



# Research in Brief

Issue 6 February 2014

## Taxation and Livelihoods: A Review of the Evidence from Fragile and Conflict-Affected Rural Areas

This joint SLRC/ICTD paper investigates the neglected topic of the impact of taxation on people's livelihoods, especially in places affected by war and violent conflict.

### Why taxation matters for livelihoods and state-building

People face particularly fierce challenges to livelihood recovery in fragile and conflict affected situations, and unusually urgent needs for basic public goods. Taxation forms a core part of the institutional context that shapes livelihood options and service delivery. Effective tax systems can support livelihoods by financing security and access to health, education and transport; but poorly designed and implemented taxation can have a negative impact on livelihoods by reducing assets (through fees and labour charges), constraining options (through taxes on market access), and distorting prices and therefore economic activity. Moreover, how taxation works at the local level has implications for governance and state building: while effective provision of public goods is often seen as a way of bolstering state legitimacy, less attention has been paid to the way coercive and predatory taxation

damages trust in public institutions and perceptions of state legitimacy.

### A broad definition of taxation

To understand the impact of taxation on livelihoods it is important to capture the full range of extractive payments that individuals and households have to make in order to pursue economic activity. It is also important to understand how different forms of taxation implemented by multiple actors at different levels interact and affect livelihood options in a given context. The paper therefore adopts a broad working definition of taxation to include "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)". This definition includes formal taxation backed up by legal sanction, and a wide range of informal tax or tax-like payments collected outside formal legal frameworks.

“ A focus on taxation – capturing both its formal and informal dimensions – stimulates new thinking about how best to support livelihoods in fragile and conflict-affected situations. ”

## Impact of taxation on livelihoods

There is limited documented evidence about the impact of taxation on livelihoods in fragile and conflict affected situations, especially at a local level where it is most likely to affect small-scale operators. Formal taxation by local governments can be problematic especially if driven by revenue concerns without regard to equity or wider economic impact. At its worst, local taxation can be excessive, arbitrary and regressive, placing severe constraints on household livelihoods. Moreover such systems help to drive informal practices such as bargaining with officials to lower rates, and payment of bribes to protect against coercive collection.

Informal taxation may also be imposed by non-state actors, with hugely divergent outcomes for livelihoods, ranging from the devastating impact of brutal extortion by armed militias to the relatively positive impact of non-state regimes with ideological and political commitments to welfare. Payments to customary leaders, managers of common pool resources and community groups providing services can offer benefits but may also be regressive and open to abuse. Their impact on livelihoods is highly dependent on context. Communities can play a significant role in taxation and public goods provision outside of formal state channels, so it is important to understand their implications for livelihoods and state legitimacy when designing new policy interventions.

## Implications for policymakers

The limited evidence available suggests that taxation has significant effects on livelihoods and can undermine economic activity of small-scale traders, substantially reduce household incomes, and entrench inequality. A focus on taxation may therefore stimulate new thinking about how to support livelihoods in fragile and conflict affected

situations. Interventions usually focus on increasing people's income and productive capacity, for example by providing seeds to farmers or loans to small businesses. However it is also important to consider the costs people incur and the way these are affected by taxation, including the cost of health, education and transport; of buying and selling produce; and of establishing and maintaining businesses.

A better understanding of how taxation works at a local level could also be important for governance and state building. Taxation brings people into direct contact with the state. Predatory behaviour by tax officials can therefore be significant in shaping state-society relations. The inability or unwillingness of state authorities to regulate extractive behaviour by other actors may be seen as a visible failure of authority. Conversely, a focus on how taxation could be better linked to the provision of services might help foster more positive perceptions and relationships. More research is needed into links between local taxation and livelihoods and its implications for state building. This could pinpoint opportunities for positive change in local tax policy and implementation by helping to identify what kind of reform would be valuable and politically viable in a given context, and how to adapt design to local circumstances.

## Further reading

Lough, O, Mallett, R, & Harvey, P (2013), *Taxation and Livelihoods: A Review of the Evidence from Fragile and Conflict-Affected Rural Areas*, Joint SLRC/ICTD Working Paper 11, Brighton: June

## Credits

This ICTD Research Brief was written by **Oliver Lough**, MSc candidate in International Development at SOAS in London, **Richard Mallett**, Research Officer of the Secure Livelihoods Research Consortium at ODI in London, and **Paul Harvey**, Director of the Secure Livelihoods Research Consortium, ODI, London..

This brief was produced by the International Centre for Tax and Development (ICTD), a global policy research network which aims to generate and disseminate relevant knowledge to policymakers and mobilise knowledge in ways that will widen and deepen public debate about taxation issues within poorer countries. It is supported with UK aid from the UK government and by the Norwegian Ministry of Foreign Affairs (MFA).

The opinions expressed are those of the authors and do not necessarily reflect the views of ICTD, nor the UK or Norwegian governments' official policies.

Readers are encouraged to quote and reproduce material from the series. In return, ICTD requests due acknowledgment and quotes to be referenced as above.

© ICTD 2014