Local Markets and Public Revenue Collection

Research Proposal — Konstantin Poensgen

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1 Gap in the Literature

Local markets are central to economic activity in low- and middle-income countries. Traders in those markets typically pay market fees and rental rates in addition to other fees (e.g., tollgate and storage fees) and, more generally, presumptive taxes. Local authorities can use these revenues for development projects or public services such as schools and health clinics. However, despite their ubiquity, little is known about how local markets (could) contribute to collecting public revenues.

While a large academic literature studies how governments in low- and middle-income countries can strengthen their tax collection capacity, these studies mainly concern taxes collected on the national level (e.g., Pomeranz and Vila-Belda, 2019; Slemrod, 2019, for overviews). Notable exceptions include Olken and Singhal (2011) who show that individuals make substantial contributions on the local level through various informal taxes (in-kind or monetary). Moreover, several recent studies focus on property taxation, a major revenue source for local governments (e.g., Jibao and Prichard, 2015, 2016; Bergeron et al., 2021, 2022; Balán et al., 2022).

However, there is almost no systematic, quantitative evidence on the role of local markets in public revenue collection. Existing evidence is limited to individual case studies primarily based on qualitative interviews with local officials, tax collectors, and market traders. Still, these studies highlight essential aspects of this type of revenue collection and showcase the potential for future research.

Prichard and Van den Boogaard (2017) provide a case study of market taxation in two districts in Northern Ghana. They find that informal practices and social norms influence the collection of these taxes. They also find that daily market fees and monthly stall rents are sizeable relative to taxpayers' income and have a regressive effect overall. Siebert and Mbise (2018) and Ligomeka (2019) study market taxation from a gender perspective in Tanzania and Zimbabwe, respectively. While women do not pay more presumptive taxes than men, they pay disproportionately more tax relative to the income they generate on the market. Also, they are disproportionately affected by toilet and storage fees. Resnick (2021) studies revenue collection in the markets of the capital city of Zambia. They find that compliance increases with service provision and trust in market officials in cooperative markets but increases in collection capacity in markets run by the city council. They also find that compliance is positively associated with policy preferences for investment in market infrastructure rather than enhancing the provision of public services like education and health.

2 Importance

Low- and middle-income countries tend to collect considerably less public revenue than high-income countries. In 2020, these countries collected about 18% of their GDP in taxes compared to around 28%

in high-income countries (UNU-WIDER/GRD, 2022). Low revenue collection matters not only for governments' ability to invest in infrastructure and provide public services but also for strengthening state capacity more broadly (e.g., Besley and Persson, 2009) and becoming independent of foreign aid flows. Limited revenue collection is even more pronounced on the local level. For example, Gadenne and Singhal (2014) show that fiscal gaps are particularly large on the sub-national level. Thus, understanding whether local market taxation can help increase (local) domestic resource mobilization can contribute to fostering local development and promoting state capacity building.

3 Research Strategy

The scarce evidence on public revenue collection through local markets calls for a multilayered research agenda. In particular, systematic data collection can pave the way for descriptive analyses, a theoretical framework, and impact evaluations.

1. **Data collection:** Systematically collect data across and within a set of representative countries. This data can be gathered from official government records, adding questions to existing surveys (e.g., World Bank LSMS), or gathering data through collection teams in the field. The data may include the types of taxes and fees, design and scope, amounts collected, the statutory tax burden, and traders' income. The data should also include more general information on local authorities' budgets and expenditures.

2. **Descriptive analyses:** The collected data can be leveraged to depict the current practice of revenue collection in local markets. For example, what type of taxes and fees are collected in practice? How relevant are these revenues for (local) budgets? What is the (statutory) tax burden for traders? The comparison across and within countries can help identify common patterns and shed light on underlying factors driving this form of revenue collection.

3. **Theoretical framework:** The descriptive analysis can help formulate a theory on local market taxation. The set-up of such theory can include the various type of taxes and fees observed in the data, varying collection capacity constraints, and the general market environment (especially supply and demand in and outside the local market). The theory can inform questions such as: What taxes or fees maximize government revenue? What are their incidence and welfare costs? What are the effects on competition, especially with traders outside the market?

4. **Impact evaluations:** Finally, impact analyses can test the predictions from the theory and identify the revenue potential and adverse effects of local market taxation. The evaluations can be based on interventions planned with local authorities and implemented in RCTs. Potential interventions include modification of the taxes collected, increasing collection capacity, and running information capacity. Moreover, policy or administrative changes may provide quasi-experimental variation that can be exploited for causal analysis (e.g., fiscal decentralization reforms). Outcomes of interest include: (i) tax compliance and payments, (ii) incidence and effect of prices, (iii) tax burden on sellers and buyers, and (iv) supply response and seller performance.

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