TAXATION IN FRAGILE STATES

A Somalia Example

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Outline

1. What do we know about (customs) taxation in fragile states?
2. The Somalia case study - parallels and specificities
3. What can donors do in this area?

Stylized facts and rationale

Poor reform record in FCV countries

1. Ratio domestic revenue to GDP lower in fragile countries than in other developing countries. (Akitoby et al. 2020, Isar 2020).

2. Tax reforms in FCV countries have a higher likelihood of failing, while also lacking sustainability (Drummond et al. 2012).

How can it be explained? What is usually neglected?

3. Political economy, history and social norms/contexts matter a lot. It is more critical in FCV countries where the State is challenged by armed groups and usually suffer from poor legitimacy. However, it is frequently neglected in taxation reforms. (Cloutier et al. 2021).

4. A multidisciplinary approach is crucial, combining findings from anthropology, history and political economy. (Cantens et al. 2021).

Key paper messages: politics of taxation reforms is key

1. Customs revenues are key for the state building.
2. But who is taxed? On what and for what? really matters
3. Taxation currently depends on a bargaining process and a power relationship especially in FCV countries. Enforcement is critical (as well as the fight against corruption) but hardly happens de facto.
4. Donors should integrate the political economy dimension of customs reforms, especially in this type of environment. It is all about politics/legitimacy and bargaining.

Customs from a fiscal perspective – a paradox

Large provider of revenues (because trade is resilient to conflicts)

More than 40% of tax revenue is actually "collected" by customs (including VAT),

Trade is needed for armed groups supplies and generates revenues for them,

Goods are easier to tax than people.

But 'bargain' with key traders => relatively low level of taxation and usually inequitable with a large burden on consumer goods

Customs define empirically an 'acceptable level of taxation' by traders to avoid smuggling and contribute to local economic activities

Revenue aspect is usually predominant for central authorities; may abandon some border posts/locations if revenue potential is low

Customs from a state-building perspective

Theoretically, contribute to the ‘fiscal contract’ : revenues for service delivery for improved state legitimacy (Brautigam et al. 2008)

Customs play a major role to generate cash to pay civil servants in remote regions
=> major role in financing state institutions in remote regions

Ambivalent role of traders that can contribute to militant groups (or not) (Lacher 2012)

Security options (such as border closures) are usually not sustainable because trade is a major source of revenues in remote regions/port areas

Customs usually play a large role in intelligence gathering and contributes to security

Customs can be seen as a facilitator between state security apparatus and traders/populations

The usual (implicit) model for taxation in LICs

What is the implicit model for taxation?

Based on the assumption that "if taxes are paid, the state will deliver (better) services" with the following implications:

- tax acceptance is coupled with a strong state legitimacy;
- a centralized and transparent revenue collection system;
- a system of formalized revenue collection.

With this in mind, the main objectives for low-income countries taxation reforms are:

- "formalization" of the informal sector to broaden the tax base (the problem of 'registration obsession' Moore 2020);
- "tax transition", to move from trade taxes to domestic resources (Chambas 2005);
- "segmenting of taxpayers" to facilitate payments (large taxpayers units for instance) (Vehorn 2011, Macedo 2011).

Why the usual model does not work well in FCV countries?

In reality, it is different:

- The State does not have a monopoly on tax and force because of poor legitimacy. There is a strong tax competition from armed groups or local authorities. (Bandula-Irwin et al. 2021). And taxation is mostly informal (Van den Boogaard et al. 2021)

- Enforcement in many cases is impossible (due to limited state presence outside ports and low capacity which leads to limited revenue collection),

- Actually, the level of taxation is mainly the result of bargaining processes between powerful actors, even at the local level. (Concentration of customs revenues: 20 traders account for 50 percent of customs revenues in Mogadishu). (World Bank 2021).

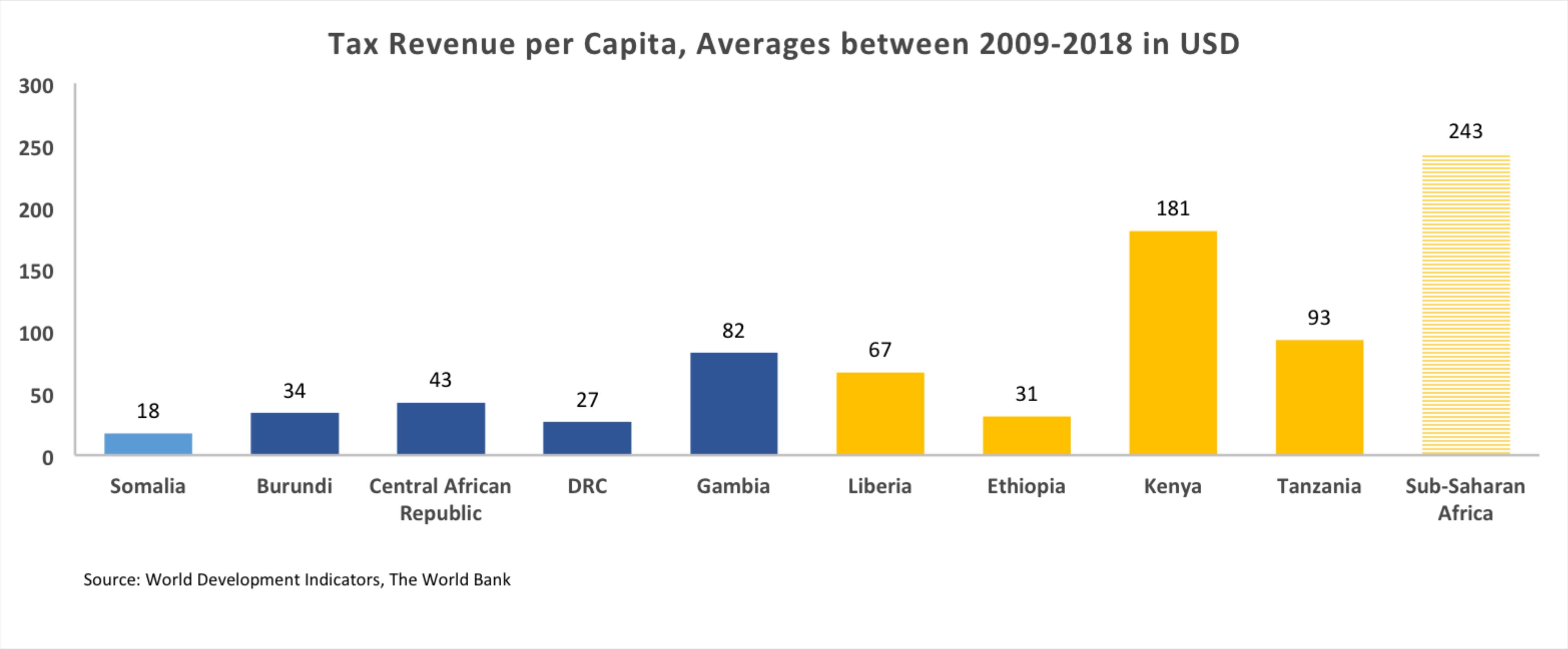
- The Somalia case study


GULF OF ADEN
DJIBOUTI
Djibouti
Āsayita
Dikhil
Saylac
Raas Maskan
AWDAL
Baki
Bullaxaar
Berbera
Karin
Xiis
Maydh
Raas Surud
Boosaaso
(Bender Cassim)
Laasqoray
Ceerigaabo (Erigavo)
SANAAG
Caluula
Breeda
Bandar Murcaayo
Butyaalo
Qandala
Bargaal
Hurdiyo
BARI
Xaafuun
Iskushuban
Karkaar Mountains
Qardho
Dudo
Bandarbeyla
WOQOOYI GALBEED
Boorama
Togwajaale
Hargeysa
Dirē Dawa
Hārer
Jijiga
Nazrēt
Burco
(Burao)
Oodweyne
Kiridh
TOGDHEER
Garadag
Xudun
Taxeex
SOOL
Buuhoodle
Laascaanood
Garoowe
NUGAAL
Gori Rit
Eyl
Degeh Bur
ETHIOPIA
Werdēr
K'ebrī Dahar
Megalo
Īmī
Gode
Shilabo
Hargele
Berdaale
Xamure
Beyra
Seemade
Gaalkacyo (Galcaio)
Garacad
MUDUG
War Galoh
Baxdo
Mirsaale
Hilalaya
Mereer-Gur
Dhuusamarreeb
(Dusa Marreb)
GALGUDUUD
Hobyo
Ceel Huur
Ferfer
Beledweyne
Ceel Buur
Xarardheere
INDIAN OCEAN
BAKOOL
Xuddur
(Oddur)
HIRAAN
Derri
Dolo Bay
Luuq
Tayeeglow
Buulobarde
Ceeldheere
Garbahaarrey
KENYA
GEDO
Baydhabo
(Baidoa)
SHABELLE DHEXE
Mahadday Weym
Cadale
El Beru Hagia
Buurhakaba
BAY
Wanlaweyn
Jawhar (Giohar)
Diinsoor
Baardheere
Balcad
Afgooye
Muqdisho (Mogadishu)
BANADIR
Qoryooley
Wajir
JUBA DHEXE
SHABELLE HOOSE
Marka (Merca)
Haaway
Baraawe
Bu'aale
Afmadow
Jilib
Bilis Qooqaani
Jamaame
0°
JUBA HOOSE
Kismaayo (Chisimayu)
Buur Gaabo
Raas Kaambooni
Garsen
Lamu
SOMALIA
SOMALIA
National capital
Regional capital
Town, village
Airport
International boundary
Regional boundary
Indeterminate boundary
Main road
Track
Railroad
0 50 100 150 200 km
0 50 100 mi

Somalia case study – the main parallels with FCV countries

- Large parts of the territory still contested (with military operations),
- Low legitimacy level of federal authorities and state-building in the making, (Cloutier et al. 2021)
- Importance of taxation competition (armed groups/local authorities/elders/religious authorities), (World Bank 2020),
- Lack of reliable data,
- Large tax administration problems.

Somalia case study – difficulties to tax



Somalia case study – what history teaches us…

1.Somalia's tax revenues has always been low [even during colonial times with massive subsidies] (less than 10 percent of GDP after 1960)

Main causes: problem of state/tax acceptability; importance of livestock/agriculture difficult to tax.

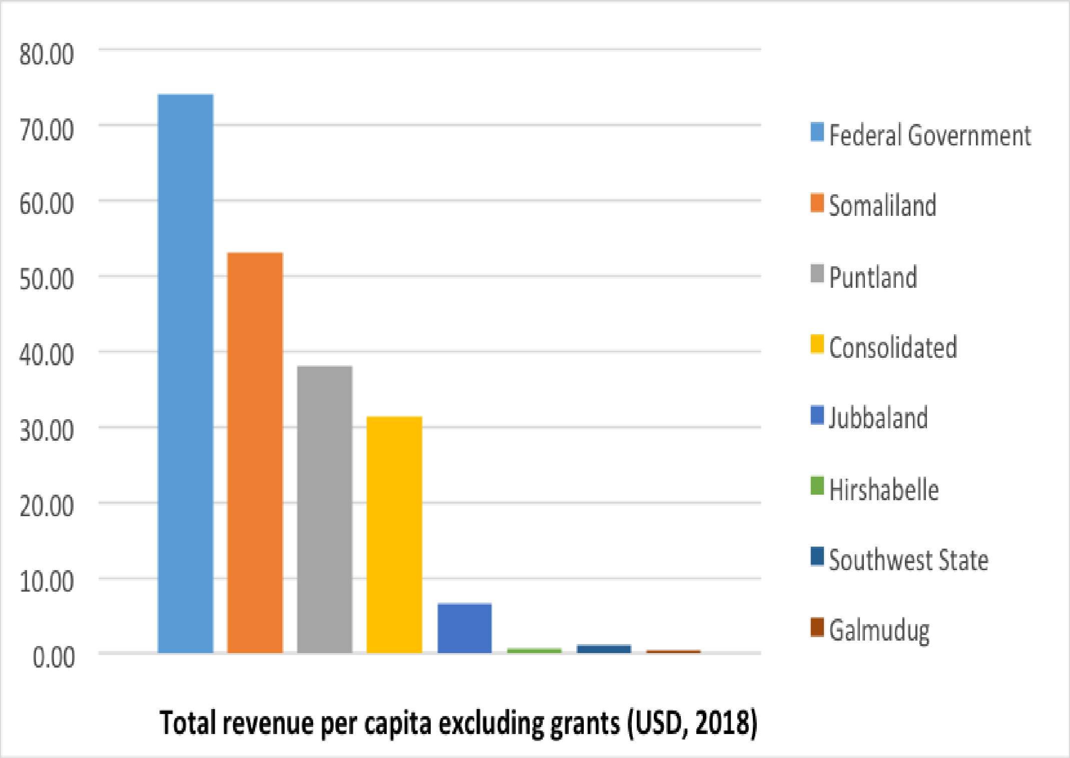
2. Trade taxes have always been the main driver of Somalia's tax revenues (It is common in fragile states. It was around 50 to 65 percent between the late 1970s and late 1980s (Purohit 1990).

3. Corporate and income tax have always been low (but higher than now).

Somalia case study – the main specificities and initial conditions

- Three main ports/customs authorities (FGS/PSS/JSS)
  - Customs revenues continue to be collected/generated at federal member states levels,
  - Some border cities collect more than federal member states => huge inequality in terms of customs revenue potential,
- Only specific duties (taxes based on packaging) and all containers stripped counting packages

  => no valuation and no HS classification
- Declarations done by customs officers



Somalia case study – what has been done and what remains to be done?

- HS classification adopted and a national tariff schedule with ad valorem rates (using COMESA schedule),

- Declarative system implemented,

- Regular high-level meetings with Puntland and Jubbaland authorities,

- Training of data analytics

=> Customs revenues continue to collect around 50% of total revenues in Somalia and have increased

Somalia case study – what remains to be done?

- A national valuation database between ports,
- Implementation of a national IT system,
- HR reforms and increased capacity/competencies,
- Revenue sharing between FGS/FMS and implementation of revenue assignment agreements

Somalia case study – what has been the main role of donors?

- Support core customs reforms on procedures/organizational structures/training,
- Support convergence of taxation level between FGS and FMS levels,
- Support initial discussions on customs revenue sharing between FGS/FMS,

Concluding remarks

Crucial to better link technique and politics in this setting

- Combine anti-fraud and anti-corruption efforts. Large traders evade taxes the most.
- Deploy customs staff in fragile borderlands to restore the presence of the State in areas challenged by armed groups. Profitability criteria should not be the only criteria.
- Use data and develop data analytics is important to improve capacity to mobilize taxation for public good.
- Deploy technical assistance on the ground to understand the political and social context of tax collectors' practices and constraints.

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Thank you for your attention!