

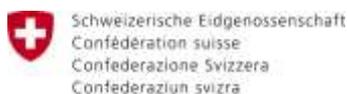


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Perspectives from the Field: SDC Cooperation for Property Taxation

Christopher Nell and Giulia Mascagni
April 2017



Swiss Agency for Development
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and Local Governance



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Perspectives From the Field: SDC Cooperation for Property Taxation A Report Prepared for the SDC-DDLG Network

Christopher Nell and Giulia Mascagni

Executive summary

This paper reviews three projects implemented in the Swiss Agency for Development and Cooperation's (SDC) Democratisation, Decentralisation and Local Governance Network (DDLGN) that aim to provide incentives for local governments to increase tax compliance and revenues. The investigation focuses on three projects that aim to improve local revenue mobilisation: (1) a competition among municipalities in Serbia, (2) a performance-based grant system in Kosovo, and (3) a project on municipal social accountability in Mozambique. By doing this, we highlight practical problems and obstacles linked to the collection of property tax, and pragmatic ways in which local tax revenues can be boosted.

The first part of the paper looks at a project in Eastern Serbia framed as a competition among municipalities for a share of an incentive fund. The project evaluates the success of property tax collection by five criteria, which include the increase in properties registered for tax. The project has seen a strong increase in registered properties among competing municipalities when compared to the rest of Eastern Serbia and thus shows that donors can help to achieve a substantial increase in property tax collection by the use of reasonable financial means. However, the success of the project should not only be evaluated in monetary terms, since this could undermine trust and local governments may fail to implement other critical broader reforms (see, for example, Fjeldstad 2011). The sustainability of the intervention also depends on whether local governments can rely on government transfers in case of low local revenues. To avoid these negative incentives for local governments in the future, the transfers to the municipalities may be partially related to how much tax revenues are generated by the local government, measured by the tax collection performance indicators of the project. The experiences from the project also suggest that the implementation of a nationwide incentive scheme would require regular adaptations, for example, in order to respond to new political realities. In general, a higher level of property taxes may lead to a more equal distribution of wealth between the genders, since properties in Serbia are mostly owned by men. The project-facilitating agency additionally tried to take on an advisory role on how the most vulnerable groups in society can benefit from the new local tax revenues.

Secondly, the paper explores an ongoing programme in Kosovo, which awards performance-based grants to eligible municipalities. Among the minimum criteria to receive a baseline grant is the collection of at least 30 per cent of the annually invoiced property tax. The best performing municipalities not only receive high-incentive grants, but are also rewarded with greater autonomy with regards to spending the grant. As men are more likely to inherit a property in Kosovo, the programme additionally intends to launch an experiment where only women who demand their fair share of the bequests will be offered a tax break. While the programme has seen an initial increase in property tax collection in the SDC-supported municipalities, there are no data available for other comparable municipalities in Kosovo. Therefore, it is difficult to attribute the rise in collection purely to the implemented project. Due to the high amounts of development aid coming into Kosovo, the sustainability of this project may also depend on successful coordination across aid organisations.

Finally, the paper discusses a social accountability programme in Mozambique. The programme aims to educate the citizens not only about their duty to pay taxes, but also about their right to be heard by their government regarding the expenditure of tax revenues.

The project has supported the establishment of citizen-run social accountability monitoring committees. The committees have subsequently engaged in an awareness-raising campaign to create dual incentives to increase revenue collection on the part of the Municipal Council, and on the part of community members to pay tax and non-tax revenues. The programme has brought about higher public representation of marginalised groups and emphasises the importance of effective communications strategies for revenue collection that show how local residents will benefit from property taxes. Finally, the project indicates that increased participation of citizens and public awareness can have a positive effect on the collection of property taxes.

Keywords: property taxation; Serbia; Kosovo; Mozambique; social accountability.

Christopher Nell was Research Officer at the Institute of Development Studies and the International Centre for Tax and Development.

Giulia Mascagni is Research Fellow at the Institute of Development Studies and Research Director at the International Centre for Tax and Development.

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1 Introduction

This paper aims to highlight practical problems and obstacles linked to the collection of property tax, and pragmatic ways in which local tax revenues can be boosted. To explore these issues, the paper looks in detail into experiences of members of the SDC network. Specifically, the investigation focuses on case studies in Serbia, Kosovo and Mozambique regarding incentives implemented to maximise tax compliance and revenues at local government level.

Worldwide, property taxes are the most important source of revenue for local governments (Bahl and Martinez-Vazquez 2007; Moore 2013). At the local level, property taxes can account for up to 40 per cent of tax revenue (Bird and Slack 2006). Often considered the ideal local tax, property tax is a particularly stable source of revenue due to its relative independence from fluctuations in the economy in times of crisis or economic downturn. The tax also has the potential to provide good correspondence between tax payments and benefits, and can play an important role in redistributing resources within communities.

Despite its significance, property tax is still an underused revenue source in developing and emerging countries as a result of administrative and political constraints (Bahl and Martinez-Vazquez 2007; Fjeldstad and Heggstad 2012). First, local communities may frequently have insufficient administrative capacity to conduct the necessary assessment of the properties. In particular, the administration of property tax generates considerable costs related to the collection of information, assessment and re-assessment, as well as register keeping. One of the key benefits of the tax, stability, may also be a substantial burden, as the tax base needs to be regularly re-evaluated to follow growth in the value of properties (Fjeldstad and Heggstad 2012). Therefore, the revenue that the tax generates may even be lower than the total collection costs, which may make it unattractive. Second, as property taxes are neither related to earnings, such as income tax, nor able to be concealed in prices, such as VAT, the popularity of property taxes is especially low among taxpayers (Bahl and Martinez-Vazquez 2007). Particularly in developing countries, where housing conditions are frequently poor and where there is often a lack of basic public services such as infrastructure, citizens may be reluctant to pay a tax for which they experience few services in return (Fjeldstad and Heggstad 2012).

Section 2 of this paper looks at a project in Eastern Serbia framed as a competition among municipalities for a share of an incentive fund. The project evaluates the success of property tax collection by five criteria, which include the increase in properties registered for tax, and collected property tax in comparison to assessed property tax. The project has seen a strong increase in registered properties among competing municipalities when compared to the rest of Eastern Serbia.

Section 3 investigates an ongoing programme in Kosovo, which awards performance-based grants to eligible municipalities. Participating municipalities are evaluated in the areas of financial management, public spaces, mobility, waste, and local democracy. Among the minimum criteria to receive a baseline grant is the collection of at least 30 per cent of the annually invoiced property tax. The best performing municipalities not only receive high-incentive grants, but are also rewarded with greater autonomy with regards to spending the grant.

Section 4 discusses a social accountability programme in Mozambique, which intends to inform citizens not only about their duty to pay taxes, but also about their right to be heard by their government on how to spend the tax revenues. The programme has supported the establishment of citizen-run social accountability monitoring committees. The committees have engaged in an awareness-raising campaign to create a dual incentive to increase

revenue collection on the part of the Municipal Council, and on the part of community members to pay local taxes and fees.

Section 5 concludes by highlighting how organisations such as SDC can continue to be involved and help towards the objective of increasing and sustaining local tax revenues.

2 Competition among municipalities in Eastern Serbia

2.1 Project description and background

The project 'Municipal Economic Development in Eastern Serbia' aims to improve property tax collection rates by creating a competition among local governments. The project stakeholders, which include the Serbian Ministry of Finance, the Ministry of Economy, the Ministry of State Administration and Local Self-Government, and the Standing Conference of Towns and Municipalities of Serbia (SKGO), agreed on five competitiveness criteria with local governments to evaluate the collection of property taxes. The project is co-financed by the Swiss Agency for Development and Cooperation (SDC) and the German Federal Ministry for Economic Development and Cooperation (BMZ). The competition was facilitated by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ).

The stakeholders first chose nine municipalities along the river Danube – symbolising the connection between one of the donor countries, Germany, and Serbia – to be part of the competition. The participating communities constitute a geographical unity and are situated in the relatively poorer regions of Serbia. The municipalities are relatively rural and structurally weak.

SDC sponsored an incentive fund, which was awarded to the municipalities depending on their performance. The best performing municipality received roughly €367,000 (CHF 400,000), the second ranked municipality obtained around €275,000 (CHF 300,000), while the third, fourth, and fifth ranked municipalities received roughly €137,000 (CHF 150,000), €92,000 (CHF 100,000), and €46,000 (CHF 50,000), respectively.

The municipalities were ranked according to the following five criteria. The first criterion reflected the coverage ratio. More specifically, the coverage ratio compared the percentage change between properties registered with the Local Tax Administration (LTA) during the project, between the end of 2013 and the beginning of 2015. The criterion aimed to encourage and reward municipalities that already had a high number of registered properties to begin with. Thus, the aforementioned ratio was subsequently multiplied by the ratio of registered properties in the LTA database to registered properties according to the 2011 census by the Statistical Office of the Republic of Serbia (SORS). For example, if the initial coverage rate of a municipality was 50 per cent (i.e. there were twice as many properties registered in the national SORS database in comparison to the local LTA database) and if the municipality showed an increase in the number of registered properties during the project phase by 100 per cent (e.g. from 200 to 400 properties), the percentage increase in the coverage was 50 per cent. It should be noted that this first criterion was an adaptation of the originally planned criterion following a change in property taxation law between 2013 and 2014. The main difference brought about by the new law was that agricultural areas were now also subject to property taxation, which was not considered in the 2011 census by the national statistical office SORS.¹

¹ The stakeholders initially intended to rank the municipalities based on the *improvement in the coverage ratios*. For example, if the coverage at the beginning of the project period was 60 per cent, the coverage gap at this point of time was 40 per cent (i.e. 100 per cent full coverage minus 60 per cent current coverage = coverage gap). If the coverage in

The second criterion indicated the ratio of the total *assessed property tax to the collected property tax* (what could have been collected according to National Tax Authorities in comparison to what was actually collected in the period of the competition) for individuals.

The third criterion measured the share of taxpayers with outstanding property payments of more than RSD 500 (roughly €4.20) to the local governments during the period from 1 January 2014 to 31 January 2015. This low amount was chosen to reflect the efforts of the municipalities to enforce tax collection not only for large and medium taxpayers, but also for small taxpayers. The rationale was that all taxpayers should be treated equally (rule of law). The project team chose, thus, the smallest amount that is enough to cover the administrative costs related to the collection of the property tax (e.g. letter and postage stamp). The motivation for this low amount was that it was common for local politicians not to strictly enforce the collection of property taxes from individuals for strategic considerations in view of upcoming elections. In comparison, local governments have generally had fewer difficulties in enforcing property taxes from companies and corporations, since businesses (institutions) do not vote. As a result, local governments were able to apply stricter enforcement, for example, by making use of threats and sanctions influencing business operations.

The fourth criterion showed the property tax rates applied by the municipality, which GIZ selected for the following reason. The total property tax payment of each taxpayer is the property tax rate multiplied by the average sale value of real estate in the respective area of the municipality (size in square metres multiplied by the average price in the area). Each local government has the freedom to choose the property tax rate, as long as it does not exceed 0.4 per cent of the sale value average. If the property tax rate implemented by the local self-government was closer to the legally prescribed upper limit of 0.4 per cent, the municipality obtained a relatively better rating as it can achieve higher revenues from property taxation. In comparison, any municipality that implemented a property tax rate of zero was excluded from the competition.

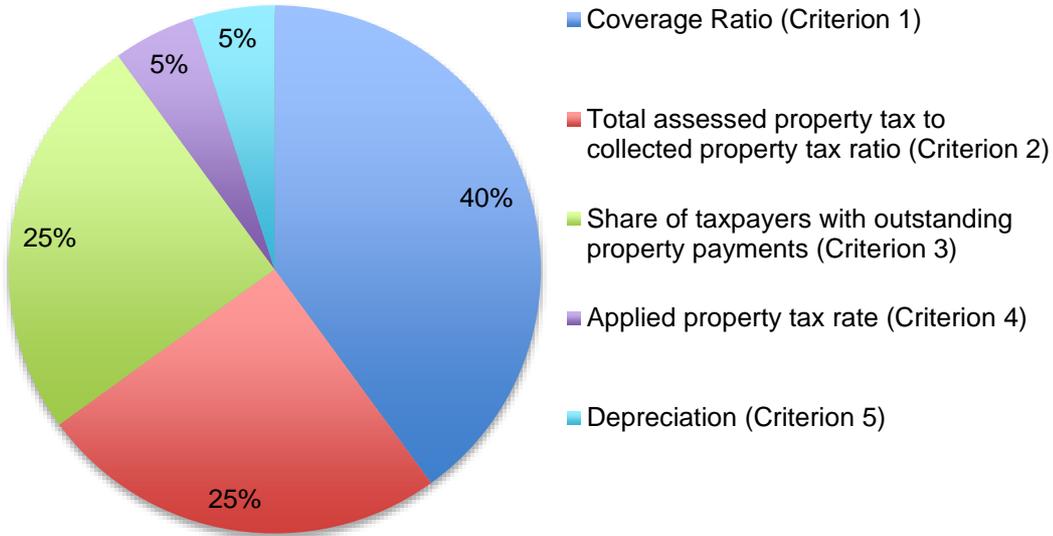
The fifth criterion reflected the potential for local governments to reduce the value of the properties by depreciation. By law the annual rate of depreciation must not exceed 1 per cent. This criterion aimed to punish those municipalities that made use of high depreciation rates (1 per cent) and to reward those municipalities that did not make use of depreciation. However, some municipalities could have been adversely affected by shocks, for example, in a negative way by a natural disaster.² In this case, municipalities may have genuine incentives to depreciate their properties. In practice, according to information from a project member, this seems to have little importance, as local policymakers appear to put little emphasis on such accounting considerations.

The overall ranking that determined the winner of the competition was inversely proportional to its respective ranking of the five criteria. In other words, the municipality that ranked first within a particular criterion obtained the highest number of points (nine out of nine), while the worst municipality received one point. Making use of a weighted average of the five criteria eventually ranked the municipalities that participated in the competition. The first criterion, the coverage ratio, contributed 40 per cent to the overall ranking. Both the second and the third criteria, measuring the collection rates of natural persons and outstanding property taxes respectively, were weighted by 25 per cent. Finally, both the fourth and fifth criteria, reflecting the property tax and depreciation rates, counted for 5 per cent each in the overall ranking. The weighting of the respective criteria in the overall competition is summarised in Figure 2.1.

the same municipality was 80 per cent by the end of the project, the coverage gap at the end of the period was 20 per cent. This means the coverage gap reduction during the observation period was 50 per cent, as the coverage gap reduction reflects the ratio between the coverage gap at the end of 20 per cent and the gap at the beginning of 40 per cent. This original criterion would have ensured that municipalities that already had a high coverage had an incentive to improve their coverage rate even further.

² Similarly, some municipalities could have been positively affected by investment decisions, for instance.

Figure 2.1 Weighting of criteria



Source: Based on information from SKGO, the Ministry of Finance, the Ministry of Economy and the Ministry of State Administration and Local Self-Government of the Republic of Serbia (2013).

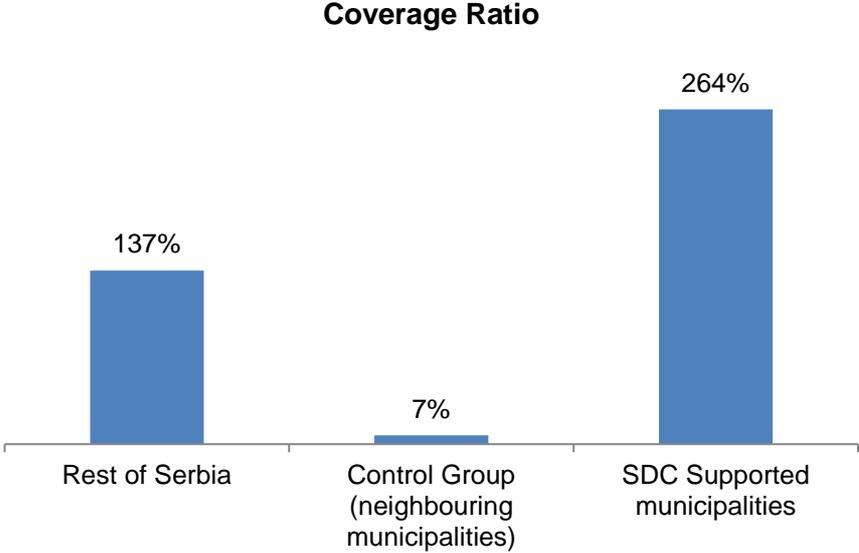
2.2 Project outcome

During the project, from 2013 to 2014, the average increase in the number of registered properties at the LTA, measured by the coverage ratio, was 264 per cent for the competing municipalities (see Figure 2.2). In comparison, the increase in the neighbouring, similarly developed, municipalities that acted as a control group for the SDC-supported municipalities was only 7 per cent. In the same period, the rest of Serbia experienced a rise in the coverage ratio of 137 per cent.

This relatively strong increase in the rest of the Republic of Serbia was mainly a result of a large increase in the number of registered agricultural properties in the Autonomous Province of Vojvodina, in response to the new law on property taxation that included agricultural areas in 2013/14. As the Vojvodina province is relatively more highly developed than other parts of Serbia and the flat landscape additionally allows more intensive agriculture, the municipalities in Vojvodina adapted quickly to the new law on property taxation by including their agricultural areas in the real estate cadastre. In comparison, among the nine SDC-supported competing municipalities, only the municipality of Negotin included agricultural areas in their real estate cadastre in response to the new property tax law. This is because there is relatively little agricultural production in the structurally weaker SDC-supported municipalities.

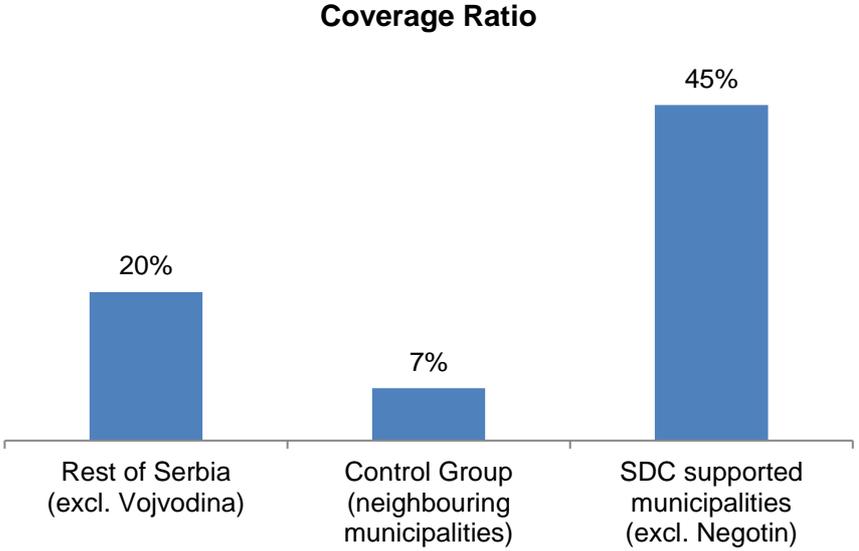
Figure 2.3 shows that the average increase in the coverage rate in the rest of Serbia was only 20 per cent if Vojvodina is excluded from the sample, while the coverage increase in the SDC-supported municipalities was 45 per cent if Negotin is excluded from the sample.

Figure 2.2 Increase in properties registered at the Local Tax Administration (%)



Source: Based on data provided by Alexander Grunauer, leader of the Municipal Economic Development in Eastern Serbia project, from GIZ, 28 April 2015.

Figure 2.3 Increase in properties registered at the Local Tax Administration (%), excluding Vojvodina and Negotin



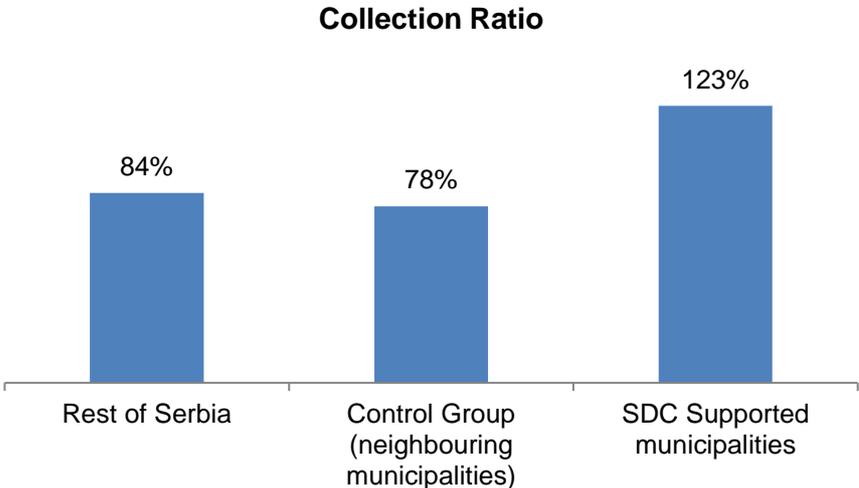
Source: Based on data provided by Alexander Grunauer, leader of the Municipal Economic Development in Eastern Serbia project, from GIZ, 28 April 2015.

In total, the number of registered properties in the nine competing municipalities increased from 126,076 to 570,998 during the project period, which reflects an increase in the total coverage ratio in the competing communities of 353 per cent. In contrast, the total increase was only 9 per cent in the control region and 19 per cent in the rest of Serbia (excluding Vojvodina). The enlargement of the property tax database in the competing municipalities should ensure that own-source revenues from property taxation also remain high after the project intervention, without having to increase the property tax rate. As a result of the project intervention, the share of property tax in own-source revenues increased by up to 20 per cent

in some municipalities. As the municipalities are now able to collect a significantly larger amount of property tax by simply accessing the current database, the project may have contributed to improved and more predictable financial security and financial autonomy of the municipalities.

In a recent evaluation by Puric *et al.* (2015), the project ‘Municipal Economic Development in Eastern Serbia’ and its five components to promote local public finances and local taxation were assessed against the OECD-DAC criteria (OECD 1991). Both the efficiency and the overall support provided by the project were rated as ‘very successful’. The project invested roughly €1,133,000 in the nine pilot municipalities, including payments for the performance-based grants. However, the total annual property tax revenues in the nine competing municipalities increased by more than €1,600,000 only one year after the intervention. Figure 2.4 shows that the increase in the property tax collection ratio was 84 per cent in parts of Serbia outside of the project during the project phase. The competing communities recorded an improvement of 123 per cent, while the comparable neighbouring communities showed a 78 per cent increase in the same period.

Figure 2.4 Increase in collected property tax (%)



Source: Based on data provided by Alexander Grunauer, leader of the Municipal Economic Development in Eastern Serbia project, from GIZ, 28 April 2015.

2.3 Effect on women and other vulnerable groups

In the case of married couples in Serbia, properties are mostly registered under the name of the husband. While property is occasionally registered under the name of the woman, for example, because of a bequest, men still own the majority of properties. Therefore, any increase in the property tax rate may generally have positive effects on the distribution of wealth between the genders. As part of the municipal project, GIZ also took on a consulting role and advised the local governments on ways to spend the increased property-tax revenues. In particular, GIZ tried to give advice on how the most vulnerable groups of society, like women, as well as the old, young citizens, and disabled citizens, can benefit from the local governments’ new revenues. The scope of this intervention remained limited, however, to the distribution of funds for existing programmes and projects.

2.4 Critical review and potential donor interventions

Organisations such as SDC and GIZ can help to establish a cost effective approach to the politically sensitive area of property taxation. The implemented project led to a considerable increase in property tax collection by the use of reasonable financial means. Nevertheless, any implications still have to be drawn with some degree of cautiousness, since performance

is measured in comparison to a non-randomly chosen control group. In other words, factors other than the SDC intervention may explain differences in performance. Moreover, it is not clear if the effects of the intervention can be sustained in the long run and thus municipalities may only experience a large initial increase in the respective criteria such as the coverage ratio. The ultimate goal of the project leaders is to implement nationwide incentive schemes to boost property tax revenues. These incentives do not have to be identical to the ones in the project. As the implementation of the programme has also shown, the incentive schemes may have to be adapted on a frequent basis, for instance, as a result of changes in the law or as a result of new political realities. When scaling-up programmes, policymakers generally have to be careful not to target just increases in monetary revenues – like the property tax collection rate – as such a narrow policy focus on the level of revenue without consideration of the tax collection process may undermine trust and broader progress of communities (see findings for Tanzania by Fjeldstad 2011).

In the past, local municipalities faced *perverse incentives*, which meant that inactive municipalities not undertaking sufficient efforts to collect local own-source revenues received higher transfers from the central government. In the future, the transfers to the municipalities may partially depend on how much tax revenues are generated by the local government, measured by the tax collection performance indicators of the project.³ While there could also be an incentive to underestimate the revenue potential itself, the central government aims to reduce transfers to municipalities that undertake little effort to meet their own potential to generate revenues from property taxation. In the long run, the accountability of local government officials should be enhanced leading to improved governance and respect for the rule of law.

2.5 Conditional cooperation

Although the municipality of Paraćin was not part of the SDC-supported municipalities, its successful form of *conditional cooperation* between the local government and its citizens is worth sharing. Paraćin is a relatively developed and progressive town roughly 150km southeast of Belgrade. The mayor of the town promised to lower the property tax rate of 0.4 per cent if the coverage ratio exceeded 80 per cent, and the local government described precisely which projects the collected money would be spent on. As a result of the promise, the collection rate increased sufficiently, so local government lowered the property tax rate.

To be precise, property tax was at the maximum allowed of 0.4 per cent in 2009, when the number of registered property taxpayers was 9,000. When SORS updated the database on properties in 2011, Paraćin initially lowered the property tax to 0.25 per cent. When the number of registered property taxpayers reached 18,800 and the coverage ratio was, as a result, higher than 80 per cent, the local government further lowered the property tax rate to 0.22 per cent in 2013, as promised. Because of the decrease in the property tax rate, the number of registered citizens in the cadastre increased even further to 22,000 in 2014.

3 Performance-based grants in Kosovo

3.1 Project description and background

The Decentralisation and Municipal Support project (DEMOS) is a performance-based grant system in Kosovo. The programme is funded by SDC and implemented by HELVETAS

³ Draft Law on Local Self-Government Financing developed by the key stakeholders, the Ministry of Finance and SKGO, as well as by the project-facilitating agency GIZ. In cooperation with these stakeholders, the project aims to strengthen the sustainability of the intervention by completing the Law on Local Self-Government Financing.

Swiss Intercooperation (HSI). DEMOS focuses on municipal performance in the following five working fields:

1. Financial management, indicated by:
 - a. Collection of property taxes
 - b. Implemented recommendations of the general audit report from the previous year
2. Improvement of service delivery in *public spaces*:
 - a. Park area per capita
 - b. Roads with public lighting
3. Mobility:
 - a. Regulate sidewalks
 - b. Local asphalted roads in the municipality
4. Waste:
 - a. Settlements benefiting from waste collection service
 - b. Share of payments made
5. Local democracy:
 - a. Number of reportings by mayor in the municipal assembly meetings
 - b. Published municipal assembly acts.

Among these five fields, the most directly relevant field for property taxation is financial management. The grants based on the performance in these five areas are awarded in addition to the municipal budget, which roughly consists of 80 per cent fiscal transfers and 20 per cent own-source revenues. In general, Intergovernmental Fiscal Transfers (IGFT) in Kosovo are determined by the number of inhabitants, the share of minorities in the community, and the area of the municipality measured in km². DEMOS uses different criteria for awarding their grants, as indicated above. What is more, the criteria are performance based, which means that a municipality can increase the size of its grant. Moreover, DEMOS aligns the awards and disbursement of the grants with the budgeting process of the municipalities. In particular, it awards the performance grants for the upcoming year in August of the previous year so that municipalities are able to include the grants in the budget they submit to the Ministry of Finance (MoF) in September. The disbursement and use of the grant are within the budget year.

Seventeen out of the 38 municipalities in Kosovo were selected to participate in the project based on eligibility and selection criteria. For instance, eligibility criteria resulted in the exclusion of eight municipalities with corrupt mayors. Subsequently, municipalities were chosen according to selection criteria, where each municipality was ranked on a scale from one to ten. These selection criteria included, for example:

- Fewer than 20,000 inhabitants, to support small municipalities.
- The share of Kosovo Serbs in the community, a minority in Kosovo. Kosovo Serbs frequently face discrimination, as they may symbolise the former oppressors for many Kosovo Albanians. Moreover, municipalities with a Serbian majority are frequently young, as they have been formed as a result of Kosovo's declaration of independence and thus require additional support.
- Whether there was an overlap with projects by other donors.
- Whether the municipality had a female mayor.
Whether there was female representation in the municipal assembly.
- Whether there was a need for support, as measured by the citizen satisfaction survey conducted annually by the Ministry of Local Government Administration (MLGA).

The programme started on 1 January 2014 and is designed to last for four years, with the potential to be extended up to a total of 11 years. DEMOS continuously monitors the interventions and compares the performance of the participating municipalities to either a small, medium, or large-sized municipality that functions as a control group. The project team

argues that the communities of Kosovo are structurally similar to each other and have similar competencies and budgets, as the number of inhabitants has the largest influence on budget size.

All 17 municipalities have to meet the following **minimum conditions** to be eligible for an SDC grant, where one condition relates to property taxation:

1. The general auditor publishes an annual report for each community, where the auditor can indicate an opinion on the development of the community.⁴ If the local government has not implemented recommendations from the general auditor from previous years, the grant size for the municipalities can be adjusted. Further, if the general auditor is not able to perform the audit, for example because the municipality does not record the bills for transfers, the municipality could be excluded from DEMOS as a last resort.
2. The property tax collection rate has to be at least 30 per cent of the annually invoiced property tax. The collection rate is measured in the following way. The municipalities send out invoices to local taxpayers each year in January. The collection rate then compares how much property tax was actually paid during the year. Project members suspect that municipalities frequently try to cheat on this number by, for instance, showing the total collection rates including settlements of property tax debts stemming from previous years. The property tax rate in Kosovo must be between 0.15 per cent and 0.5 per cent of the value of the property. However, almost all local governments choose 0.15 per cent, because of political motives such as future local elections.
3. The municipality pays the required annual membership fee to the Association of Kosovo Municipalities, which is a platform for local governments to exchange ideas on how to improve the development of the municipalities, for example, by lobbying for legal changes.
4. The municipality has to engage in anti-corruption measures outlined in compliance with the anti-corruption strategy of DEMOS.
5. The municipality needs to report the correct data in the performance management system. DEMOS does not rely solely on data from the MLGA, but also has its own survey-based monitoring system. As the project members are suspicious that some data in the performance management system published by the MLGA are incorrect for political reasons, DEMOS hires an external organisation to evaluate the validity of the reported data. For example, municipalities are eligible to obtain higher grants if the area of parks in towns is large. Thus, the MLGA could try to include areas such as football fields to be counted as parks to increase the chance of a municipality accessing grants from the SDC fund.

If the municipality fulfils all the minimum conditions, it is evaluated in the areas of financial management, local democracy, public spaces, mobility, and waste. The municipality can obtain a maximum of six points in all five areas in total. It may get up to 2.5 points for its financial management (of which 1.5 points account for property taxation), 1 point for local democracy, and the remaining 2.5 points can be acquired in the fields of public spaces, mobility, and waste. If the annual collection rate of the invoiced property tax is between 30 and 50 per cent, the municipality obtains 0.5 points and thus ensures the minimum score to obtain the baseline grant. If the annual collection rate is between 50 and 70 per cent, the municipality gets 1 point, while it obtains 1.5 points if the collection rate exceeds 70 per cent.

⁴ The general auditor is officially accountable to the Assembly of the Republic of Kosovo. In comparison, the head of the general auditors, the Auditor General, is independent from central government.

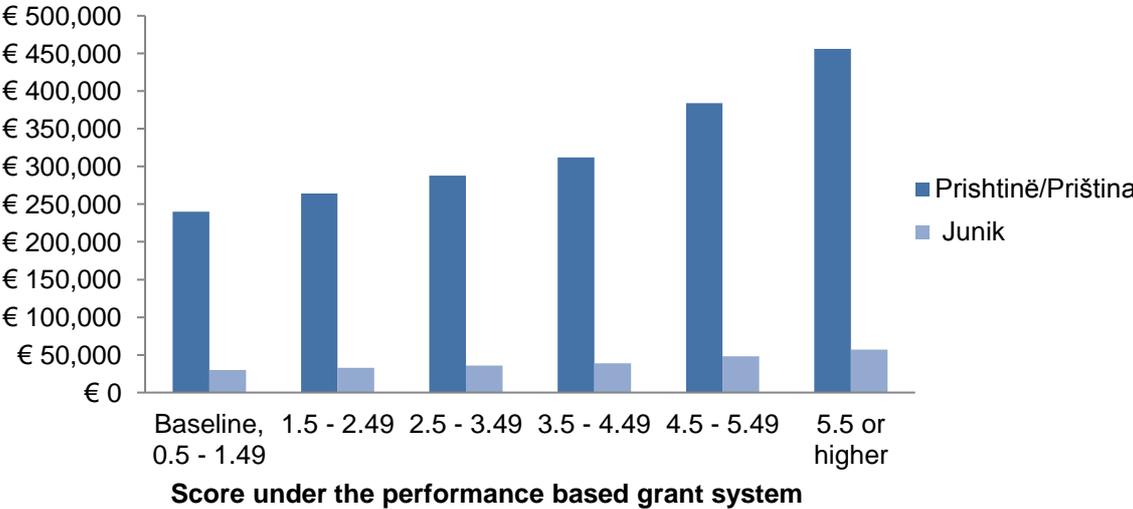
The best performing municipalities have an additional incentive to improve their property tax collection rates, which is to receive their grants earlier and to have more flexibility in spending the funds. To be eligible, the municipalities are required to collect at least 70 per cent of the annually invoiced property tax, in addition to fulfilling the minimum conditions above and obtaining a score of at least 4.5 points.

The incentive grants consider the size of the municipality. Census data on municipal population from the MLGA determines the size of the baseline grants that the municipalities can claim for satisfactory performance. However, an equalising factor enables smaller municipalities to receive more funds *per capita*, in comparison to bigger municipalities.

The baseline grant of the capital city Prishtinë/Priština is €240,000. If the city scores between 1.5 and 2.49 points in total, the baseline grant automatically increases by 10 per cent to €264,000. If the city scores between 2.5 and 3.49, the baseline grant is increased by 20 per cent to €288,000. The baseline grant is then increased by 30 per cent to €312,000 if the score is between 3.5 and 4.49. If the city scores between 4.5 and 5.49 points, the baseline grant is increased by 60 per cent to €384,000, while it increases to €456,000 if the city's score is higher than 5.5 points. In comparison, the baseline grant of the considerably smaller town of Junik is still €30,000, for example, despite only having about 6,000 inhabitants. Junik's baseline grant increases in the same progressive manner as the grant of any other participating municipality in the DEMOS project.

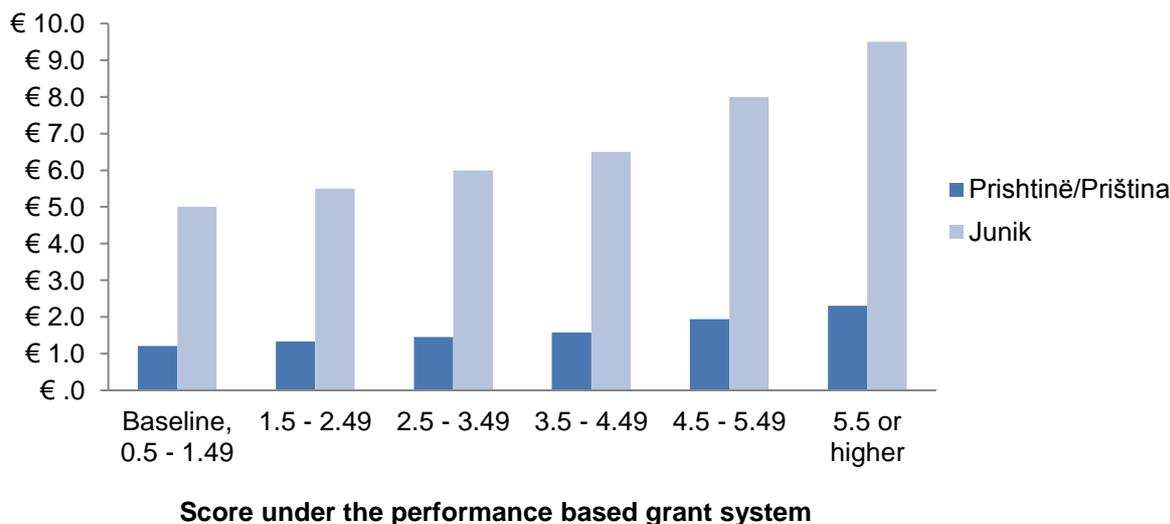
Figure 3.1 and Figure 3.2 depict the total and per capita incentive grants per points awarded for Prishtinë/Priština and Junik respectively. Figure 3.2 illustrates that smaller municipalities receive higher grants per capita than larger municipalities.

Figure 3.1 Incentive grants



Source: Based on data from HELVETAS Swiss Intercooperation and Swiss Cooperation Office Kosovo (2014).

Figure 3.2 Incentive grants per capita



Source: Based on data from HELVETAS Swiss Intercooperation and Swiss Cooperation Office Kosovo (2014).

Local taxpayers were generally not informed about the performance-based grant system. Only local governments are notified about the details of the project. Nevertheless, national newspapers have reported on public ceremonies in which the municipalities receive the grants.

3.2 Technical assistance and use of grants

DEMOS provides technical assistance to all participating municipalities in their five operating fields: financial management, public spaces, mobility, waste management, and local democracy. For instance, it may provide training for local governments on how to enforce the payment of outstanding property tax by making use of sanctions like blocking bank accounts or potential confiscation of real estate.

If the municipalities are eligible to receive grants, they have to submit project proposals in the five operating fields in which DEMOS provides technical assistance. The programme may also be involved in tenders, technical monitoring, and audit projects financed by the grants. The best performing municipalities, those that obtain more than 4.5 points, are not required to submit these project proposals. Furthermore, the high-performing municipalities have more flexibility in spending the grants, are subject to less intensive monitoring by DEMOS, and receive their grants earlier. However, DEMOS offers on-demand technical assistance through local consultancies for all municipalities if they have problems with the implementation of a project, for example.

3.3 Project evaluation and outcome

To evaluate the performance of the municipalities, DEMOS relies on central government data, from which the scoring of the municipality is then automatically determined. Nonetheless, the project team discusses the results with both municipalities and central institutions before the decisions of the performance-based grant scheme are definite. If local governments have any complaints about the correctness of the data, the team checks if these complaints are valid. There have been, however, no complaints about the accuracy of the data so far. Central government does not have the right to intervene in the allocation of the grants, and in general, the grant system is not political. These processes ensure that local governments are certain about the level of the grants conditional on their performance.

Table 3.1 depicts the change in property tax collection of the 17 SDC-supported municipalities from 2013 to 2014.⁵ Column (3) of the first row of Table 3.1 shows that in 2014 the property-tax collection ratio, which is the ratio of the total *billed* property tax to the *collected* property tax (considering settlements of property tax debts from previous years), was almost 52 per cent in Gjakovë. In column (4) we see that the collection ratio in Gjakovë increased by almost 7 per cent during the first year of the project, 2014. In 2014, the property tax collection ratio was about 51 per cent in total and 48 per cent on average in a municipality (see column (3) at the bottom of Table 3.1). During the first year of the project, 2014, the collection ratio in the SDC-supported municipalities increased on average by more than 6 per cent relative to the previous year (see the base of column (4)).

Table 3.1 Increase in collected property tax from 2013 to 2014

	(1) Total billed 2014 (€)	(2) Total collected 2014 (without debt) (€)	(3) Collection ratio 2014	(4) Difference to collection ratio in 2013
Gjakovë	1,633,755	842,260	51.55%	6.95%
Kaçanik	250,901	124,268	49.53%	4.74%
Kamenicë	281,579	129,492	45.99%	No data
Lipjan	806,526	466,248	57.81%	19.57%
Novo Bërda	75,110	26,629	35.45%	2.58%
Rahovec	324,050	184,446	56.92%	8.30%
Pejë	1,771,575	897,800	50.68%	7.76%
Prishtina	5,393,566	2,726,606	50.55%	No data
Shtime	133,383	73,419	55.04%	7.01%
Shtërpce	208,250	41,245	19.81%	7.08%
Viti	342,155	169,564	49.56%	3.49%
Hani Elezit	97,203	56,590	58.22%	6.68%
Junik	43,813	26,856	61.30%	5.62%
Kllokot	54,734	24,821	45.35%	1.66%
Graçanicë	456,673	284,619	62.32%	14.44%
Ranillug	35,144	15,232	43.34%	5.07%
Partesh	7,772	1,409	18.13%	-8.12%
AVERAGE	700,952	358,324	47.74%	6.19%
TOTAL	11,916,189	6,091,504	51.12%	

Source: Based on data provided by Norbert Piljs, head of the Decentralisation and Municipal Support (DEMOS) project by HELVETAS Swiss Intercooperation in Kosovo.

3.4 Effect on women and other vulnerable groups

Among the selection criteria that determined the participation of municipalities in the DEMOS project were whether the municipality had a female mayor, and whether there was female representation in the municipal assembly.

Women in Kosovo rarely own property, which might be reinforced by tradition. By law, male and female descendants are both eligible to obtain a fair share of potential bequests. In practice, however, female descendants 'voluntarily' pass on their bequest to their male counterparts, because women want to avoid conflicts with their families. As the system of social security in Kosovo (social assistance scheme and pension system) seems

⁵ There is no comparable data available for the three control municipalities.

inadequately resourced, families play an important role in protecting people during bad times. As stated by a DEMOS project member, women are often afraid of giving up this security provided by their families and thus do not demand their share of the bequest.

As a result of this skewed distribution of bequests between men and women, DEMOS intends to launch an experiment in three municipalities. To obtain a more equal distribution of properties, only women who demand their fair share of the bequests would be offered a tax break under the DEMOS proposal. However, the offer of these tax breaks is exclusively the decision of local governments and DEMOS has only conducted legal and financial feasibility analyses of this policy. The results of this analysis have to be discussed before a decision to continue can be made.

3.5 Critical review and potential donor interventions

The project has only made use of three control municipalities. This additionally is a selected sample (potentially leading to a selection bias), as these municipalities did not qualify to be one of the 17 communities that participate in the performance-based grants system (e.g. as a result of corruption in the municipality). Therefore, the municipalities that received the grants are in several respects different to those that did not receive them, making it difficult to compare them. The programme is very comprehensive, it encompasses a lot of different incentives from offering technical assistance to varying grant size, and it is not restricted to property taxation. On the one hand, the comprehensive programme may generally lead to quick improvements in the municipal performance in several areas. On the other hand, the non-linear award scheme makes it difficult to disentangle the effects of the respective incentives like the collection rate of property taxes or area of parks per capita, as it is possible that the municipalities treat the different incentives as substitutes. In addition, there may be a tendency for local governments to only just surpass the thresholds that mean the reward of a higher grant. In other words, the municipality may have little incentive to invest in further improvements in the collection of property taxes if it is not able to obtain the minimum score for the next highest grant.

In principle, local communities should have high incentives to perform well in the DEMOS project, as they can obtain grants and decide how to spend the money. However, politicians often act tactically, as there are large amounts of development aid coming into Kosovo. This means that aid organisations may undermine each other's as well as the central government's work. If local governments have the prospect of accessing *unconditional* grants, local governments may show little effort to improve the performance of the municipality. The DEMOS project leader thus envisions a joint donor basket, where donors cooperate when designing and implementing their programmes. Rather than neutralising the work of each other, cooperation and integration with other projects may lead to higher leverage. Nevertheless, such a joint donor basket would require careful planning and coordination in order to work properly. The long-term goal is to hand over the programmes to the governments (as has been successfully done in Uganda and other African countries) and thereafter, municipalities should be able to find their own ways to generate sufficient revenues.

4 Municipal social accountability monitoring in Mozambique

4.1 Project description and background

The SDC project Municipal Social Accountability Monitoring Program (MuniSAM) in Mozambique makes use of a different approach to increase the collection of property taxes

than the aforementioned cases in Serbia and Kosovo. While MuniSAM is only indirectly related to property taxation, the programme shows that increasing public awareness and participation of people by informing them about social accountability can have an effect on the collection of local revenues such as property taxes. The project is funded by SDC and was implemented by Concern Universal Mozambique in partnership with national civil society organisations in six out of the 43 municipalities in Mozambique. The programme aims to educate citizens not only about their duty to pay taxes, but also about their right for the government to take their particular requirements into account when deciding how to spend the tax revenues. MuniSAM intends to support local citizens in the establishment of social accountability monitoring committees (SAMComs).

The members of SAMComs and local Municipal Council and Municipal Assembly members were introduced to a process-based approach to social accountability. The components and areas of engagement of the MuniSAM programme included own revenue collection of the municipality. The SAMCom members were provided with a basic set of skills for monitoring key municipal processes and engaging with municipal governments. In particular, these civil society groups working with the MuniSAM team were trained in areas related to resource mobilisation and revenue collection. The SAMComs subsequently engaged in an awareness-raising campaign, which created a dual incentive to increase revenue collection on the part of the Municipal Council and on the part of community members to pay tax and non-tax revenues.

It is required that Municipal Property Tax (*Imposto Predial Autárquico* – IPRA) is charged on the property value of buildings within municipal precincts that are either recorded in the property register or declared as the market value by the owner. The property tax rate in Mozambique is 0.4 per cent of the value of residential houses and 0.7 per cent of the value of business and commercial buildings. In addition, taxpayers have to pay the Municipal Property Transfer Tax (*Imposto Autárquico de Sisa* – ISISA) and Municipal Land Use Licence (*Licença de Uso e Aproveitamento do Solo Autárquico* – DUAT) for the improvement of buildings.

The levying of property tax is a responsibility of the municipal tier of governance in Mozambique. However, own sources of revenue make up only 37 per cent of municipal revenues, with 48 per cent from central government transfers and the remainder from donations. Collection of property-related tax revenues (property taxes and property transfer taxes) are acknowledged to be the most underutilised forms of municipal own revenues in Mozambique. Many of the recorded values of buildings within property registers have not been updated since the colonial era. Moreover, municipalities have experienced challenges in ensuring the accuracy of the values of buildings and properties listed in these registers, which is the responsibility of a building valuation committee. Weimer (2012) shows that only a few municipalities have the required capacity to conduct proper valuations. In addition, only a small number of communities have invested in developing the capacity of their cadastre and urbanisation services.

Aside from administrative challenges related to the collection of property taxes, there are informal reasons for why Mozambican citizens are often unwilling to pay local government taxes. According to a project member, there was a widespread perception that the payment of taxes was a form of colonial oppression, as people were forced by Portugal to pay taxes during the colonial period. As a result, across Mozambique, current property taxes are found to contribute minimally to municipal taxes, while municipalities continue to draw most of their current own revenues from the imposition of market fees.

4.2 Project evaluation and outcome

According to Concern Universal Mozambique (2013), the level of tax revenues has been increased in response to the MuniSAM programme in the municipality of Metangula.

More precise figures are reported for the municipality of Cuamba, where SAMCom led to an increase in the collection of local revenues from 400,000 Meticaï (currency in Mozambique) to 700,000 Meticaï during the project phase. This increase in revenues was, however, mainly the result of an increase in the collection of *local market fees* rather than property taxes. Nonetheless, MuniSAM indicated that raising public awareness about the payment of taxes as well as participation of citizens might have the potential to generally increase local revenue payments. It remains unclear whether MuniSAM has led to a sustainable increase in general participation, especially whether the monitoring committees are still running without direct project support.

The successful increase in the collection of local government revenues in Cuamba is in opposition to the scheme the Mocuba District Administration had initiated during the pilot phase of the social accountability programme (Social Accountability Monitoring and Evaluation – SAME). The scheme in Mocuba allowed district service departments to retain 5 per cent of collected revenues as an incentive for increasing revenue collection. However, confusion arose over which tier of sub-national governance (municipal, district, or provincial) was institutionally and administratively responsible for collecting property taxes. While municipal council officials in Mocuba insisted that property tax collection was the responsibility of the district rather than the municipality, the Mocuba District Administration indicated that it did not collect property taxes.⁶ The confusion over who is responsible for tax collection is to some extent a result of the formal institutional rules governing the different levels of government. For example, provincial institutions (Provincial Directorates for Planning and Finance – DPPF) rather than municipalities themselves maintain property register databases in large parts of Mozambique, even though the provincial governments are not accountable for the collection of property tax. In addition to weak administrative capacity, the incentives offered to increase property tax collection were largely unsuccessful due to the lack of a clear communication strategy to help local residents understand why it would be in their interests to pay the taxes.

4.3 Effect on women and other vulnerable groups

According to a project member, the MuniSAM project has led to an improvement in the public participation of marginalised and more vulnerable groups such as women. However, public participation of these groups was very low in the past. Women had played a leading role such as being elected as chairpersons in a number of the social accountability monitoring committees. It remains to be seen whether the effect of the increase in gender participation can be maintained without direct support from MuniSAM.

4.4 Potential donor interventions

Organisations such as SDC could assist local state and civil society actors to publicly debate and develop detailed resource-mobilisation implementation strategies, as well as revenue collection plans. Donor organisations could also assist local state and civil society actors to draft communication strategies for revenue collection, to explain to local residents how they benefit from property taxes. Furthermore, organisations could support efforts to build the capacity of local interest groups to engage with key local government processes such as needs assessment, strategic planning, budgeting, monitoring and evaluating the implementation of these plans. As stated by a project member, such implementation and communication strategies are currently not in place in countries with administrative capacity similar to Mozambique. However, they may be crucial for providing local communities with a clear view about the link between the payment of property-related taxes and local government's ability to meet the needs of its citizens. In other words, instead of exclusively focusing on incentives for revenue collection, giving people insights into the broader

⁶ Law 1/2008 (and Decree 63/2008) states that the municipality is accountable for the collection of the municipal property tax, and the municipal tax on property transfer. At the same time, Article 135 of LOLE, 2005, indicates that districts may collect fees and charges for both applications for use and development of land in areas covered by urban plans and for the occupation of public spaces due to construction and usage of buildings.

processes through which resources are used to help realise their needs may prove to be relatively more successful.

5 Conclusion

This report reviews projects implemented in the SDC-DDLG Network that aim to provide incentives for local governments to increase tax compliance and revenues. The investigation focuses on three projects, which aim to improve local revenue mobilisation: (1) a competition among municipalities in Serbia, (2) a performance-based grant system in Kosovo, and (3) a project on municipal social accountability in Mozambique.

On the one hand, the competition in Serbia creates more uncertainty for municipalities in comparison to the performance-based grant system in Kosovo where municipalities can, at least theoretically, determine the size of the grant themselves without having to infer the performance of the competing municipalities. Consistency and predictability of the performance indicators generally play an important role in facilitating the planning and budgeting of the municipalities and help donors to evaluate project performance over time. Increased credibility of projects can be achieved by providing precise performance evaluation and monitoring manuals (e.g. how to handle appeals or to share outcomes) and by involving all relevant stakeholders in required adaptations of the programme (as done in the Serbian project after the change in the law on property taxation).

On the other hand, competition in Serbia creates a dynamic incentive for communities to perform better than others and thus may lead to very large increases in collection rates in some places. In other words, competitions like the programme in Serbia may lead to large increases in collection rates in a few places, while programmes like the one in Kosovo may lead to small but more evenly distributed increases in collection rates across municipalities because of the higher certainty with respect to the municipalities' budgeting.

The competition in Serbia allows disentangling the impact of the intervention on property taxation more clearly, as the intervention exclusively focused on property taxation. In comparison, local governments participating in the comprehensive performance-based grant system in Kosovo may see the different incentives as substitutes. In other words, it is difficult to draw conclusions with regard to the effectiveness of the *individual* performance criteria, such as the coverage ratio, in broad-ranging projects. Similarly, it is hard to identify the impact of the individual measures of the relatively complex programme on social accountability in Mozambique. While achieving progress in the performance of several indicators may require larger financial incentives for the municipalities to reform, comprehensive projects like DEMOS and MuniSAM could lead to broader improvements in municipal development.

In general, performance criteria should be clear, simple, quantifiable, and achievable by the municipality. In addition, making the data, which determine the size of the grants, publicly available increases the credibility of the respective awards and bonus systems. The DEMOS team has undertaken substantial efforts, for example, hiring an external organisation to confirm the validity of the reported data and using an additional own survey-based monitoring system, in order to assure quality and credibility in the assessments.

In contrast to the project in Mozambique, the projects in Serbia and Kosovo made use of non-randomised control municipalities. Comparing the selection of the control groups of the two projects, it is a positive feature of the Serbian study that it used a large set of municipalities as controls from a geographical area that is very similar to the SDC-funded municipalities. During the project phase in Serbia, the SDC-supported municipalities experienced an increase in the coverage rate of more than 264 per cent, while the corresponding control municipalities recorded an increase of only about 7 per cent.

The increase in the competing municipalities was mainly driven by a sharp increase in a few municipalities – potentially because of the competitive nature of the project. Preliminary results from Kosovo show that in 2014, during the first of the four project years, the collection ratio in the SDC-supported municipalities increased on average by 6 per cent relative to the previous year. As there is currently no comparable data available for the control municipalities, it is difficult to attribute this increase in the collection ratio purely to the DEMOS programme. In other words, there may have been other confounding events, such as economic stability and growth, that could have had an impact on the collection of property taxes.

The intervention in Serbia has demonstrated that donor and implementing agencies can help to achieve a sizable increase in property tax collection by the use of reasonable financial means. However, the incentive schemes may have to be adapted regularly. Whether the effects of the project can be sustained in the long run and whether it will also work for currently non-supported municipalities, remains to be seen. The sustainability of the projects may also depend on successful coordination across aid organisations and governmental departments, particularly in countries with high incoming aid and where municipalities can rely on higher government transfers in case of low local revenues. Good practice also combines performance-based awards with capacity-building activities, where associations of local authorities may be included to share their experiences. The skills and expertise of local associations may also be used in the selection of the performance indicators, and in decisions related to design, evaluation, and monitoring of the award system. Nevertheless, performance indicators should not be excessively output oriented. As Fjeldstad (2011) shows, narrow monetary focuses on increases in property tax revenues without consideration of the tax collection process may erode trust and wider progress in municipalities. If the project is too output-focused, local governments may solely react to the project's incentives but neglect to reform other critical areas of the municipality, such as municipal budget planning, good governance, efficiency, or satisfaction of citizens. In other words, programmes should not distort local priorities or lead to biased investments. Instead, donor organisations could assist local state and civil society actors to develop resource-mobilisation implementation strategies and draft communication strategies for revenue collection to show how local residents will benefit from property taxes. Thus, it could be preferable for incentive schemes to put emphasis on cross-sectoral indicators, like good governance, to ensure significant non-temporary impacts. In order to achieve systemic and sustainable institutional reforms, not only generous funds but also targeted assistance to build capacity have to be provided to those stakeholders who are eager to reform the municipality.

As properties are mostly owned and registered by men, increases in property taxes are expected to lead to a more equal distribution of wealth between the genders. To further improve equality, it is additionally advisable for donors and local governments to explicitly consider the effects on vulnerable groups not only when allocating grants and designing property tax systems, but also when deciding on ways to spend local tax revenues. The social accountability programme in Mozambique led to a higher public participation of marginalised groups and shows that revenue collection and resource mobilisation are not isolated processes. By considering economic as well as political interests, SDC could foster broader social accountability processes by encouraging engagement between citizens and their local governments. In so doing, SDC may also aim to give recommendations on gender-responsive municipal budgeting and policies. Interventions to reduce gender inequalities, such as the tax credits for women in Kosovo as incentives to demand their fair share of bequests, may contribute to strengthening the relationships between citizens and local governments.

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