

Researching livelihoods and
services affected by conflict

Taxation, livelihoods, governance: evidence from Nepal

Report 8

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At the centre of SLRC's research are three core themes, developed over the course of an intensive one-year inception phase:

- State legitimacy: experiences, perceptions and expectations of the state and local governance in conflict-affected situations
- State capacity: building effective states that deliver services and social protection in conflict-affected situations;
- Livelihood trajectories and economic activity under conflict

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Executive summary

With a new Constitution freshly inked, the space for governance reform in Nepal has expanded. What needs to follow?

This report provides some clues. Through a mixed-methods empirical analysis of taxation – a useful window into other political and economic processes – we show how local governance actually works and how it needs to change.

The story is perhaps not as one might think. After years of predatory taxation by the state and other political actors, notably Maoist insurgents throughout the 1990s and 2000s, we might expect to see a simple continuation of these extractive behaviours. In fact, households today appear to be taxed at an all-time low. Drawing on original survey data from more than 1,000 households spread across seven sites in two districts – Sindhupalchok in the north and Jhapa in the east – we find that government taxes absorb less than 1% of annual household income. Moreover, just 0.5% of those surveyed reported abstaining from any livelihood activity in the past year due to excessive taxation. In the past, this picture might have looked quite different.

But dig a little deeper and this good news story starts to fall apart. Taxes may be low, but qualitative evidence shows people continue to pay in other ways. In the absence of an enabling environment – public health clinics that deliver, a steady supply of electricity, government responsiveness to local needs – the costs of development and public goods provision are essentially being passed down the chain to communities and individuals. Taxes which could be used to pay for such systems are not doing so: marginal tax burdens aside, the majority of respondents say they receive nothing in exchange for the government taxes they pay.

The void created by weak or poor-quality government delivery is being filled by various forms of non-government action. Community groups are established, trade associations have sprung up, individual donations to local causes are thriving. That almost 50% of total household taxes are paid to non-government actors, such as religious organisations and community groups, is testament to this.

The reasons behind weak government taxation help explain what is wrong with local governance in Nepal. Budget allocations from central to local government have risen over recent years, and various Acts have theoretically devolved more power to individual Village Development Committees (VDCs) and municipalities. However, a number of factors continue to constrain the capacity of local government to both enforce taxes and provide quality public goods. These include: fragmented (yet still quite centralised) policy-making processes; the informal nature of political relationships, which often override newly introduced formal sets of rules; and the continued influence of political parties, whose members are often far more embedded in the communal social fabric than official bureaucrats have been for some time.

What this all means is that the government is both disconnected from and unresponsive to local communities. Our evidence suggests this is the key problem facing local governance in Nepal. As a result of it, people are being forced to pay extra just for adequate or necessary services, such as education, electricity and irrigation, and their trust in government is being even further eroded.

How might taxation help? Three findings from our analysis stand out. First, we see a positive association between the number of taxes paid and an individual's perception of the government. Second, there is a similarly positive relationship between number of taxes paid and civic engagement (such as participation in public meetings). And third, we find a negative association between the number of unrewarded taxes paid – that is, those which are perceived to generate no return for the individual – and perceptions of government.

The message? Tax more, but also tax better. The theory behind taxation suggests it can bring state and society closer together, thereby strengthening state legitimacy. But unless there is a clear dividend to the taxpayer, such transformations are unlikely to follow.

1 Introduction

When people think about projects aimed at supporting the livelihoods of the poor, the focus tends to be on trying to increase people's incomes or productive capacities. Aid agencies distribute seeds, provide loans to small businesses and try to stimulate value chains. Largely ignored in attempts to support livelihoods is the expenditure side of the equation – what people have to spend in order to get by and, maybe, to get better off. In other words, development policies tend to be far more concerned with what goes into a household's budget than what comes out of it.

This paper is interested in the second part of the equation: the expenditure component. Clearly, there are various outgoings from a household budget that fall under this umbrella, including money spent on standard consumption items (food, durables, transport and so on), inputs required for the running of microenterprises and agricultural activities, and user fees charged for access to services. Falling somewhere within and between these, although at the same time forming a distinct category, is taxation – the particular focus of this paper.

We are concerned with taxation here for two reasons. The first is that tax is becoming an increasingly prominent part of the global agenda around poverty reduction; well-functioning domestic tax systems are now frequently championed as a means towards sustained economic growth and national self-sufficiency (OECD, 2014). But most of the policy discourse centres on a rather technical set of questions concerning system design at the macro level, driven by the *a priori* assumption that domestic revenue generation is necessary for national development (and that the most important question, therefore, is how to build better tax regimes). As it is, the local experience of taxation – as it *actually* works for people on an everyday basis – is taken for granted, deemed for the most part irrelevant to the bigger questions of system design and implementation.

This neglect of the micro-dimensions and foundations of tax is likewise reflected in the way in which household economies are usually made legible. Standard household surveys, such as those used for living standards measurement exercises, take great care to capture information on certain parts of the 'expenditure component'. Consumption is a good example. But the collection of data on the taxes paid by households – including tax amounts, services accrued in exchange for payment, and degrees of (in)voluntariness – does not form part of the dominant empirical approach. Direct engagement with this gap is the first contribution of our

study to the literature. Through the generation of original evidence from Nepal, we aim to improve understanding of the ‘expenditure side’ of the livelihoods equation.

There is a second reason why we are interested in the study of taxation: its instrumental quality. While tax is, on the one hand and in its simplest form, a financial outgoing from the household economy, at the same time it cannot be understood simply as a neutral payment from one actor to another. Fiscal sociologists argue that taxation lies at the heart of relations between political authorities of some kind (typically states) and the individuals they seek to govern (typically citizens) (see Martin et al., 2009). It is the clearest expression of a bargain struck; the acceptance of rule in exchange for certain rights and privileges. To pay a tax, it is argued, is to enter into a social contract with a political authority.

Such is the strength of this line of thinking that domestic taxation is today framed not only as a means towards autonomous economic growth, but also as a means towards post-conflict state reconstruction and a pathway out of fragility (see McLoughlin, 2014: 343). In countries like Nepal, this is seen as a priority. Conflict and crisis are understood – normatively if not always empirically – to cause a collapse in state-society relations; a disintegration of the bond between public and government. Although there is by no means a settled consensus on how to restore state legitimacy in and following these situations, taxation is nonetheless touted as a worthwhile attempt, backed by enough historical evidence from various parts of the world and a ‘double-win’ logic that is easy to swallow. Here is the second contribution of our study: to examine whether, in the case of post-conflict Nepal, taxation – or particular types and arrangements of taxation – might generate some kind of ‘governance dividend’ (Moore, 2015).

This paper, then, is ultimately concerned with exploring and testing the role that taxation plays in: (1) local economic activity, with a particular focus on the household; and (2) processes of state formation at the micro level. In addressing these issues, the paper’s analysis seeks to shed light on three separate research questions:

- 1 What does the average household tax burden look like?
- 2 What is the relationship between taxation and people’s livelihoods?
- 3 What is the relationship between taxation and state legitimacy?

It considers these questions in a post-conflict environment, albeit one in which recovery has been slow. Nepal may no longer be ‘at war’, but everyday struggle and tension can be found both in people’s attempts to build secure livelihoods as well as the country’s political marketplace. Post-Constitution frustrations still linger, and strikes and protests (*bandhs*) – manifestations of political disenfranchisement, often violent – are commonplace in many parts of Nepal. All of this plays out against a historical backdrop of predatory and extractive state behaviour, linked in turn to a form of state-society relations that can be described for many Nepalis as, at best, chronically troubled. Citizens have long been subject to taxes of various kinds, from state levies placed on agricultural production and land ownership to the ‘less official’ financial exactions administered by Maoist rebels during the years of insurgency towards the end of the twentieth century.

Using mixed-methods data generated in two districts, this paper updates that picture. We start by outlining in conceptual terms why taxation matters for our understanding of livelihoods and governance, before providing background on the context for this study as well as the methods used to generate evidence. In the three sections that follow (4-6), we draw primarily on statistical analysis of our survey data to answer each of the three research questions outlined above in turn: what does the average household tax burden look like? What is the relationship between taxation and people’s livelihoods? What is the relationship between taxation and state legitimacy? Section 7 acts as more general discussion of the findings as a whole, bringing in qualitative evidence more extensively to analyse what is really going on. Finally, Section 8 ends with some brief conclusions.

2 Why tax matters for livelihoods and governance: a conceptual framing

The subject of taxation has received a good deal of attention in the academic literature over recent decades, much of it from the fields of public administration, public finance, law, political science and political sociology. Throughout most of the twentieth century, as Martin et al. (2009: 1) recount, the literature largely treated taxation as a measure of social change, as an activity or process that is symptomatic of other things, such as ‘democracy, capitalism, the rise of the state, or the modernization of society’. In other words, to study taxes was to use them as a window through which to examine other aspects of politics and economy. The application of tax enforcement as a measure of state performance (see Putzel and Di John, 2012) is just one contemporary example of this long tradition.

More recently, taxes have come to be seen as possessing a *causal* (or theoretical) as well as a *symptomatic* (or methodological) value (Martin et al., 2009). That is, while they reveal insights about, or can be used to measure, other phenomena and processes, they are at the same time responsible for helping to produce those things. According to an emerging field called the new fiscal sociology, there are ‘relations of taxation’: taxes produce social, economic and political consequences of their own making. In line with this, an expanding literature deals with the role that taxation by states does or can play in various sorts of developmental and political processes, from resource mobilisation to public goods provision to wealth redistribution. The central idea is that particular forms of taxation are capable of producing multiple effects, and can thus be understood as a means to an end, or rather a range of ends.

As a starting point, the payment of taxes is theoretically beneficial for the individuals paying them: the revenues generated through taxation can be used to fund public services and various forms of welfare systems, which members of society can draw on in order to keep themselves healthy, to educate their children, to get from a to b, and so on. Beyond this, taxes are also understood to shape the relations between state and society in profound ways. Theoretically, it is through the economic bargain created by the process of taxation that expectations between different parties are forged, that populations literally ‘buy in’ to the idea that it is the nation-state above all else that defines the political order, and that (nascent) states start becoming accountable and responsive to their funders (the public). Tax, then, is understood to be nothing less than a primary mechanism of state formation (see Schumpeter, 1991); some even go as far as claiming that, ‘In the modern world, taxation is the social contract’ (Martin et al., 2009: 1).

We see this in the agendas, approaches and activities of the world's major development agencies, particularly vis-à-vis their work in places affected by fragility and conflict. For example, in the foreword to a recent report by the OECD, it was noted that, 'accountable tax systems are perhaps more crucial in fragile states than anywhere else. Domestic revenues are not only a way out of aid dependency – they are important for building mutual accountability between citizens and states' (OECD, 2014: 1). It is through such a process that further (indirect) effects on people's livelihoods may emerge, as, through the establishment of a set of rights and responsibilities, citizens in theory get a greater say over public service delivery and at least a modicum of control over the actions and composition of their government. This instrumental framing of tax is a popular one: tax systems are good for states and good for people.

Of course, taxation does not always work this way (Meagher, 2013; Moore, 2015). In order for these kinds of effects to emerge, taxes must first be designed, administered and spent in a particular way. It is quite possible, for example, that a government that is very good at enforcing taxation is at the same time very bad at using that revenue to provide public goods in an equitable manner. A system of taxation that looked like this would unlikely produce much in the way of positive effects on either the livelihoods or the governance front, at least from the perspective of individuals within society (i.e. those being taxed with no return). We would consider this to be an expropriative tax system, resembling the 'stationary bandit' model discussed by Sanchez de la Sierra (2015), especially if violence and excessive coercion are liberally used to enforce the taxes.

What is apparent is that three aspects in particular of a tax system appear important in shaping the kinds of livelihoods and governance outcomes we might theoretically expect to see:

- the amount of taxes being levied on an individual or a household by the collecting agent (that is, the size of the tax burden)
- the way in which taxes are collected by the collecting agent
- the way in which taxes are spent by the collecting agent.

For this reason, we cannot simply talk of a tax burden as an abstract entity. Two different households sharing broadly similar economic circumstances and paying a similar amount in taxes per year may still have very

different experiences of, and attitudes towards, the payment of those taxes. Violently enforced taxes may, for example, undermine people's perceptions of the state, as might the payment of taxes which see no obvious or recognisable return.

If new fiscal sociology is anything to go by, then taxation – including *the way in which* people are taxed – is central to a range of processes relevant to those working in (and on) international development and governance, including how people make a living, how they recover after crisis, and how they form and experience relationships with the state. It appears logical that the study of such processes would benefit from a zoomed-in, up-close analysis of the everyday, local nature of what people pay, what they get in exchange, and how they feel about it – the micro-foundations and dynamics of taxation, as it were. However, the study of tax, development and governance is often approached from a fairly abstract macro-economic perspective (see Lough et al., 2013). Mainstream narratives focus predominantly on the questions of how to build effective revenue authorities, the ways in which higher amounts of domestic revenue can be accumulated, and how to bring sizeable informal economies into the fold. These are important issues, but the problem with the macro approach is that it all but completely misses out on what happens at the local level. There is far more thinking evident about how tax affects state capacity, for example, than how it directly and indirectly affects the livelihoods of those who actually pay it. But if we are interested in how people recover from crisis and conflict, we should also be interested in these questions. What people can and cannot do to survive and accumulate is a consequence of how their environment is regulated. That is, the actions of powerful actors, such as the state or an armed group, shape local economic activity.

The central implication of this perspective is that the local realities of everyday governance – in both a political and economic sense – must be engaged with. It is by now well accepted that governments are not the only political authorities that govern. There is increasing agreement that, around the world, 'actually existing' governance – that is, governance as it is rather than how one thinks it ought to be – is networked (Leonard, 2013), hybrid (Boege et al., 2009), and negotiated on a continual yet shifting basis (Hagmann and Peclard, 2010). Just as governments are not the only ones who govern, so too are taxes administered by organisations and authorities other than governments.

Given the intimate connections we know that taxation has with questions of economic activity, social order and state formation, it would not make much sense to simply ignore this reality. One might, for example, plausibly expect cases of intense non-government taxation to shape, in one way or another, the nature of relations between state and society. At an even more basic level, where non-government taxation occurs but goes uncounted, one might expect to arrive at a worryingly inaccurate estimate of household tax burdens. The same goes for payments exacted by government actors which are not officially codified in law. The orthodox view would be that such payments constitute cases of corruption and divergence from the norm; that they have no place in the calculation of tax burdens. But while it might be tempting to write them off simply as manifestations of state failure or corruption, these kinds of payments – whether those made to non-government actors or those made to government outside the law – still form part of the regulatory landscape. As the OECD (2014: 45) puts it:

Whether these payments are legal or illegal, corrupt or not, it is important to develop a better understanding of these local level and informal processes and their relationship to formal taxation. Without it, debates about how to mobilise greater domestic revenue miss an important part of the picture.

Indeed, some of the most insightful recent works on tax and governance grapple with this issue head on, extending their analysis outside the formal realm of the bureaucratic Weberian state to explore the practices, norms and meanings of everyday taxation – as they are actually experienced by individuals (see, for example, Prichard and van den Boogaard, 2015; Titeca and de Herdt, 2010; Twijnstra et al., 2014).

The point is that, without looking beyond the formal, statutory taxes that people pay, one's analysis – and the policy interventions that may stem from it – are likely to 'miss the wide variety of other tax payments people may already be making, such as legal non-tax instruments like business licences, payments to corrupt officials, or payments to customary providers of public goods' (Lough et al., 2013: 10). With respect to our own study, asking only about Nepalese households' official tax payments to the government would leave us with a very partial picture of (1) how local economies actually work, and (2) how local governance actually works. Subsequently, we set out to examine both tax-like payments made to non-government actors, as well as taxes paid to government actors that exhibit characteristics of informality. In so doing, we adopt

the broad definition of taxation suggested by Lough et al. (2013: 10), which covers both formal and informal variants of tax:

All payments – whether cash or in kind, including labour time – that are made as a result of the exercise of political power, social sanction or armed force (as opposed to market exchange).

Such a definition enables us to capture a range of taxes and tax-like payments, including: those made to armed insurgents, of which there is a recent history in Nepal (see next section); those made to community-based organisations and social or religious institutions, which may, as the definition suggests, be enforced through social sanction; and those made to the government which may deviate from that which we might consider 100% legal and official (but may still be enforced through the exercise of political power). The implication of this broad definition is that it does blur the line between formal/informal, official/unofficial and legal/illegal categories of payment. From the perspective of the individual making the payment, this may not matter all that much: in a crude sense, payments that people make through obligation, force or social pressure can all be considered burdens on the household economy, regardless of how official they may or may not be. They all absorb expenditure that could be used for something else.

Under these circumstances, informal taxation potentially covers payments that orthodox classifications would never consider. A case in point is donations made to non-government actors such as religious organisations. There is, of course, a continuum to contend with here. *Zakat* may be considered by many to constitute a tax more than a voluntary donation, whereas less apparently coercive religious payments may be considered otherwise. The point is, the distinction is not necessarily clearcut – certainly less so than the legal *de jure* perspective holds. In practice, many payments that might be considered taxes are subject to negotiation between the involved parties, and degrees of voluntariness are often evident (so long as something is expected in return at some point down the line). Along the same lines, payments one might assume to be purely voluntary may in practice exhibit certain characteristics of coercive enforcement, albeit of a more subtle and less visible nature. As will be seen in the coming pages, religious donations among our sample in Nepal – which appear to be quite prevalent – may not always be freely made. Rather, they are sometimes the result of an institutionalised social obligation to contribute to community welfare. We are reminded here of the

relational nature of taxes, as put forward by the new fiscal sociology, which again blurs the distinction between voluntary and involuntary.

Ultimately, this paper should be considered an effort to engage more directly with the question of informal taxation than many other primary research studies on tax have to date (with of course some exceptions, a recent notable one being Bodea and LeBas, 2014). The empirical research literature on informal tax is small and relatively young. Lough et al.'s (2013) recent review – a joint endeavour of the Secure Livelihoods Research Consortium (SLRC) and the International Centre for Tax and Development (ICTD) – highlighted the need for a better understanding of the basics of informal tax, arguing for more empirical data on the subject. This paper responds to that call, and tries to do so in a way that experiments with a way of doing so rather than establishing a set approach. More specifically, it seeks to: document what people actually pay; conduct some exploratory work into how we might operationalise the concept of informal tax into research and policy; and start to examine how taxation – including both formal and informal practices – might shape livelihoods and governance outcomes. We do not claim to lay down the parameters, definitions and analytical methods perfectly, but we do hope that the paper stimulates thinking on these issues.

3 The case study: context and empirical design

Where did we examine these under-researched issues, and how did we do it? In this section, we first provide background on Nepal as a case study for this research, including a brief overview of historical and current taxation practices, before describing the methods used to generate evidence.

3.1 Context

Despite being nearly a decade on from the signing of a peace accord, Nepal remains troubled by political instability and entrenched social inequality. A process of gradual if fragmented decentralisation since 1999 has reformed the way public authority in Nepal looks and works, but gaps in basic functions such as service delivery continue to exist (Upreti et al., 2012) and the current system of state governance is deemed not to work particularly well for large sections of the Nepalese population (The Asia Foundation, 2012). In a recent survey of more than 3,000 people across three districts (Bardiya, Ilam, Rolpa), SLRC found that nearly 60% of respondents felt that local government decisions never reflected their own priorities (Upreti et al., 2014). The equivalent figure vis-à-vis central government decision-making was even higher, at just under 70%.

These numbers must be seen against a backdrop of (reported) widespread misuse of funds and abuse of power by those with access to state resources and government positions (Pyakurel et al., 2013; The Asia Foundation, 2012). The country's current tax system is imbricated in this network and culture of apparent political malpractice, but very little research to date has looked rigorously at: (1) how tax practices in Nepal shape both local economic activity and people's relationships with power structures of both a formal and informal nature (in particular from a micro-level perspective); and (2) what the nature of the informal and formal tax regime tells us about the state and structure of local governance more generally.

There is a long history of taxation in Nepal. As far back as the 5th century BCE, the Licchavi rulers levied taxes on various activities and commodities within the Kathmandu Valley, including trade, fishing, agriculture, onions and garlic. But it was the Mallas rulers, who replaced the Licchavi from 1200 BCE onwards, that became the first to exact taxes on land. Land tax has since been a regular feature of the Nepalese tax system, and indeed helped define both economic relations between different caste and class groups, as well as people's relationship with the state. After the unification of the country in the mid-

eighteenth century, the Shah regime imposed a range of new taxes on the general population. These extended beyond commonly taxed economic activities and commodities, such as land, forestry, mining and market activity, and included payments to be used to finance various national festivals and royal ceremonies.¹ From 1846 to 1951, it was the Ranas who ruled Nepal. Their main sources of government revenue were land tax and customs and excise duties.

It has been noted that the principle of tax collection throughout the Shah and Rana administrations was arbitrary and discretionary, and reflected the predatory nature of the system more generally (Pyakurel et al., 2013: 11). Hutt (2007: 13) points out that the extractive nature of the Nepali state has remained deeply ingrained for hundreds of years: the 'ruling elite continued to regard the mass of the population as revenue-producing subjects rather than citizens with rights'. Riaz and Basu (2007) are in broad agreement with this view, arguing that, since 1816, taxation by the Nepali state has been of a kind of banditry; that, in the absence of public goods provision, the state must be considered deeply extractive. There has thus been a chronic, long-running failure to move beyond an extractive set of relations towards the embedding of a fiscal contract, whereby certain rights and returns are guaranteed by the state. The legacies of this condition can still be seen today (The Asia Foundation, 2012).

How did these historical tax systems actually work? A brief look at land tax during the Rana regime helps illuminate the intersections between state, brokers and society in the enforcement of tax. Drawing on the work of Regmi (1976) and Krauskopff and Meyer (2000), Arjun Guneratne (1996; 2002) has written about the historical political economy of land tax in Nepal, illustrating how land revenue systems in fact had quite distinct regional characteristics. In particular, different structures could be observed in the Terai, the hill regions and the Kathmandu Valley. His analysis shows that there has not been a single, homogenous evolution of tax systems in Nepal. Rather, the state's extractive apparatus appears to have developed unevenly across space, and in a non-linear fashion over time. Guneratne looks specifically at the historical structure of the land revenue system in the Terai, of which one of our focus districts, Jhapa, is situated. In the Terai region, local agents of the state (*jimidar*) were

responsible for first recruiting settlers into a particular *mauja* – a village-level unit of cultivable land – before collecting taxes on the land they came to work. The *jimidar* would then transfer land revenues to the *caudhari*, who would in turn deliver it to the revenue office. The position of the *jimidar* was an ambivalent one. On the one hand, they exercised a certain amount of power and authority over local populations within the *mauja*: they had the right to extract forced labour from village households – for example, forcibly recruiting porters for the military – and were the providers of credit to farmers. One would assume this would leave local farmers with little choice but to agree to pay land taxes, for a failure to do so would likely result in a refusal of credit. The words of one tenant farmer (*raiti*), quoted by Guneratne (1996: 10), highlight the kind of power held by *jimidar* over local populations:

Because of the Rana government, they [the jimidars] could order us to leave our houses, go to India, or go to the mountains and [we] would have to go. Now those conditions aren't there any more. They can't say those things now. That's the way it was in the old days. Even if you had land. When the jimidar ordered it, you had to leave.

On the other hand, if the *jimidar* failed to raise enough revenue from a particular area, they themselves would be held personally responsible by the state – and would have to find an alternative way to fund the balance.

There are two further points which emerge out of Guneratne's analysis, which will be of relevance for our later analysis. First, we learn that the formal tax system within which the *jimidar* were key functionaries was actually far from being unreasonably extractive. In fact, evidence suggests that land taxes in certain regions were kept deliberately low by the Rana regime in order to encourage settlement into under-populated areas (in Chitwan, for example). In addition, it is noted that the inefficiency of the Rana administration meant that land tax was not revised regularly enough to keep pace with inflation. The low taxes were thus part strategy, part state incapacity. Second, although the formal land tax burden was relatively marginal during this period, local populations were actually subject to heavier exactions courtesy of the *jimidar*, whose state rewards were fairly meagre: just 4-5% of the revenue collected, which, given the low rates, would not have been much. Guneratne reports that many peasant cultivators in fact paid more in taxes to the *jimidar* than they were legally obliged to. This was achieved through a manipulation of the bureaucratic land registry system, which was in turn made possible

1 For example, *walak* was collected from each family to celebrate national festivals, *gaddimudark* for coronation ceremonies, *goddhwa* for the wedding ceremonies of princes and princesses, and *godan* for funeral ceremonies.

by their exploitation of ‘the peasants’ general illiteracy and ignorance of the regulations’ (Guneratne, 1996: 28). Related to this extraction of non-codified, informal tax, the *jimidar* enjoyed access to power and status in village society, and typically played multiple roles in addition to tax collector, from law and justice enforcer to convenor of religious worship – a finding supported by research from other parts of the country (Gidwani and Paudel, 2012). We will return to these two points later on, relating as they do to our own findings.

After decades of simmering frustrations, the Maoist insurgency (or ‘The People’s War’) was formally initiated in 1996, lasting for a decade. The spread and intensification of violence around this time was accompanied by a considerable expansion of non-state taxation in Maoist-controlled areas of the country. This was technically illegal, as the interim government was the only political authority entitled to extract taxes on Nepalese citizens, but evidence suggests it was both widespread and coercive. Citing a report in *Himal*, a Nepali news outlet, Hutt (2007: 21) describes:

The way in which the East/West Highway is broken into sections by the different local Maoist governments and vehicles are stopped and drivers taxed at regular intervals. Local businessmen believe themselves fortunate if the tax demand is ever less than 100,000 rupees.

Qualitative research conducted as part of this study provides further evidence of the tax burden during this time. In site 5 (in Sindhupalchok district), a former VDC (local government) chair described how today’s tax pressures are low compared to the period of insurgency. In those days, the frequency of Maoist demands for ‘donations’ was very high; the ‘donations were forceful and intense, and were often collected by the youth cadres of political parties’.² At the same time, state presence throughout much of the country effectively disintegrated: according to The Asia Foundation (2012), by 2002 the majority of VDC offices in Nepal were empty. Today, while the donations are still there, rates are far lower – typically between NPR 5 and 500, according to the former chairman – and payments are not coerced. Another respondent from Jhapa made similar comments, pointing out that ‘around 17 years ago, the Maoists were charging people along the road’.¹³ Again, this respondent noted that such practices are now rare.

The exaction of informal taxation by the Maoists throughout the 1990s and 2000s did not emerge in a vacuum. As discussed, past agents of the state, such as local landlords, were in effect ‘tax farmers’ (Murshed and Gates, 2005); this was particularly the case during the Rana regime. The extortion of local populations by different political forces has long been a characteristic of governance in Nepal, as has been the general failure of those authorities to productively reinvest revenues. This malaise has, unsurprisingly, not gone unnoticed by the citizens of today. As our survey data later show, taxes collected by the government are widely seen as extractions that ultimately serve no purpose (see Section 6): ‘The state taxes general people and in return we get nothing’.⁴

Today, the enforcement of formal tax laws and administration is overseen by the Inland Revenue Department, whose head office is in Kathmandu. While the Department has 22 field offices throughout the country (covering 75 districts), geographical coverage is considered poor, and the low number of offices is seen by some to symbolise the limited reach and penetration of the formal tax system more broadly (Pyakurel et al., 2013). The country’s tax base is often portrayed as narrow and inadequate, and the capacity of the government to raise domestic revenues through taxes is understood to be heavily constrained by deep-rooted corruption and ineffective bureaucracies. Talking at his office, the VDC Secretary of site 5 explained to us that the inefficiencies and weak capabilities we see today at the local government level are in part a hangover from insurgency. His constituency was without a proper VDC office for over a decade – it was burned down during the war, along with all the VDC’s registration and citizenship records.⁵ The loss of such ‘vital registrations’ (in his own words) would have certainly obscured the legibility of society thereafter, and – in the process – undermined state power (see Scott, 1998).

In the years since, the government’s failure to meaningfully decentralise has in effect served to maintain and consolidate state incapacity at the sub-national level, with debilitating consequences for core state functions such as tax collection. As a report by The Asia Foundation (2012) highlights, formal attempts to empower local government, such as the Local Self-Government Act (LSGA) of 1999, have typically fallen well short of promoting effective decentralisation: ‘The

2 Interview 24 [key informant, male, 60s, site 5]

3 Interview 07 [key informant, male, 60s, site 2]

4 Interview 13 [business interview, male, age unknown, site 3]

5 Interview 25 [key informant, male, age unknown, site 5]

LSGA [has become] a repository of unfunded mandates rather than an enabling instrument for local bodies to take control of their affairs'. At the root of this failure are: issues of chronic under-resourcing in relation to both budget and staffing; the resilient structures of local political economy, which find themselves embedded within informal logics of governance; and a long history of state-society disconnection.

In the continued absence of locally elected government representatives – a situation constantly reproduced at the central level by stalled efforts to finalise the Constitution – development committees at the VDC level are designed to be democratic and accountable structures for local planning. However, it is generally understood that control over planning and resources is dominated by local elites and political parties, rather than the VDC office. How did this condition arise? According to The Asia Foundation (2012), formal state policies that took root from 2002 onwards reinforced informal modes of *de facto* governance and consolidated the position of local elites. When the tenure of locally elected representatives expired in 2002, the government authorised civil servants to take over the functions of the local bodies. This transition happened almost overnight. The new VDC offices found themselves without the political authority and legitimacy of the communities' former locally elected representatives, and so, as a coping strategy, resorted to informal consultations with key local elites on almost all major decisions taken at the local level. As the report makes clear, 'This opened an entirely new political space, outside of formal procedures, where government decisions were made' (4). The short-lived All Party Mechanism (APM) – formed in 2009 as a consultative forum consisting of different political parties on a one-party-one-representative basis – essentially lent further legitimacy to the 2002 coping strategy, as local government officials became mandated to consult the APMs on major resource allocation and local development decisions. While the APM was formally dismantled in 2012, in practice 'the same corps of actors continues to shape key local decisions; they merely refrain using the APM banner in the deliberations' (ibid: 5). We return to these core issues of local political economy in the analysis of Section 7.

Many of those who have written about tax and development in Nepal conclude that the government should work towards building a broad formal tax base (e.g. Aalen and Hatlebakk, 2008; Pyakurel et al., 2013), and that expansions in extractive and redistributive power are necessary for national progress. In fact, this

is a popular policy prescriptive for the development of low-income and fragile countries more generally (OECD, 2014), and one which often includes a proposal to bring the informal economy under the tax net (see, for example, a presentation by Sharma and Duwadi, 2013 of Nepal's Inland Revenue Department). There have also been calls for a simplification of the government's tax and registration procedures, which some argue currently create further space for the exaction of bribes. For example, Wily et al. (2008: 70) describe the present land administration system as 'paper-bound, vulnerable to manipulation and rent-seeking by officials', going on to identify no fewer than seven points in the process where bribe-taking is possible.

The government's weak capacity to enforce taxes, as well as the ability of businesses and individuals to escape taxation, are core elements of the popular narrative surrounding tax and development in Nepal. Tax evasion and illicit financial flows, particularly by registered corporations, are considered a major problem in Nepal, and receive considerable attention in the national media. According to Pyakurel et al. (2013), large-scale tax evasion results in a leakage of NPR 5 billion per year. Behind these losses is an apparent picture of bribery and complicity between corporations and the state; it has been reported that business houses raise millions in order to pay off the right officials so that they can avoid being placed on the VAT register (ibid). Furthermore, although taxation accounts for the vast majority of Nepal's total domestic revenue (86.5%), most of that is made up of indirect taxes, such as VAT. Reports suggest that the share of the Nepalese population paying *direct formal taxes* is extremely small: estimates suggest the share to be as low as 3%, or 800,000 people.⁶ The analysis of Lough et al. (2013) suggests it may be wise to handle this figure with some caution. As the authors point out, 'studies focused on taxation through formal channels...have concluded that poorer people are not taxed, since they are either formally exempt or participate in "hard-to-tax" informal sector activities' (Lough et al., 2013: 10). Such an approach typically overlooks the payment of taxes that might be classed slightly differently.

To our knowledge, there has been very little research into Nepal's tax systems from a micro-perspective. We know only a limited amount about what individuals, households and small businesses actually pay, as well as how they feel about tax. One exception is a recent

6 Figure as reported by the Government of Nepal and printed in *Nepal News* on 12 May 2012 (in Pyakurel et al., 2013: 3).

paper by Pyakurel et al. (2013) for the South Asian Tax Justice Network. The findings of primary research presented in their report suggest a number of things about Nepal's tax systems and the people who pay. First, tax rates – as actually paid by households – seem quite low. For example, typical land tax payments ranged from NPR 10 to 150 per year (10 US cents to \$1.50).⁷ Second, taxpayers are not always aware of how much their household pays – roughly 20-25% of respondents in each research site did not know how much income tax they paid. Third, while their findings suggest that people are often not aware of VAT – either they think they do not pay it or otherwise have no idea of the rate – people do seem much more aware of what kind of direct taxes are enforced by the government. Finally, the authors' perceptions data suggest that household tax burdens are subject to spatial variation: while 82% of respondents in Parbat district felt they paid more in tax after 2006 compared to before, the equivalent share of respondents in Kathmandu was far lower at 20%. This gap can perhaps be partly accounted for by Nepal's uneven economic geography. Work by the likes of Aalen and Hatlebakk (2008) shows a spatial inequality in the structure of economic activity across the country, and it is possible that sub-national tax systems reflect this. While the findings of Pyakurel et al. (2013) may be illustrative of some broader trends, it must be noted that they originate from a very small sample size: the survey was administered to just 32 respondents in two locations, Kathmandu and Parbat district, of whom 65% were male. Thus, while not directly comparable, our research can be used to assess how much more widely the findings of Pyakurel et al. (2013) are applicable.

So, what might we reasonably expect our findings to look like? Based on the analysis above, we hypothesise three things.

First, although the state has been able to enforce taxes on various assets and activities for centuries, capacity constraints in this area have nonetheless been apparent. These constraints appear to be more pronounced today, in the aftermath of insurgency. Formal attempts to decentralise political and fiscal authority have produced lacklustre results, and local organisations and agents of the state find themselves enmeshed in a political

economy environment that undermines their ability to act autonomously. For this reason, we might expect to see a relatively low formal tax burden on households, which ties in with more recent (yet limited) evidence that many are successfully avoiding formal taxation. At the same time, we may not be surprised to see households paying at least some informal tax to non-government actors: the Maoist insurgency sets a recent precedent for such practices.

Second, the Nepali state has a history of not providing public goods in exchange for the taxes it collects. We might expect to see some semblance of this characteristic still in operation today. Recent evidence illustrates the public's frustration with the Government of Nepal, which is in turn linked to the delivery of poor quality services and government non-responsiveness to local demands and interests. As a result, we might expect to see actors other than the government filling this void, potentially providing some form of public or club goods through the levying of informal taxes on households.

Third, because of the state's poor record in delivering public goods in exchange for taxes, we might also expect that individuals paying a higher number of taxes and/or a greater amount of tax are less likely to share a healthy relationship with the government.

3.2 Empirical design

This is a mixed-methods study which draws on original household survey and qualitative data collected between February and April 2014. The survey instrument was developed jointly with researchers at the ICTD during a workshop in Brighton, UK in mid-2013, and later revised and tailored to the Nepalese context. The ICTD is running a closely connected empirical study in Sierra Leone, and the two pieces of research are intended to complement each other in their investigation of informal taxation across different contexts.

The final instrument included a total of 12 modules designed to generate data on household livelihoods, proxy measures of household wealth, features of the local context, taxation, and governance (the authors are happy to supply a copy of the final instrument upon request). One of the central aims of the instrument was to collect information on the full range of taxes and tax-like payments made by a household – or rather, the fullest range of payments we could possibly collect information on given the nature and limitations of using questionnaires (i.e. an inability to be as open-ended as we might have liked). Based on a prior understanding of

⁷ Official government figures show that, in 2011/12, the share of total tax revenue made up of land and vehicle tax was just 3.8%, which was lower than several years previous.

the tax system in Nepal, as well as some brief scoping work in-country, a list of payments was planned out well in advance of survey implementation, and enumerator training and piloting was used to refine the list further. The final list included taxes paid to central government (such as income and vehicle taxes), local government (such as land and property taxes and business licences), non-government actors (such as donations to religious organisations and contributions to community groups providing services), as well as a few miscellaneous taxes, namely unpaid labour time and checkpoint fees. The full list can be found in Annex 1. In addition, as we could not be certain that our list would always capture every tax and tax-like payment made by a household, for each major category – central government, local government and non-government – we asked respondents if there were any other taxes we had missed.

Surveys were administered using electronic tablets to a total of 1,039 households between February and March 2014 by a team of 11 enumerators and two field supervisors. Households were randomly drawn from seven purposively selected sites across two purposively selected districts: Jhapa, a Terai district in the far east of the country on the Indian border; and Sindhupalchok, a mountain district to the north of Kathmandu on the Tibetan border (see Figure 1).

The intention of this study was not to generate a nationally representative dataset of household tax expenditure (which would have, in any case, been well beyond feasibility given budget and logistical constraints). Rather, our interest was in testing and exploring a few key

(potential) relationships between taxation, livelihoods and governance. We could have opted to do this in a single ward or a single district, but in order to (1) expand the geographical coverage of the study (even if by a relatively marginal degree), and (2) allow us to see whether patterns observed in one place were also evident in another, we chose to work in two districts. By doing so, we can be more certain that results are not simply attributable to the characteristics of a single place; we can better examine whether relationships of interest are consistent across geography.

We identified two districts which, we felt, differed sufficiently in terms of two main characteristics: (1) histories of violence and conflict, as represented by Maoist insurgent activity; and (2) differences in economic geography. Relative to Jhapa, Sindhupalchok experienced higher levels of insurgent activity throughout the 1990s and 2000s, as was more generally the case with hilly and mountainous regions of the country. While the structure of the local economies differs, both districts are sites of cross-border trade and aspects of the illicit are evident in each. For example, while the Government of Nepal has tried to halt the export of betel nuts into India, smuggling operations, which reportedly involve networks of high-profile traders, have proven resilient in Jhapa (Tiwari and Adhikari, 2014). Meanwhile, in Sindhupalchok, the government's ban on exporting rice into Tibet is continually undermined by small-scale acts of subterfuge with the tacit approval of border guards (see Section 6.1). Table 1 presents some basic development indicators for Jhapa and Sindhupalchok, and additionally includes Kathmandu as a reference point.

Figure 1: Map of Nepal showing Jhapa and Sindhupalchok

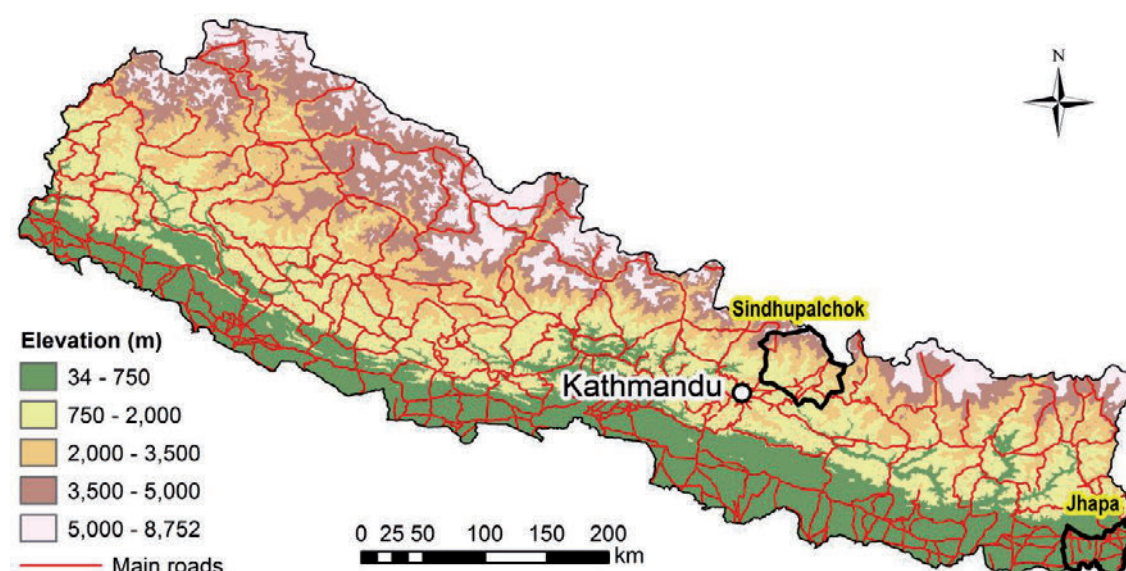


Table 1: Core district-level development indicators for Jhapa, Sindhupalchok and Kathmandu

	Jhapa	Sindhupalchok	Kathmandu
Geographic zone / Development region	Outer Terai / Eastern Development Region	Mountain / Central Development Region	Hill / Central Development Region
Human Development Index value, 2011	0.518	0.455	0.632
Economically active population (no.)	330,000	150,000	615,000
Gross Domestic Product (GDP), in NPR million	40,500	13,000	197,000
Labour productivity relative to national average (national average = 100)	103.8	73.2	271.1

Source: Government of Nepal and UNDP (2014)

While wanting to spread the sample across two districts for the reasons outlined above, we also wanted to achieve geographical representativeness at the level of at least some kind of administrative unit. We felt this was important for enabling direct comparisons between different kinds of communities (e.g. those with local economies dominated by business ownership compared to more agricultural ones). Again, budget and logistics dictated that we scale down to ward level for this purpose (there are typically nine wards per VDC/municipality).

A total of seven research sites (wards) were established across the two districts: four in Jhapa, three in Sindhupalchok. As mentioned, our selection of VDCs/municipalities was made on a purposive basis: in order to have a sampling strategy that would allow us to explore the effects of differential economic geography, a set of

criteria was drawn up and areas subsequently identified in accordance with those specifications. In terms of ward selection, an initial scoping trip was carried out by members of the Nepal Centre for Contemporary Research team in advance of survey implementation (December 2013 to January 2014). In addition to assessing the political and security situation of each site, the team also used this trip to identify an appropriate ward in each VDC/municipality. The strongest candidates were wards which contained large populations and were relatively convenient to access. Our survey sample was designed to achieve a confidence level of 95% at a confidence interval of 7%, and representativeness at the ward level. We also aimed to achieve a sample demonstrating approximate gender parity (in the end, 46% of respondents were female). Drawing on our survey data, Table 2 presents some basic information about each of the seven sites.

Table 2: Basic characteristics of the seven wards/sites

	Ward / Site						
	1	2	3	4	5	6	7
District	Jhapa	Jhapa	Jhapa	Jhapa	Sindhupalchok	Sindhupalchok	Sindhupalchok
Sample size (no. of households)	178	133	134	164	123	156	151
Main livelihood activity in ward (by income earned)	Own business (52%)	Own business (29%)	Work for private sector (25%)	Agriculture (27%)	Own business (42%)	Own business (46%)	Paid housework (29%)
Main livelihood activity in ward (by time spent)	Own business (58%)	Agriculture (36%)	Work for private sector (26%)	Agriculture (41%)	Own business (45%)	Own business (48%)	Agriculture (30%)
Mean annual HH income (NPR) ⁸	680,937	401,916	297,557	360,113	408,242	460,216	368,340
% of HHs receiving remittances	25	37	24	30	7	21	11
Mean number of HH income sources	1.6	1.6	1.6	1.6	1.9	2.0	1.8

⁸ These figures were calculated using income data recorded from households' three main income sources.

In terms of sampling within the household, we aimed to interview an economically active member of the household, who had a good understanding of household economic affairs, and who was above the age of 18. In practice, although we were unable to guarantee selection of the actual taxpayer in every instance, our data show that respondents were often the ones making the payment. 59% of respondents answering questions about land tax, for example, reported that they were responsible for paying the tax, and the equivalent shares for other taxes are typically in the 60-80% range (see Annex 2). It is possible, therefore, that respondents did not always have the right information to provide accurate answers, although we might plausibly assume that their engagement in and awareness of household economic affairs – a criterion for selection in the first place – would have provided them with a general sense of financial outgoings.

We set out to achieve gender parity and ended up with a sample consisting of 46% women and 54% men. This was considered important in order to minimise a potential gender bias within the dataset. However, at the same time we should recognise that interviewing someone who may not be considered the ‘household head’ raises questions in itself.⁹ Throughout fieldwork, we were struck by the gendered aspects of tax-paying. Women often saw their husbands as ‘the taxpayers’, while they themselves felt personally more responsible for everyday reproductive economic matters. Indeed, according to one of our interviewees, many consider a ‘good wife’ to spend most of her time in the home (although she personally disagreed strongly with this).¹⁰

Social expectations of this nature work together with other norms to limit women’s mobility, potentially restricting their access to certain spaces (such as the VDC office or land registry). These ideas may then feed into the social construction of ‘the taxpayer’ as a strong, male figure. It is entirely possible, then, that male and female respondents approached the questions around household taxes slightly differently. This would not be unexpected: evidence suggests that it is common for

different individuals within the same household to report differently against seemingly objective measures, such as income, asset ownership, employment levels or food security (see Bardasi et al., 2010; Coates et al., 2010; Demombynes, 2013). Thus, when it comes to taxes – one particular form of household expenditure – it may be that the frames of reference from which respondents draw have similarly gendered dimensions. This may be particularly relevant when researching informal taxes, which for one reason or another may be less ‘visible’ within the household economy.

In addition to the household survey, qualitative data collection was carried out both during and after the main phase of survey implementation. The aim of the qualitative methods was to generate a different kind of data that could be used to better understand the process of tax administration, to contextualise tax payments within the broader household economy, and to explore people’s feelings towards local governance and service provision in a more in-depth way. Subsequently, we set out to interview – using semi-structured checklists – a range of respondents, from households (including some of those formerly interviewed for the quantitative survey) to local business people (shop owners, rickshaw drivers) to key informants (VDC secretaries, border guards). A total of 32 formal interviews were conducted, a list of which is included as Annex 3. Wherever quoted or referenced in the following analysis, footnotes are used to indicate the identity of the respondent (and are cross-referenced to the table in Annex 3).

Quantitative data analysis was informed by an analysis guide, designed in advance by the research team. Analysts produced hundreds of tables of descriptive statistics, at different scales (sample population, district, ward), which were then interpreted over the course of several weeks. Following interpretation and analysis of the descriptive statistics, a series of regression models were built to enable further examination of key variables of interest (tax expenditure, perceptions of the government, civic participation, satisfaction with services).

⁹ The use of inverted commas here is intended to reflect the idea that ‘household head’ is a socially constructed – and contested – concept.

¹⁰ Interview 27 [HH interview, female, late 20s, site 6]

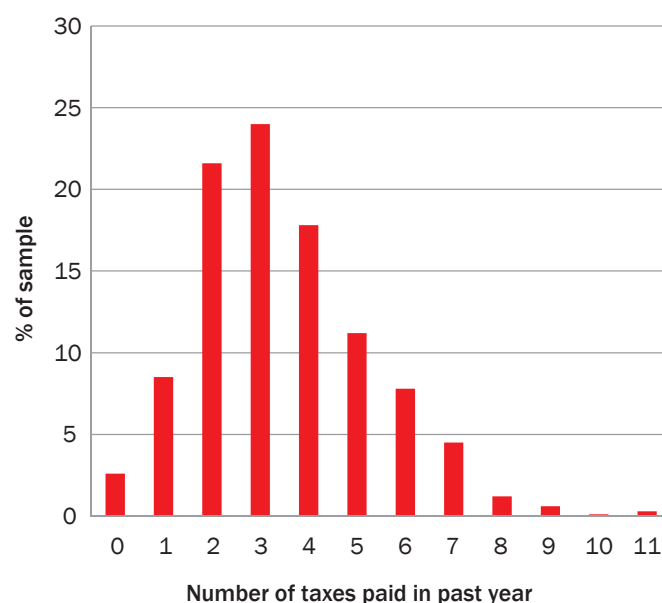
4 What does the average household tax burden look like?

In the first of three sections devoted to our findings, we take a largely descriptive look at the average household tax burden (for those households in our sample population). We consider how many households are paying any kind of tax in the first place, the prevalence of different types of taxes, and the composition of formal tax relative to informal tax.

4.1 Most households pay at least some tax

The popular narrative surrounding Nepal's tax system implies that tax avoidance is rife and that only a tiny minority pay anything at all. While our data are of course not nationally representative, we find that the majority of households in our sample population (97%) paid at least some tax in the past year (see Figure 2).

Figure 2: Number of taxes paid in last year by households in sample

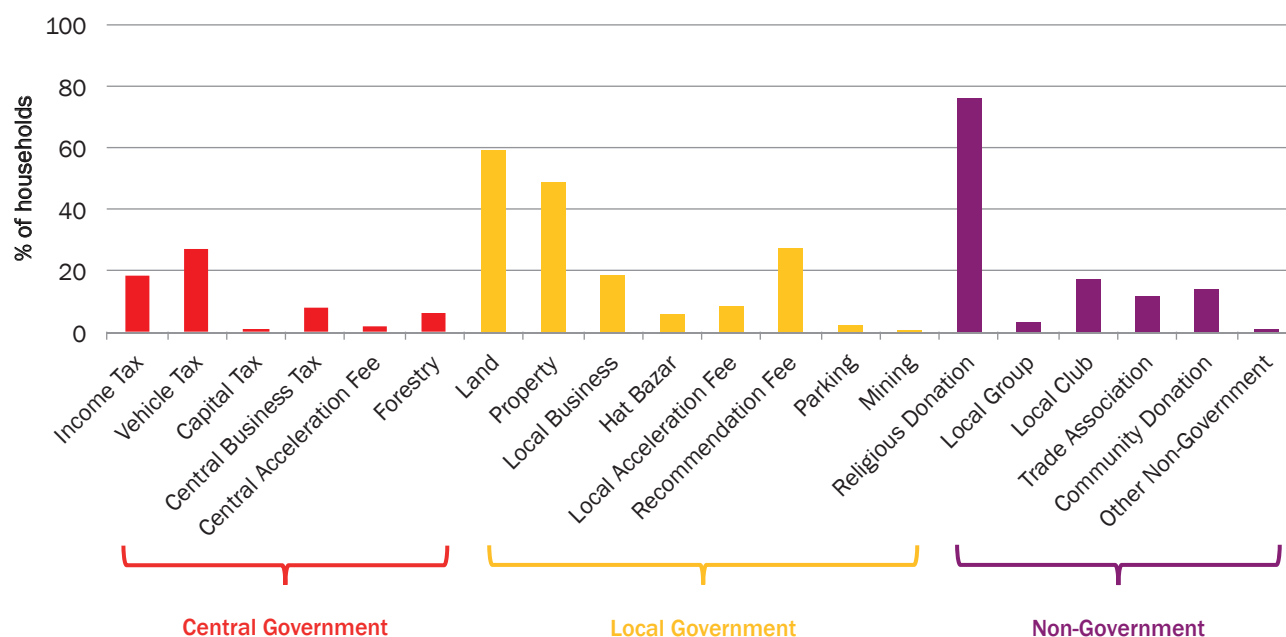


Within our sample population, the mean number of taxes paid by households is 3.7, with the largest share of households (24%) paying three taxes. This varies very little across the two districts. In monetary terms, annual average tax expenditure is NPR 10,454 – around \$100. However, there is considerable variation between households: at the lower end, some respondents reported not paying any tax whatsoever, while, at the upper end, one household reportedly paid more than NPR 500,000 in the past year (more than \$5,000).

Figure 3: Households in our sample paid an average of NPR 10,454 in annual tax. Where did that go?



Figure 4: Tax prevalence, by % of households paying each type of tax



On average, households pay a higher number of local government taxes (1.8) than central government taxes (just 0.4). The mean number of non-government taxes paid sits somewhere in-between, at 1.2.¹¹

When we consider the composition of tax expenditure, the breakdown looks a little different. Of the \$100 or so of annual tax expenditure, the largest share – about 45% – goes to non-government actors. That is followed by taxes to local government (about 30%), and finally taxes to central government (about 25%) (see Figure 3).

What taxes specifically are people paying? We find that nearly 60% of the sample population pay land tax, that around half are paying property tax, and that sizeable

shares are paying various other forms of government tax (see Figure 4). These figures might be lower than some policy makers might like, but, they again contradict the idea that people aren't paying anything at all.

However, it is a non-government payment that we find to be the most prevalent: over three-quarters of our sample had made a religious donation in the past year. Other forms of non-government taxation are less widespread: payments to local clubs, trade associations and community projects are made by fewer than 20% of households.

In Section 2, we reflected upon the extent to which a donation can be considered a form of tax *per se*. There is of course an argument that such payments are voluntary, which therefore potentially invalidates the inclusion of religious donations as informal taxes. That might be true, but we are interested here in examining whether a coercive basis exists for payments of this kind (if there is, then we might think differently about their classification). Our data highlight a number of features of the religious

¹¹ These figures do not include the extractions included in the fourth column of the table in Annex 1: unpaid labour time and checkpoint fees. For these, we find that just under 13% of households in our sample contributed unpaid labour time to local governments, while just under 6% paid a checkpoint fee in the past year – a far lower share than we might have expected a decade or so ago during the Maoist insurgency.

donations made by households in the sample. First, they are typically negotiable with the collector/recipient: just under three-quarters of those making the payment reported being able to consult on the rate. Second, 44% of households making a religious donation *always* (as opposed to *sometimes*) received a receipt for this, indicating at least some degree of formality to the payment. Third, of all government and non-government taxes, our data suggest that religious donations can perhaps be considered the most 'coercive': just under half of those making a religious donation reported that failure to make the payment would likely result in 'coercive consequences'. For most other taxes, the share of households reporting this is typically around 10%. This does not mean that non-payment of religious donations is met with violence or imprisonment; the majority of households reporting coercive consequences identified the 'punishment' as social exclusion or peer pressure from others within the community. Thus, the coercive basis for donations is in fact subtler, operating at the level of unspoken social expectations and obligations. Even members of the local elite are not exempt from these pressures. In Guneratne's study (1996: 29) of land tax in the Terai during the Rana regime, he suggests that the local enforcers of land tax (*jimidar*) never became a pure money-lending class because of 'the fact that the cultural norms of hospitality require constant expenditure, and the most onerous burden falls on the village elite'. The same would be expected of the village elite today.

More generally, past studies have provided evidence of links between social capital and displays of generosity or altruism. For example, Brooks (2005) asks whether social capital increases the likelihood of giving, and finds a positive relationship. Our data suggest the link might also work in reverse: does giving enhance one's social capital? While this is not something we investigated through our qualitative research, we found some indicative evidence that donations and social status appear to be at least partially connected. Chandra, an interviewee from site 2 who had lived in the community for over 40 years, reckoned he donated 'about 3,000 NPR annually to such informal groups [such as religious or community organisations]. Such type of donation is not mandatory, but donating them increases our reputation and social status. So I like to donate them'.¹² Tara Lal Upreti, an interviewee from Site 1, agreed: 'Donations are not mandatory, yet we are happy in donating. It makes our social height better'.¹³

For some people then, donations are driven at least in part by reputational concerns, an idea with some support in the academic literature (Cappellari et al., 2011). There is a social function to giving which helps guarantee membership of (and status within) the community and, vice versa, protects against exclusion. Connected to this is the fact that religious institutions have historically proven to be quite influential in parts of Nepal, playing an instrumental role in local dispute resolution and thus emerging as legitimate forms of public authority (Owen and King, 2013).

4.2 Informal taxes – especially those paid to non-government actors – are common

Of the 3.7 taxes the average household pays in a year, at least one of these is a payment to a non-government actor. But what about the formal/informal split? Given that taxes are generally only considered taxes in a *de jure* sense if they are officially codified by the state, we can say with some confidence that all payments to non-government actors fall under the informal heading. However, it is also possible that taxes paid to the government may exhibit aspects of informality: simply because a payment is made to a formal state actor, even if it is directly in exchange for something else (services, preferential treatment, access to documents, and so on), it does not necessarily follow that the transaction is formal. Indeed, agents of the state, such as local government officials, may perpetuate systems of informal taxation when they accept informal payments in return for a discount on the formal rate of taxation – 'fraud among consenting adults', as Tegara and Johnson (2007: 7) put it – or when they make additional extractive demands in order to supplement their meagre state wages (Titeca with Kimanuka, 2012). In one of our research sites, an interviewee offered some insights into such practices:

The hospital staff here are not good. The maternity health service is not good here. The government doctors do not treat well and refer to their own private clinic and charge higher. The reason behind poor service of the hospital is that the doctors invested a lot in their study and now the offered salary to them is very poor; that is why they are not sincere in their job and refer people to private clinic where they either have connections or work there.¹⁴

¹² Interview 09 [HH interview, male, 71, site 2]

¹³ Interview 05 [HH interview, male, 51, site 1]

¹⁴ Interview 15 [HH interview, female, 24, site 3]

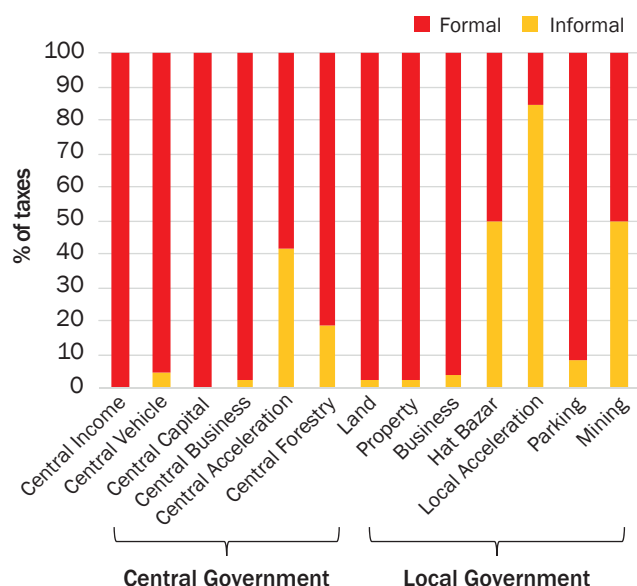
In order to be classed as an informal tax, we proposed that a payment must fulfil at least one of the following criteria:

- No receipt is ever received upon payment
- Any receipt received often shows a different amount to that which was paid
- The collecting agent is a non-government actor
- Non-payment brings coercive or threatening consequences, including verbal abuse, physical violence and social exclusion within the community.

In line with the basic purpose of this study, we consider these criteria to be tentative and exploratory rather than final and absolute. While there is logic to the selection of each, we are in no position to claim them to be tried and tested, or indeed universally applicable.

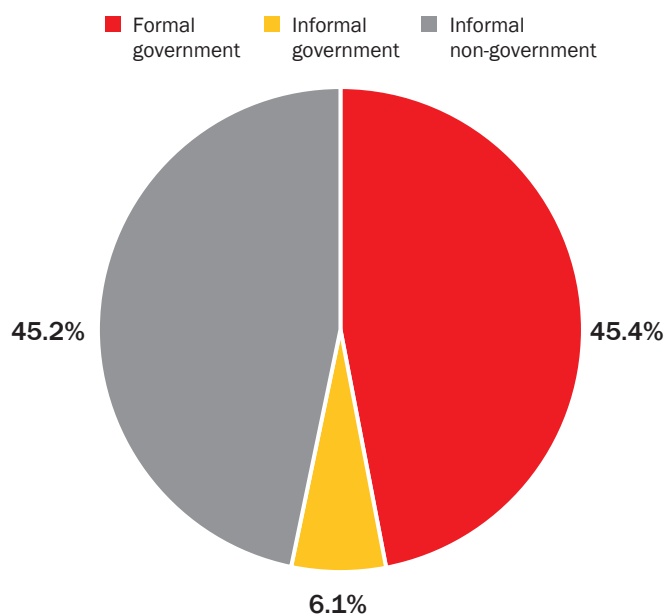
Using the criteria, our data show that the average household in our sample population pays 1.5 informal taxes (out of a mean of 3.7 taxes in total). This figure includes payments to non-government actors, which we automatically assign as informal, as well as taxes paid to the government which display certain informal characteristics. The latter, however, make up only a small fraction of the informal taxes we recorded: households on average pay 1.2 non-government taxes, and just 0.2 informal taxes to government. Put differently, of all the government tax payments recorded in our data, 10% can be classified as informal using our current criteria. This can largely be accounted for by a small number of government taxes which exhibit any real degree of informality (see Figure 5).

Figure 5: The proportion of government taxes paid which are classified as formal vs. informal



Finally, what portion of annual household tax expenditure can be classified as informal using the criteria above? We already know that at least 47% of household tax expenditures are informal, paid as they are to non-government sources. In addition to this, we must add the share of tax revenue going to government actors which qualifies as informal. Using the classification criteria outlined in section 4.2, we calculate this to be 6% (Figure 6). In other words, 6% of the average household tax burden is absorbed by payments to the government that are either unreceipted, 'differently receipted', or backed up by coercive consequences (or a combination of these). Taken together, we find that just over half of the average household's tax expenditure – 53% – can be classified as informal (see Figure 6).

Figure 6: Formal vs. informal split of the average household tax burden



5 What is the relationship between taxation and people's livelihoods?

In the previous section, we established how much tax the average household (in our sample population) pays, and started looking at the nature and composition of a typical tax burden. While a useful starting point, that information tells us little about how taxes relate to the household economy and to people's economic behaviour. The purpose of this section is to move the analysis forward by responding to the second research question guiding our study: what is the relationship between taxation and people's livelihoods?

We are interested here in three things in particular: the size of tax burdens relative to household budgets; the way in which tax burdens are distributed across different wealth groups; and the returns which taxes are seen to generate (or not).

5.1 Tax burdens are small relative to the size of the household economy

If the mean amount of household tax expenditure is NPR 10,454 over the course of a single year – around \$100 – how does this stack up within the context of the household economy? To enable such a comparison, our survey generated data on three separate proxy measures of household wealth: annual household income, annual household non-tax expenditure, and asset ownership. Following the work of Morris et al. (2000), we were able to measure expenditure and asset ownership by constructing a list of specific items and asking respondents to report against these.¹⁵ We also collected non-exhaustive data on annual incomes by asking about a household's three main income sources over the course of the past year as well as the amount contributed by each. These are imperfect measures, but they do enable an approximate estimation of the relative size of household tax burdens.

Using this approach, we find that the mean annual household income in our sample population is NPR 434,676 (around \$4,400), while mean annual household expenditure is NPR 1,127,509 or around \$11,400.¹⁶ As expected, our estimates of household expenditure

¹⁵ The calculation to estimate asset ownership and expenditure in this analysis was derived from Nepal Living Standards Measurement Surveys data.

¹⁶ Our estimations of annual income and expenditure, while sharing a similar distribution within our own data, are considerably higher than those reported by the Nepal Living Standards Measurement Surveys. We can be confident in saying that our higher average figures are caused neither by the way we imputed missing values (of which there were only 29) nor by a small number of outliers (our median values are also high). It is of course possible that respondents exaggerated their income and expenditure to enumerators, or that we unintentionally sampled from comparatively wealthy communities.

are considerably higher than our income estimates: this expenditure figure takes into account the value of households' own production, which is particularly significant in Nepal given the widespread use of agriculture for subsistence purposes.

For our sample as a whole, mean tax expenditure comes in at just under 3% of annual household income and just under 1% of annual household (non-tax) expenditure. There are, however, some variations – see Annex 4 presents for disaggregated data on mean expenditure on different tax types for each ward/site.

The boundaries between which one might classify a tax burden as small, medium or large are arbitrary and up for discussion. By most measures, however, it is quite clear that the average tax burden on households in our sample is far from excessive. Our findings on the limited 'disabling potential' of the current tax system in Nepal seem to support this. Taxes feature as an important part of the broader regulatory environment in which individuals, households and small businesses attempt to make a living. From this perspective, taxes deemed too punitive can deter people from engaging in certain livelihood activities. In other words, high taxation in a particular sector or on a particular commodity may increase the cost of participating in that activity beyond acceptable levels. It is then possible that, through the creation of a 'disabling institutional context' (Ellis and Mdoe, 2003: 1381), taxation regimes regulate what kinds of livelihood activities households choose (or are forced) to pursue. In order to try and get a sense of the extent to which taxes are restricting the economic activities of households in our sample population, our survey instrument asked two questions:

- First, whether a household had taken out a loan in the past year in order to pay taxes (the estimated size of average tax burdens reported above suggests this is unlikely to be the case)
- Second, whether anyone in the household decided not to engage in a particular economic activity in the past year because of the taxes associated with that activity.

Results indicate that the tax systems in our survey sites are nowhere near excessive enough to drive people away from participating in certain activities on a wide scale: just 1% of households had taken a loan in the past year to pay for taxes, and an even smaller share – 0.5% – reported not engaging in a particular economic activity in the past year as a result of unacceptably high taxation. This data is in line with qualitative evidence suggesting a dramatic contraction of the tax burden in recent decades. It appears that in Nepal's long history of state taxation (Guneratne, 1996; Hutt, 2007; Riaz and Basu, 2007), the tax burdens we are seeing here stand at an all-time low.

As we will later see, however, these low rates of taxation are to an extent offset by the costs associated with accessing essential services. Weak provision of quality public goods by the government compels people to seek alternatives. Where good enough services are absent, the void is filled through privatisation, trade associations, the creation of community self-help groups, voluntary donations to local causes, and allegiance to influential political parties who can (partly) steer the distribution of resources. Section 7 explains.

5.2 Wealthier households pay more in absolute terms but less in relative terms

Many parts of the world are characterised by regressive tax systems, in which the tax incidence falls on the poorest members of society. This phenomenon is not limited to low-income countries. A recent report by the Institute on Taxation and Economic Policy, for example, found that virtually every state tax system in the USA is 'fundamentally unfair, taking a much greater share of income from low- and middle-income families than from wealthy families' (Davis et al., 2015).

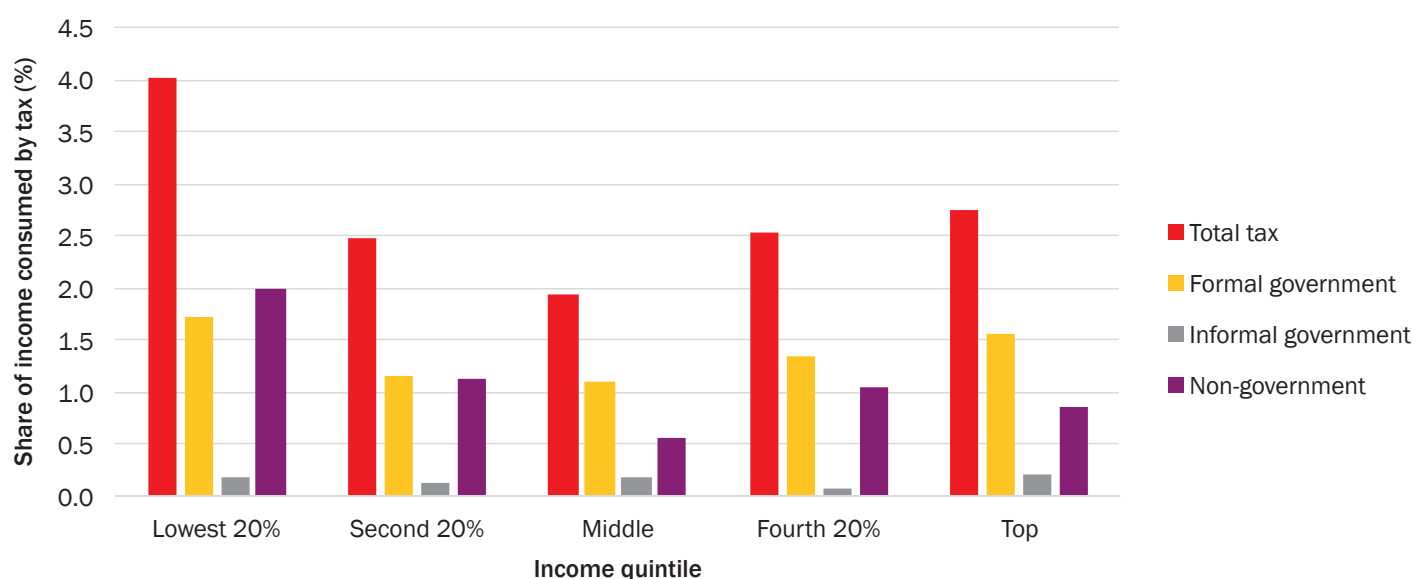
In order to assess whether this is true of our sample population, we calculated household tax burdens across income quintiles. Put crudely, in an unequal and regressive tax system, we would expect to see the poorer quintiles paying a proportionally greater amount of tax (relative to their income). Table 3 below shows the mean household tax expenditure-to-income ratios across income quintiles in our dataset. It also presents the relative distribution of each category of tax: formal government (about 47% of the total tax share), informal government (about 6%), and non-government (about 47%).

Table 3: Tax expenditure to income ratios, by income quintile

Income quintile	Total tax: income ratio	Formal government tax expenditure: income ratio	Informal government tax expenditure: income ratio	Non-government tax expenditure: income ratio
First quintile (poorest) (N 213)	4.01%	1.7%	0.2%	1.99%
Second quintile (N 201)	2.47%	1.1%	0.1%	1.13%
Third quintile (N 258)	1.93%	1.1%	0.2%	0.57%
Fourth quintile (N 156)	2.52%	1.4%	0.1%	1.05%
Fifth quintile (richest) (N 204)	2.75%	1.6%	0.2%	0.85%

Overall, the tax system is taking a greater share of income from the poorest households than from wealthier ones. However, the distribution broadly follows a U-curve: it is households in the middle that pay the smallest share, while households at the top are paying the second greatest share (2.75% compared to the 4.01% extracted from the poorest). Distributions of the disaggregated tax categories – formal government, informal government, and non-government – follow a broadly similar ‘U-shaped’ pattern (see Figure 7).

Other studies into the effects of local tax regimes on household economies are hard to come by, particularly in low-income countries. One notable paper by Bahiigwa et al. (2004), however, observes a generally similar pattern of incidence in parts of rural Uganda. Using qualitative and quantitative data, the authors found evidence of a highly regressive local tax system: while households in the bottom quartile paid between 9 and 12% of their income as taxes, those at the top paid between 1 and 5%. These numbers are not, of course, directly comparable to ours, but they nonetheless convey a similar message.

Figure 7: Percentage of income consumed by total tax, formal government tax, informal government tax and non-government tax, by quintile

5.3 People don't feel they get much in return for their taxes

What do people feel they receive for their \$100 in taxes? While we are not able to say objectively what this tax revenue was actually used for, we are able to say what taxpayers *thought* they got.

Overall, we find that just under 60% of households paid at least one tax for which nothing was received (according to the perception of the respondent). This figure varies quite considerably from ward to ward. For example, around half of the households in ward 1 paid at least one tax for which nothing was received (which conversely means that the other half felt something was received for every tax paid). Meanwhile, in ward 2 – just 25 kilometres down the road – 70% of households paid at least one tax for which nothing was received.

Our qualitative research suggests that community members in ward 2 felt particularly frustrated with the state for failing to deliver locally specific services. The VDC in which ward 2 is located sits directly on the Kankai River. Every year, the Kankai's banks break. Despite continuous appeals to the local government for effective management of this annual problem, very little appears to have been done. While a levee has been constructed which runs alongside the river bank, this apparently offers minimal protection. The frequency with which ward 2's community members talked about the Kankai's annual floods – and the problems this causes – suggests it is a major local concern. One interviewee from site 2, Dambar Guragain, was keen to express his frustrations:

The terrible floods (mai khola) are [one of] the main problems in this place. The local government is not sincere about solving these problems, or maybe it does not have the capacity to tackle it [...] There are no influential people here who could voice on our behalf. The DDC [district development committee] allocates budget to solve the flood problems annually, but the budget itself gets politicised, and some people with better connections with the political parties misuse the funds.¹⁷

Breaking the overall tax burden down, we find that non-government taxation performs comparatively well against government taxation. While just under 20% of non-government taxes are seen *not* to generate any

returns for the payer, the equivalent figures for government taxes are higher: 40% in the case of formal taxation and 26% in the case of informal government taxation. It is necessary to make a point here about the different kinds of taxes covered by these categories, and about how people's expectations vis-à-vis returns are unlikely to be uniform. Non-government taxation covers things like donations to religious actors. As discussed in Section 4, so many people seem to make these donations because of the social function such an act performs (in terms of increasing one's social status, securing group membership). The material basis for making a religious donation is less obvious; people may not expect much – if anything – in the way of direct, tangible returns. Compare this to, say, land tax, where one might reasonably expect a protection of rights, an irrigation service, some form of insurance, or something else. Thus, different expectations are attached to different taxes, making it easier for some collecting agents to fall short of meeting them.

Further disaggregation of the data reveals that it is not just one or two taxes that account for the figures outlined in the paragraph above. In fact, a substantial share of respondents felt nothing was received in almost all cases, across the entire range of taxes (see Table 4).

Table 4: Percentage of respondents who feel nothing is received, by individual tax

	Tax	Frequency (n)	%
Local government	Land	337	54.89
	Property	278	54.83
	Business	69	35.57
	Hat-Bazar	18	29.03
	Acceleration	28	31.46
	Recommendation	39	13.64
	Parking	0	0
	Mining	4	50
Central government	Central income tax	65	33.85
	Central vehicle tax	61	21.71
	Central capital tax	1	33.33
	Central business tax	21	25.93
	Central acceleration	4	16.67
	Central forestry	4	5.8
Non-government	Religious	151	19.11
	Local group	6	16.67
	Local club	44	24.31
	Trade association	9	7.38
	Community donation	40	27.59

¹⁷ Interview 10 [HH interview, male, 48, site 2]

Frustrations with these aspects of the system were voiced with some regularity during qualitative interviews. One of the main problems with the way things are currently done seems not to be unmanageable or punitive tax burdens, but rather the apparent dysfunctionality of the system. In our first research site, one interviewee complained that, despite paying land tax regularly for several years, he had yet to see any evidence of a useful return on this:

Some seasons are remarkable for crop failure, which creates difficulties in sustaining our livelihood. Even in such a situation, the tax collector does not facilitate on our account [help us out]. It is a frustrating problem that we do not have an insurance system ... Our agricultural activity is not insured by the tax collector.¹⁸

We recorded many other comments like this; further samples are shown in Box 1.

Box 1: The unmet expectations of taxpayers

We expect fast and effective services from the local government. We are sending our children to foreign countries for work. If the government collected tax in a good way and employment was proper, we would not have to send our children to a foreign country. [Interview 03]

The state taxes general people and in return we get nothing. [Interview 13]

People are paying tax, but the government is not creating job opportunities. [Interview 14]

Our survey also asked respondents whether they thought the collecting agent uses tax revenue for the benefit of the community. The results paint a generally negative picture, although we again see a sharp difference between taxes collected by the government and taxes collected by non-government actors: just 5% of formal and 9% of informal taxes paid to the government are seen to be used by the government for the benefit of respondents' communities, while the equivalent figure for non-government taxes is up to 41 percentage points higher (see Table 5). Again, it is necessary to point out how the type of tax might heavily influence respondents' perceptions. Religious organisations or local youth groups are often considered to be more embedded within the community than formal state organisations, and many people may have no particular reason to believe the revenues they generate

are being used elsewhere. Taxes paid to the government, on the other hand, might be spent quite legitimately on things elsewhere which benefit other communities.

Table 5: Share of taxpayers who believe the collecting agent uses revenue for the benefit of the community most of the time, by formal government, informal government and non-government taxes

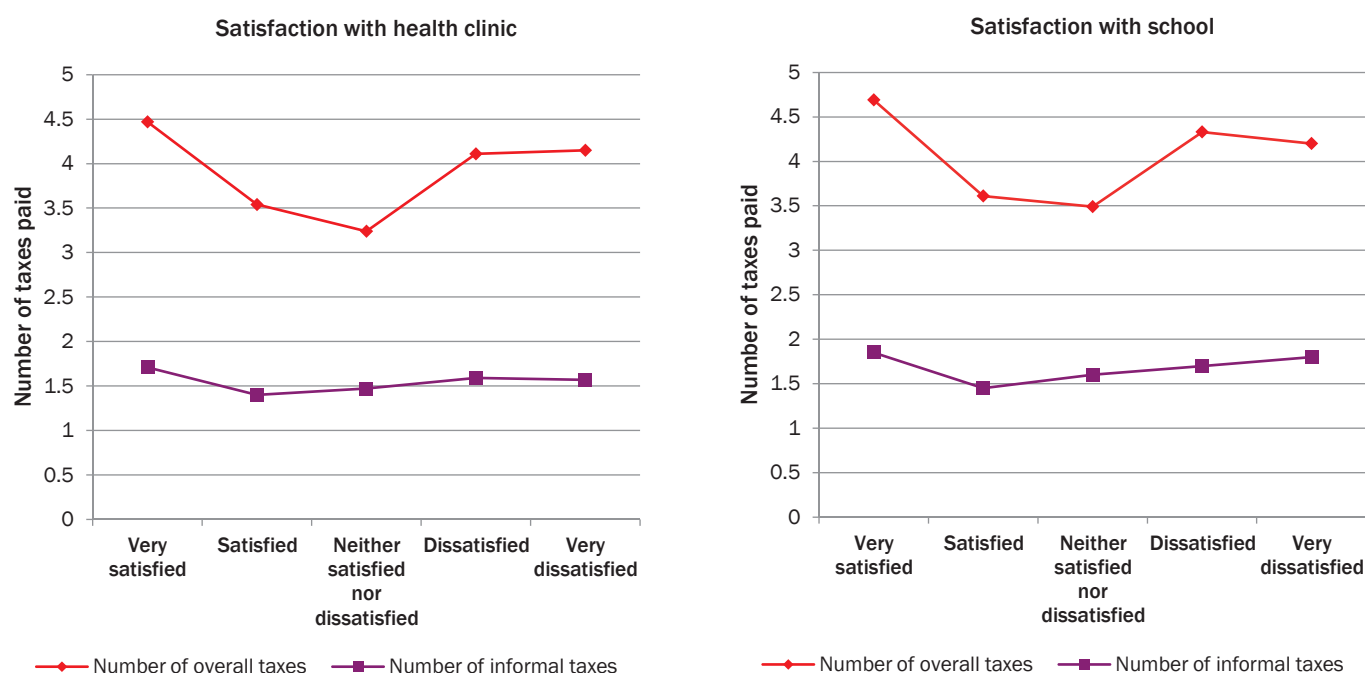
	Formal government taxes	Informal government taxes	Non-government taxes
% who believe the collecting agent uses revenue for the benefit of the community most of the time	9.43	4.61	46.27

Our survey data also allow us to explore any potential associations between household tax burdens – that is, how much is paid in taxation over the course of a year – and the quality of local service provision. Generally speaking, we find a positive relationship between the amount of tax paid by a household and satisfaction with the services used (as measured by respondents' own judgements of service quality). For example, respondents who reported satisfaction with their health service lived in households which paid, on average, more than NPR 4,000 (about \$40) in additional taxes in the past year relative to those reporting dissatisfaction (significant at 5%).

However, the relationship is less clear when we consider the *number* of taxes paid. While 'very satisfied' respondents paid, on average, a greater number of taxes than less satisfied respondents, it does not appear to follow that the more taxes paid, the more satisfied the individual. The same pattern does not appear to hold for the number of informal taxes paid (see Figure 8).

18 Interview 05 [HH interview, male, 51, site 1]

Figure 8: Levels of satisfaction with health clinic and primary school services, by number of overall and informal taxes paid in past year



We cannot be certain about what accounts for this pattern. However, it is possible that we might be seeing an effect of paying taxes on people’s expectations vis-à-vis service delivery and their willingness to speak up when things either exceed or fail to meet those expectations. Looking at the two graphs, we can see a clear and consistent dip in the overall number of taxes paid when respondents report feeling neither satisfied nor dissatisfied with their health and education services. Thus, it appears that those paying more taxes have stronger (although not necessarily more positive or negative) views on the quality of their local public services than those paying fewer taxes. Regression analysis results lend some support to this: we find no statistically significant association between the number of taxes paid by a household and a respondent’s level of satisfaction with their local health post (see Annex 5.1).

6 What is the relationship between taxation and state legitimacy?

Fiscal sociology theories suggest that taxation plays a central role in the formation of relationships between citizens and public authorities – Moore’s (2015) ‘governance dividend’. Since the beginning of European state formation, there has been a solid and enduring relationship between the state and extraction (Thies, 2004). Taxation has long been applied as a tool of governmentality, designed not only to make populations legible to the state and to raise revenues, but also to secure legitimacy from within society. Tax revenues can be used to provide public goods to, and protect the rights of, a given population, thus theoretically conferring a degree of performance-based legitimacy to the state.¹⁹ Through this process, states and citizens are understood to enter into a mutually dependent relationship underpinned by the notion of fiscal exchange.

The purpose of this section is to explore a series of associations and interactions between the taxes people pay and a series of variables associated with what we might term ‘governance outcomes’. These include levels of engagement in public meetings (as a measure of civic participation) and people’s perceptions of the government more generally. Such an approach draws on methods used by the SLRC to measure (using proxy indicators) state legitimacy through a longitudinal panel survey in five countries (see Mallett et al., 2015). We also consider a few measures of how people view particular types of tax, such as perceived fairness and transparency, which is useful for understanding the *relational* nature of taxation – that is, the way in which taxes are collected by the collecting agent (see Section 2). It is to this dimension to which we first turn our attention.

6.1 Government taxes are seen as fairer but less transparent than non-government taxes

It is sometimes thought that informal governance is essentially shorthand for a shadowy form of politics wherein corruption and brokerage are the norm. In contrast, a formal state that functions in accordance with ‘good governance’ principles, or at least loosely in line with the Weberian model, is expected to be open and transparent in its operation. As such, we might anticipate people to generally have a clearer idea of how formal government taxation works relative to informal and non-government taxation.

¹⁹ Performance- or output-based legitimacy is understood to emerge when a public authority is seen to deliver on citizens’ expectations vis-à-vis material outcomes, such as services, economic opportunities, security, and so on.

For each tax paid by a household, our survey asked respondents whether they were aware of how the tax rate was calculated. As Table 6 shows, just over 47% of formal government taxes can be classified as transparent by this indicator (in the sense that the calculation process of just over 47% of those taxes was known to respondents). In comparison, the equivalent figures for informal government tax and non-government tax are 42% and 60%, respectively. Insofar as we might expect formal government taxes to be more open and transparent, these figures are quite surprising: there is not all that much difference from one category to the next.

Table 6: Negotiability, transparency and fairness of formal government taxes, informal government taxes and non-government taxes

	Formal government taxes	Informal government taxes	Non-government taxes
Transparency % of taxes whose calculation process is reported as known	47.35%	41.80%	60.31%
Fairness % of taxes perceived as being applied and collected fairly	82.79%	41.39%	76.55%

How do people perceive the fairness of these different taxes, particularly in relation to how evenly they are (seen to be) enforced across the community? Our survey data show that formal government taxes are perceived to be the fairest of all tax types: 83% of formal government taxes were reported as being fairly applied and collected, compared to 77% of non-government taxes and 41% of informal government taxes.

When we consider the high share of respondents who (feel like they) do not receive much in return for their taxes, these ‘fairness ratings’ are quite surprising. While it is not clear what accounts for this, it is possible that people attach a strong sense of fairness to the moral economy aspect of taxation (see Lough et al., 2013: 19). In other words, taxes may be considered fair if their rates reflect the personal circumstances of an individual or household, rather than the official rulebook. This means that when a household suffers a major loss or shock of some kind, such as a fire in their property, a ‘fair tax’ would be seen

as one whose rate shifts downwards in order to reflect this unfortunate event. There is actually some limited qualitative evidence that this happens from time to time. According to the VDC Secretary in site 5, if someone in the VDC is badly affected by a natural disaster or a disease, the local government office will reduce the amount of tax demanded of that person or even waive it altogether.²⁰ In some cases, the office will go further by providing financial assistance to the affected household (given that a previous system of disaster compensation had been dismantled in the VDC, this appears to be done on an informal basis). It is not, one might argue, particularly surprising that this happens: indeed, the informal and personalised nature of local governance in Nepal lends itself quite organically to such practices. In the words of one interviewee, ‘We can talk, bargain, consult with the nearer one [local government officials]’.²¹

6.2 More taxes are associated with greater civic participation

Theories of fiscal sociology imply that taxation can be a means through which engagements and interactions between states and their citizens can be increased. The basic idea is that if someone is funding the government out of their own pocket, they are more likely to care about what the government does with public funds. We started to see how this might play out in the previous section, where we observed a possible link between the number of taxes paid and the strength of an individual’s view on service quality. Another way of investigating this question is to examine levels of civic participation. Following this, our survey asked respondents about their experiences of interacting with the local government vis-à-vis community issues and concerns over the past year. We were interested in:

- whether respondents had attended any public meetings organised by local government over the past year and, if so, how they evaluated the experience(s)
- whether respondents had organised collectively with others within the community in order to raise an issue or concern with the local government and, if so, how they evaluated the experience(s).

In conceptual terms, these two questions constitute crude proxy measures of what Gaventa (2006) refers to as *invited* and *claimed* spaces of participation. Invited spaces, such as public consultations and

20 Interview 25 [key informant, male, age unknown, site 5]

21 Interview 02 [HH interview, male, 30s, site 1]

forums, are created when efforts are made to widen participation in governance and development processes. Claimed spaces, on the other hand, are created more autonomously by relatively powerless actors wishing to convey a message or 'have a say'. Public protests, such as the regular *bandhs* we have seen in parts of Nepal over the past few months, are one example. Engaging in one type of space does not of course substitute for engagement in the other. In fact, regression analysis shows that respondents in our sample who raised an issue in the past year were also statistically much more likely to also attend a community meeting (significant at 1%) (Annex 5.2).

Our data show that just over one-fifth of respondents had participated in at least one local government meeting over the past year, while around 15% had gotten together with others to raise an issue with the local government. In both cases, the majority of the sample population reported not only that they had not participated in such activities, but also that they 'would never do this' (67% and 68%, respectively).

Qualitative evidence suggests this hasn't always been the case. One former VDC secretary described how current levels of citizen participation are much lower compared to the 1990s. During that time, he said, there were five people from each ward who were partly responsible for planning services and development. These individuals apparently shared a close relationship with the rest of the community, and would seek to actively involve them in decision-making processes. But today, 'while there is greater budget allocated from central government, people's participation in local governance is worse'.²² The following story, told by an interviewee from a different district (Jhapa), adds some colour to the picture:

The front road of my house was built 32 years ago. It was gravelled 15 years ago, and it is the same now – there has been no progress. For five years, we have been told 'this road will be pitched this year'. I think they [the government] are just creating a myth. In 2052 [1996], the local people themselves invested to widen the road. Each household paid 100 to 200 rupees (according to their economic status, and contributed five days free labour. At that time, the CPN-UMI party was leading the government. It had a programme slogan called Aafno Gaon Affai Banau ['Let's make our village ourselves']. This programme

encouraged local people's participation in development work. Some 20 years ago, this amount [100 to 200 rupees] and the free labour contribution was not a joke. It was great public support and participation. But after that, no governments have been formed and no such programme for people's participation have been designed.²³

The high shares of non-participation speak quite strongly to the state of local governance in Nepal. As The Asia Foundation (2012) has pointed out, state-society relations in Nepal have been critically undermined since the 2000s by electoral dysfunction and absence of legitimate community representatives. Even the formation of citizen forums at the local level has not had the desired effect, designed as they have been around formal rules and procedures rather than taking into account the 'informal and political aspects of governance' (3). Indeed, when asked about the experience of their participation, the majority of respondents (N=208 and N=150, respectively) felt nothing was really achieved by their efforts. One example of this comes from an interviewee in site 6: 'Previously there was no fine system here [for non-payment of taxes]. Now it has been applied. Since I was participating in meetings, I should have known this. Some secrets are not revealed'.²⁴

Actual experience aside, our data show quite convincingly that those who pay more tax are more likely to engage in civic participation. Those who attended a meeting in the past year paid a higher number of overall taxes and a greater amount of tax expenditure than their non-participating counterparts (see Figure 9, which plots the number of taxes paid against a civic participation index). The same pattern holds when we look at whether respondents raised as issue with local government in the past year, and is in fact more pronounced. What's more, results from logit regression analysis demonstrate a highly significant association between the number of taxes paid by a household and participation in a local government community meeting over the past year (at 1%) (Annex 5.2). This association is robust even when controlling for variables relating to individual characteristics of the respondent (such as gender and age), satisfaction with services, and geographical location.²⁵

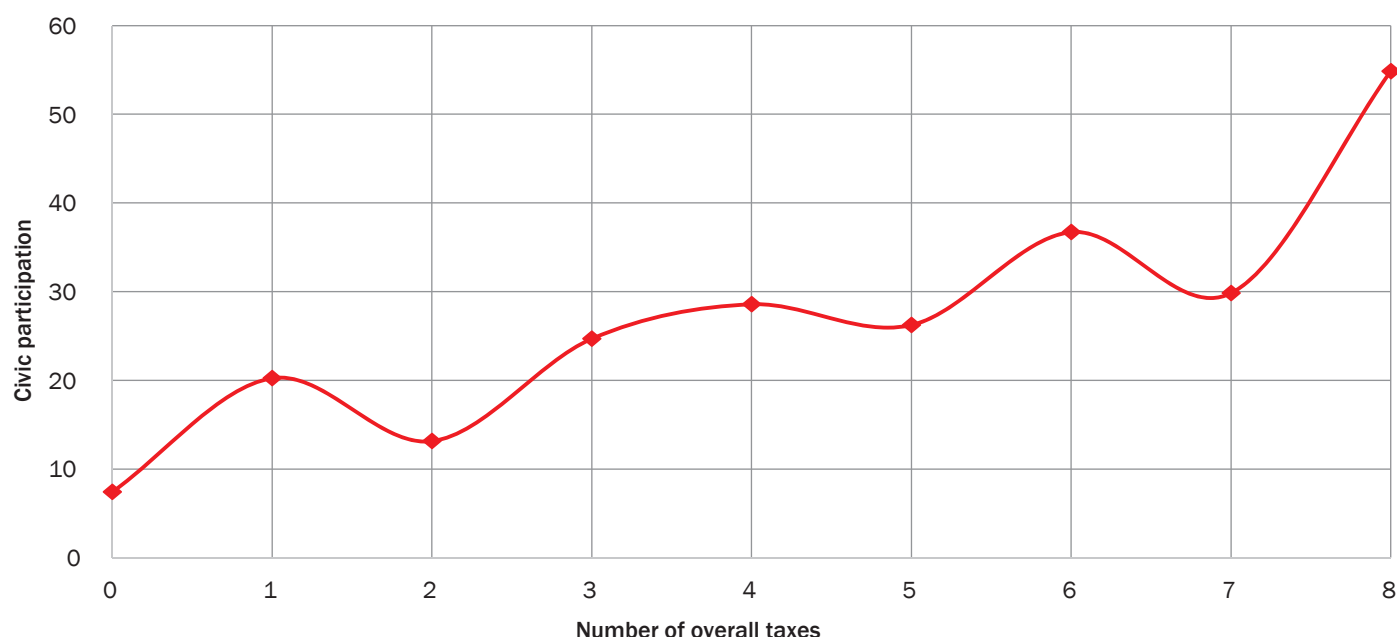
23 Interview 19 [HH interview, female, 50, site 4]

24 Interview 29 [HH interview, female, 40s, site 6]

25 It is necessary to point out that we cannot be certain of the existence of a causal relationship here. It might also be the case that the direction runs in the reverse. That is, that more regular meeting attendance encourages people to pay more taxes.

22 Interview 24 [key informant, male, 60s, site 5]

Figure 9: Civic participation, by number of taxes paid in past year



Note: The civic participation variable is a binary variable ranging from 0 to 1 and equalling 1 if the respondent attended a local government meeting in the last year meeting or stated that he or she was involved in raising an issue in the community. On the graph the Y axis represents the percentage of respondents for whom the civic participation variable equals 1.

6.3 More taxes are associated with greater trust in government...unless those taxes are 'unrewarded'

Our survey asked respondents a series of questions that aimed to gather information on their attitudes towards government responsiveness and trustworthiness. While not always clear and consistent, the data suggest there is a generally positive correlation between taxes and trust in government. We find, for example, that respondents who agreed that those in power – at either the central, district or VDC level – cared about their opinion paid a higher number of taxes as well as a greater amount of tax over the past year than those who disagreed (see Table 7).

Table 7: Tax burdens, by perception of government (central, district, VDC)

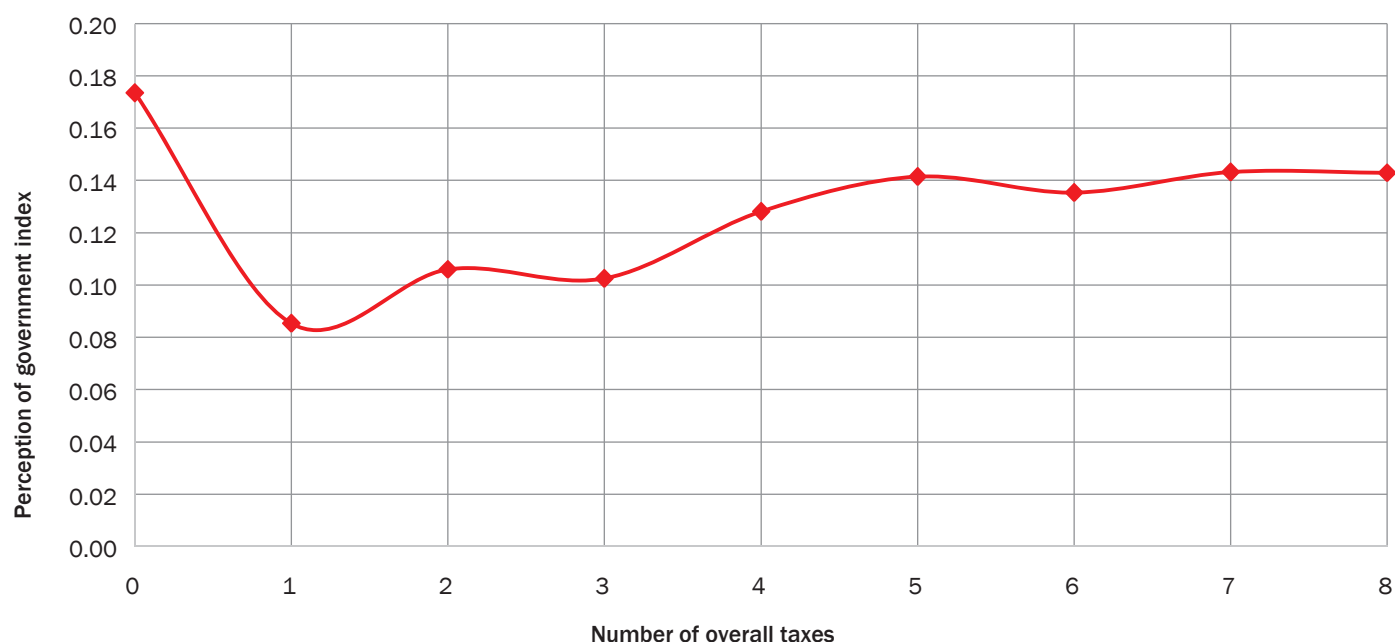
		Central	District	VDC
Do you agree that those in power care about your opinion?	No	3.5 taxes / NPR 9,980 in taxes	3.4 taxes / NPR 9,043 in taxes	3.3 taxes / NPR 8,786 in taxes
	Yes	4.1 taxes / NPR 24,351 in taxes	4.4 taxes / NPR 27,898 in taxes	4.0 taxes / NPR 15,399 in taxes

A similar picture emerges when we consider responses to the question, 'To what extent do you feel that the decisions of those in power reflect your own priorities?', which required respondents to select one option from a five-point scale (ranging from 'never' to 'always'). With some minor exceptions and inconsistencies, we find that more positive responses to this question are associated with greater tax burdens.

In order to further the analysis, we constructed a 'perception of government index'.²⁶ On the face of it, descriptive statistics suggest there is little evidence of a clear relationship between the number of taxes paid and people's perceptions of the government (as measured by the constructed index) (see Figure 10). That said, if we were to remove the first data point – for those paying zero taxes (only 3% of the sample) – we would see a more consistently positive relationship.

²⁶ The perception of government index is a composite index with four dimensions: (1) perceived likelihood that the government will misuse tax revenues; (2) perceived likelihood that the government will misdirect money allocated for a project; (3) how often do decision of those in power reflect your priorities? (4) Do those in power care about your opinion? Within each dimension three levels of government are evaluated by the respondent: central, local, and district government. The index ranges from 0 and 1, where 0 is the most negative perception and 1 the most positive, and has a mean of 0.13.

Figure 10: Perception of government index scores, by number of taxes paid



Furthermore, controlling for geographical factors, OLS regression results show that the higher the number of taxes paid in the past year, the better a respondent feels about the government (at 5%) (see Annex 5.3). A separate Tobit regression analysis finds an even stronger association (at 1%) (see Annex 5.4). (It must be pointed out that the R-squared values for each regression are not strong.) Thus, while not entirely consistent, there is certainly evidence from our data analysis to suggest a positive relationship between taxation and better attitudes towards the government. Of course, it could also be the case that individuals feeling more positively about the government in the first instance are more tax-compliant – and therefore pay more.

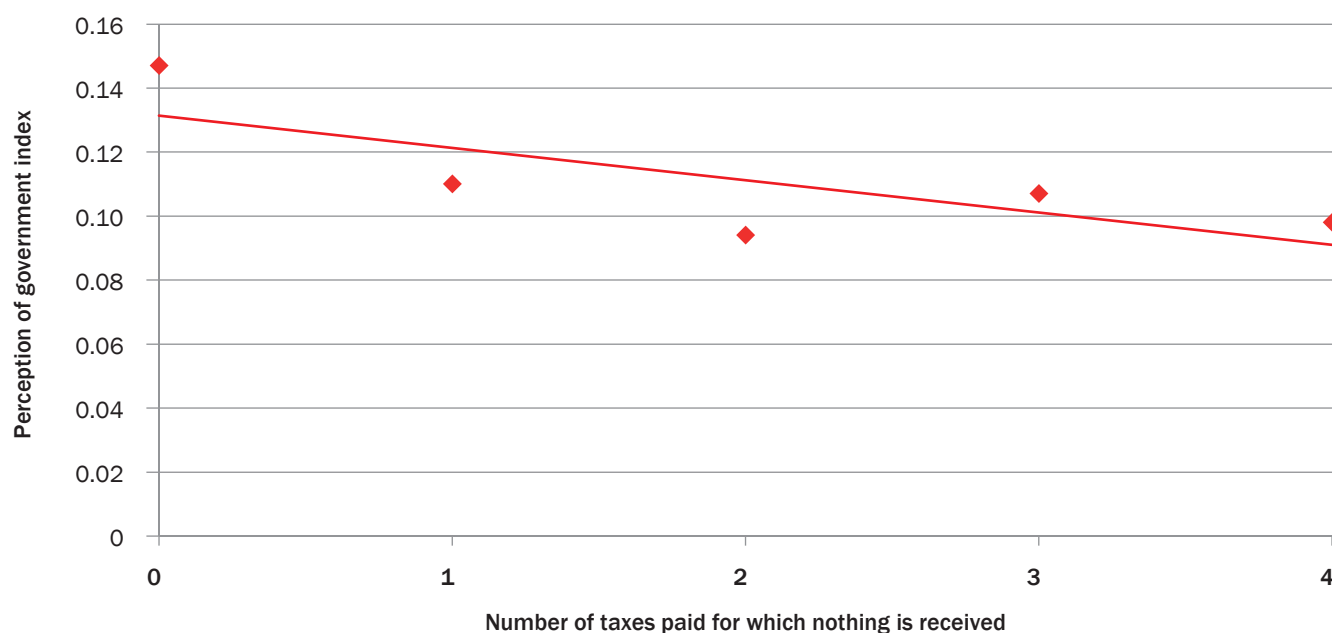
Where this general relationship starts becoming more nuanced is when we look more closely at the nature of the taxes paid. For example, we reported earlier that around 60% of households in the sample population pay at least one tax for which nothing is received (as reported by the respondent). How might this affect taxpayers' perceptions of government? Figure 11 plots the number of taxes where nothing is received against our perception of government index.²⁷ The slope of the trendline indicates that, generally speaking, respondents from households which pay a higher number of 'unrewarded' taxes tend to have worse perceptions of the government.

²⁷ Within our dataset, there were eight households paying five taxes for which nothing was received, and two households paying six such taxes. Because the number of observations for each is so low, we have removed the values from this figure.

Finally, while Tobit regression analysis finds a positive association between number of taxes paid and perceptions of the government, as mentioned above, the same analysis shows that respondents are actually less likely to think positively about the government when their household tax burden is larger in relative terms (see

Annex 5.4). That is, when taxes absorb a greater share of household income, respondents appear to have worse perceptions of the government. This suggests that it is not just the number of taxes paid *per se* that matters, but also how tax expenditure stacks up in the context of the broader household economy.

Figure 11: Number of taxes paid for which nothing is received, by perception of government index



7 Discussion: taxation, livelihoods, and the limits of the state

By our estimates, Nepalese households are today being taxed less than ever before. The average household within our sample population pays the equivalent of around \$100 in formal and informal taxes per year, which comes in at just a fraction of their annual incomings and general outgoings.

Is this a good news story? Our analysis suggests not. While Nepalis are no longer subject to heavily punitive tax regimes, the system continues to work against them in other ways. Public goods are inconsistently provided by the state and, when they are, their quality is problematic. Citizens – rather than government – are expected to foot the development bill, not through high tax rates but through an accumulation of multiple user fees. And, more broadly, the state continues to be disembedded from society: local representation and accountability are non-existent, and the low levels of citizen trust in state institutions suggest a legitimacy crisis.

In this final analytical section, we ask what our quantitative and qualitative findings tell us about the state of local governance and development in Nepal more generally. It is split into three parts. The first discusses how the withdrawal of the state from public life has given rise to multiple forms of bottom-up, community-driven provision of various public goods. In the second part, we show how, although tax burdens appear low by our estimates, Nepalese households are still expected to foot the bill of development and service delivery in other ways – most notably through the heavy and regular exaction of user fees. In the third part, we draw out what our analysis says about the nature of state-society relations in contemporary Nepal, arguing that an explanation for why formal taxes are kept so low helps us gain insight into the problematic nature of local governance.

7.1 Filling in the gaps: state weakness and the rise of non-government public goods provision

It is not uncommon for non-government actors to be involved in the provision of public goods. This in fact happens to varying degrees around the world, including in places affected by fragility and conflict (Batley and Mccloughlin, 2010). Our qualitative research in Nepal suggests non-state provision of public goods is fairly widespread in many parts of the country (although we are in no position to attach any numbers to this). These modes of provision take many forms, and are apparent in various sectors. While the government itself might occasionally be absent from these mechanisms of provision, at other times it might be responsible for co-

producing public goods alongside community actors. There is no uniform way in which this happens.

In site 3, we met Rohan, a young man still at school.²⁸ Rohan explained that taxes did not really constitute much of a burden for his household, estimating that they accounted for just 5% of annual expenditure. In exchange for the payment of these taxes, Rohan felt that the government was ‘helping, but not much’. For this reason, when asked what he thought about tax, his reply was: ‘it is just a government process’. For Rohan, taxation represented little more than a standard bureaucratic procedure, something the government was required to do but which offered little in the way of returns. He went on to point out some of the problems affecting his community – problems he felt the government should be using his family’s tax money to fix. Of particular concern was the lack of streetlights along a nearby road, which not only made journeys physically difficult but also exposed residents to certain risks. As he explained, ‘Lights are important because of thieves in the area and snakes in the winter months. The road can be dangerous’. The government had done little to improve the situation over the past year. In response, Rohan’s local youth group – which is unregistered and meets only infrequently – took it upon themselves to fill this particular gap in community service provision. The group set out to raise 50% of the estimated funds required to finance a row of streetlights through community donations, and sought the remaining 50% from the municipality office. They eventually raised NPR 700 for each pillar which, when matched by local government contributions, was enough to implement the project. Rohan clearly remembers how happy he felt upon completion of the work, describing to us in detail the striking brightness of the newly fitted streetlights. He remains positive about the experience to this day, even though the inevitable questions of responsibility for maintenance have begun to emerge. Pointing to the lamp nearest us, Rohan explained that although it stopped working some months ago, the government had so far refused to do anything about it, citing a lack of financial resources and time. Further fundraising and action by the youth group was of course one possibility, but due to upcoming exams, members had stopped meeting for the time being. As of April 2014, the future and longevity of Rohan’s streetlight project looked uncertain.

As we showed in Section 4, a remarkably large share of survey respondents – more than three-quarters of those

interviewed – reported making a donation to a religious organisation. Our qualitative research revealed that, in addition to these donations, people frequently give money to other causes deemed worthy. One interviewee from site 1 told how he gives donations to ‘old age homes, orphan homes, diseased people ... Sometimes sports groups come and ask for a donation, and we donate some money to them’.²⁹ Meanwhile, in site 2, we were told by one interviewee that he often supports the fundraising efforts of festival organisers,³⁰ and by another that he sometimes donates to students from the local campus looking for ways to fund ‘educational excursions’.³¹ In site 5 in Sindhupalchok, we were told how wealthy members of the community were making large donations to the construction of a new temple, driven by a sense of obligation and in an attempt to buttress their status within society. Many similar stories were heard at our other research sites.

Likewise, certain economic sectors are subject to ostensibly non-state forms of regulation, which nevertheless shape the nature of access to and participation in those labour markets. We can take the example of rickshaw trade in Jhapa district. In comparison to other economic activities, this sector appears quite closely regulated. In order to operate, a rickshaw driver first requires a licence. Failure to comply with this attracts a fine of around NPR 550. A number plate is also necessary. In order to obtain these, drivers must present their birth school certificates to the local government office, as well as pay a fee of NPR 50.³² Once these have been secured, the driver goes about finding a rickshaw. It is quite unusual for the average Nepali rickshaw driver to own his (and it usually is ‘his’) vehicle. Drawing on quantitative data from the eastern plains – including from Jhapa district – Hatlebakk (2012) shows how, despite the fact that a driver could theoretically make enough money in a single year to cover the cost of purchasing a rickshaw, the majority still rent theirs. Rather than myopic tendencies (that is, the inability to plan for tomorrow), this decision is driven by subsistence constraints – consumption levels in the present day are simply too low to allow for future savings. Informal conversations with rickshaw drivers in Jhapa suggest that the daily cost of hiring the vehicle absorbs roughly 20% of what the average driver makes each day. On top of this, it is not always possible for drivers to bargain for the best

29 Interview 03 [HH interview, male, 58, site 1]

30 Interview 09 [key informant, male, 71, site 2]

31 Interview 10 [HH interview, male, 48, site 2]

32 Interview 18 [business interview, male, 47, site 4]

28 Interview 14 [HH interview, male, 19, site 3]

market rate. As one respondent from site 4 explained, the local Rickshaw *Sanchalak* (Operation) Committee fixes the price a driver can charge for shorter journeys, only permitting negotiation for much longer rides. At the same time, however, the Committee provides a service to rickshaw drivers operating in their territory, assisting in the case of road accidents and any resulting disputes. For example, if another vehicle were to collide with a rickshaw but refuse to pay for repairs, the Committee would enter into negotiations with the owner. A similar kind of 'trade union' was found to exist in site 3 for those in the autotrading business: for an annual levy of NPR 100 – and a NPR 1,000 to 1,500 contribution to the annual general meeting – members received life insurance (3 lakhs in the case of death) and could access loans from the union at a reduced interest rate.³³

What connect these different examples of public goods provision and economic regulation are their origins. In each case, these mechanisms have emerged in order to fill a gap created in the first instance by government inaction. What we are essentially seeing here are strategies for development and social protection under conditions of weak state presence and capacity. The state is taxing people – admittedly not a great deal – but it appears to be failing to provide much in the way of a return. Thus, it is left to local communities to fill in the gaps of public goods provision – and to pick up the tab for doing so.

7.2 Who pays for development? User fees as tax

Budget allocations from central to local government have risen over recent years in Nepal, and various formal Acts have theoretically devolved more power to individual VDCs and municipalities. However, we know from the existing literature that various political economy factors are acting as constraints on effective decentralisation. The Asia Foundation identifies a series of underlying problems confronting local governance. First, while new sources of rents were introduced in the form of block grants and aid funding, local government capacity generally failed to adjust. VDCs, for example, continued to be staffed by a single secretary and an untrained assistant. As a result, the Local Self-Government Act (1999), which was intended to dramatically enhance the state of local governance, essentially 'became a repository of unfunded mandates rather than an enabling

instrument for local bodies to take control of their affairs' (The Asia Foundation, 2012: 1). Communities can see how this works in practice, with several interviewees – including VDC officials – identifying the primary cause of local underdevelopment as weak local government autonomy. Second, The Asia Foundation shows that planning processes have been subject to huge fragmentation. While local and district bodies have been tasked with designing their own plans since 1999, in practice the plans coming from those levels have been overlooked by the National Planning Commission at the central level. The continued reliance on sectoral ministry planning essentially made the local-level process redundant. And third, the decade-long insurgency resulted in a widespread 'emptying' of local bodies – indeed, by 2002, most VDC offices in the country were unstaffed. Some would argue that the legacies of this are still being felt today: there continue to be no locally elected government representatives; VDC Secretaries are often absent from their offices for long periods of time (Hagen-Zanker et al., 2015); and state guidance plans for local development, which are centrally formulated, fail to take into account the way in which local politics and governance continued to develop informally throughout the period of conflict (The Asia Foundation, 2012).

Today, Nepal's system of local governance is considered dysfunctional. This is manifested in the weak enforcement of formal taxes as well as weak provision of public goods. As a result, while households escape the punitive tax burdens of past decades, they are left to contend with poor state services that do little to form an effective enabling environment. What are the consequences of this situation? Our evidence shows that, in each site visited, local communities are being forced to pay extra just for adequate or necessary services. Weak state provision creates opportunities for the emergence of private provision – in addition to the forms of community-based collective action described above.

We see this in relation to multiple sectors. In site 2, we interviewed Chandra, a man whose family had long been dependent on agriculture. He was unbothered by the state's extractive activity, but was highly critical of its lack of intervention: 'I think the land tax is not a burden to me, but the irrigation charge is really a burden'. He was referring to the irrigation service that had recently been implemented by a corporation (*Kankai Irrigation Aayojana*), access to which cost him NPR 1,200 each year. (In comparison, his land tax was NPR 250 per year.) Chandra was not displeased with the quality of this irrigation service, but he expressed concerns about

33 Interview 13 [business interview, male, age unknown, site 3]

how expensive it was, particularly as he essentially has no choice in the matter: 'Without this irrigation service, I cannot cultivate my land'. Chandra is confronted with limited livelihood options. The economic geography of his local area enables and promotes some forms of livelihood activity (agriculture), but works against the pursuit of others. When the state fails to provide an essential service – irrigation in this case – he has no alternative but to turn to private providers who are in a position to charge high fees.

While not burdened with an irrigation charge, another interviewee – Khemraj from site 4 – explained how the money he pays as a formal land tax is minimal relative to other forms of regulation on his agricultural activity. Khemraj's family owns one *kattha* of land, on which he pays, together with property tax, just NPR 85 per year. To meet subsistence needs, his family also cultivate another landowner's fields. In exchange for doing so, the landlord takes half of Khemraj's total production of rice and straw each year. In addition to this, Khemraj took issue with the state of the schools in his community. He felt deceived by the government, who promised free education services yet still enforced charges of various kinds:

I am not satisfied with the quality and process of government services here. I can give you a lot of examples... For example, even though government says school education is free of cost, here is a public school that takes different types of fees such as exam fee and class registration fee. I am not satisfied with this type of system. If a student in a public school is charged like this, why do they say, 'school education is free of charge?' The government is not being responsible in this matter and the public school is not being accountable. I twice complained about it in the school, but they did not respond to me positively.³⁴

Electricity shortages (or periods of 'loadshedding') are common, and considered to constitute a major constraint on economic activity. Electricity charges, including for the use of generators, were regularly cited by interviewees as one of the most burdensome forms of 'tax' they face. Certainly, relative to various formal state taxes, such as land or property tax, electricity charges are both regular and expensive. As one interviewee put it, 'Land tax is NPR 300 annually. Electricity bill is NPR 300 every two months'.³⁵ But why is it seen as a tax? Scott and Seth

(2013) point out that the availability of electricity is often regarded as a public good. In line with this, interviews and informal conversations with people in Jhapa and Sindhupalchok (as well as Kathmandu) suggest that the capacity to provide reliable electricity is seen as a core function of the state. This is particularly pronounced among those trying to run a business. A regular power supply is one of the basics of firm operation, as perhaps illustrated no more explicitly than by the World Bank's widely referenced *Doing Business* rankings, which use access to electricity as a key measure of business constraints (see World Bank, 2010). While there are certainly several other, markedly less formal or technical barriers to economic activity, the importance of something as basic as electricity to people's livelihoods, to national economies and to perceptions of the state should not be underestimated. Indeed, the World Bank's 2011 *World Development Report* highlighted the role that a functioning power supply can play in early post-conflict recovery and development: one example from Liberia discussed how a 100-day plan that included the restoration of electricity to certain areas of Monrovia was designed to 'help restore confidence in the state and jumpstart recovery in economic activity and basic services' (World Bank, 2011: 191). Thus, it is perhaps unsurprising that people view an irregular supply of electricity as a failure of government, and the cost of having to invest in a private electricity source as a form of taxation. While it might not conventionally be seen as such, from the perspective of individuals living in weak economic environments and under fragile systems of state governance, bad electricity becomes as much a tax on their livelihoods as do regulated extractions on their incomes or the licences required to set up a business in the first place.

It is unfortunate that we did not collect detailed information on user fees as part of our survey. Indeed, this was not something we were originally concerned with exploring. However, evidence from other sources suggests this practice is widespread in various parts of the country and across multiple sectors. In a recent series of papers for the SLRC, for example, researchers show how the payment of user fees for basic services is not always associated with better quality (Paudel et al., 2015). In their study of healthcare in Rolpa district, Paudel et al. (2015) find that the low quality of the government-run system drives people to other providers. Not only does this attract further cost, but it also deepens the lines of social and economic inequality. As the authors conclude, '[R]icher people primarily use higher-quality private clinics, while poorer people sometimes turn to

34 Interview 22 [HH interview, male, 60, site 4]

35 Interview 02 [HH interview, male, 30s, site 1]

poorly regulated private providers of highly questionable quality' (24). Dissatisfaction with the service, despite payment of user fees, comes out even more strongly in the study on water, with some communities in Rolpa even having to pay additional costs for maintenance of public infrastructure (Acharaya et al., 2015).

Ultimately, while current formal taxes in Nepal are low by historical standards – for various reasons (see below) – the costs of local development and service provision are essentially being passed down the chain. Consumers and users end up footing the bill, and they have little alternative. Because there is little in the way of local government accountability, and because there is no apparent social contract underwritten by a legitimate tax system, the chances of citizens being able to voice their frustrations and demands – and to get a response – are slim to none.

7.3 Why formal taxation in Nepal is so low, and what that tells us about the limits of the state

According to our survey data, the average household in our sample population pays about as much in tax to non-government actors as it does to local and central government (approximately \$47 compared to \$53 a year). And if we consider formal state taxes alone – those paid to government sources which display no aspects of informality – we see that this particular form of expenditure is marginal relative to the average household economy: in most cases, formal state tax expenditure is equivalent to less than 1% of annual household income.

Why is formal taxation in Nepal so low, especially in relation to historical standards? Nepalese citizens have lived through centuries of punitive extractive activity at the hands of the state (Hutt, 2007; Riaz and Basu, 2007), although this has not always been legal. Indeed, Guneratne (1996) has shown how, under the Rana administration, land taxes in the Terai were kept deliberately low in order to encourage population movements into certain areas of wasteland. Yet, people were still subject to heavy forms of taxation, as village-level tax collectors (*jimidar*) – poorly paid and under pressure from the centre to hit revenue targets – abused their positions of power by unofficially exacting higher rates on local farmers.

In a sense, something similar is happening today. Our research suggests that formal tax burdens are being kept low by a combination of capacity constraints on state

actors at the local level. Capacities to tax are often seen to be a function of state infrastructural power, closely related to the physical presence and penetration of the state across territory. Thus, the fact that the Nepalese Inland Revenue Department has just 22 field offices throughout the country is considered a reflection of state incapacity more generally. Yet, capacity is about more than infrastructure and physical reach, although these are of course important elements. Multi-year research by the European Centre of Development Policy Management (ECDPM) has shown that capacities are made up of a set of more specific *capabilities*, which individually reframe the analysis in more relational and political terms (see Morgan, 2006). For example, being capable of establishing supportive relationships means that agents and organisations must be able to build alliances with others in order to leverage resources and actions, accrue legitimacy in the eyes of stakeholders, and deal effectively with competition, politics and power differentials.³⁶ All evidence suggests that formal, local-level state actors in Nepal are particularly constrained in this area. State bureaucrats, implanted in VDC offices from afar, often have little in the way of actual political clout in local affairs; they are for the most part disconnected and disembedded from the community, representing a deeper malaise with the nature of state-society relations in Nepal. As one interviewee from Sindhupalchok observed, 'The state presence is there, but they are just running offices. They are not working seriously'.³⁷

Approaching capacity from a relational perspective helps us better understand the particular nature of whatever binding constraints are affecting state governance (Clarke and Oswald, 2010; Denney and Mallett, 2014). In Nepal, the role of political parties and the persistence of patronage-based relationships are an important, closely intertwined part of the story here. It is common for people who have done well for themselves in life to provide scholarships for poor students in their former schools, or to engage in some other (visible) act of generosity in their hometown. This is intimately connected to culturally significant ideas about social status and public image (see Section 4): providing welfare in one's village, in one form or another, is an established means of defining and projecting one's identity as a wealthy, powerful, connected and yet generous member of the community. 'Being seen' is a vital dimension of this act, as the process of giving is as much about public display as it is altruism.

36 For a discussion of how the ECDPM capability model might be applied to the study of capacity development in fragile states, see Mallett et al. (2014).

37 Interview 30 [HH interview, male, 29, site 6]

Such ideas extend into the realm of local politics. Political parties in different VDCs often battle it out for public support, which – despite the lack of any locally elected government body in Nepal – is still considered the foundation of a party’s power base. Community members are often keen to engage with local politics through this means, recognising as they do the influential role that political parties tend to play in the *de facto* functioning of local government (and the relatively subdued role that the VDC office sometimes assumes). We were even told by one current VDC Secretary that if someone in the community has a problem with a particular service, they are in fact more likely to visit a party representative than come directly to the VDC office.³⁸ Indeed, through the formal channels of the local governance process, such as committee meetings and local assemblies, political parties are able to shape the agenda for local development (even though local capacity to implement programmes is ultimately constrained by budget and guidelines administered by the central government). Thus, community members feel compelled to develop connections with a political party if they wish to have much of say in the development of their area. As one interviewee, a former VDC secretary, put it:

Why do people pay donations to political parties? There are two reasons. First, they think that if they their household were to face any difficulties in the future, then the political party will help them because they have donated. Second, they feel that if they do not pay, then their household will be insecure amongst the political parties – as a result, they will face difficulties anyway.³⁹

Because the political parties are locked into an ongoing battle to win public support, they are highly unlikely to talk honestly and openly about taxes. They also have little incentive to raise taxes in the first place. Inclusion in the local centres of political decision-making affords parties access to state resources, such as the annual block grants transferred from central government. While supposedly democratic structures such as village-level committees are intended to act as mechanisms for fair, unbiased local planning, in reality it is political parties who ‘drive the process’⁴⁰ – although some studies suggest that local-level bureaucrats, politicians and community elites often share a rather more collusive than competitive relationship (The Asia Foundation, 2012). In

any case, with the power and influence to shape how state funds are used, combined with the private donations that community members frequently make to the parties, the imperative to raise revenue through formal channels is dampened. Thus, even though VDCs are theoretically able to set their own tax rates on predetermined activities, flows, commodities and assets, the dynamics of the local political economy appear to undermine their overall capacity to actually do so.

38 Interview 25 [key informant, male, age unknown, site 5]

39 Interview 24 [key informant, male, 60s, site 5]

40 Interview 24 [key informant, male, 60s, site 5]

8 Conclusion

This paper has looked at tax systems in Nepal. Using mixed-methods data from seven sites dotted across two districts – some in the northern mountains of Sindhupalchok, others in the flat Eastern Terai of Jhapa – it has asked: how do these tax systems work? How do taxpayers feel about them? And what does their structure tell us about the governance of economic and political life in those places?

The conventional narrative surrounding tax and development in modern-day Nepal is one of evasion and state incapacity. Business houses are seen to bypass formal modes of taxation by alternatively engaging in informal transactional methods – paying off government officials in order to gain ‘exemption’ – and many households are understood to go untaxed altogether. This paper has shown that narrative to be flawed. Within our sample population of just over 1,000 households, representative of several thousand more across seven wards in two districts, over 97% reported paying at least one tax in the past year. The average household paid more than three taxes, equivalent to around \$100.

Placed in context, however, this is a small tax burden – marginal compared to the size of the average household economy. Particularly when we consider *formal* taxes – codified duties enforced by the government – most households get by without having to pay very much at all: usually less than 1% of annual income.

Is this good news? In a simplistic sense, it is. Most households are paying very little, meaning they have more to spend on other things, and only a tiny minority of those we surveyed (0.5%) reported that they had been put off from pursuing a particular livelihood activity in the past year because of high taxes. By historical standards, it seems that citizens have never had it so good. The Nepalese state has a long history of implementing extractive and at times coercive forms of tax collection. This no longer seems a defining characteristic of the tax system, and many households are capable of avoiding various taxes without severe consequences.

Dig a little deeper, however, and the story is less rosy. While households might have more in the coffers, the low tax rates they face are at the same time reflected in (and associated with) the generally poor state of public goods provision found in many parts of Nepal. Budget allocations from central to local government have risen over recent years in Nepal, and various formal Acts have theoretically devolved more power to individual VDCs and municipalities. However, a number of factors continue

to constrain the capacity of local government to both enforce taxes and provide quality public goods, including: poor resourcing; fragmented (yet still quite centralised) policy-making processes; the informal nature of political relationships which often override the newly introduced formal sets of rules; and the continued influence of political parties, whose members are often far more embedded with the communal social fabric than official bureaucrats have been for some time.

As a result, local communities are being forced to pay extra just for adequate or necessary services, such as education, electricity and irrigation. Weak state provision has thus created opportunities for the emergence of both private provision as well as bottom-up forms of community-based collective action. This is evidenced by the fact that many individuals we surveyed make donations to religious-based and local community organisations. Indeed, we find that nearly half of average annual tax expenditure at the household level goes to non-government actors.

Ultimately, while current formal taxes in Nepal are low by historical standards, the costs of local development and service provision are essentially being passed down the chain. Consumers and users end up footing the bill, and they have little alternative: there is little in the way of local government accountability, and there is no apparent social contract underwritten by a legitimate tax system, so the chances of citizens being able to voice their frustrations and demands – and to get a response – are far from promising. It is instructive that, when feeding back some reflections from his time ‘in the field’, one survey enumerator for this study wrote the following: ‘Everywhere in rural areas, people wanted us to tell government bodies about their problems for roads, electricity, cheap hospitals’. While the state is clearly visible at the local level, the form and function it takes appears to be of an almost exclusively bureaucratic nature. People can see it, and they occasionally feel its benefits. But to many, the state means little more than an office staffed by disconnected government officials with whom interactions rarely take place. There appears to be very little sense of a meaningful relationship beyond this.

8.1 Is this what we expected to see?

In Section 3, we hypothesised three things we expected to see in our research findings. How did we fare?

The first hypothesis stated that while formal tax burdens would be low, households would also be paying informal

taxes to non-government actors. Both appear correct. The political economy of local governance in Nepal is keeping taxes low, and state disembeddedness from communities undermines its ability to extract revenue. At the same time, most households are paying something to actors other than the government. What is perhaps surprising is that the size of the informal tax burden is, like formal tax, still quite small. In the original literature review that helped inform the design of this research (Lough et al., 2013), the limited evidence available suggested informal tax burdens can often be punitive and suffocating. Given the high levels of informal taxation administered by Maoists throughout the 1990s and 2000s, we might have expected to see a continuation of this practice by various actors. That simply does not appear to be the case. If anything, the characteristics of informal tax have shifted: direct extractions have been replaced by user fees and the need to self-provide public goods. In other words, the dynamic has become subtler.

Second, we hypothesised that an (expected) lack of return from formal taxes in the form of public goods would be met with different modes of non-government provision. Our research suggests this is indeed the case. The void is being filled through privatisation, trade associations, the creation of community self-help groups, voluntary donations to local causes, and allegiance to influential political parties who can (partly) steer the distribution of resources.

Our third hypothesis stated that, because of the government’s poor reputation in providing good returns, those paying more tax would think more negatively about the government. We actually found this not to be the case. There is a positive association between taxes paid and perceptions of government. So too is there one between taxes paid and civic participation (such as attending community meetings). While we cannot be certain about the direction of causality, these results nevertheless speak to the ‘governance dividend’ that tax is capable of producing under certain conditions (Moore, 2015). When we consider the number of unrewarded taxes paid in the past year, however, we observe a negative association with perceptions of government. That is, the higher the number of unrewarded taxes paid, the worse people felt about the government. Ultimately, then, it is not the number of taxes or the amount paid that matters, but the terms of the bargain. With a new Constitution freshly inked, time will tell whether those terms improve.

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Annex 1: Range of taxes included in the survey instrument

Central government tax	Local government tax	Non-government tax	Miscellaneous
Income tax <ul style="list-style-type: none"> Charge imposed on annual earnings. Income may include the earning 'from employment, profession, investment or windfall gain'⁴¹ 'Inland Revenue Department under Ministry of Finance administers income tax' Vehicle tax <ul style="list-style-type: none"> Tax on vehicle (petrol and diesel-powered) ownership (bus, car, motorbike, scooter etc.) Capital gains tax <ul style="list-style-type: none"> Tax levied on net profit gained by individuals and corporations when they sell capital assets in a higher value than original/purchased value Business licence <ul style="list-style-type: none"> Company registration payment for the first time and annual tax to renew is applicabl Special acceleration fee <ul style="list-style-type: none"> Official payment required to facilitate and speed up bureaucratic processes Forestry tax <ul style="list-style-type: none"> Royalty paid to District Forest Office Excise Duty <ul style="list-style-type: none"> An indirect tax imposed on products which are harmful to public health (tobacco and cigarettes etc.) and products for luxury, and products that create an adverse effect on the environment⁴² Customs tariff <ul style="list-style-type: none"> Each exported and imported good is liable to customs duty, with the exception of those made exempt under law⁴³ 	Land tax <ul style="list-style-type: none"> Annual tax determined by size and type of land owned. This type of tax varies based on Himal, Pahad and Terai Regions Rent tax <ul style="list-style-type: none"> Charge imposed on annual earnings gained from rent (house, business mall, land, land-house etc.) For non-commercial renting it is charged by 10% of the total income (no reduction applicable), while for commercial renting, the tax payer can reduce the actual expenditure related to earning and pay Property tax <ul style="list-style-type: none"> Annual tax on owned dwelling, determined by size of dwelling Business licence <ul style="list-style-type: none"> Business registration and renewal fee Hat-bazaar fee <ul style="list-style-type: none"> Required for accessing selling space in local market (market dues) mostly to be paid to the tender owner Special acceleration fee / goodwill payment <ul style="list-style-type: none"> Required to facilitate and speed up bureaucratic processes Recommendation fee <ul style="list-style-type: none"> Required for recommendation and approval letters from local government Parking fee <ul style="list-style-type: none"> Required for securing vehicle space in the market, and mostly the tender owner collects such fee and pays the amount (as stated in the tender) to the local government Mining tax <ul style="list-style-type: none"> Paid if extracting slate, gravel, sand, stone, red/yellow mud 	Payments to religious organisations <ul style="list-style-type: none"> Membership fees, donations for religious functions and projects – often not mandatory Payments to local groups <ul style="list-style-type: none"> Payments to groups providing security or community policing Payments to local clubs <ul style="list-style-type: none"> Includes youth clubs or other peer-oriented clubs Membership payments to trade / market associations <ul style="list-style-type: none"> Required in order to access the associations Community donations <ul style="list-style-type: none"> For local development projects, such as well-building, and building waiting stations in road sides, school buildings, repairing basic service infrastructures (reservoir, public taps etc.) 	Unpaid labour time <ul style="list-style-type: none"> For contributions to VDC / municipality development projects Checkpoint fees <ul style="list-style-type: none"> Payments demanded en route, e.g. when crossing a district border via roads.

41 Income Tax Act, 2058 (2002). [Amended by Financial Act, 2068 (2011)]. Date of Authentication and the Publication 2068.7.03(27 Oct. 2011).

42 See more: www.ekantipur.com/2009/11/30/top-story/ca-panel-proposes-new-tax-structure/303619.html.

43 Section 3 (5) of ' Customs related Act, Rules Archive (2071 BS)'. Kathmandu: Department of Customs, Ministry of Finance.

Annex 2: Data showing whether survey respondent is the actual taxpayer, by tax type

Tax	Are you responsible for making the tax payment?			
	Yes, I am responsible	No, someone else in my household is responsible	More than one person pays the tax	Don't know
Land	59	38	2	0
Property	61	37	2	0
Business licence	65	34	1	1
Hat bazaar fee	61	35	3	0
Acceleration	67	25	7	1
Recommendation	61	31	8	0
Parking fee	56	40	4	0
Mining	88	13	0	0
Central income	67	30	3	0
Central vehicle	59	39	3	0
Central capital gains	100	0	0	0
Central business licence	64	35	1	0
Central acceleration	54	46	0	0
Central forestry	67	33	0	0
Religious	69	19	12	0
Local group	78	19	3	0
Local club	75	22	3	0
Trade association	75	22	2	0
Donation	63	24	13	0

Annex 3: List of interviewees

Informant No.	Name	Occupation	Gender	Age	Site No.	District
1	Unknown	VDC Secretary	Male	?	1	Jhapa
2	Yagya	Canteen worker	Male	30s	1	Jhapa
3	Bhawani	Unemployed	Male	58	1	Jhapa
4	Lila	Shop owner	Female	36	1	Jhapa
5	Tara	Agriculture	Male	51	1	Jhapa
6	Krishna	Agriculture	Female	52	1	Jhapa
7	Yamanath	Former school principal	Male	60s	2	Jhapa
8	Rasik	Shop owner in hat bazaar	Male	Unknown	2	Jhapa
9	Chandra	Unemployed	Male	71	2	Jhapa
10	Dambar	Unknown	Male	48	2	Jhapa
11	Basudev	VDC Chair	Male	Unknown	2	Jhapa
12	Sapan	Shop owner	Male	50s	3	Jhapa
13	Unknown	Shop owner	Male	Unknown	3	Jhapa
14	Rohan	Student	Male	19	3	Jhapa
15	Birmala	Agriculture	Female	24	3	Jhapa
16	Dipa	Student	Male	18	3	Jhapa
17	Punam	Shop owner	Female	30	3	Jhapa
18	Dines	Rikshaw driver	Male	47	4	Jhapa
19	Khadananda	Agriculture	Female	50	4	Jhapa
20	Rajan	Municipality officer	Male	Unknown	4	Jhapa
21	Mina	Shop / restaurant owner	Female	31	4	Jhapa
22	Khemraj	Agriculture	Male	60	4	Jhapa
23	Yogendra	Agriculture	Male	59	4	Jhapa
24	Unknown	Former VDC Chair	Male	60s	5	Sindhupalchok
25	Unknown	VDC Secretary	Male	Unknown	5	Sindhupalchok
26	Unknown	Local NGO director	Male	Unknown	6	Sindhupalchok
27	Unknown	VDC Secretary	Male	Unknown	6	Sindhupalchok
28	Dil Bahadur	Agriculture	Male	50s/60s	6	Sindhupalchok
29	Unknown	Agriculture / own business	Female	40-50	6	Sindhupalchok
30	Unknown	Hotel owner	Male	29	6	Sindhupalchok
31	Reshmila	Business owner	Female	26	6	Sindhupalchok
32	Unknown	Border policeman	Male	Unknown	7	Sindhupalchok

Note: Some names have been changed at the request of the interviewees

Annex 4: Breakdown of tax expenditure, by tax type and site

Tax	Site						
	1	2	3	4	5	6	7
Land	476	196	193	548	66	111	44
Property	264	36	516	198	47	103	62
Business licence	3406	153	131	120	875	395	54
Hat bazaar fee	92	92	212	171	0	4	0
Acceleration	701	138	162	240	420	61	871
Recommendation	264	46	26	78	44	56	39
Parking fee	45	0	0	0	3	39	
Mining	0	2	2	2	0	336	0
Local other	1155	21	157	167	61	20	292
Central income	10175	1701	404	575	374	1970	241
Central vehicle	5175	808	437	762	1002	1929	1760
Central capital gains	0	38	0	30	0	5	0
Central business licence	276	82	0	35	109	331	93
Central acceleration	239	38	37	91	167	49	466
Central forestry	0	0	0	330	0	25	3
Central other	0	0	6	76	57	26	0
Religious	4657	2436	571	1435	2135	2593	2747
Local group	365	23	0	366	74	136	262
Local club	859	216	68	257	302	171	46
Trade association	342	98	3	34	29	141	9
Donation	1162	190	14	219	402	586	219
Other non-gov	0	18	0	4	150	12	0

In 10 out of the 22 taxes, site 1 has the highest mean expenditure, often by a long way. Certain taxes such as central income tax, local business tax, trade association membership, and vehicle tax are far higher in this VDC than in others.

Annex 5: Regression Tables

Annex 5.1: Logit regression: satisfaction with health post by household tax variables, respondent characteristics, and controlling for VDC

VARIABLES	Satisfied with health post	Std Err	z	P> z	95% confidence interval	
Number of taxes paid by HH	-0.07	0.05	-1.61	0.11	-0.16	0.02
Ratio of tax expenditure to income	1.02	1.25	0.82	0.41	-1.42	3.47
Percentage of total tax expenditure which is informal	0.00	0.00	-0.06	0.96	0.00	0.00
Health post is in same ward	-0.21	0.19	-1.07	0.28	-0.59	0.17
Perception of government index	2.48***	0.58	4.29	0.00	1.35	3.62
Attended local meeting (M1)	-0.03	0.12	-0.29	0.77	-0.26	0.19
Raised issue in community (M4)	-0.10	0.13	-0.77	0.44	-0.34	0.15
Anyone in HH is member of local group	0.04	0.17	0.23	0.82	-0.29	0.37
VDC						
Anarmani	Ref					
Shivagunj	0.84***	0.31	2.70	0.01	0.23	1.44
Bhadrapur	-0.47	0.30	-1.55	0.12	-1.06	0.12
Mechinagar	0.04	0.28	0.15	0.88	-0.50	0.58
Melamchi	-0.07	0.30	-0.24	0.81	-0.66	0.52
Chautara	-1.40***	0.30	-4.67	0.00	-1.98	-0.81
Tatopani	-0.66**	0.29	-2.25	0.03	-1.24	-0.08
Constant	0.73*	0.34	2.14	0.03	0.06	1.40
Observations	753					
Pseudo R-squared	0.0841					

Annex 5.2: Logit regression: civic participation, by household tax variables, respondent characteristics and controlling for VDC

VARIABLES	Attended a community meeting	Std Err	z	P> z	95% confidence interval	
Number of taxes paid by HH	0.19***	0.06	3.11	0.00	0.07	0.31
Ratio of tax expenditure to income	-0.32	1.45	-0.22	0.83	-3.17	2.53
Percentage of total tax expenditure which is informal	0.00	0.00	0.39	0.69	0.00	0.01
Female respondent	-0.37	0.23	-1.63	0.10	-0.82	0.07
Age of respondent	0.01	0.01	1.48	0.14	0.00	0.03
Anyone in HH is member of local group	0.01	0.23	0.05	0.96	-0.43	0.46
Raised issue in community in last year	1.27***	0.13	9.70	0.00	1.01	1.52
Perception of government index	1.34**	0.67	1.99	0.05	0.02	2.67
Satisfied overall with health service	-0.02	0.22	-0.08	0.93	-0.45	0.42
VDC						
Anarmani	Ref					
Shivagunj	-0.38	0.45	-0.83	0.41	-1.26	0.51
Bhadrapur	0.83*	0.44	1.91	0.06	-0.02	1.69
Mechinagar	0.51	0.39	1.32	0.19	-0.25	1.27
Melamchi	0.85**	0.40	2.11	0.04	0.06	1.64
Chautara	-0.05	0.39	-0.12	0.91	-0.80	0.71
Tatopani	1.36***	0.41	3.34	0.00	0.56	2.16
Constant	-4.97***	0.74	-6.71	0.00	-6.42	-3.52
Observations	750					
Pseudo R-squared	0.2288					

Annex 5.3: OLS regression: perception of government by taxes paid by household, controlling for VDC

VARIABLES	Perception of government index	Std Err	t	P> t	95% confidence interval	
Number of taxes paid by HH	0.0063**	0.00	2.31	0.02	0.00	0.01
VDC						
Anarmani	Ref					
Shivagunj	-0.0082	0.02	-0.45	0.65	-0.04	0.03
Bhadrapur	0.0027	0.02	0.13	0.89	-0.04	0.04
Mechinagar	-0.0131	0.02	-0.74	0.46	-0.05	0.02
Melamchi	0.0439**	0.02	2.26	0.02	0.01	0.08
Chautara	0.0397**	0.02	2.24	0.03	0.00	0.07
Tatopani	0.0530***	0.02	2.71	0.01	0.01	0.09
Constant	0.0811***	0.02	4.62	0.00	0.05	0.12
Observations	800					
R-squared	0.0375					

Annex 5.4: Tobit regression: perception of government by household tax variables, controlling for VDC

VARIABLES	Perception of government index	Std Err	t	P> t	95% confidence interval	
Number of taxes paid by HH	0.01***	0.00	2.86	0.00	0.00	0.02
Ratio of tax expenditure to income	-0.27**	0.13	-2.08	0.04	-0.53	-0.02
Percentage of total tax expenditure which is informal	0.00	0.00	-1.17	0.24	0.00	0.00
VDC						
Anarmani	Ref					
Shivagunj	-0.01	0.03	-0.51	0.61	-0.07	0.04
Bhadrapur	0.00	0.03	0.02	0.98	-0.06	0.06
Mechinagar	0.00	0.03	0.00	1.00	-0.05	0.05
Melamchi	0.07**	0.03	2.53	0.01	0.02	0.13
Chautara	0.05**	0.03	2.00	0.05	0.00	0.10
Tatopani	0.08***	0.03	2.74	0.01	0.02	0.14
Constant	0.02	0.03	0.61	0.54	-0.04	0.08
Observations	785					
Pseudo R-squared	0.1263					



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