Taxation and livelihoods: evidence from fragile and conflict-affected situations

Key messages
- In developing countries - particularly those affected by conflict - people and small businesses often have to make a variety of payments to a range of actors. These payments take the form of both formal and informal taxes.
- A narrow focus on formal tax (administered by governments through official channels) does not capture the complex, multi-layered reality of taxation.
- The cumulative economic impact of formal and informal taxes on poor people is often significant, but the implications for state-building and governance are unclear.

Introduction

Despite growing interest in the linkages between taxation, development and governance, surprisingly little attention has been paid to the relationship between taxation and people’s livelihoods, particularly in places affected by conflict. Yet, it is in these contexts that people encounter fierce challenges to livelihood recovery, often finding themselves operating in a political economy environment that is at once complex and shifting, as well as brutal and exploitative. People affected by conflict tend to have urgent service-related needs, and violent conflicts can erode trust in governance actors.

Drawing on a recent working paper (Lough et al., 2013), this evidence brief provides an overview of the evidence base when exploring the relationship between taxation and livelihoods in conflict-affected situations. It discusses the geographical, methodological and thematic nature of the evidence base, summarises key findings, clarifies what the research means for policy-makers, and provides links to relevant empirical material.

What is this Evidence Brief based on?

The working paper on which this evidence brief is based emerged through a selective review of key literature on taxation and livelihoods in low-income rural areas (particularly those affected by conflict) in more than 20 countries. The review involved a search of key journal databases using pre-determined search strings and, for retrieved documents, full text searches for key words. The same process was repeated using Google Scholar and the standard Google search in order to capture institutional and non-academic literature on the topic. Snowball sampling was also used, with the starting point determined by references from key documents and existing literature reviews. As the study progressed, the publication records of any authors whose work emerged as particularly relevant were also reviewed, along with the publication databases of organisations involved in similar research. The authors also shared and discussed the project’s concept note with academics, researchers and practitioners in relevant fields.
Evidence Brief October 2013
Taxation and livelihoods: evidence from fragile and conflict-affected situations

How does taxation really work in fragile and conflict-affected situations?

- Individuals, households and small businesses are taxed, not just by central and local government by a range of actors, from military officials and insurgent groups to customary managers of common-pool resources and local authority figures. Those to whom the payments are being made often overlap.

- Taxes that are enforced exhibit varying degrees of formality. Informal taxes can be heavily institutionalised and may fund public services when the state cannot. Some are administered within codified frameworks and through official channels, while others are imposed on an informal, less regulated and potentially more coercive basis. Examples of such informal taxes include customary levies and tithes, payments made at checkpoints and roadblocks, and money elicited in exchange for functions that should be provided free at the point of service.

- The burden of informal taxes on households in low-income rural areas may be just as, if not more, substantial than the burden of formal taxes.

- Multiple taxation – both formal and informal – can have powerful cumulative effects on household and business economies. Taxes not only directly affect spending, but they can also influence economic behaviours and activities – for example, by deterring individuals from pursuing particular livelihood options. As the number of taxes rises and the overall burden becomes heavier, households may find themselves unable to accumulate assets, thereby slowing post-conflict economic recovery at the micro level.

- In many cases, taxation does not work in the interests of those paying the taxes. Taxation can be used to fund basic services, social protection transfers, and other vital public goods. But these benefits are not always realised, possibly due to a number of reasons, including: 1) the impact of informality, coercion, and social networks on processes of distribution and exchange; 2) a disconnect at the district level between revenue collected and services provided; 3) the existence of regressive tax regimes; and / or 4) the loss of revenues as a result of inefficiencies within the collection system.

Some illustrative examples

<table>
<thead>
<tr>
<th>Country</th>
<th>Source</th>
<th>Who is making the payment?</th>
<th>What is the payment?</th>
<th>Who is the payment being made to?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sudan</td>
<td>(Buchanan-Smith et al., 2012)</td>
<td>A livestock traders in Darfur</td>
<td>Protection money</td>
<td>Private armed guards</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Payment of checkpoint fees for market access</td>
<td>People at checkpoints</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Increased trading costs</td>
<td>Local authorities</td>
</tr>
<tr>
<td>Somalia</td>
<td>(Hedlund et al., 2013)</td>
<td>A refugee in a Somali refugee camp</td>
<td>Rent payments</td>
<td>Various local government taxes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Percentage payment on all cash transfers and food aid received (typically between 5% and 10% per transfer)</td>
<td>First quartile (lowest income) pay 12% of total household income; second quartile pay 6%; third quartile pay 4%; fourth quartile (highest income) pay 3%</td>
</tr>
<tr>
<td>Uganda</td>
<td>(Bahligwa et al., 2004)</td>
<td>A poor household in rural Uganda</td>
<td>Zakat</td>
<td>Local government</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>State</td>
<td>Community</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Non-state</td>
<td></td>
</tr>
</tbody>
</table>
What does the evidence base look like?

This figure classifies the evidence into six thematic areas. It shows how many studies were retrieved and reviewed, and what kinds of methodology were employed.

<table>
<thead>
<tr>
<th>Themes within the literature</th>
<th>Number of studies reviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customary structures/community payments</td>
<td>15</td>
</tr>
<tr>
<td>Formal taxation</td>
<td>12</td>
</tr>
<tr>
<td>Informal economies</td>
<td>10</td>
</tr>
<tr>
<td>Legitimacy and authority</td>
<td>5</td>
</tr>
<tr>
<td>Trade and micro enterprises</td>
<td>8</td>
</tr>
<tr>
<td>War economies/rebel groups</td>
<td>3</td>
</tr>
</tbody>
</table>

Geographical focus of evidence

- Sub-Saharan Africa: 60%
- South Asia: 28%
- East Asia: 5%
- MENA: 7%


3. Prud’homme, R. (1992) ‘Informal local taxation in developing countries’. Environment and Planning C: Government and Policy 10(1): 1-17. This paper attempts to apply to the area of local taxation in developing countries the concept of ‘informality’ which has been so successfully utilized in other areas.


So, what does this all mean?

Informal taxation is a policy and research blindspot. If researchers, international actors and governments are interested in the relationship between taxation and livelihoods, then an exclusive focus on formal tax by state actors is inadequate. By limiting academic and policy attention to taxes administered through official statutory frameworks, the detrimental effects of multiple taxation on individuals, households and small businesses will be missed. What we are left with is an incomplete picture of how people make their livelihoods at the local level, why particular economic activities continue to be pursued or avoided, and how particular institutional contexts either enable or constrain the potential for wealth accumulation. Against a backdrop of significant donor support for economic recovery in conflict-affected situations, these issues represent striking analytical and policy blindspots.

To support pro-poor economic recovery, reform of formal and informal taxation regimes is needed. However, alleviating the pressures of taxation regimes – particularly those which do not benefit the taxpayer – is not straightforward. In many cases, informal taxes operate as part of a protection racket set-up, meaning that finding realistic ways to change the incentives for those who gain from such behaviours is a difficult and politically sensitive task. Formal taxation systems need to be both able and willing to regulate extractive behaviour by other actors.

We know that multiple taxation exists – and that its economic effects can be significant – but our current understanding does not go far beyond this. Further research into the types and nature of payments made by individuals, households and businesses, and the kinds of institutional contexts that enable their existence, will help those with the mandate and capacity to engineer reforms to decide where and how to do so.

If you only read five things, make them...


3. Prud’homme, R. (1992) ‘Informal local taxation in developing countries’. Environment and Planning C: Government and Policy 10(1): 1-17. This paper attempts to apply to the area of local taxation in developing countries the concept of ‘informality’ which has been so successfully utilized in other areas.


Evidence Brief October 2013

Taxation and livelihoods: evidence from fragile and conflict-affected situations

Reviewed studies forming the evidence base, by country

Afghanistan


Indonesia


Kenya


Lebanon

Nepal

Pakistan

Senegal

Sierra Leone


Sri Lanka

Sudan

South Africa

South Sudan

Tanzania

Uganda


Vietnam

Cross-Country


LADDER reports.
