

Why pay?

Motivators for payments of local market dues in Rwanda and Uganda

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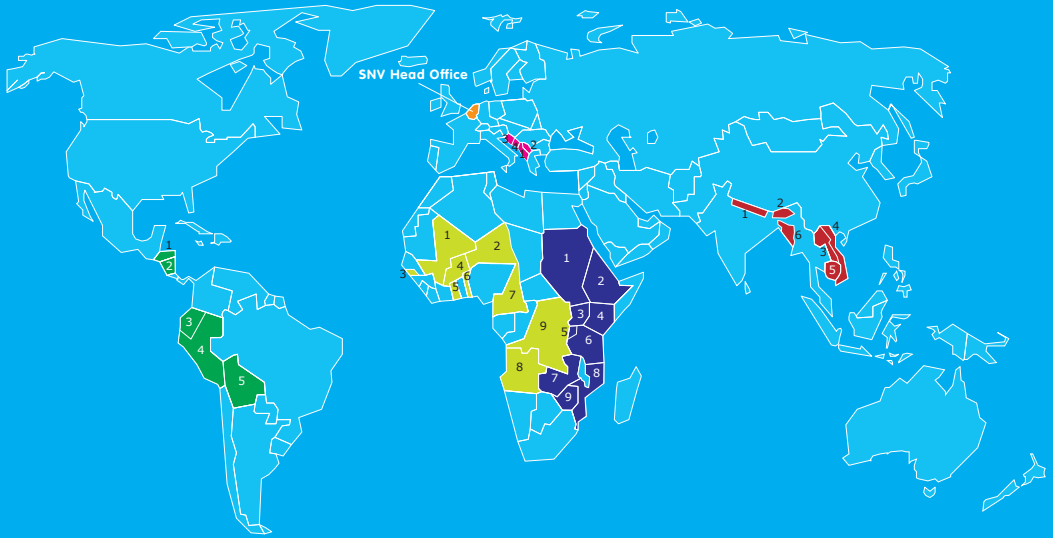
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Abstract

Market dues are important for local governments because they are one of the few revenue sources under their control. Understanding what motivates payment is therefore crucial. In Uganda, privatization of collection demotivates payment while in Rwanda, locally recruited collectors motivate. In both countries failure of local governments to deliver quality services de-motivates.

1 Introduction

Since the 1990s, Rwanda and Uganda have embarked on decentralisation processes hitherto regarded as making a significant contribution to development within the respective national poverty reduction programmes. The local government system in both countries is based on a devolutionary form of governance with different levels of local councils. Fiscal decentralisation policies not only handed over to local councils the responsibilities to plan, manage, and monitor local development, but also, granted legal autonomy and discretionary decision-making power to raise and invest resources.

In both countries transfers from central governments and grants from the international community continue to constitute the bulk, approximately 90%, of funds made available to local governments to execute local responsibilities. The former, being funds earmarked by central government for implementation of specific programmes, implies that centrally determined priorities may not necessarily meet locally felt needs. Besides, the subsidies generally are not released in time or not released at all. To respond to the challenge of meeting the locally felt needs, local governments are encouraged to find ways to enhance local revenue to support implementation of specific programmes in this respect.

1.1 Significance of local revenue

There is a general agreement amongst decentralization authors that a viable local revenue base is central to the development and sustenance of a strong decentralized local governments system. Local revenue, among other things, promotes ownership and autonomy of the local governments (Local Government Finance Commission of Uganda, 2003). Unless local governments have some significant freedom to alter the level and composition of their revenue, neither local autonomy nor local accountability which are central to decentralization are meaningful. Furthermore, local revenue payment is vitally important for the citizens to reinforce accountability for service delivery by locally elected politicians and appointed civil servants.

Districts are vested with legal autonomy and authority to raise their own revenue of which market dues are a major source. In Rwanda market dues represent the highest source, up to 60% of local revenue, while in Uganda where it is the second highest source after Graduated Tax, market dues makes up almost 20% of locally raised revenues. Therefore, it is logical for the two countries to improve the collection of market dues as a means to enhancing revenue for local governments.

Markets are focal points of lively and thus taxable economic activity. An important and interesting factor in the expansion of market dues in Uganda has been the privatisation of the collection. The positive results on the revenue side have also exposed the value of and need for improved market infrastructure provision (Livingstone and Charlton, 2001). Where the privatisation has been done properly through a transparent, competitive tendering process, the yield can increase substantially as well as reducing the local government's costs of revenue collection. The local governments only need to monitor the contractor instead of collecting directly from the market vendors.

1.2 The research question

Tax evasion as reflected in persistent resistance by the public to pay is an important part of the problem of raising local government revenues. Dealing with the problem requires some understanding of

the factors underlying the individual's decision whether to pay or evade taxes. In general, one of the "motivators" for tax payment is fear of getting caught for evasion. However, because market dues are paid before entering the market, fear of getting caught does not affect the taxpayers' decision as much as the opportunity to sell (economic factor).

Therefore, it is important to know the non economic factors that influence willingness to pay as perceived by taxpayers themselves. It is hoped that the conclusions to this study will inspire ways to change behaviours and policies related to market dues collection in order to foster legitimacy and accountability of local government leaders so as to attract trust, and confidence of tax payers for revenue enhancement.

2 Objectives and assumptions of the study

2.1 Main objective

To identify factors (formal and informal) that motivate or de-motivate tax payers with specific reference to market dues.

2.2 Specific objectives

1. To describe the methods used in collection of the market dues;
2. To gauge the tax payers' perception of the "fairness"/or the "unfairness" of the tax collection system;
3. To assess how much this perception positively and/or negatively shapes the attitude, behaviour and propensity of taxpayers towards paying;
4. To gauge the level of satisfaction tax payers feel with respect to the services provided from collected funds;
5. To assess how much this feeling positively and/or negatively shapes the attitude, behaviour and propensity of taxpayers towards paying;

2.3 Assumptions

The underlying assumption is that apart from economic benefit, tax payers are willing to pay in as much as they have the feeling that:

1. They benefit from social services provided by local governments to the communities using the funds raised from taxation;
2. The current tax collection system is fair and equitable;
3. There is transparency in tax collection.

2.4 Legitimacy and accountability

In the context of this study, legitimacy refers to what is fair. What is legitimate conforms with the rules, standards, and accepted or acceptable values deeply rooted within the community. To measure legitimacy efforts are deployed to identify the feeling of tax payers about whether the tax collection system is fair or not.

Accountability is used here to refer to the extent to which local governments are responsible to the community for their (local governments) actions i.e. that there is transparency in service delivery and the services rendered are satisfying (in quality and quantity) to the needs of the community. Thus, tax payers consider local politicians as being accountable when the former are satisfied with the use of collected funds. This implies that local governments need to ensure that services are tailored to satisfying strongly held and shared specific needs such as security, social services, sanitation, business conflict management.

Legitimacy and accountability are concepts that are closely related and interdependent in the sense that the two proxies used to measure them are interdependent. Indeed, what is fair brings some satisfaction, and vice versa, what causes satisfaction is fair. For the purpose of this research, issues of fairness and the level of satisfaction were used as proxies for legitimacy and accountability.

In relation to the above definitions, the working assumption then is that if taxpayers are satisfied with the services delivered by the local government and feel that the tax collection system is fair and equitable, then they would be willing to pay more taxes.

3 Methodology

The research was conducted in selected locations in one province of Rwanda (Kigali Ngali Province) and three sub-counties of Arua district in Uganda. These were selected being among the lowest administrative units where local taxes are collected. The research focused on taxpayers and District Authorities /Leaders / Administrators.

The study team used various methods (Literature Review, Questionnaires; Interviews using interview guide and direct observation) to collect data and information. This was done in order to;

1. Put the study into context and review experiences in tax collection from various parts of the world;
2. Investigate issues of legitimacy and accountability of the taxes collected, the tax collectors and methods used;
3. Examine if legitimacy and accountability motivate people to pay or not to pay tax i.e. identify the benefits for payment and sanctions for non-payment.

Respondents were asked to give an indication of their appreciation of the quality of services they receive in return for paying taxes. They were also asked to give comments on their perception of fairness or unfairness of the dues paid and, how tax collectors behave with the contributors.

4 Review of related literature

While implementing the decentralisation policy, Local Governments still finance most of their expenditures largely from transfers from the central government which unfortunately are mainly in the form of conditional grants. This curtails district autonomy in decision making and therefore the challenge for local governments is to raise their capacity to mobilise local revenues because of the limits inherent in a system of substantial transfers from the centre. In the Joint Annual Review on decentralisation in Uganda , it was emphasised that if the public pay taxes and actually know that through their taxes they pay directly for the cost of political representation, then they are more likely to hold those politicians to account for their performance and

this accountability will be constant (Ministry of Local Government, 2004). This implies that local politicians are more likely to respond to the needs and priorities of their citizens when making decisions. Local Governments with strong revenue collection capacity have greater scope for autonomy which should enable them to be more responsive to the needs and priorities of their citizens.

A number of stakeholders are concerned with the persistent decline in local revenue over the past few years and the ever-increasing dependence of local governments on Central Government transfers to finance service delivery. Worse still in Uganda, with effect from financial year 2005/06, Government has proposed to suspend Graduated Tax which is currently, the highest source of local revenue. This will mean a drastic fall in local revenues and therefore the need to identify alternative sources of financing local governments.

With respect to privatisation of markets, there are examples of political manipulation in relation to award of tenders which have undermined potential of this innovation and negatively affected people's willingness to pay (Devas and Etoori 2004). The willingness to pay is not independent of the way taxes are collected. The coercive element of the taxpayer-tax collector relationship assumes that taxpayers' behaviour is influenced by factors such as the tax rate determining the benefits of evasion, and the probability of detection and penalties for fraud which determine the costs. The problem is thus one of rational decision making under uncertainty whereby tax evasion either pays off in lower taxes or subjects one to sanctions (Fjeldstad 2004). In the case of market dues, the sanction takes the form of non entry which is overcome by the economic push to sell.

An increase in corruption establishes a negative public perception that causes citizens to be unwilling to enter into reciprocal relationships with the government thus undermining the legitimacy of the tax administration (Fjeldstad and Tungodden, 2003). Local governments have also not evolved mechanisms for independently establishing the real profitability or actual revenue potential of their markets and therefore do not benefit optimally from this arrangement.

Dealing with the policy problem of revenue enhancement and tax evasion requires some understanding of the factors underlying the

individual's decision whether to pay or not to pay taxes (Fjeldstad 2004). For the public to hold the government accountable, and for it to appreciate the positive side of local taxes, it requires that the electorate is informed about the way local revenues are being used and how they actually contribute to the delivery of local services. Unwillingness to pay is the result of a combination of political protest to the degradation of public services, perceptions of unfairness of the charges which do not take ability to pay into consideration as well as corruption and other administrative failings by the local governments (Tripp, 1997).

Government trustworthiness tends to legitimise the public sector and therefore impose some social norm to pay taxes. When government is perceived to be trustworthy, citizens are more likely to comply with its demands in general. Government trustworthiness is linked to citizen's perceptions of the capacity of the government to make credible commitments about the use of their taxes. In the study on citizen's views on taxation in local authorities in Tanzania most respondents said they would be willing to pay more taxes if public services were improved (Fjeldstad, 2004).

A taxpayer may be seen as exchanging purchasing power in the market in return for government services. Positive benefits may increase the probability that taxpayers will comply voluntarily without coercion. Without material benefits, willingness to pay becomes less assured. Although most taxpayers may not assess the actual value of what they receive from government in return for taxes paid, they have general impressions about their terms of trade. Taxpayers' behaviour is therefore affected by their satisfaction or lack of satisfaction with the terms of trade. If the system is perceived as unjust, tax evasion may be considered as an attempt to adjust the terms of trade with government (Fjeldstad and Semboja, 2001). Basing on the literature review, one can conclude that indeed satisfaction and fairness motivate (willingness) people to pay taxes in general and that this research is an attempt to establish that the same is true with local market dues.

5 Research findings

In this section, analysis is made of the factors that influence willingness to pay as identified by this study in Rwanda and Uganda. The research findings drawn from the two countries neighbouring each other, which adopted the devolutionary form of decentralisation and are facing challenges to local development which are similar in some ways and very different in others, will make a stronger case for or against the working assumptions mentioned above.

5.1 Rwanda context

In Rwanda, Gashora was chosen as the district to be investigated. Reports available indicate that in Kigali Ngali the district of Gashora is the best performing financially, with market dues as the most important revenue source. Gashora has 15 small business places of which the three most busy, Kabukuba, Rilima, and Batima, were selected to provide information. Once a week, each business place holds an open-air market whereby all kinds of basic items can be bought (food, drinks, agricultural material, cloths, etc.), and services provided (hair dressing, bicycle repairing, etc.). The market place is surrounded by small shops which, operate on a daily basis selling a variety of articles. An annual fee of 40.000 francs is paid to purchase trading licenses on top of which vendors have to pay 200 francs on every market day for selling their items. On market days, tax collectors normally pass before every merchant and shop owner to collect the dues. Every merchant pays 200 FRW, regardless of the type or the amount of items sold. Taxpayers are left with receipts indicating the amount paid. The tax collector is accompanied by a local police officer in order to confiscate goods to be sold when one fails to pay. District authorities indicated that about 80.000 FRW of tax revenues are collected from markets every week. In a year the total amount collected is around 4.160.000 FRW (\$ 7.428).

5.2 Uganda context

The study for Uganda was conducted in Arua District where three markets, Ejupala, Nyadri and Kampala in Vurra, Nyadri and Logiri sub-counties respectively were selected as samples to provide information. To enrich the findings, the markets were selected with considerations

of rural-urban variations and diversity of buyers and sellers given the proximity of some of the markets to the border between Uganda and Democratic Republic of Congo. The markets operate mainly in open air and are open twice a week. All kinds of merchandise (both food and non food items) are sold. The method used to collect market dues is by imposing a daily rate determined by the collectors (currently in an ad hoc manner) depending on the amount/value of the items brought for sale. There is no uniform approved rate and different collectors value the items differently.

The respondents were aware that local revenue collection had improved significantly in some market as a result of privatisation of collection. For example in Arua revenues from tendered charges including markets improved from Ushs 150m (\$87.463) in 1996/97 to Ushs 400m (\$ 233.236) in 2000/2001, which is a considerably fast rate of growth in such a period (Devas and Etoori, 2004).

In Arua like other parts of Uganda, collection of market dues was privatised. The use of private contractors instead of government employees has however, raised controversy in tax administration. Market places are supposed to be tendered out on the basis of a reserve price, based on an assessment of the revenue potential of the individual market. In practice, however, the process of awarding tenders is not always transparent. Political manipulation in relation to award of tenders has undermined the potential of this innovation and negatively affected people's willingness to pay (Devas and Mashab 2004). Quite often, it tends to favour local tycoons who have connections to the Councillors or members of the District Tender Board that award the tenders.

Secondly, local governments have not evolved mechanisms for independently establishing the real profitability of their markets and therefore do not benefit optimally from this arrangement. The contractors have exploited this loophole by intentionally under-declaring the value of the market, leading to loss of revenue by the local governments. The contractor/tenderer ends up with supernormal profits at the expense of the vendors. Since the extra money collected is not remitted to the local governments, it is not spent on improvement of public services and therefore the community sees no direct benefit from paying. In Vurra sub-county, two respondents

claimed that money from their efforts is taken to enrich the market collectors while leaving them to sweat for nothing. As a result, tax payers are not willing to pay more and given an opportunity to evade, many would not to pay. In addition, the privatized market dues collection is conceived as being extractive in nature, i.e. it transfers resources from the poor to rich tax collectors. (See example in table 1).

Table 1: Operation in Practice of Market Tender System in 6 Districts

Category	Data Based on Sample Markets					
	Mbale	Kamuli	Mubende	Masaka	Ntungamo	Arua
Agreed Tender	900,000	750,000	1,400,000	60,000	500,000	710,000
—Lost Revenue"	598,792	2,416,583	2,083,667	268,750	3,958,875	509,833
20% Margin Permitted	299,758	633,317	696,733	65,750	891,775	243,967
Total Collected	1,798,550	3,799,900	4,180,400	394,500	5,350,650	1,463,800
Actual Total Margin	898,550	3,049,900	2,780,400	334,500	4,850,650	753,800
Actual % Gross Margin	99.8%	406.7%	198.6%	557.5%	970.1%	106.2%

Source: Uganda Rural taxation Study, 2003.

Table 1 indicates that the private tender system is driven by the rents generated by the gap between the reserve price and taxes collected, resulting in massive transfer of money from taxpayers to private tax tenderers rather than to the local governments. The actual gross margins realised by the private tenderers due to the undervaluation of the market yield was quite a substantial amount (up to 970%). People actually pay market dues but the private tax collection clearly ends up transferring money from the ordinary taxpayers to the contractors rather than to the local governments.

This was in contrast to Rwanda, where tax collection was done by agents of the government who were recruited from the community where they serve and therefore well known. In this case the legitimacy was guaranteed by the government.

In both countries, market dues were collected in the morning before vendors were able to sell anything failure of which meant denial of access to the market. Because of the advance collection, this method had no consideration for bad market days. Whether one was able to sell anything or not was not of concern to the collectors. This practice was perceived as unfair, extractive and inconsiderate of people's

ability to pay. There was also an element of coercion in collection of market dues. In Rwanda, the collectors were accompanied by Police Officers to ensure compliance. Failure to pay resulted into confiscation of merchandise until one was able to pay thus breeding further resentment.

5.3 Fairness/Unfairness of dues paid

In both Uganda and Rwanda, the taxpayers felt that the amount charged was unfair compared to the level of earning and profits made. This became more complicated for the permanent vendors who were required to purchase annual trading licences paid separately to the Revenue Authorities, on top of paying market dues whenever one went to the market to sell.

Table 2: Perception of Fairness of the Market Dues -by Age Category

Perception	Age Category									
	<18	%	18-29	%	30-49	%	50+	%	Total	%
Fair	1	17%	10	40%	9	39%	3	50%	23	38%
Not Fair	5	83%	15	60%	14	61%	3	50%	37	62%
Total	6		25		23		6		60	

Table 3: Perception of Fairness of the Market Dues -by Location

Perception	Location (Sub-County)							
	Vurra	%	Logiri	%	Nyadri	%	Total	%
Fair	8	40%	9	45%	6	30%	23	38%
Not Fair	12	60%	11	55%	14	70%	37	62%
Total	20		20		20		60	

The tables 2 and 3 on the previous page are extracts from the Uganda case study and indicate that 62% of the respondents considered the rates paid as unfair. This was true for all age categories and in all three locations that were sampled.

In Uganda, there was no systematic criterion used to set the rates demanded from the vendors. The method used to collect market dues was by imposing a daily rate determined by the collectors (currently in an ad hoc manner) depending on the amount/value of the items

brought for sale. There was no uniform approved rate and different collectors value the items differently and therefore encourage exploitation.

In a related study on rural taxation conducted earlier in Uganda, it was confirmed that there was unfairness in the market dues charged to certain categories of vendors. Analysis was done on how much vendors are paying in dues as a proportion of their earnings/sales. It was revealed that tax rates do not just vary by commodity; but also vary widely by district, creating spatial distortions in markets and prices. Examples of such variations in percentage rates discovered that larger quantities or sizes of all products (bags, sacks and larger animals) attracted lower tax rates than smaller quantities (tins and small stock). For instance, the effective tax rate on a chicken (the proportion of market dues represented as a share of the gross margin i.e. sales price minus purchase price) was over 10 times the rate of a head of cattle. Table 4 below is an illustration of this scenario.

These variations when applied in practice meant that market dues are steeply regressive in character. (Bahigwa, Ellis, Fjelstad and Iversen, 2004). Poor people with small quantities to sell pay relatively much higher dues than people with larger quantities to sell. Using this as a perception of fairness, it was evident that the proportion of the profit spent in dues was unfair to vendors and therefore affected willingness to pay.

In Rwanda on the other hand, the system of taxation was considered to be unfair because of the uniformity of taxes (40.000 FRW paid for a trading licence and 200 FRW on traded goods on each market day) regardless of the size of the business. Indeed, a person who traded one basket of tomatoes, and someone who traded 10 baskets, all paid the same amount. This implied that the tax burden was heavier on the smaller vendors who were most likely the poorest. Similarly, food and agricultural merchants complained about the fact they were imposed the same levy whether the weather had been good or not, and irrespective of the harvests. The general opinion was that the amount of tax chargeable from a particular merchant should be decided on the basis of the business size or category.

Table 4: Market Dues as a Percentage of Sales Prices

Crop Taxes	Unit	Market Dues	Sales Price	Tax as %
Beans	bag	1,000	38,300	2.6
Cassava	bag	500	21,667	2.3
Maize (dried)	sack	500	15,000	3.3
Potatoes	sack	500	11,192	4.5
Millet	tin	300	5,750	5.2
Groundnuts	bag	1,000	18,000	5.6
Millet	bag	1,000	14,000	7.1
Maize (dried)	tin	200	2,667	7.5
Groundnuts	tin	500	5,000	10.0
Potatoes	tin	300	3,000	10.0
Livestock Taxes				
Cow (live)	animal	2,000		1.1
Pig (live)	animal	1,000	24,750	4.0
Goat (live)	animal	1,000	18,500	5.4
Duck	bird	300	3,091	9.7
Chicken	bird	300	2,526	11.9

In terms of who collected the tax, 70% of the interviewees in Rwanda were satisfied with the government tax collectors because the latter are recruited from the community where they were well known. In terms of who collected the tax, 70% of the interviewees in Rwanda (see table 5) were satisfied with the government tax collectors because the latter are recruited from the community where they were well known.

Table 5: Satisfaction with tax collectors in Rwanda

Responses	Number	%
Yes	14	70
No	6	30

Table 6: Satisfaction with Security at Market Place

Responses	Number	%
Yes	19	95
No	1	5

5.4 Satisfaction of services delivered by the local government

In Rwanda some respondents indicated that they were supportive of taxation because it was mandatory and sanctions were imposed on whoever did not comply. There was evidence that some of the public services provided by the local government as part of its obligations to the population were paid for using the money collected locally. The money paid through market dues got rewarded to the satisfaction of the population through provision of security at the market.

Table 6 above indicates that 95% of the respondents were satisfied with the security at the market. The district of Gashora signed a contract with a "local association of former soldiers"(but today demobilised) to guard the market and the taxpayers were happy with the way the market was guarded. This group of respondents expressed willingness to pay even more taxes to increase the number of guards and equip them to ensure more security at the market. Similarly in Uganda, sufficient security was provided by the private contractors to safeguard the property of the vendors in the market.

However, in both countries, apart from security, the majority of respondents were not satisfied with the level of service delivery in return for tax payment. Specific reference was made to cleanliness and sanitation facilities at the market place. Table 7 below represents results from Uganda which indicated that more than 80% of the taxpayers were not satisfied with cleanliness and sanitation.

Similarly in Rwanda, 100% of the respondents were not satisfied with the services. Sanitation facilities were cited as inadequately provided for or maintained in the market area. The toilets were not regularly cleaned and the waste not removed.

People paid taxes in anticipation of services but if these services were not provided satisfactorily, it negatively affected their willingness to pay. Respondents in Rwanda indicated they would be willing to pay more taxes if they had assurance that local authorities would for example pay more attention to sanitation and cleanliness in the market.

Table 7: Levels of Satisfaction on the Quality of Services provided at the Market

Cleanliness	Vurra	Logiri	Nyadri	Total	%
Satisfactory	3	2	6	11	18%
Unsatisfactory	17	18	14	49	82%
Don't know (not bothered)	0	0	0	0	0%
Total	20	20	20	60	
Sanitation	Vurra	Logiri	Nyadri	Total	%
Satisfactory	2	2	4	8	13%
Unsatisfactory	18	17	16	51	85%
Don't know (not bothered)	0	1	0	1	2%
Total	20	20	20	60	

6 Conclusion

In general the amount charged in market dues was considered unfair. In Rwanda, application of a uniform rate regardless of quantity of goods sold was considered unfair because it did not take into account the proportion of their earnings. In Uganda, absence of a standardized criterion of fixing the rates payable for different types and quantities of goods de-motivates payment.

In Rwanda, use of locally recruited public servants who were, known and trusted by the community enhanced accountability and legitimacy. In Uganda, while the use of private contractors raised controversy (flaws in the tendering process and the extractive tendencies in execution of the contracts), taxpayers still preferred them to government employees. This implied that the perception of unfairness had more to do with the rate than who was collecting the market dues.

This study indicates that the systems for market dues collection in both countries are considered unfair, inequitable and not sufficiently accountable in the utilization of funds collected. If the two countries, are to support enhancement of local revenues it is imperative for them to devise mechanisms to improve people's perception of fairness.

In both countries, taxpayers were not satisfied with service delivery because there was insufficient link between taxes and services. There was no evidence of improvement in service delivery derived from increased collections. The provision of basic services required for effective operation of the market such as sanitation, cleanliness, security was unsatisfactory.

From the literature, one can conclude that indeed satisfaction and fairness motivate people to pay. This research has established that the same is true with local market dues given the assumption that economic considerations play an important role. People's perception of fairness of the taxes and their level of satisfaction with the services delivered increases or decreases trust, confidence, legitimacy and accountability and therefore motivate taxpayers to pay.

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