



Impact Capital
for Development



POLICY BRIEF

Leveraging Own Source Revenues to Realize the Power of Local Governments



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I. Why Is Optimizing Own Source Revenues Important?



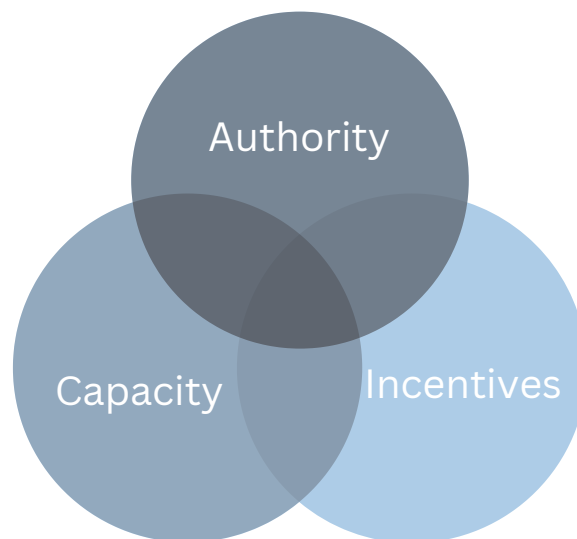
An essential element of local government finance is own source revenues (OSRs), which consists of taxes and fees that a local government is authorized to collect. OSRs are strategically important for transformative infrastructure development because they often support the operation and maintenance of local assets. Ensuring proper budget allocation for the financial, human, and material resources to manage assets over their lifespan is critical because it allows continued delivery of essential services for citizens, such as transport, water and sanitation, and solid waste management.

However, underinvestment on maintenance of infrastructure is often a financing gap and it is estimated to cause up to 2% loss in gross domestic product (GDP). Therefore, optimizing local OSRs is strategically important in ensuring day-to-day operations of local assets, delivering the promises of decentralization, and enhancing local governance and accountability, especially in low-income countries.

OSR also provides a means for local governments to collect information about the level and quality of public services that their citizens desire as local governments need to provide improved services in exchange for taxes. Increasing OSR can also provide funding to cash-strapped localities whose responsibilities often surpass funding received from the national government, which could help facilitate access to credit for more infrastructure investment at the local level.

II. What Are the Typical Bottlenecks?

While OSR benefits are widely accepted, using OSR systems in an adequate, effective, and efficient manner remains a challenge for many local governments in developing countries. For example, local governments in low-income countries generate only \$12 per capita per year from OSR, compared to \$2,944 per capita per year in high-income countries. Some of the key bottlenecks that explain these drastic differences include the following:





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Authority:

While local governments can influence national-level legislation on using and administering revenue sources, they do not possess sufficient OSR authority. This is because taxation is a key component of the national government's power, and it is not always easily or sufficiently devolved, compared to decentralizing functional responsibilities. Because local governments do not have the necessary OSR authority, low compliance rates become another challenge, which leads to decreased revenue at the local level. This structural challenge needs to be tackled by creating an enabling environment for local governments to possess the appropriate level of OSR authority for effective decentralization and regional equality.

Capacity

Developing the right OSR policies and building effective administrative systems to implement those policies require significant capacity from local governments, including on asset management. However, many localities in developing countries are often small and underfunded, lacking the human resources needed to develop OSR systems. These challenges are compounded by the fact that the nature of taxes and fees devolved to local governments is often not the easiest to administer or control politically. For example, taxes on land or property require costly, complicated, and contentious valuation rolls and are politically difficult to enforce against the will of local landowning elites. To address this bottleneck, capacity-building efforts are needed for local civil servants to devise and implement improved policies and practices, such as diagnostic tools or data systems for better OSR administration.

Incentives:

Effective OSR policies and systems are often not in the interests of tax collectors, politicians or economic elites, all of whom benefit from tax loopholes, lack of enforcement, or reduced business or property tax rates. Since raising taxes is generally politically unpopular, local governments are often unlikely to optimize OSR, especially when they have access to politically 'cheaper' sources of funding, such as IGFTs. Such incentive challenges could be addressed by making information more readily available through adequate data management, reporting, and control systems to hold government officials accountable. Another solution is to make OSR optimization a precondition for local governments to receive funding, such as intergovernmental transfers and external credits from development partners.

I.Examples of Effective OSR Practices

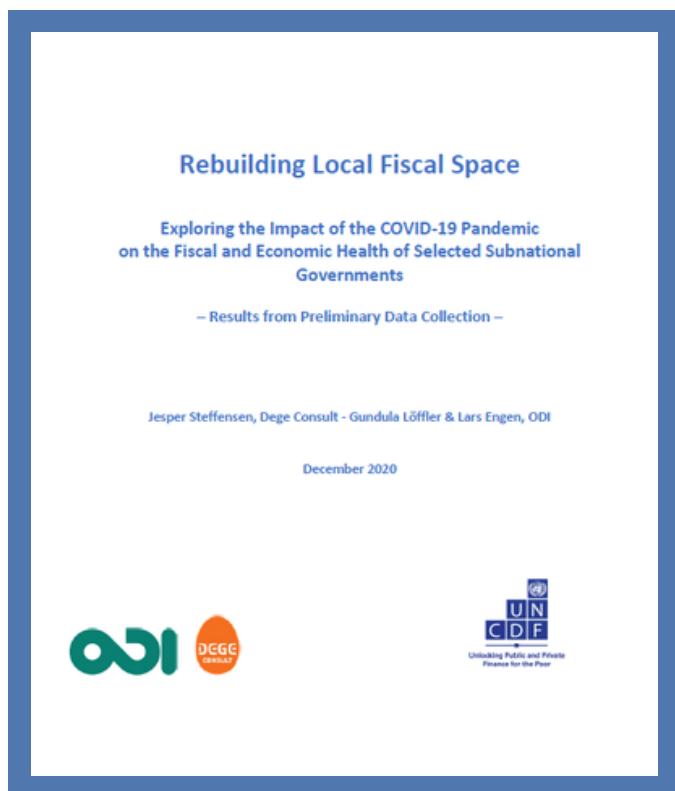
In many local government contexts, old assets are often neglected and new ones are built without putting in place an asset management framework for proper maintenance over time. This hinders the economic and social sustainability of public infrastructure investments, leading to loss of OSR that could have been used for other purposes.



To help address this challenge, UNDESA and UNCDF have developed a **UN handbook for local and national governments on infrastructure asset management**. The toolkits include a diagnostic tool, asset management action plans, emergency response plans, climate vulnerability assessment, and a tool for building enabling environment. Many developing countries participated in the pilot phase, including Tanzania, Uganda, Nepal, and Bangladesh, by engaging their local government staff in capacity-building and assessment activities to understand their current status quo and determine a framework for future actions. Such asset management practices can help local governments to better plan the allocation and spending of OSR across local expenditures in economically and socially sustainable ways.



Another example of UNCDF's work in promoting effective OSR reforms is its collaboration with ODI on the "Rebuilding Local Fiscal Space Initiative," which aims to provide tools and recommendations on improving local fiscal space in light of the challenges caused by COVID-19, including loss of OSR, non-conducive intergovernmental fiscal transfer systems, increased costs of service delivery, and loss of local economic development. The diagnostic phase resulted in a report assessing the impact of the COVID-19 pandemic on the fiscal and economic health of the six pilot subnational governments (Chandpur, Bangladesh; Kumasi, Ghana; Gulu, Uganda; Telita, Moldova; Chiapas, Mexico; and Harare, Zimbabwe). Based on the initial findings, concrete workplans on enhancing OSR were developed for each government and specific measures have been implemented and positive results have been shown. For example, with the support from this initiative, Kumasi has improved its tax administration process including a taxpayer census to update taxpayer data for all revenue sources. A revenue increase of 29% is foreseen with the addition of the previously missed businesses to the taxpayer register.

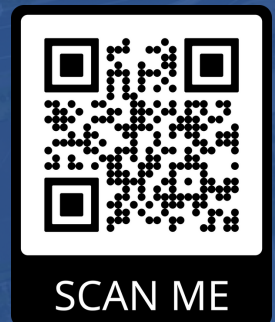




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This policy brief's content directly comes from the UNCDF's flagship publication – Local Government Finance is Development Finance. For more information about the book, download [here](#) or via + QR code

For more information on the work of the Local Transformative Finance Practice, visit <https://www.uncdf.org/local-development-finance>



SCAN ME

The UN Capital Development Fund makes public and private finance work for the poor in the world's 46 least developed countries(LDCs).

UNCDF offers “last mile” finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development.

UNCDF's financing models work through three channels: (1) inclusive digital economies, which connects individuals, households, and small businesses with financial eco-systems that catalyze participation in the local economy, and provide tools to climb out of poverty and manage financial lives; (2) local development finance, which capacitates localities through fiscal decentralization, innovative municipal finance, and structured project finance to drive local economic expansion and sustainable development; and (3) investment finance, which provides catalytic financial structuring, de-risking, and capital deployment to drive SDG impact and domestic resource mobilization.

