underlying factors that shape subnational revenue outcomes.

- **Avoid a narrow focus on increasing revenues.** Stakeholders need to be mindful of the unintended consequences that can result from designing programs around the sole goal of achieving higher revenue targets. Such an approach can lead to harmful outcomes such as incentivizing the increased use of regressive tax policies or the adoption of enforcement tactics that infringe on taxpayers' rights.

- **Ensure the appropriate leadership of key local and national stakeholders in the design and implementation of subnational DRM reforms.** The success of DRM reforms depends on understanding the incentives of key local stakeholders and ensuring they are engaging in the reform process. Ensuring engagement and leadership of key stakeholders (including, individual citizens and civil society groups, elected officials, and private sector actors) in designing and implementing subnational DRM programming is critical to success.

Improving subnational resource mobilization will require an adaptive approach, which builds on international and local evidence, and adapts to changing needs, realities, and opportunities. By leveraging its access to expertise, resources, and innovations, USAID has a significant opportunity to support locally led efforts to reform and improve subnational DRM and broader subnational governance and PFM systems.

INTRODUCTION

Domestic resource mobilization (DRM) is seen by many donors, international organizations, and national leaders as central to a country ensuring sustainable progress towards development goals.[1] Increased mobilization of domestic revenue, especially tax revenue, is associated with greater public expenditure on social services, including public health,[2] and is linked to improvements in governance[3] and development outcomes.[4] The question of how to mobilize resources at the subnational level has become increasingly important, especially as more service delivery responsibilities[5] are shifted to subnational governments[6] as part of decentralization.

Improving subnational DRM in developing countries, and particularly increasing own-source revenue, can advance wide-ranging development objectives. It can increase accountability for expenditure decisions and public financial management;[7] encourage civic engagement in local political processes;[8] and improve government efficiency.[9] DRM improvements can alleviate burdens on national budgets (when generating subnational own-source revenue)[10] and raise critical revenue to finance sustainable growth.[11]

However, there are numerous obstacles to strengthening subnational DRM systems, ranging from political disincentives to limited technical capacity. Although many of these barriers can be addressed through the tailored adaptation of solutions and best practices from around the world, doing so requires patience and flexibility. While national and subnational policymakers, tax administrators, civil society organizations, and taxpayers (both citizens and firms) are the most important stakeholders in addressing these barriers, donors can play an important role. Donors can advise on policies and strategies and make targeted programmatic investments to strengthen the capacities of subnational tax administrations and public financial management systems.

Improving subnational DRM alone, without other governance reforms and strong economic development strategies, is insufficient, and it is not a standalone solution to many of the local service challenges that stymie pro-poor growth. In some places, existing intergovernmental arrangements and limited decentralization may require significant attention to national-level DRM and governance reforms. However, improving subnational DRM is critical to achieving sustainable financing of local services, promoting government accountability, and enhancing resilience to shocks, particularly in urban areas.

This report reviews the latest evidence from academic and practitioner literature and provides information on adapting international best practices, accurately diagnosing policy problems underlying poor DRM, and laying the groundwork for technical assistance programs. To complement

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[1] The Addis Tax Initiative outlined commitments and efforts by development partners, partner countries, and other stakeholders to enhance DRM in partner countries. In so doing, these partners affirmed the importance of DRM to advance development objectives and meet the Sustainable Development Goals. See Addis Tax Initiative, "About," accessed February 3, 2021, https://www.addistaxinitiative.net/about

[2] Tamarappoo et al. 2016

[3] Moore 2015

[4] USAID n.d.

[5] Since the 1980s, significant decentralization of many fiscal and administrative responsibilities has had profound implications for many subnational governments, particularly the decentralization of responsibilities for service delivery and the challenge of matching these responsibilities with sufficient revenue. This decentralization is largely driven by the principle of subsidiarity: decisions should be handled by the lowest appropriate unit of government.

[6] In some countries, half of the national budget is allocated to lower levels of government (Arturo Gutierrez, "What are we talking about when we talk about "subnational" governments?" World Bank Blogs (blog), August 26, 2015, https://blogs.worldbank.org/governance/what-are-we-talking-about-when-we-talk-about-subnational-governments)

[7] Ato Brown, Ofosuhene, and Akenten 2019; Ambrosanio and Bordignon 2006

[8] Cheema and Rondinelli 2007

[9] Ciblis and Ter-Minassian 2015

[10] Smoke 2019

[11] Bahl and Linn 2014

this research, highlight relevant examples, and reflect policy considerations, we interviewed 12 international experts in subnational governance or public financial management. While the literature summarized and insights surfaced in this brief may have broader relevance, the brief focuses primarily on strengthening subnational DRM for improved service delivery in urban areas of developing countries, including cities (small- and intermediate-sized), city-regions, and peri-urban areas.

To assist USAID and its local partners in this effort this report includes evidence on:

- The main sources of subnational revenue
- How subnational DRM can support improved service delivery
- Common barriers to improved subnational resource mobilization
- The mutually supportive relationship between local private sectors and subnational DRM
- Emerging solutions for subnational DRM challenges
- Strategic guidance for donor-supported subnational DRM efforts

The report concludes with two appendices: a table showing the composition of subnational revenue by country and guidance for assessing practical considerations for subnational DRM program design. The guidance Illustrates the types of tasks Mission staff should consider undertaking and the types of questions staff should ask to help them identify effective, locally appropriate programming.

WHAT ARE THE MAIN SUBNATIONAL RESOURCE STREAMS IN DEVELOPING COUNTRIES AND CHALLENGES TO THEIR WIDER USE?

Good data on subnational government revenues are hard to come by and average estimates mask significant variations in subnational DRM within and between countries. Public financial management systems and practices vary across countries, which makes it difficult to reliably compare subnational revenue performance from one country to the next. Nonetheless, a review of data from the OECD-UCLG World Observatory on Subnational Government Finance and Investment provides a useful snapshot of the state of subnational DRM, globally (see Table 1 and complete country data in appendix A).

Across USAID partner countries, total subnational government revenue (i.e., comprised of both intergovernmental transfers and own source revenues) accounts for 23 percent of general government revenues and 6 percent of GDP, on average. But there is considerable variation between and within regions and income groups. While subnational government revenue accounts for 36 percent of general government revenue in the Asia-Pacific region (albeit with significant intra-regional variation), it comprises just 10 percent and 13.5 percent in Africa and Latin America, respectively.[12]

Similarly, when grouped by income, subnational revenue comprises a smaller percentage of overall revenue in low-income countries than in middle-income countries although there is wider variation among middle income countries.

FIGURE 1

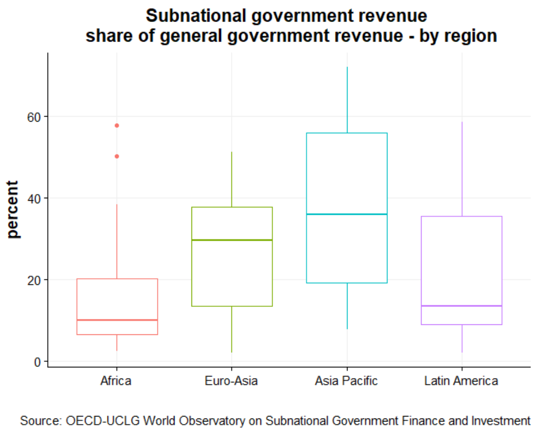
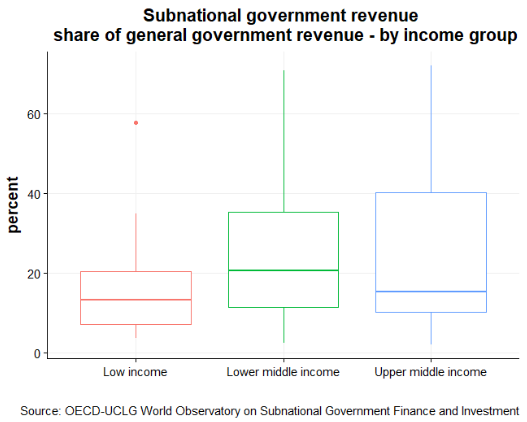


FIGURE 2



Subnational governments fund their operations and services through a range of revenue sources, especially intergovernmental transfers (including grants and subsidies) and own-source revenues (OSR), such as taxes and user charges that subnational governments have autonomy to collect and can use at their discretion.

Intergovernmental transfers are by far the largest component of subnational government revenue. In developing countries, about half of subnational government revenue is composed of intergovernmental transfers/grants, under a third come from taxes, and the remainder from charges and fees and other sources (including property income). These patterns generally hold across

[12] Data points indicate the median. Region names are as they appear in the OECD-UCLG World Observatory on Subnational Government Finance and Investment dataset; Europe as well as Middle East and West Asia omitted from chart due to limited number of observations.

regions and income groups.[13] There are several countries where intergovernmental transfers make up 75 percent or more of total subnational government revenue. These countries include Kenya, Mauritius, and Rwanda in Africa; Ecuador, Mexico, and Peru in Latin America; and Azerbaijan in Euro-Asia. In Uganda, subnational governments rely on central government transfers for 96 percent of their revenues.

The data also show that taxes account for a greater portion of subnational government revenues in lower middle-income countries (35 percent), as compared to upper middle income (29 percent) and low-income countries (34 percent). However, it is quite surprising to find that taxes make up a larger share of subnational government revenues in low-income countries than in upper middle-income countries. Ordinarily, one might expect subnational governments in higher income countries to draw more heavily on taxes than their counterparts in lower income countries, since their higher income status might come with significant advantages, such as a broader tax base and greater capacity to collect and administer taxes. But this does not seem to be the case, suggesting that other factors might be at play.

Finally, although a promising revenue stream, user tariffs and fees make up only 6 percent of subnational government revenues on average. However, some countries do collect significant revenues from this source, such as Jamaica (16 percent), Honduras (19.5 percent), and Jordan (32.1 percent).

TABLE 1. Subnational Government Revenue in USAID Partner Countries by Income Group[14]

Country income group	Subnational revenue figures (average mean)			Subnational revenue composition (average (mean) percent of total)			
	Per capita ($ PPP)	As percent of general government revenue	As percent of national GDP	Transfers and grants[a]	Taxes	Tariffs and fees	Other
Low income	77.0[b]	18.3[b]	3.9[b]	50.5[b]	33.5[c]	3.6[b]	6.4[c]
Lower middle income	442.1[d]	24.3[d]	5.8[d]	49.3[d]	34.7[e]	4.3[d]	9.1[e]
Upper middle income	1,089[f]	24.8[d]	7.1[f]	52.8[f]	28.9[f]	7.1[f]	11.3[f]

Source: Authors calculations based on OECD-UCLG World Observatory on Subnational Government Finance and Investment

Notes: [a] The OECD_UCLG database classifies this category as “grants and subsidies” which not only includes transfers (by far the largest component) but also grants from international organizations. See expanded note at the end of Appendix A for a longer description of how these terms of defined in the source data.

[b] n = 10
[c] n = 9
[d] n = 22
[e] n = 21
[f] n = 23

[13]

[14] A more detailed version of this table, including mean (with standard deviation) and median for all points, is included in Appendix A.

INTERGOVERNMENTAL TRANSFERS

Intergovernmental transfers, typically unconditional (general) or conditional (sector- or project-specific) grants, are the largest source of subnational government revenue in most countries.[15] Broadly speaking, transfers comprise a larger percentage of subnational revenue in unitary countries than in federal countries and in developing countries than in developed ones. Within countries, poorer, more rural areas generally rely more on transfers than wealthier, more urban areas – the latter of which typically have more robust economic activity and stronger administrative capacities. Institutions, the composition of national tax systems, and the revenue raising capacity of subnational government units all play an important role in determining the importance of transfers to subnational government revenues.

A concern articulated by some observers is that by providing a politically and administratively easy revenue stream, intergovernmental transfers act as disincentives to mobilizing own-source revenue for subnational governments.[16] If central transfers are reliable and reasonably sufficient to cover basic needs, then subnational authorities may not feel pressure to generate own-source revenue that has a political cost. Theory and some evidence also suggest that overreliance on central transfers can reduce subnational financial decision-making autonomy, undermine accountability and responsiveness to local citizens, and encourage the adoption of less responsive budgets.[17]

Yet, transfers are a common and necessary component of a well-functioning subnational revenue system, and it is difficult to judge what an "overreliance" on transfers is. The wide variation in usage, even among countries with similar levels of development and legal systems, suggest that there is no single ideal proportion of transfers.

Transfers help bridge the funding gap between subnational responsibilities and subnational capacity to raise own-source revenue. Transfers are an efficient way to raise and distribute revenue, help stabilize subnational government budgets, and incentivize improvements in public financial management and development outcomes (when structured as conditional transfers). Transfers can also reduce inequities between richer and poorer subnational jurisdictions.[18] Without transfers, subnational governments may underspend on critical services like education or health that are known to yield significant external benefits, hurting national development goals in the process.[19] There is also evidence that, **if well structured, transfers can help improve subnational revenue mobilization**.[20]

Intergovernmental transfers will remain a critical revenue source for subnational governments for the foreseeable future.[21] As such, **policymakers and their advisors need to pay careful attention to how intergovernmental transfers are designed and implemented. This includes the adoption of**

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[15] Smoke 2019

[16] Joseph-Raji 2015; Smoke 2019; Bahl and Linn 2014

[17] Hoffman and Gibson 2005; Boex et al. 2014; and Canavire-Bacarreza, Martinez-Vazquez; and Sepulveda 2012

[18] Crook 2017 and Bahl and Linn 2014. The uneven distribution of the tax base across subnational territories means that some areas are better endowed (in terms of resources) to provide services to citizens. This can lead to disparities in the quality of service provision in key areas such as education and health, and it ultimately demonstrates the crucial role for intergovernmental transfers in mitigating such disparities (Ter-Minassian 2020).

[19] Bahl 2000 http://www1.worldbank.org/publicsector/LearningProgram/Decentralization/ITFPrinciples.pdf

[20] There are two ways this might occur: transfers provide resources to strengthen local administrative capacities (including tax enforcement) and, through local spending which stimulates the economy, transfers expand the local tax base (Canavire-Bacarreza, Martinez-Vazquez; and Sepulveda 2012). In addition, by increasing public spending on service delivery and reinforcing local accountability linkages, transfers can encourage stronger voluntary compliance with locally administered taxes (Boex et al. 2014). In addition, a study from Cote d'Ivoire found that central government transfers supported municipal revenue mobilization for tax revenue and, to a lesser extent, non-tax revenue (Brunn and Sanogo 2017). Nonetheless, the revenue enhancement potential of intergovernmental transfers is subject to political constraints. As Masaki 2018 put it: "the degree to which central government grants "crowd in" local revenues is determined by the interplay of the existing fiscal capacity at the local level as well as the political sensitivity (or cost) of tax enforcement."

[21] Due to extreme inequalities of tax base resources in many places, improvements in local tax mobilization will only improve revenues "at the margin", leading to continued dependence on transfers (Crook 2017).

objective and transparent distribution formulas and careful coordination with other aspects of the intergovernmental fiscal system.[22] Poor design of intergovernmental transfer systems may create perverse incentives which make subnational governments less intentional about recovering costs associated with service provision.[23] Transfers can, on the other hand, be designed to encourage successful own-source revenue mobilization; for instance, through a distributional formula that includes local tax effort as a determinant of the amount of transfers (box below).[24]

Performance-Based Transfers

In a performance-based transfer model, subnational governments receive resources after meeting certain, pre-agreed performance targets.[25] Central governments can leverage performance-based transfers to improve the effectiveness of subnational governments, while high-performing subnational governments benefit by receiving "higher subsequent transfers."[26] This model may be best suited to incentivize improvements on metrics related to administrative impact – especially public financial management measures like budgeting, accounting, financial reporting, and responding to audits – and own-source revenue mobilization.

Mongolia's transfer formula, for instance, includes a variable that entitles subnational governments to additional grants if they show better performance in collecting own-source revenue.[27] This means that performance-based transfers could be beneficial to both central and subnational governments. In Indonesia, however, the adoption of an incentive in the general-purpose grant program to increase own-source revenue was "never fully understood by regional government officials" and was eventually eliminated from the allocation methodology.[28]

In most cases, performance will be linked to capital grants, rather than operating grants, which are typically unconditional. This is in part due to the costs of administering these transfers and ensuring costs are commensurate with the funds at stake. It is also important for the central government to regularly revisit and update the performance measures and targets.

While it may be neither likely nor desirable that performance-based transfers will supplant unconditional grants and transfers, their targeted and strategic use could affirm the importance of transfers while incentivizing a variety of improved subnational outcomes.

Own-Source Revenue

Own-source revenue (OSR) refers to funding streams that subnational governments have the authority to raise directly. While subnational OSR currently represents a relatively small percentage of both total government revenue and even subnational government revenue in many places,[29] it is seen by some policymakers, researchers, and development practitioners as critical to improving local service delivery and sustainably raising funds for development.[30] There are several potential own-source revenue streams but two – taxes and user charges – are most frequently linked to service

[22] Schroeder and Smoke 2003
[23] Schroeder and Smoke 2003
[24] Bird 2010 and Boex et al., 2014
[25] Muwonge and Ebel 2014
[26] Muwonge and Ebel 2014
[27] UNDP n.d.
[28] Lewis and Smoke 2008
[29] Subnational own-source revenue currently represents only about 7 percent of total government revenue in developing countries and 37 percent of total subnational revenue in developing countries (as compared to 50 percent in high-income countries)
[30] Bahl and Linn 2014

provision.[31] We consider each revenue stream and some of the primary barriers to their wider efficient adoption thus far:

- **Taxes** are compulsory payments to government with benefits provided to taxpayers generally, not necessarily in proportion to payments.[32] Non-property taxes, such as local sales tax, payroll taxes, and business taxes are often poorly designed, leading to distortions and inefficiencies.[33] While the risk of poor design also impacts their efficacy, property taxes, on the other hand, are considered by some to be "the most desirable of local taxes" since they have the potential to approximately match tax burdens with benefits. Property taxes are also difficult to evade since property is immovable. They do not interfere with market decisions if applied evenly and predictably. And when designed and implemented well, they do not impose heavy burdens on poor households.[34] The merits of property tax, coupled with the understandable reluctance of central governments to give subnational governments the authority to control lucrative income and consumption taxes,[35] mean that "property tax–driven decentralization has become conventional wisdom."[36] However, subnational governments struggle to harness the full revenue potential of property taxes, as a result of several challenges, discussed in the box below. A few critical improvements to property taxes could help enhance their use. Bird (2010), for example, suggests investments in the "sharp end" of tax administration: consistent updates to cadastral maps and valuations; improvements in using information from property registries, public utilities, and other sources; and investing in improved collection and enforcement. Additional potential investments to improve the use of property taxes are included in the solutions section of this report.

- **User charges** on the consumption of services (e.g., water or electricity), while seen as underutilized[37], have been called the "backbone of financing" for urban service delivery.[38] When properly priced, user charges can sustainably raise revenue to cover service costs in an administratively feasible manner and enable governments to make "more efficient decisions about how much [of a service to supply] and citizens can make more efficient decisions about how much to consume."[39] User charges can also encourage more efficient land use if marginal cost pricing is used (rather than uniform pricing) where governments charge higher fees to consumers who are far away from existing services and thus costlier to serve.[40] Other fees for the use of public facilities and to support regulatory enforcement (e.g., market access fees, parking fees, licensing and permitting fees) also have revenue potential for subnational governments.

  Although a common objection to user charges is that they are regressive, studies have shown this is not necessarily the case and tailored pricing systems (such as those with low initial charges for first block of service use) can help mitigate this.[41] Potential challenges to user charges include the politics of raising the price of necessary services, concern that charges are highly regressive, resistance from residents who object to the removal of a

[31] Other own-source revenue streams include business licenses, permits and fees (e.g. fees for outdoor advertising or market access), and rental of subnational government property.
[32] OECD 1996
[33] Bahl and Linn 2014
[34] Bahl and Linn 2014 and Slack and Bird 2014
[35] Central government reluctance is "valid" in the sense that these taxes are more efficiently managed at the central level and they were devolved to the subnational level it would create horizontal tax competition creating negative externalities and race-to-the-bottom in interjurisdictional competition.
[36] Bird 2010
[37] Martinez-Vazquez 2013
[38] Bahl and Linn 2014
[39] Bird and Slack 2007
[40] Bird and Slack 2007
[41] Bird and Slack 2007

subsidy they once enjoyed, and willingness to pay, particularly for services perceived as low quality.[42] Undercharging relative to the cost of service provision is a frequent issue and limits governments' ability to raise revenue to improve service delivery.[43] As is the case with user charges, local government fees can generate adverse economic effects if they are poorly designed and arbitrarily applied. For instance, arbitrarily high business license fees can make it difficult for small businesses to get started, let alone survive.[44]

CHALLENGES TO THE WIDER ADOPTION OF PROPERTY TAXES

Despite their significant potential, in practice, property taxes have been "a relatively minor source of revenue in most developing countries."[45] It is estimated that property taxes generate only 0.3 to 0.6 percent of GDP for developing countries compared with as much as 2 to 3 percent of GDP for developed countries.[46] Why is this so?

There are several primary barriers to wider use of property taxes:

- **Administrative costs and barriers**. Administering property taxes requires securing reliable property valuation, managing bill delivery, and enforcing collection – all of which can be costly and difficult undertakings.[47] Many operations are conducted manually and technology to support property tax systems in developing countries is rare.[48] Additionally, in many countries, even in decentralized ones and those with federal systems, maintaining and updating land registries and cadasters is the responsibility of a national entity and local governments may have trouble accessing this information.[49]

- **Political obstacles.** Property taxes are often unpopular with voters and politicians because they are "visible, seemingly subjective, and tax unrealized increases in wealth."[50] Taxpayers are regularly reminded that they have to pay them and are faced with the logistical burden of doing so.[51] Those liable to pay the most (i.e., those with highly valued property) are also often politically influential and can resist compliance.[52] Additionally, efforts to raise property taxes through updating the cadaster or through more efficient administration may be blocked by higher levels of government that control rate setting powers, sometimes due to politics. In the Mexican state of Jalisco, for example, it was reported that the state congress regularly rejected requests to update the cadaster by opposition-controlled municipalities while approving those of its own party.[53]

- **Challenging tax rate structures.** Many developing countries use a differentiated (rather than uniform) tax rate system whereby applicable tax rates vary by property class (e.g., one tax rate for residential properties, another for a certain type of commercial property). While there are valid reasons for adopting variable rates, purely politically-motivated engineering of differentiated tax rates can lead to revenue loss as well as losses in equity

[42] Bahl and Linn 2014
[43] Ato Brown, Ofosuhene, and Akenten 2019
[44] Fjeldstad, Chambas, and Brun 2014 https://www.cmi.no/publications/file/5098-local-government-taxation-in-sub-saharan-africa.pdf
[45] Bahl and Linn 2014
[46] Kelly 2013
[47] Ali, Deininger, and Wild 2018; Ahmad, Brosio, and Poschl 2014; Bahl and Linn 2014. Many local governments have outdated property valuations which do not reflect current market values (Mutua and Wamalwa 2017), yet major cadastral updates require fieldwork, surveys, valuation, and organized record-keeping (Ahmad, Brosio, and Poschl 2014).
[48] Slack and Bird 2014; and Ali, Deininger, and Wild 2018
[49] Erba 2004
[50] Bahl and Linn 2014
[51] Piracha and Moore 2016
[52] Piracha and Moore 2016
[53] Ahmad, Brosio, and Poschl 2014

and efficiency.[54] Where zoning regulations are weak, tax administrators exercise significant discretion in how they determine and apply tax rates to different properties and may abuse this discretion due to a lack of oversight.[55] A potentially better approach is to use a uniform tax rate system in which the amount of tax depends on property value. Although valuation determinations may still be vulnerable to manipulation, this system is easier to administer and, with proper oversight and clear guidelines, can reduce "discretion during the tax liability assessment process."[56]

SUBNATIONAL BORROWING

Some subnational governments have access to external resources, such as grants or concessional loans from donors, subsidized loans from national development banks, loans from private banks, or proceeds from the issuance of bonds.[57] **Subnational borrowing can provide resources to bridge short-term revenue gaps and finance capital infrastructure**.[58] However, debt cannot be treated as revenue because it must be repaid. Excessive public borrowing from domestic sources can also crowd out borrowing and investments by the private sector, by increasing competition for capital and raising the cost of borrowing, with adverse effects on economic growth.[59] Further, unsustainable subnational fiscal policies can lead to insolvency, which may require central government bailouts.[60] For these reasons, some countries have legal restrictions on subnational borrowing.[61]

In some places, such as the Mexican municipality of Tlalnepantla de Baz, the issuance of revenue bonds on the local capital market allows local governments an attractive and financially feasible way to fund needed infrastructure investments without using direct federal transfers. Key to success in Tlalnepantla de Baz, however, was the strong (AAA) bond credit rating which, in turn, was made possible due to credit enhancements, such as a partial credit guarantee provided by the International Finance Corporation. Additionally, this bond was issued on the local capital market in local currency, reducing the foreign exchange risk.[62]

Subnational government borrowing is generally best suited to larger, wealthier cities and regional governments, with sufficient technical capacity and revenue to make borrowing feasible.[63] For some subnational entities without access to credit markets, their national governments have provided them with subsidized loans facilitated through special financial intermediaries (e.g., municipal development banks) that are government managed or regulated.[64]

International experience points to **several challenges associated with subnational public borrowing schemes**:

- Intermediaries develop lending monopolies, eroding their incentives to operate efficiently.

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[54] Kelly 2013
[55] Kelly 2013
[56] Kelly 2013
[57] Many subnational governments face significant constraints on their ability to undertake domestic or external borrowing. These could include a requirement for central government approval of borrowing, outright bans on subnational borrowing, and excessively high-risk premiums (Ter-Minassian and Craig 1997).
[58] Freire 2014
[59] Junquera-Varela et al. 2017
[60] Canuto and Liu 2013
[61] Martinez-Vazquez and Vulovic 2016
[62] World Bank 2016
[63] Smoke 2019
[64] Smoke 2019 and Schroeder and Smoke 2003

- Strong ties between intermediaries and the central governments that sanction their existence leads to the politicization of lending decisions, often manifesting in lending to nonviable projects or with overly favorable terms.

- Loan repayment is often undermined due to political considerations.

- The implicit guarantee of central government controls related to subnational debt can undermine long term fiscal discipline.[65]

The weak financial footing of municipalities is perhaps the most significant barrier to borrowing, particularly for infrastructure finance. There is also often a lack of supply; domestic lenders are often unable to lend for the maturities required for capital projects (five or more years). However, municipal borrowing for infrastructure can be challenging, even where jurisdictions have relatively strong administrative capacities, robust tax bases, and legal frameworks providing access to local and international capital markets. Examining Nairobi's experience in borrowing to finance water infrastructure, Kithatu-Kiwekete (2015) finds that the city was unable to comprehensively engage capital markets, relied on loans "facilitated by the relationship-based model with the national treasury,"[66] and required central government intervention to meet financial obligations on its debt. Broadly, some caution that "unchecked increases in municipal indebtedness" can lead to "urban fiscal stress."[67]

JOHANNESBURG MUNICIPAL BORROWING

Johannesburg's municipal borrowing experience emphasized a market-based relationship with the central government, creating a strong incentive for the city administration to implement fiscal discipline. Johannesburg also inherited the capacity to manage debt from the apartheid authorities; this, combined with a local government restructuring exercise and growing demands on municipal spending, further strengthened incentives for the city to build its capacity for carrying municipal debt. But the city also inherited bad debt from the apartheid authorities, which had adverse effects on its creditworthiness, raising its cost of capital.[68] Further, the downgrading of the South African Government's credit rating, had the associated effect of downgrading many subnational entities within the country.[69] Such downgrades are typically attributable to national economic and political forces which subnational entities have little to no ability to influence.

It is important to note that while a credit downgrade – including those caused by the downgrade of the national government – may increase the cost of borrowing for subnational governments, it does not necessarily mean they will be excluded from the market entirely. In any case, most subnational governments should focus on borrowing in local markets and currencies because it has less risk and is easier to manage (in part because governments' revenue is in local currency). Furthermore, the downgrade of the national government's credit rating will likely have no impact on subnational governments borrowing locally.

HOW CAN SUBNATIONAL DRM SUPPORT IMPROVED SERVICE DELIVERY?

Intuitively, one can expect stronger subnational DRM (i.e., more resources) to contribute to improved service delivery. While this may hold generally, in practice, the relationship is more

[65] Smoke 2019 and Singh and Plekhanov 2005
[66] Which, the author suggests, lacks stringent requirements relating to municipal creditworthiness and credit ratings
[67] Dethier 2013, cited in Kithatu-Kiwekete, 2015
[68] Kithatu-Kiwekete, 2015
[69] Kumar and Reddy 2019

complicated. The performance of local systems for service delivery is dependent on a wide range of public management factors which in turn can depend on institutional strength, economic conditions, and political realities. Relevant public financial management considerations include whether local governments are assigned the appropriate mix of own-source revenues and intergovernmental fiscal transfers, have adequate autonomy over their own-source revenue instruments, and can effectively administer their local finances.[70] **Having more resources available will not necessarily lead to the provision of higher quality services, unless those resources are well managed and there is a framework for accountability.**

Accountability and the ability of governments in urban areas to deliver results is directly related to the level of trust citizens have in government and their motivation to pay taxes. As part of the social contract, city residents and businesses pay taxes to government with the expectation of something in return.[71] Some studies suggest that voluntary compliance with taxation improves when local governments are able to deliver high quality services,[72] but the evidence is not conclusive. The quality of public services also matters for political legitimacy and credibility of urban local governments, both of which are key factors in local efforts to "work with their residents" to increase mobilization of local resources.[73] Consistent with this point, Joseph-Raji (2015) finds that in Edo State, Nigeria, perceptions of improvement in services helped build the credibility of state government campaigns promoting tax compliance.

Communication and perceptions of fairness are key to accountability. Clear communication to taxpayers on what the taxes, fees, and charges are and, on the expenditure side, what these revenues are paying for, builds trust and creates a clear accountability link. Related is the notion of fairness. Taxpayers are aware that those making decisions on tax laws and policies are often those with significant property and wealth. Tax motivation will decrease if taxpayers perceive that the structure is unfairly allocating the tax burden.

Some experts argue that local governments should charge directly for services wherever possible, particularly when consumption can be linked to specific individuals and households (e.g., for waste collection).[74] User charges, discussed above, have the dual benefit of producing revenue to sustain (and even improve) service delivery while also encouraging efficient consumption of resources.[75] However, the level of compliance with those charges is often low because of the poor quality of service provision and inefficiencies in charge collection and administration.[76]

Getting prices right is a major challenge for implementing user charges due to the lack of local capacity to measure usage and set prices for certain services. For example, the pricing of water may not be well aligned with the costs of providing it.[77] There are also equity considerations as poor populations could be excluded from public services due to high costs.[78] People are more likely to pay service charges "if they feel that the government is providing services equitably, collecting revenue fairly and using the revenue to provide services."[79]

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[70] Boex et al. 2014
[71] Coplin and Nwafor 2019
[72] Kelly 2013, PMORALG 2013, Slack and Bird 2014
[73] Kelly 2013, Mutua and Wamalwa 2017, Scheerens and Van Ongevalle 2018, and Sarzin 2007
[74] Slack 2012
[75] Fjeldstad 2006. In order to avoid the heavy burden of user fees on low-income service users (including potentially excluding them from service access), systems can consider targeted subsidies or sliding scales, although this may require a degree of administrative capacity.
[76] Masaki 2018
[77] Kithatu-Kiwekete 2015
[78] Scheerens and Van Ongevalle 2018
[79] Fjeldstad 2016

Property taxes are less easily connected to public services in the mind of the average taxpayer than are user charges.[80] This makes it important for governments to invest in awareness efforts that would help citizens appreciate the importance of property taxes as a "general-benefit tax" that supports certain public goods like roads and drainage.[81] But there are exceptions. For instance, some study participants in Nairobi attributed the high default rate on property taxes to poor service provision.[82] Citizens noted that they would resist compliance with rates and fees "without seeing a direct link between what they pay and service delivery," with some going on to say that the local authority should pursue service delivery with the same enthusiasm as it does with revenue collection.[83] Similarly, in Sudan, improved perceptions of a subnational tax system might be partially due to improvements in service delivery.[84] Additionally, there are opportunities to create "strong and legally-binding links between revenue and expenditure" in order to clearly link property taxes with service delivery and build trust.[85]

Determining which services should be primarily financed by charges versus taxes depends on what Prud'homme (1994) calls "chargeability." **Services that are excludable and subtractable[86] (e.g., water and power) are "chargeable" and should largely be financed by fees while services like maintaining public spaces or constructing infrastructure should be primarily or partially financed by taxes because it is difficult to make people pay the true cost of their consumption**. Prud'homme makes three important observations related to this concept of "chargeability": technological advancements are constantly expanding the realm of what's chargeable; the societal benefits (externalities) of some chargeable services mean governments may wish to finance them, at least in part, through taxes (e.g., education); and the greater the chargeability of a service, the easier it is to decentralize that service because local user fees can cover costs, without need for central government subsidies.

It is worth noting that user fees can impose a heavy burden on lower-income service users and even exclude segments of the population from service usage.[87] On the other hand, full indiscriminate subsidization of services may lead to inefficiency and over-consumption, and any targeted subsidy would require administrative capacity to manage. Consequently, **governments and service providers should consider subsidy needs when determining the rate and variation of service charges**.[88] Furthermore, any approach to subsidies should be designed with administrative feasibility in mind.

An examination of the literature, suggests **four principles for identifying an effective own-source revenue stream for services**[89]:

1. Revenue should exceed both the cost of revenue administration and the minimum operational service requirements to buffer for unexpected needs (i.e., a rainy-day fund) and provide a funding source for capital investment needs (either as direct funding or to service debt).

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[80] Kelly 2013. Slack and Bird (2014) note that property taxes are also used to finance high visibility local services, such as roads and transport.
[81] Kelly 2013
[82] Mutua and Wamalwa 2017
[83] Mutua and Wamalwa 2017
[84] Fjeldstad 2016
[85] Prichard 2017
[86] Excludable refers to whether people who have not paid for a good can ordinarily be excluded from using it and subtractable refers to whether one person's consumption limits the availability for another person (without increased supply).
[87] McDonald 2003
[88] Fjeldstad 2006
[89] Authors synthesis from a variety of sources: Appiah et al 2000, Martinez-Vazquez 2007, Smoke 1994, Coplin and Nwafor 2019, Fjeldstad 2016

2. To ensure sustainability, the revenue model (instrument and pricing structure) should be regularly revisited with goal of steady revenue growth over time, keeping pace with changes in service demand and the cost of providing services.

3. The price should balance the benefit principle and the ability-to-pay principle[90] to ensure it reflects demand for service but does not place an onerous burden on low-income payers.

4. Rates should be highly visible and transparent so that tax burdens are clearly perceived and understood and should establish clear links between payment and service provision.

With these principles in mind, local leaders can structure OSR revenue streams that provide sustainable funding for service delivery while ensuring access.

[90] Building from John Stuart Mill (1848), the benefit principle implies that those deriving benefits from a service should be the ones to pay for that service (e.g., paying a toll to use a road) while the ability-to-pay principle of taxation suggests some proportionality between amount of tax paid and each taxpayers' wealth.

WHAT ARE THE BIGGEST BARRIERS TO RAISING ADDITIONAL OWN-SOURCE REVENUE?

Many subnational governments in developing countries have limited tax bases,[91] yet even accounting for this, revenue collection often falls below potential. On average, subnational tax share of total taxes in developing countries is about 10 percent – half that of developed countries.[92] Evidence suggests there are a few reasons for this, the two most critical being:

1. **Political considerations and incentives can conflict with efficient tax administration.** While, in theory, responsibility for delivering and funding a specific service should rest with the unit of government that can do so most efficiently, in practice this is often not the case, due, at least in part, to interests invested in the status quo. In other words, political interests often run counter to government efficiency. Consequently, there is often weak central government leadership and support for mobilizing additional subnational own-source revenue.[93] While this limited support may be due to valid considerations, such as limited subnational capacity, political interests also play a part. For instance, central government leaders may not want to give up control of, or compete for, lucrative tax bases[94] or are wary of increasing the success and visibility of competitive local politicians.[95] There are also structural factors. Functions that may be locally supported in some countries, such as schools, may nonetheless remain centrally supported in others, along with the revenue streams to finance them, due to the political alignment of labor unions and ministry staff.

   Even as countries decentralize, the allocation of autonomy, resources and accountability is uneven, with central control of the funding serving as a lever with which to retain administrative control of much local service delivery. At the same time, subnational governments rely mostly on central government transfers and consequently may lack sufficient incentive to generate own-source revenues. This is particularly true if local revenue and expenditure responsibility exposes local officials to greater political accountability without yielding additional resources[96] (i.e., if transfers are reduced in proportion to locally raised revenue).[97]

   There are other local factors that can make local revenue generation difficult. For example, local politicians may pressure tax administrators to relax the tax collection effort, especially during election periods.[98] Lack of transparent administration may also favor politically connected individuals.[99] Finally, the mobility of certain kinds of taxpayers (e.g., many businesses) can also foster tax competition among subnational governments, further limiting the scope and incentive to raise own-source revenue.[100]

2. **Limited tax administration capacity.** Many subnational governments lack the administrative and technical capacity to manage tax systems, including the ability to assess the revenue

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[91] Ato Brown, Ofosuhene, and Akenten 2019
[92] Bird 2010
[93] Ankamah and Yao 2013
[94] Ter-Minassian 2020
[95] Bahl and Linn 2014
[96] Increasing own-source revenue will not necessarily yield additional resources if transfers are reduced in proportion. This depends on the way transfers are structured as most conditional/earmarked transfers for devolved services (e.g., health or education) use some kind of formula. This may be an issue, however, for unconditional transfers and/or transfers that are allocated as gap-filling measures.
[97] Ato Brown, Ofosuhene, and Akenten 2019; Ter-Minassian 2020; PMORALG 2013; Bahl and Linn 2014. “Gap filling” transfers may especially diminish incentives to impose “onerous” local taxes (Ahmad, Brosio, and Poschl 2014)
[98] Canavire-Bacarreza, Martinez-Vazquez, and Sepulveda 2012; Fjeldstad 2006
[99] Coker, Folasade. Interview by authors 28 August 2020.
[100] Ter-Minassian 2020

base and conduct collection and enforcement.[101] Subnational tax administrations need resources – in systems, personnel, vehicles, and security – which may not be forthcoming from elected officials who do not understand this need. This is related to a broader lack of adequate systems for planning, implementing, and controlling financial resources.[102] An analysis from Ghana, for example, found that land valuation boards do not have adequate resources to consistently value and revalue properties, and most districts do not have adequate revenue databases or are unable to maintain them properly.[103] In Nairobi, Kenya, there is often a gap between projected revenues and actual receipts, reflecting a lack of people with needed skills to assess potential revenue, undertake realistic forecasting, and lead revenue management and administration.[104] These capacity constraints can undermine resource mobilization even when local leaders have the political will and commitment to strengthen resource mobilization.

Even when these two issues are reasonably addressed there may be other challenges to raising own-source revenue, such as:

3. **Weak incentives for taxpayers, administrators, and private collectors.** Revenue collectors often have little motivation to collect and fully enforce revenue obligations.[105] Even when revenue collection is outsourced to private collection agencies, there are still risks of revenue loss from corruption, exacerbated by a lack of consistent monitoring and auditing.[106] Finally, taxpayers may lack sufficient trust in local governments, undermining compliance and tax motivation.[107] And this lack of trust is understandable. For instance, in the case of some parts of the Democratic Republic of Congo, it is estimated that as much as 80 percent of tax payments are diverted away from government coffers.[108]

4. **Adverse political structures and lack of accountability**. Scheerens and Van Ongevalle (2018) describe local taxation as a bargaining process among stakeholders seeking to protect their interests: local authorities want to collect enough revenue to cover the funding gap for basic needs (e.g., operating and maintenance costs[109]), while politicians, eyeing reelection, want to collect taxes up until it starts to become too burdensome to citizens. Corruption and embezzlement undermine confidence in local revenue authorities.[110] A final issue relates to exemptions. In defining the tax base, policymakers must decide what not to include. While some exemptions may be merited,[111] others are politically motivated and can greatly

[101] Canavire-Bacarreza, Martinez-Vazquez, and Sepulveda 2012; Financial and Fiscal Commission 2020; Fjeldstad 2006; Ato Brown, Ofosuhene, and Akenten 2019
[102] Ato Brown, Ofosuhene, and Akenten 2019
[103] Ankamah and Yao 2013
[104] Mutua and Wamalwa 2017. Admittedly, this could also reflect a budget practice common in many places: intentionally overestimating projected revenue (often for political reasons). Regardless, professional financial management capacities and transparent budget forecasting procedures help mitigate for this and encourage the adoption of realistic budgets.
[105] Adu et al. 2019 and Ankamah and Yao 2013
[106] Ankamah and Yao 2013
[107] Fjeldstad (2006) notes three relevant dimensions of citizens' trust that are often lacking: "(1) trust in the local government to use revenues to provide expected services, (2) trust in local governments to establish fair procedures for revenue collection, and (3) trust in other citizens to pay their share."
[108] Paler et al. 2017 https://www.ictd.ac/publication/survey-on-total-tax-burden-in-the-drc/
[109] Often, public servant wages are covered by conditional transfers for specific sectors and unconditional transfers for basic administrative personnel and functions.
[110] Fjeldstad 2006
[111] Exemptions may be needed from an equity standpoint, but their blanket application could hurt revenue potential. For instance, it might make sense to exempt poor farmers from taxes on their land (in fact, according to Kelly's 2013 study, collecting those taxes may cost more in administration than the revenue realized), but extending that exemption to large commercial farmers implies missed revenue potential—especially if the public sector provides services to those agricultural properties. Similarly, exempting all residential properties from taxes may be politically expedient, but likely generates "large loss in forgone revenue" and will impact equity since it does not target those who might be in greatest need of a tax break.

decrease potential revenue, contribute to inequity, and lead to distortions.[112] The ability to determine exemptions gives local officials significant political influence.[113]

5. **Limited revenue authority for subnational governments**. At a structural level, most subnational governments have limited revenue authority[114] and, in particular, they often have little to no control over the setting of tax rates or even the tax base.[115] For instance, county governments in Kenya do not have a clear legislative framework to affect the imposition of taxes and fees.[116] Kenyan counties have had to fill this gap through annual County Finance Acts to provide for revenue collection, which are often subject to legal dispute. In addition, in countries with multiple levels of subnational government, there may be lack of clarity on authority for specific taxes. In Pakistan, for instance, responsibility for the administration of property taxes is split among three tiers of subnational government, meaning that no level has clear authority and incentive to increase yields.[117] This is why intergovernmental fiscal and administrative relationships need to be clearly articulated, with roles and responsibilities well defined.[118] There may be arguments in some cases for additional subnational revenue-raising discretion (box below).

SUBNATIONAL DISCRETION TO RAISE REVENUE

Subnational governments are typically given more responsibility for expenditure than can be reasonably funded through existing revenue streams.[119] If this gap cannot be bridged by transfers, subnational governments may need to raise additional OSR. Raising sufficient OSR can be challenging for a variety of reasons: technical and political constraints enumerated earlier, a limited local economic base, or the failure of subnational governments to utilize the revenue authorities they have been given. However, subnational governments may not have sufficient authority to raise the funds needed to pay for the services they are obligated to deliver.

An important question arises: what is the right balance between national and subnational revenue authorities? Central governments typically have lower costs per unit of tax collected and are more efficient at collecting taxes, in part because they have the authority and capacity to tap more efficient taxes (e.g., VAT), with the scale necessary for efficient tax administration[120] and enforcement.[121] At the same time, subnational governments do have incentives to expand the tax base they reach and may be capable of doing so with the right authorization and support.[122]

The authority of subnational governments to set tax and fee rates is essential to align local taxes with service delivery and provide a basis for local accountability.[123] However, it is hard to establish the relationship conclusively and broadly between increased autonomy and improved own-source revenue collection. Autonomy can be abused: in Uganda and Tanzania, for example, there is

112 Kelly 2013
113 Ahmad, Brosio, and Poschl 2014
114 Bahl and Linn 2014. Sometimes subnational governments also have limited expenditure responsibilities, although this is decreasing due to decentralization, leading in turn to unfunded mandates.
115 Ato Brown, Ofosuhene, and Akenten 2019 and Canavire-Bacarreza, Martinez-Vazquez, and Sepulveda 2012
116 Mutua and Wamalwa 2017
117 Piracha and Moore 2016
118 Ato Brown, Ofosuhene, and Akenten 2019
119 Fjeldstad 2006
120 There are noteworthy examples of central government tax administrations collecting revenue on behalf of local governments. For example, the central government in Chile collects property taxes on behalf of local governments and transfers the proceeds to them (Freire and Garzon 2014). In Rwanda in 2014, the central government transferred responsibility for the collection of all district taxes and fees to the Rwanda Revenue Authority (Kopanyi 2015). Rwandan districts retain responsibility for setting the local rate and defining any authorized exemptions. They communicate this information to this national authority which are supposed to transfer collected funds to each district every month.
121 Canavire-Bacarreza, Martinez-Vazquez, and Sepulveda 2012 and Bahl and Linn 2014
122 Bird 2010
123 Ambrosanio and Bordignon 2006 and Bird and Slack 2007

evidence that when local governments were granted wide powers to impose taxes, a proliferation of nuisance taxes followed.[124] Country-specific factors, including political dynamics, socio-cultural histories, and administrative capacities, will all help to determine the appropriate level of subnational discretion for OSR (i.e., which revenue raising authorities the national government will assign to subnational governments and which it will keep itself or leave unassigned).

[124] Sarzin 2007

WHAT IS THE RELATIONSHIP BETWEEN SUBNATIONAL DRM AND THE PRIVATE SECTOR?

Local private sector actors are employers, drivers of economic activity, and critical contributors to the sustainable generation of subnational own-source revenue. Well-designed subnational public financial management systems can also support private sector development while ensuring funds are responsibly raised and spent to advance development goals.

Smart policies and systems for public revenue and expenditure can stimulate economic growth and expand the local tax base. Virtuous cycles can form where sound, market-enabling policies – including coherent, sensible, low burden, and easy-to-comply with tax policies – stimulate economic growth and increase revenue. This increased revenue can then be re-invested in social services, infrastructure, and the supporting services necessary for both foreign investors and domestic entrepreneurs.[125] Government spending also creates opportunities for the private sector to sell to the government. Additionally, DRM efforts can provide indirect benefits for private sector actors. For instance, at the national level, the introduction of unique taxpayer identification numbers can help facilitate commercial bank transactions and tax administration databases can be used for broader economic management efforts.[126]

On the other hand, poorly designed revenue policies can be a drag on local private economic activity, ultimately hurting revenue potential. For example, the proliferation of nuisance fees may discourage economic activity and ultimately cost more than they yield. Highly distortionary taxes may negatively impact resource allocation decisions, such as excessively high license fees inhibiting small-scale and start-up enterprises.[127] Corruption or inefficient tax systems adversely affect the development of the private sector by increasing transaction costs and uncertainty and undermining trust.[128]

Getting the right tax structure for business is important. Local governments should aim to adopt policies that raise sufficient local revenue while avoiding excessive, distortionary taxes and fees which depress economic activity, fuel informality, and hurt productivity and competitiveness.[129] Some have argued that the best tax on businesses may be a broad-based, uniform tax with a reasonably low, non-distortionary rate.[130] There is some debate on whether businesses are capable of paying higher property tax rates or whether they pass the rate on to consumers in the form of higher prices.[131] That said, the case for higher tax rates on businesses seems stronger in instances where commercial properties receive public services, but fail to pay for them in full through direct charges or fees.[132]

Tax incentives and exemption regimes are sometimes considered important to stimulate investment, but other aspects of the investment climate have greater influence on the level and quality of private investment.[133] This suggests the need to carefully consider the merits of tax incentives – in particular, asking whether incentives truly support policy priorities or unnecessarily forgo revenue. Indeed, excessive use of incentives and property tax exemptions may undermine

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[125] Cheema and Rondinelli 2007
[126] Junquera-Varela et al. 2017
[127] Fjeldstad 2006
[128] Junquera-Varela et al. 2017
[129] Mutua and Wamalwa 2017
[130] Bird 2010
[131] Kelly 2013
[132] Kelly 2013
[133] Fjeldstad 2016

growth if it limits government's ability to invest in the conditions for long-term growth, including infrastructure and related services.

The private sector can also play a number of roles that directly or indirectly support service delivery and strengthen subnational DRM. In addition to being taxpayers, private sector actors help fund critical infrastructure needs as lenders in local capital markets, as investors in municipal bonds, and as counterparties in public-private partnerships (PPPs). In some cases (e.g., Tanzania and Uganda), governments have outsourced the collection of certain revenue sources to the private sector in order to increase revenue collection and decrease collection costs.[134] These desired benefits are, however, unlikely to materialize if contracts are not competitively awarded. This underscores the need to link or sequence DRM efforts with broader public financial management reforms, such as transparent procurement practices. Additionally, contracting private firms to manage revenue collection requires careful auditing and oversight. But even this will not eliminate opportunities for corruption, and it could also undermine tax administration legitimacy.[135]

In addition to their roles in mobilizing resources, **governments also often turn to private sector partners to support service delivery** (e.g., contracting private firms to manage solid waste collection, street cleaning, infrastructure maintenance, and other needs). For Kumar and Reddy (2019), PPPs offer a potentially more cost-effective way for subnational governments to deliver infrastructure and public services than traditional procurement. A 2020 report from the South African Financial and Fiscal Commission, for example, recommends financing local government infrastructure projects through PPPs.[136] A separate review of several PPP contracts for infrastructure and services observes that they can sometimes bridge government financing needs while improving service quality.[137]

Despite their possible benefits, however, PPPs are far from reaching their potential. Several factors constrain the wider use of PPPs, particularly in developing countries, including arcane legislative requirements,[138] a trust deficit between public and private sectors, and weak ability to negotiate and manage complex PPP agreements.[139] Importantly, since PPPs need a reliable revenue stream, they may be a poor fit for some sectors and countries.[140] For the foreseeable future, therefore, **PPPs likely have limited applicability for subnational governments in the poorest countries** which, due to weak institutional capacities, are poorly positioned to negotiate and manage PPP projects in the public interest.[141]

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[134] Haas and Manwaring 2017
[135] Haas and Manwaring 2017
[136] The South African Financial and Fiscal Commission is an independent constitutional advisory institution.
[137] Smoke 2019
[138] Kumar and Reddy 2019
[139] Bahl and Linn 2014
[140] Smoke 2019; Bahl and Linn 2014
[141] Bahl and Linn 2014

WHAT SOLUTIONS EXIST TO STRENGTHEN SUBNATIONAL DRM SYSTEMS?

Available literature and interviews suggest **several opportunities for donor-supported efforts to improve subnational DRM** (Table 2). These efforts reflect a mix of policy reforms and program interventions that have demonstrated some success in addressing specific challenges. However, none of these evidence-informed solutions are silver bullets.

It is critical to note that **revenue systems are embedded within wider political economy dynamics**. For instance, if local leaders are appointed by central authorities, they face less local accountability. If local accountability mechanisms are weak and information not transparent, local revenue functions may not be constrained by citizen or council proximity. If literacy rates are low, or economic, security, and social conditions leave residents with few resources and high levels of distrust, there will likely be limits to the progress that work on local revenue systems can reasonably achieve.

Although these constraints are real and significant and immediate opportunities to tackle them may not exist, USAID and other donors should not disengage on DRM. Instead, this complexity points to the importance of thinking of the system, rather than through piecemeal reforms. Kelly (2013), for example, suggests that property tax reforms should be integrated with broader public sector management and decentralization reforms. This interconnectedness also suggests that efforts to address DRM capability be integrated within broader programs on governance and citizen engagement as well as sector-specific reforms. Lessons for DRM can also be drawn from adjacent programs and research. For instance, through their examination of local-level corruption and the link between governance arrangements and local performance, Ivanyna and Shah 2010, surface insights relevant to design of DRM programs.

In advancing solutions, local leaders and donors must also contend with the difficult question of how to catalyze and sustain the political will and commitment needed to drive real improvements in subnational DRM. Addressing the commitment issue may require, among other actions, strengthening local accountability and civic engagement and educating local officials on the importance of improving DRM. Improving the links between those who set and those who administer tax policy can help on both accounts. In Za'Kpota, Benin, for example, a framework between local elected officials and civil servants was created to facilitate discussion on DRM strategies and problems related to the local economy.[142]

Before helping local partners define critical challenges and identify appropriate solutions, donors should undertake a thorough review of the enabling environment for subnational DRM within the partner country. Such a review should include:

1. **A description of the relevant legal, political, economic, and social context in the country** and in specific subnational unit(s) of focus (e.g., What are the laws related to subnational own-source revenue and how have these evolved? Are there relevant proposed policy changes on the horizon? What does the national decentralization strategy say about subnational DRM? Is there an association of subnational governments and does it have a position on this topic in terms of policies? What are the relevant political economy dynamics, constraints, and opportunities facing local leaders?)

2. **A catalog and assessment of past and ongoing efforts to improve subnational DRM**, including both donor- and non-donor-supported efforts as well as reflections on lessons learned (e.g., What donors have been active in supporting subnational DRM both directly and within the context of other projects like subnational governance or accountability? Are

[142] Scheerens and Van Ongevalle 2018

there lessons that can be shared across jurisdictions? What efforts have been made to improve own-source revenue collection and administration and did they yield sustainable results?)

3. **A thorough scan and general assessment of the existing revenue structure, tax administration, and public financial management capacities in the target unit**(s) (e.g., What is the composition of subnational revenue and the overall finance picture? What is the level of fiscal autonomy and what are the available subnational revenue authorities, including unexploited authorities? How complete and accurate are tax registries? What is the composition of economic activity?)

To be truly robust, this effort should include a political economy analysis and should utilize interviews with key stakeholders.[143] Notwithstanding the needs for adapting politically feasible approaches that consider incentives and payoffs for all parties, there are several diagnostic assessment tools and practical solutions that have been attempted in recent years. **Diagnostics enable donors to have a fuller understanding of the landscape and ensure programming really addresses critical issues rather than superficial ones**. Such a review should be informed by technical capacity assessments, such as the IMF's Tax Administration Diagnostic Assessment Tool or the World Bank's Property Tax Diagnostic Tool, when a recent one is available or can be undertaken in a timely manner.

In recent years, several promising solutions have been attempted by subnational governments, often with donor support (Table 2). These solutions all attempt to overcome key challenges and bottlenecks to improved revenue mobilization to support improved subnational governance and service delivery. Of course, solutions will need to be tailored to the unique circumstances of the places in which they are to be applied.

[143] A political economy analysis "digs beneath the formal structures and technical interventions to reveal the underlying interests, incentives, and institutions that enable or frustrate change." (Edwards, Greene, and Kingsley 2016)

TABLE 2. POTENTIAL SOLUTIONS TO COMMON SUBNATIONAL DRM CHALLENGES

CHALLENGES	POTENTIAL SOLUTIONS	EXAMPLES
Outdated, inaccurate, or difficult to maintain property registries	• **Use of GIS technologies**, such as remotely sensed imagery, can reduce the cost of establishing and updating tax registries by checking the completeness of valuation rolls and, coupled with data on land values, running "land valuation models at a fraction of the time and resources required by more traditional technologies."[144] When GIS is successfully integrated in city business processes pertaining to land administration and revenue mobilization, it can help unlock untapped revenues and block leakages.[145] • **Incentivize taxpayer registration** by making registration a prerequisite for other important transactions, such as opening a bank account[146] or by making citizens show proof of tax payment before they can receive certain public services. • **Adopt a more efficient property valuation system**. In order to improve the effectiveness of property taxation, jurisdictions need efficient property valuation.[147] This often means upgrading from obsolete manual valuation techniques to computer-assisted mass appraisal approaches or hybrid systems that are more efficient.[148] • **Adopt land value taxes as an administratively easier option**. Policymakers may also consider whether to adopt land value taxes, which impose a higher tax rate on land than on improvements, or tax only the land value. This option reduces some, although not all, of the complexities of property tax valuation.	• Tax authorities in **Kigali, Rwanda** used high-resolution remotely sensed imagery to confirm the completeness of land valuation rolls and enabled running land valuation models "at a fraction of the time and resources required by more traditional technologies."[149] • **Freetown, Sierra Leone** has implemented a "points-based method" for efficiently estimating property value. It is simple to implement and offers accuracy, progressivity, and transparency."[150]
Inefficient and nontransparent system for	• **Digitization of revenue collection processes** can address one of the most significant causes of low own-source revenue generation[151] by helping to improve transparency and accountability[152] and by improving efficiency and preventing leakages.[153] Technology solutions can replace cash transactions with electronic payments and improve	• In **Tanzania**, an information system was developed to help manage property registration and revenue collection in municipal councils. Introduction of the system was followed by "a significant increase in collected own revenues"

[144] Ali, Deininger, and Wild 2018
[145] Namangaya 2018
[146] Joseph-Raji 2015
[147] Zebong, Fish and Prichard 2017
[148] Grieco et al. 2019
[149] Ali, Deininger, and Wild 2018
[150] Greico et al. 2019 https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/14799/ICTD_SummaryBrief_19_Online.pdf?sequence=7
[151] Dzansi et al. 2019 h
[152] Adu et al. 2011
[153] Mutua and Wamalwa 2017

revenue collection or management	transparency, efficiency, and recordkeeping throughout the entire revenue lifecycle. These technologies cannot by themselves reduce corruption and boost revenue and need to be integrated and synchronized among core revenue functions. Lack of funding and technical capacity often makes such technological solutions out of reach to certain subnational governments. Prichard and Fish (2017) offer several lessons for successful IT reform such as the need to link IT reform to broader tax collection reform, focus on simplicity and local appropriateness of a given system, and to ensure solutions are cost-effective and locally managed.[154]	attributed by McCluskey and Huang (2019) to improved taxpayer confidence and increased efficiency, among other improvements.[155]
Existing revenue instruments are inefficient or insufficient	● **Streamline fees** by abolishing costly and unproductive revenue instruments (e.g., nuisance fees that cost more to collect and enforce than they yield). Replace or bundle these fees into a single payment such as a surcharge to property tax or single business permits.[156] Through efficiency, this streamlining can both raise more revenue while decreasing the costs and burdens to taxpayers. ● **Redesign regressive local taxes to improve efficiency and encourage tax compliance**. Urban local governments can conduct analysis to uncover options to improve the equity of tax instruments, in lieu of abolishing them.[157] ● **Identify new tax instruments** within the parameters of a given country's tax policy framework.	● Policymakers in **Nairobi, Kenya** introduced a Unified Business Permit (UBP) as a way to curb the multiplicity of trade licenses.[158] The UBP consolidates the requirements for running a business in the city into a sole instrument. ● In **Edo State, Nigeria**, the government introduced a new luxury tax (a consumption tax on new hotels and event centers) to raise additional revenue while minimizing impact on poor taxpayers.[159]
Limited local tax administration capacity which reduces authorities' ability to collect revenues	● **Autonomous local revenue agencies** exist in more than 50 countries and can help overcome local capacity challenges while sustainably raising more stable revenue.[160] The reform may require major restructuring (e.g. merging multiple agencies) and/or recruiting new staff.[161]	● Beginning in 1996, some municipalities in **Peru** have created their own semi-autonomous tax administration services, responsible for collecting revenue (and financed through a share of the revenue they collect, creating a clear incentive) but local authorities retaining responsibility for regulating their work.[162]

[154] Prichard and Fish 2017
[155] McCluskey and Huang 2019
[156] Ankamah and Yao 2013 and Fjeldstad 2016
[157] Sarzin 2007
[158] Mutua and Wamalwa 2017
[159] Joseph-Raji 2015
[160] von Haldenwang, von Schiller, and Garcia 2014
[161] Junquera-Varela et al. 2017
[162] Canavire-Bacarreza, Martinez-Vazquez, and Sepulveda 2012

Poor motivation of collectors	● **Use performance incentives to motivate collectors** by a combination of carrots (e.g., performance-based bonuses) and sticks (e.g., harsher punitive measures up to and including firing personnel or rebidding a private contract).[163]	● Randomized experiments in **Punjab, Pakistan**, found that offering tax collectors large monetary or desirable non-monetary incentives could increase revenue growth.[164]
Poor compliance/ cooperation of taxpayers	● **Improve public education** on the importance of settling financial obligations to government tax/fee collectors.[165] There are several ways that governments try to improve tax education including campaigns, integrating tax education into school curricula, using tax "edutainment", tax training and seminars, and mobile tax units.[166] The experience of Edo State, Nigeria, shows that it is important to carry citizens along in the implementation of stronger efforts to mobilize local revenues. Failure to do this can lead to "massive resistance."[167] ● **Launch collection campaigns** to visibly increase tax collection and enforcement, with the goal of boosting revenue and improving compliance.	● In Uganda, the **Kampala Capital City Authority** launched a series of reforms including a taxpayer education and sensitization program and communication campaigns. Combined with other tax administration reforms, these efforts helped Kampala increase its own-source revenue by more than 100 percent in four years.[168]
Transfers weaken incentives for increasing own-source revenue	● **Support the design and strategic use of performance-based transfers.** Adopting conditional transfers can encourage improved subnational government performance, particularly on administrative measures (e.g., public financial management metrics) and collection of own-source revenue. The thoughtful design, objective application, and transparent communication of these tools is key to their success. Donors can also help evaluate the effectiveness and consistent application of different transfer formulas, helping build best practice evidence.	● **Mongolia's** transfer formula includes a variable that entitles subnational governments to additional grants if they show better performance in collecting own-source revenue.
Weak perception of local accountability	● **Support local stakeholder groups** such as taxpayer associations. Civil society groups have successfully advocated for measures to boost revenue such as revenue-sharing mechanisms for the extractive sector.[169] Donors can support these efforts through convening dialogue, training these groups to analyze PFM materials, and supporting the development of an accessible dashboard on local revenue and expenditure. Such dashboards can be difficult to maintain so effort should be made to ensure that they are easy to update (automated if possible) and government staff have the capacity to manage them.	● In **Mozambique**, a municipal social accountability program sought to "Integrate citizens into tax administration and policymaking" including through the formation of accountability monitoring committees. These committees raised awareness for tax compliance and improved citizen participation in tax administration decisions.[170]

[163] Adu et al 2011
[164] Khan, Khwaja and Olken 2015
[165] Adu et al. 2019
[166] Mascagni and Santoro 2018
[167] Joseph-Raji 2015
[168] Andema and Haas 2017
[169] Coplin and Nwafor 2019
[170] Nell and Mascagni 2017

HOW SHOULD DONORS APPROACH SUPPORTING SUBNATIONAL DRM?

USAID has a unique and important role to play in supporting improved subnational revenue mobilization which, in turn, is critical to achieving significant development outcomes: stronger subnational governance, improved service delivery, and sustainable funding for local development. USAID is one of the leading donors supporting improved DRM, investing more than $30 million per year on DRM assistance in over 20 countries, with a further $6 million invested by other U.S. Government partners.[171] As the agency's experience has shown, such investments can offer a good return on investment, unlocking significant additional resources for development.[172] USAID has an opportunity to build on lessons from its national-level work to drive improvements in resource mobilization at the subnational level—an area where donor support has been limited.

In general, **donor support for subnational domestic resource mobilization to-date has been limited**, and "the reform of the sub-national tax system has not been a priority over the mobilization of central government revenues."[173] By one estimate in 2015, only 4 percent of total development assistance on DRM had a subnational focus.[174] Yet, there is significant room for USAID to contribute to subnational DRM because, as available evidence suggests, national governments may not always have sufficient incentives or resources to invest in strengthening subnational revenue mobilization.

Aligned with its core competencies, there are **three primary ways that USAID can support subnational DRM**:

- Use its **convening power** to assemble key public, private, and civil society stakeholders to identify DRM challenges and build coalitions in support of difficult reforms.

- Tap international best practice to inform locally appropriate **policy advice and technical assistance** programs, linked to national DRM and public financial management efforts.

- Lend **visible support** to local leaders who have made clear, effective revenue improvements, and use these as peer learning opportunities. These efforts can raise the profile of effective reforms, reinforce and lend credibility to these efforts, and extract replicable lessons. **Coordinate with other development partners**, such as the U.S. International Development Finance Corporation, to ensure investments that stimulate local economic activity mutually reinforce subnational DRM efforts. This can include an assessment of potential DRM and PFM benefits of economic investments, such as increased local revenue from taxes and other fees. If the assessment finds little expectation that such revenue will be collected or paid, USAID can consider providing support to address that capability, or advise development partners to ensure a fuller accounting of estimated economic impacts.

Importantly, improving subnational resource mobilization takes a lot more than adhering to global best practices. The empirical literature suggests that even when best practices are followed, "local revenue generation continues to suffer from frustrating underperformance."[175] What ultimately

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[171] USAID, "Domestic Resource Mobilization," accessed February 1, 2021, https://www.usaid.gov/what-we-do/economic-growth-and-trade/domestic-resource-mobilization

[172] USAID estimates, for example, that national-level reforms it supported in El Salvador through a $5.8 million program helped boost annual national revenue by $350 million and annual expenditures on social services by $160 million (USAID n.d.(b)). While national level policy and regulatory changes differ from more targeted engagement with subnational partners in both scale and potential impact, this data does suggest investing in improved DRM, if accompanied by a solid strategy, adaptable technical assistance, and empowered partners can yield a positive return.

[173] Fjeldstad 2014

[174] Oxfam 2017. This figure is based on OECD data on Official Development Assistance disbursements, but it is likely an underestimate as it may not capture subnational DRM work happening under local government support programs.

[175] Smoke 2019

makes or breaks revenue reforms are the "underlying incentives of the actors involved and how the elements of the intergovernmental system work together."[176] In other words, local demand and political will are essential. Appendix 2 presents a set of programming considerations for USAID staff in deciding on how best to engage on subnational DRM issues in each partner country.

Keeping these points in mind, and building off a review of literature and interviews with subject matter experts, we offer the following **recommendations for USAID to strengthen subnational DRM programming**:

- **Ground strategy in the realities of each country, subnational context, and behavioral norms.** USAID programming is increasingly designed with a deep appreciation of country context. Opportunities and constraints are embedded in a host of other political, historical, and economic conditions. While there is no systematic study of the conditions that are more favorable to local DRM improvements, the questions surfaced in this report provide USAID and others a framework for assessing the potential drivers of change and barriers to progress. A country's subnational tax structure reflects its governance model and decisions about the allocation of governance responsibility and discretion.[177] Any strategy to improve a subnational revenue system should be based on detailed analysis of incentives for national and local stakeholders and the existing policy framework. Donors should build from the opportunities and constraints of the existing fiscal relationship. For instance, are there any promising but unexploited revenue streams that a subnational government has the authority to tap? Subnational reform efforts should focus on areas where there is local autonomy to act independently or where there is opportunity for coordinated action at the national level. Understanding taxpayer behavior, influenced by social norms, is also important to determining the optimal DRM strategy, including the most effective "carrots and sticks" to motivate taxpayer compliance.

- **Help policymakers weigh efficiency, efficacy, and impact considerations to select locally appropriate revenue instruments.** Donors can help local stakeholders assess the utility of existing and potential revenue streams by considering the political acceptability of the revenue source and rate as well as its impact on taxpayer behavior. Creating and applying a cost-benefit framework that considers operational, distributive, and political considerations can help prevent the proliferation of high-cost, low-return nuisance fees and maximize the beneficial impact of a revenue structure. Available literature suggests several principles for identifying a good own-source revenue stream for services (box below).

- **Adopt a flexible, iterative approach based on experimentation, refinement, and scale-up**. Often, large development programs are implemented based on preliminary evidence of success in other places or driven by the convictions or interests of key officials or donors. At launch, some donor programs prescribe an exact approach, which is incompatible with the messy and gradual nature of subnational DRM reform. Instead, USAID staff should consider enabling a flexible, problem-driven approach which aims to surface several potential solutions, all grounded in a clear theory of change and informed by evidence and analytics. Solutions should be designed collaboratively, blending the technical and political expertise of international and local experts, local and national policymakers, and other key stakeholders (see below). Solutions could then be implemented through a pilot or on a trial-basis with emphasis on monitoring and evaluating impact. Information collected will enable continuous learning and help determine if the program should be scaled as-is, scaled with modifications, or shelved.

[176] Smoke 2019
[177] Bird, Martinez-Vasquez, and Torgler 2008

- **Increase support for subnational DRM by linking with broader programs and funding on decentralization, local governance, and public financial management.** Recent, donor-supported programs to strengthen local governance increasingly include revenue collection improvement in their scopes. This shows a growing recognition of the value of nesting DRM within broader subnational programs. There is considerable overlap between the goals, tools, and stakeholders involved in DRM reforms and other programming, such as governance and accountability. In practical terms, staff should identify opportunities for aligning DRM objectives with existing or planned programs nominally focused on other, adjacent issues, including decentralization, governance, and PFM. Such programs include anti-corruption efforts; training for civil society members and local government officials on public administration and civic engagement; and efforts to formalize land tenure and business activity. The close, mutually reinforcing relationship between improved, transparent local governance and stronger subnational resource mobilization presents particularly good opportunities for collaboration. USAID's newly formed Bureau for Development, Democracy, and Innovation (DDI), and particularly the Governance team within DDI's Center for Democracy, Human Rights and Governance, could serve as a resource to Missions in building out context-specific opportunities to sharpen the focus on subnational DRM in wider local governance efforts.

- **Adopt a realistic and sustainable but ambitious performance measurement framework.** In addition to tracking revenue performance, USAID programming should adopt nuanced performance measurement indicators that shed light on underlying factors that shape subnational revenue outcomes.[178] This can help ensure that other important outcomes related to subnational DRM are considered, such as improving citizen's experiences with the tax administration system and building trust between citizens and subnational governments.

- **Avoid a narrow focus on increasing revenues.** Increasing subnational revenues is an important goal but it should not be the only focus of DRM programs. Stakeholders need to be mindful of the unintended consequences that can result from designing programs around the sole goal of achieving higher revenue targets, such as incentivizing the increased use of regressive tax policies or the adoption of enforcement tactics that infringe on taxpayers' rights. Fully engaging beneficiaries (including local government officials) in program design (see next bullet), such as through USAID's co-creation approach,[179] could help ensure programs are focused on additional, locally prioritized goals.

- **Ensure the appropriate leadership of key local and national stakeholders in the design and implementation of subnational DRM reforms.** The success of DRM reforms depends on understanding the incentives of key local stakeholders and ensuring they are engaging in the reform process. As with USAID programming broadly, ensuring engagement and leadership of these stakeholders in designing and implementing subnational DRM programming is critical to success.

    - **Individual citizens and civil society groups.** The literature suggests citizens are more motivated to comply with tax obligations when they perceive that the system is fair, and governments provide services of value. Skilled and well-resourced civil society organizations can help "raise awareness, generate political will, and hold policymakers accountable"[180] for service delivery, potentially yielding positive contributions to the subnational DRM effort, even if indirectly. USAID investments in

[178] For an example. See the Tax Administration Diagnostic Tool (TADAT's) eight performance outcome areas: https://www.tadat.org/tadatAtAGlance
[179] USAID 2017
[180] Coplin and Nwafor 2019

the capacity of civil society organizations, such as taxpayer associations, can serve as a catalyst for citizen-led accountability across a wide range of governance objectives. In addition, they can empower civil society actors to exert greater influence on fiscal policy decisions. Participatory budgeting efforts involve citizens in defining priorities and provide an ideal opportunity to explain how tax and fee compliance helps the government meet citizen expectations for those priorities. Building citizen engagement on tax reform can create the demand needed to unlock political support.[181]

- **Elected officials.** While issues related to political will and motivation are crucial to improving subnational DRM, donor efforts frequently focus on addressing technical barriers (e.g., updating registries) and ignore or largely leave untouched political economy barriers. At a minimum, political stakeholders should be engaged during design to ensure programs are realistic and appropriate. Failing to do so "can lead to project failure and abandonment later."[182] Future USAID programs would benefit from an understanding of the ways that local politicians intervene in subnational DRM processes,[183] the motivation for those interventions, and their impacts on revenue mobilization outcomes at the subnational level. For example, the perceived unpopularity of raising local revenue may discourage politicians from supporting reform. Intentional outreach to politicians to illustrate the benefits of tax reform (including by linking to politically popular service improvements) and tailor reforms to local political economy realities, may secure political support. In turn, this may lend credibility to the reform program and improve long-term sustainability of reforms.[184]

- **Private sector actors.** Improving the local business environment and strengthening subnational resource mobilization are often interdependent goals. As drivers of economic activity and employment, private sector actors are important partners, especially when formalized. These partners are more likely to support formalization and DRM reforms if they perceive benefits in doing so. It is important that private sector actors be afforded sufficient opportunity to have their concerns and views heard and addressed through reforms. For example, the business community is well placed to flag revenue instruments or requirements that are particularly costly to comply with, discourage investment, are duplicative, or compare unfavorably with those found in other jurisdictions. USAID, in thinking broadly about the incentives and conditions for private sector development, can reflect these considerations in its programs to support subnational DRM (and PFM broadly). To facilitate engagement of small and medium-sized enterprises, including by encouraging formalization[185], USAID could support the creation or strengthening of associations representing these organizations.[186] There may also be opportunities for local authorities to engage private sector actors to complement certain tax administration activities (e.g., independent auditing of records).

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[181] Fjeldstad 2014
[182] Platz, Intini, and Hilger 2016
[183] This report earlier explored how local politicians can have both positive and negative influences on DRM outcomes. For example, they can help strengthen the legitimacy of tax authorities, which would allow them administer revenue instruments effectively. Conversely, they can pressure tax administrations to relax the tax collection effort during election periods and even "denigrate the usefulness of local taxes when speaking to citizens." (Fjeldstad, Chambas and Brun 2014)
[184] According to Scheerens and Van Ongevalle (2018), tax compliance seems to improve when local politicians participate in sensitization efforts.
[185] Specifically, transitioning enterprises from informality to the formal economy by providing incentives and removing barriers to formalization. For more, see OECD 2007.
[186] Junquera-Varela et al. 2017

CONCLUSION

Mobilizing resources at the subnational level is key to advancing local and national development goals. With more—and better managed—resources, subnational governments will be better placed to respond to the ever-growing demands they face, including for expanded access to improved services. However, the barriers to improving subnational DRM, including increasing collection of own-source revenues, are sizable and include both technical and non-technical (e.g., political) hurdles. These issues are thankfully beginning to receive international attention in proportion to their importance for sustainable development efforts. A growing body of evidence is pointing the way to effective strategies and solutions. By leveraging its access to expertise, resources, and innovations, USAID has a significant opportunity to support flexible, locally led efforts to reform and improve subnational DRM and subnational governance and PFM systems more broadly.

APPENDIX A. COUNTRY DATA ON SUBNATIONAL REVENUE

The data below are sourced from the OECD-UCLG World Observatory on Subnational Government Finance and Investment database (except for data indicating USAID partner country which was sourced from USAID). Data was extracted on April 19, 2021 and reflects latest year available, which varies by country.

TABLE 1: SUBNATIONAL REVENUE COMPOSITION BY COUNTRY

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Albania	Upper middle income	Unitary	Y	73	539.6	17.7	4.7	75.8	15.9	8.0	0.4
Angola	Lower middle income	Unitary	Y	181	-	-	-	-	-	-	-
Argentina	High income	Federal	N	2,301	3,037.3	42.8	15.2	2.7	86.1	9.6	1.6
Armenia	Upper middle income	Unitary	Y	502	222.7	10.7	2.5	43.0	19.1	0.0	37.9
Australia	High income	Federal	N	570	7,862.8	49.6	16.3	44.9	33.4	13.7	8.1
Austria	High income	Federal	N	2,107	8,901.6	35.9	17.6	73.8	9.9	11.3	5.0
Azerbaijan	Upper middle income	Unitary	Y	1,608	129.3	2.1	0.7	76.6	20.0	2.2	1.3
Bangladesh	Lower middle income	Unitary	Y	5,930	-	-	-	-	-	-	-

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Belarus	Upper middle income	Unitary	Y	1,325	2,957.2	38.8	16.3	21.6	69.3	6.3	2.8
Belgium	High income	Federal	N	605	12,451.7	52.6	26.7	56.9	26.1	8.7	8.3
Benin	Low income	Unitary	Y	77	27.1	7.9	1.3	49.8	32.1	13.2	4.9
Bolivia	Lower middle income	Unitary	N	352	750.4	33.2	10.4	58.4	25.9	15.7	0.1
Bosnia and Herzegovina	Upper middle income	Federal	Y	154	567.5	10.9	4.7	11.7	57.0	28.3	3.1
Botswana	Upper middle income	Unitary	Y	16	621.1	11.2	3.7	56.5	43.5	0.0	0.0
Brazil	Upper middle income	Federal	Y	5,597	3,073.4	58.6	20.3	39.7	49.4	1.4	9.5
Bulgaria	Upper middle income	Unitary	N	265	1,326.5	19.6	6.9	70.8	13.5	13.4	2.3
Burkina Faso	Low income	Unitary	Y	364	-	-	-	-	-	-	-
Burundi	Low income	Unitary	Y	119	7.0	7	0.9	0.0	-	0.0	-
Cabo Verde	Lower middle income	Unitary	N	22	282.1	13.8	4.3	43.8	17.3	0.0	38.9

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Cambodia	Lower middle income	Unitary	Y	1,856	44.9	7.9	1.2	20.4	76.5	2.3	0.7
Cameroon	Lower middle income	Unitary	Y	370	-	-	-	-	-	-	-
Canada	High income	Federal	N	3,972	13,600.3	75.2	30.3	25.8	53.6	13.3	7.3
Chad	Low income	Unitary	Y	483	-	-	-	-	-	-	-
Chile	High income	Unitary	N	361	860.7	16.5	3.7	52.6	41.7	5.5	0.3
China	Upper middle income	Unitary	Y	3,216	2,813.8	72	18.2	43.9	47.9	1.4	6.8
Colombia	Upper middle income	Unitary	Y	1,134	1,801.1	30.2	12.8	50.8	28.9	3.2	17.1
Costa Rica	Upper middle income	Unitary	N	81	219.8	5.4	1.3	15.2	53.3	31.2	0.3
Croatia	High income	Unitary	N	577	2,766.8	25.2	11.7	48.8	38.4	10.9	2.0
Cyprus	High income	Unitary	Y	380	351.0	3.7	1.5	43.7	21.2	34.8	0.3
Czech Republic	High income	Unitary	N	6,272	3,897.5	27.9	11.2	37.9	46.4	14.3	1.4

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Denmark	High income	Unitary	N	103	17,541.8	66.1	35.2	59.3	35.4	4.7	0.6
Dominican Republic	Upper middle income	Unitary	Y	159	89.6		0.6	80.1	10.3	8.6	1.1
Ecuador	Upper middle income	Unitary	Y	245	422.3	10.2	3.8	84.9	13.1	0.0	2.0
El Salvador	Lower middle income	Unitary	Y	262	243.2	12.3	3.2	48.9	11.4	0.0	39.7
Estonia	High income	Unitary	N	79	2,835.3	23.6	9.5	84.6	3.5	10.8	1.2
Eswatini	Lower middle income	Unitary	Y	68	66.9	2.9	0.8	22.8	17.5	0.6	59.1
Ethiopia	Low income	Federal	Y	927	173.5	57.8	10	62.8	37.2	0.0	0.0
Finland	High income	Unitary	N	312	9,612.6	40.9	22.2	30.5	45.9	21.3	2.3
France	High income	Unitary	N	35,476	4,676.7	21.3	11.3	31.3	51.5	15.8	1.4
Georgia	Lower middle income	Unitary	Y	74	588.8	20.7	5.9	46.1	39.9	10.2	3.8
Germany	High income	Federal	N	11,471	10,532.8	47.9	21.6	26.4	56.9	11.5	5.2

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Ghana	Lower middle income	Unitary	Y	254	-	-	-	-	-	-	-
Greece	High income	Unitary	N	338	1,026.8	7.6	3.8	65.3	24.7	9.2	0.8
Guatemala	Upper middle income	Unitary	Y	340	174.8	13.5	2.2	69.1	11.2	7.4	12.3
Guinea	Low income	Unitary	Y	350	-	-	-	-	-	-	-
Honduras	Lower middle income	Unitary	Y	298	103.4	8.1	2.5	45.6	23.4	19.6	11.5
Hungary	High income	Unitary	N	3,197	1,685.6	14.1	6.3	51.8	36.0	11.5	0.7
Iceland	High income	Unitary	N	74	6,378.7	21.7	12.6	11.0	76.3	9.2	3.4
India	Lower middle income	Federal	Y	267,464	896.4	70.8	14.6	20.6	72.2	6.1	1.1
Indonesia	Lower middle income	Unitary	Y	83,892	938.3	55.9	8.1	82.7	15.7	1.0	0.7
Ireland	High income	Unitary	N	31	1,603.2	8.3	2.2	50.1	19.2	26.6	4.1
Israel	High income	Unitary	N	257	2,092.0	15	5.6	48.0	44.1	4.5	3.4

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Italy	High income	Unitary	N	7,980	5,555.3	30.9	14.5	46.8	40.4	11.2	1.6
Ivory Coast	Lower middle income	Unitary	Y	234	28.3	2.6	0.7	37.8	62.2	0.0	0.0
Jamaica	Upper middle income	Unitary	Y	14	54.6	2.2	0.6	83.9	0.0	16.1	0.0
Japan	High income	Unitary	N	1,788	6,561.5	43.5	15.5	43.3	47.4	6.2	3.1
Jordan	Upper middle income	Unitary	Y	113	218.5	6.7	2.4	1.3	43.2	32.1	23.4
Kazakhstan	Upper middle income	Unitary	Y	7,169	2,238.0	51.3	8.9	58.0	41.2	0.7	0.1
Kenya	Lower middle income	Unitary	Y	47	136.6	20.6	4.3	88.7	3.3	0.0	7.9
Korea	High income	Unitary	N	243	5,255.4	41.4	14.3	57.7	32.8	8.2	1.3
Kosovo	Lower middle income	Unitary	Y	38	766.2	28.1	7.5	74.8	19.8	5.5	0.0
Kyrgyzstan	Lower middle income	Unitary	Y	484	131.7	11.1	3.7	15.8	69.4	7.9	6.9
Latvia	High income	Unitary	N	119	2,486.5	26.1	9.7	30.2	60.8	7.8	1.2

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Lithuania	High income	Unitary	N	60	2,489.8	24.2	8.3	88.2	4.5	6.1	1.2
Luxembourg	High income	Unitary	N	102	5,310.9	11.9	5.2	51.8	28.6	18.5	1.1
Madagascar	Low income	Unitary	Y	1,723	-	-	-	-	-	-	-
Malawi	Low income	Unitary	Y	35	9.7	3.7	0.8	71.2	13.1	15.1	0.6
Malaysia	Upper middle income	Federal	N	167	676.3	13.4	2.4	19.2	0.0	0.0	80.8
Mali	Low income	Unitary	Y	763	-	-	-	-	-	-	-
Malta	High income	Unitary	N	68	161.7	1.1	0.4	92.5	0.0	7.5	0.0
Mauritania	Lower middle income	Unitary	Y	233	-	-	-	-	-	-	-
Mauritius	Upper middle income	Unitary	N	143	326.0	6.9	1.5	84.3	4.4	10.7	0.6
Mexico	Upper middle income	Federal	Y	2,511	2,220.4	53.6	12.4	92.4	7.4	0.0	0.2
Mongolia	Lower middle income	Unitary	Y	2,081	1,108.9	35.9	9.1	58.4	36.9	3.5	1.2

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Montenegro	Upper middle income	Unitary	Y	23	1,106.5	11.6	6.3	12.0	39.6	21.0	27.4
Morocco	Lower middle income	Unitary	Y	1,625	291.7	14.7	3.7	63.9	25.6	3.6	6.9
Mozambique	Low income	Unitary	Y	64	-	-	-	-	-	-	-
Namibia	Upper middle income	Unitary	Y	71	286.6	7.6	2.8	20.7	8.2	0.6	70.5
Nepal	Low income	Federal	Y	760	-	-	-	-	-	-	-
Netherlands	High income	Unitary	N	392	7,003.3	31.6	13.9	73.2	10.1	13.2	3.6
New Zealand	High income	Unitary	N	78	1,695.0	10.8	4.3	26.6	51.7	16.6	5.2
Nicaragua	Lower middle income	Unitary	Y	155	231.5	16.7	4.4	51.1	29.2	4.7	15.0
Niger	Low income	Unitary	Y	262	-	-	-	-	-	-	-
Nigeria	Lower middle income	Federal	Y	811	202.0	38.3	3.4	47.4	30.7	0.0	21.9
Norway	High income	Unitary	N	440	9,556.8	30	16.4	45.8	38.1	12.7	3.4

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Palestinian Authority	Lower middle income	Unitary	N	456	41.6	8.9	3.1	9.2	12.8	0.0	78.1
Panama	High income	Unitary	Y	78	135.0	2.9	0.6	28.4	43.1	7.7	20.9
Paraguay	Upper middle income	Unitary	Y	274	187.7	8	1.5	40.2	37.8	19.3	2.7
Peru	Upper middle income	Unitary	Y	1,891	1,023.3	40.7	7.9	94.4	5.6	0.0	0.0
Philippines	Lower middle income	Unitary	Y	43,761	311.0	20.8	4	68.4	22.2	9.2	0.2
Poland	High income	Unitary	N	2,874	3,598.0	33.9	13.1	57.6	32.7	8.0	1.7
Portugal	High income	Unitary	N	310	1,888.2	14.2	6.1	32.9	40.9	17.7	8.6
Republic of Moldova	Lower middle income	Unitary	Y	960	476.5	26.2	8.9	70.2	25.8	3.2	0.9
Republic of North Macedonia	Upper middle income	Unitary	N	81	723.4	17.1	4.9	63.6	26.7	7.5	2.2
Romania	Upper middle income	Unitary	N	3,223	2,116.7	29	9.2	83.7	10.2	4.5	1.6
Russian Federation	Upper middle income	Federal	N	22,410	5,830.0	63.2	23.1	52.3	38.1	8.5	1.2

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Rwanda	Low income	Unitary	Y	30	108.0	17.5	5.6	89.2	9.5	1.1	0.3
Senegal	Low income	Unitary	Y	602	44.6	5.6	1.3	25.9	35.5	0.0	38.6
Serbia	Upper middle income	Unitary	Y	176	1,090.2	17.4	7.5	25.7	53.2	0.0	21.1
Sierra Leone	Low income	Unitary	Y	22	-	-	-	-	-	-	-
Slovak Republic	High income	Unitary	N	2,938	2,168.4	18.1	7.1	74.2	7.3	17.0	1.6
Slovenia	High income	Unitary	N	212	2,741.6	19.3	8.4	39.5	41.3	17.3	1.9
South Africa	Upper middle income	Federal	Y	266	2,496.3	50.2	18.8	70.3	7.4	6.3	16.1
Spain	High income	Federal	N	8,191	7,466.7	54.5	20.6	51.0	39.8	8.4	0.7
Sri Lanka	Lower middle income	Unitary	Y	350	286.3	16.4	2.3	71.2	25.7	3.1	0.0
Sweden	High income	Unitary	N	311	11,987.9	48.4	24.5	32.9	55.0	9.8	2.4
Switzerland	High income	Federal	N	2,248	13,513.3	61	21.2	24.6	53.5	18.1	3.8

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Tajikistan	Low income	Unitary	Y	438	257.2	34.9	9.1	16.7	81.0	2.4	0.0
Thailand	Upper middle income	Unitary	Y	2,517	702.9	19.3	4.1	62.0	34.6	0.0	3.4
Togo	Low income	Unitary	N	160	-	-	-	-	-	-	-
Tunisia	Lower middle income	Unitary	Y	374	242.2	6.4	2.1	69.2	22.2	4.0	4.6
Turkey	Upper middle income	Unitary	N	1,470	905.7	10.3	3.5	70.1	12.5	13.5	4.0
Uganda	Low income	Unitary	Y	169	59.7	20.9	3.3	96.3	1.4	2.2	0.0
Ukraine	Lower middle income	Unitary	Y	11,733	1,200.5	39.7	15.3	53.7	36.0	4.9	5.3
United Kingdom	High income	Unitary	N	420	4,134.1	25.2	9.7	67.0	16.3	14.2	2.5
United Republic of Tanzania	Low income	Unitary	Y	169	45.1	18.9	4.6	89.7	4.8	2.1	3.4
United States	High income	Federal	N	38,960	9,953.6	52.6	17.3	23.7	50.8	22.5	3.1
Uruguay	High income	Unitary	N	131	702.6	10	3.2	29.1	48.2	7.9	14.8

Country	Income group	Form of government	USAID partner country	Number of subnational government units	Subnational revenue per capita ($ PPP)	Subnational revenue as percentage of general government revenue	Subnational revenue as percentage of GDP	Grants and subsidies (transfers) (% of subnational revenue)	Taxes (% of subnational revenue)	Tariffs and fees (% of subnational revenue)	Other (% of subnational revenue)
Uzbekistan	Lower middle income	Unitary	Y	215	725.9	33.2	11.1	26.2	64.0	6.2	3.7
Vietnam	Lower middle income	Unitary	Y	11,938	706.1	45.8	11.2	0.0	-	0.0	-
Zambia	Lower middle income	Unitary	Y	103	-	-	-	-	-	-	-
Zimbabwe	Low income	Unitary	Y	102	38.6	9.1	1.6	3.7	86.6	0.0	9.7

TABLE 2: SUBNATIONAL REVENUE SUMMARY FOR USAID PARTNER COUNTRIES

Country income group	Subnational revenue figures						Subnational revenue composition (percent of total)							
	Per capita ($ PPP)		As percent of general government revenue		As percent of national GDP		Grants and subsidies		Taxes		Tariffs and fees		Other	
	Average	Median	Average	Median	Average	Median	Average	Median	Average	Median	Average	Median	Average	Median
Low income	77.0[b] (80.6 standard deviation)	44.8	18.3[b] (16.8)	13.3	3.9[b] (3.4)	2.45	50.5[b] (36.8)	56.3	33.5[c] (31.5)	32.1	3.6[b] (5.6)	1.6	6.4 [c] (12.5)	0.6
Lower middle income	442.1[d] (363.0)	289	24.3[d] (17.8)	20.6	5.8[d] (4.3)	4.15	49.3[d] (23.8)	30.0	34.7[e] (21.4)	21.4	4.3[d] (4.6)	3.6	9.1[e] (14.8)	3.8
Upper middle income	1,089[f] (1,037.0)	621	24.8[d] (20.9)	15.4	7.1[f] (6.3)	4.7	52.8[f] (27.9)	56.5	28.9[f] (19.7)	19.7	7.1[f] (9.6)	2.2	11.3[f] (16.7)	3.1

Source: Authors calculations based on OECD-UCLG World Observatory on Subnational Government Finance and Investment (data extracted April 19, 2021). Standard deviations are shown in parentheses.

Notes: [a]The OECD_UCLG database classifies this category as transfers from central governments and international organizations. See expanded note at the end of Appendix A for a longer description of how these terms are defined in the source data.

[b] n = 10

[c] n = 9

[d] n = 22

[e] n = 21

[f] n = 23

TABLE DEFINITIONS

Per OECD/UCLG (2016) the revenue data categories in the above tables are defined as follows:

- "**Grants and subsidies** category includes transfers to subnational governments from the central government (representing the great majority) but also from higher levels of government (state or regional governments) and from international organizations (e.g., European Union structural funds, international aid, etc.). They comprise current and capital expenditure grants. A distinction can also be made between unconditional/general/non-earmarked transfers vs earmarked (assigned conditional) transfer. Non-earmarked grants can be general purpose grants or block-grants and are often based on distribution formulas. There are other distinctions between grants, including discretionary grants, matching grants, and equalization grants. General and earmarked grants are not recorded as such in the national accounts while such information is crucial to assess the level of autonomy of subnational governments over grants."

- "**Tax revenue** category comprises both own-source and shared taxes. National accounts, however, do not make the distinction between these two categories. Therefore, the tax revenue indicator only partially reflects the real level of tax autonomy of subnational governments."

- "**User charges and fees** include revenues coming from the sales of public goods and services which are charged to users. In turn, these charges or fees help finance a number of local public services and facilities in areas such as water treatment and distribution, collection and treatment of waste, cultural and sporting facilities and activities, public transport, car parks, school meals, energy, nursing homes, etc. They also comprise the payment for administrative services. User charges and fees are considered as own-source revenue, as subnational governments generally have significant leeway in this regard. However, the freedom to set the level of tariffs and fees may be limited by regulations (e.g., in strategic or "essential" sectors such as energy, water, education or some social services) but also by users' capacity to pay, especially in developing countries. In addition, charging for local services also demands a capacity for offering this service, which is not the case in many developing countries or centralized countries."

- The **other** category includes property income (revenue from financial and nonfinancial assets) as well as other revenues.

APPENDIX B. ASSESSING PRACTICAL CONSIDERATIONS FOR SUBNATIONAL DRM PROGRAM DESIGN

Opportunities for USAID to support subnational DRM efforts will vary considerably depending on a range of national and local factors, such as political will and commitment. Additionally, strategies for advancing subnational DRM may be able to effectively leverage and align with investments in other, adjacent, areas such as governance.

The below table is designed to help USAID staff navigate these opportunities. It contains a set of scoping tasks and questions that staff should ask while determining conduciveness to DRM programming and reforms and assessing the optimal strategy and approach to advancing subnational DRM. A number of these questions could be addressed during strategic planning sessions embedded within the Agency's program cycle. These questions could also form the basis for detailed scopes of work to be carried out under relevant USAID programming. By investing in answering these questions, USAID can ensure that solutions pursued are appropriate for the local context, aligned with Agency priorities, and informed by evidence.

This table is meant to be illustrative of the types of tasks staff should consider undertaking and the types of questions staff should ask. The questions are not exhaustive nor is this exercise itself sufficient. Discussions and collaboration within Missions; conversations with other development partners, and, especially with national and local stakeholders; a careful review of local evidence and national and international good practices; and an iterative and flexible approach are all likely necessary to ensure successful subnational DRM programming.

TASK	GUIDING QUESTIONS
Assess political will and commitment	• Does the national government have a stated commitment to improving domestic resource mobilization? To what extent does this commitment include objectives at subnational levels? Does the national government see strengthening local finances as a priority? • Are intergovernmental fiscal relationships well defined? • How conducive is the subnational political environment for policies and programs to boost resource mobilization? How does this differ within country (geographically, level of government, political party allegiance, etc.)? • Is there an association of subnational government authorities? If so, has it expressed a position on DRM reforms?
Identify entry points	• What has been the experience to-date with subnational DRM? What is the composition of subnational DRM (e.g., mostly transfers with the remainder being non-property tax)? Which reforms and investments have been successful, and which have faltered? Why? • Is the partner country's commitment to improving DRM codified in a reform program? If so, is the country seeking USAID or other international assistance to implement this plan? • Have local leaders (elected officials, finance ministries, revenue authorities, civil society groups, business leaders, etc.) indicated an interest in and commitment to DRM reform?

	• Are there new or planned national policies that will reform the national DRM framework? For example, policies to increase performance-based transfers? • Is funding a binding constraint to the expansion or improvement of service delivery in a priority sector or sectors? • Is there a national decentralization strategy or policy? How does subnational DRM fit within this? How can USAID make the case for—and support—improving subnational DRM as part of those broader reforms?
Define the programming strategy	• At the subnational level, what constitutes a greater barrier to realizing potential revenues—tax policy or tax administration? Is there scope for USAID programming to improve administration, even when tax policies may be slow to change? • How are USAID projects in the partner country addressing the intersection between citizen engagement and service delivery challenges at the subnational level? • How can improvements in DRM be integrated in those efforts? • Which programming tools (e.g., policy dialogue, research, training) can be leveraged to link subnational DRM to broader goals of improving local government responsiveness and accountability? • How could USAID adapt implementation strategies to the varying political, cultural, and capacity conditions across subnational jurisdictions within the partner country? • How could programming engage across the rural to urban continuum?
Articulate alignment with USAID priorities and continuous evidence-based learning	• How would programming align with and reinforce broader Agency priorities? • How could programming leverage and engage new or underrepresented local partners (e.g., civil society organizations, the business community)? • How would USAID define success? What key indicators would USAID track to understand whether programming is contributing to progress in improving subnational DRM? What is the evidence base for selecting those indicators? • How can USAID leverage such performance information to engage a wider set of stakeholders in identifying—and taking advantage of—opportunities for program improvement?
Consider the pathways to scale	• How will USAID and local and national partners define “scale” for promising practices identified through programming? • How will progress be sustained after USAID funding ends? Are the reforms self-sufficient (i.e., do they pay for themselves)? • What are the political vulnerabilities of program results after USAID’s formal involvement ends? Are there interests that can undermine progress? How can these risks be managed and mitigated?

Answering these questions should help USAID staff identify and understand relevant factors and conditions for subnational DRM programming. However, this is just an initial step. In order to use this information constructively to improve the effectiveness of existing programming or build new, locally appropriate programming, staff should consider the following actions. These actions are illustrative and should be tailored to local needs and opportunities:

- **Convene theory of change workshops with USAID staff and local stockholders** to reconsider the programming context, discuss assumptions on how programs produce their intended impacts, and identify actions USAID and its partners can take to mitigate risks to program outcomes.
- **Update monitoring and evaluation frameworks** for existing programs, as appropriate, and develop guidance notes to inform M&E approaches for new ones.
- **Integrate findings into Country Development Cooperation Strategies (CDCS)**, highlighting how subnational DRM intersects with established strategic priorities and potential entry points for USAID programming.
- **Review portfolio of USAID's governance programs in country** to identify opportunities to capture lessons from their DRM-relevant components.
- **Cultivate networks of policy champions** to gain a better understanding of their priorities and constraints regarding subnational resource mobilization and identifying when—and where—USAID's assistance can be most helpful.
- **Identify a subset of questions and issues that merit further study and analysis.**
- **Convene learning sessions with other donors** as a potential entry point for aligning programs, pursuing joint learning, and advancing shared priorities across agencies.
- **Develop talking points for engaging local and national policymakers** on subnational DRM issues. Focused messaging rooted in evidence would demonstrate significant appreciation of the local policy context, bring visibility to USAID's work on DRM, and strengthen the Agency's value as a strategic partner.

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