



ICTD Summary Brief 2

Informal Taxation in sub-Saharan Africa: A Synthesis

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Historically research about taxation and development in low-income countries has tended to focus on formal tax systems. However, recent research – among which the ICTD has played a leading role – suggests that this focus on formal taxation often overlooks very extensive and important systems of informal taxation: tax-like payments, made to both state and non-state actors, that are outside of statutory tax laws. Attention to these systems of informal taxation is important, not only because of the immediate implications of informal taxation for the livelihoods of taxpayers, but also because it can fundamentally reorient our understanding of fiscal decentralisation and the ways in which taxation may contribute to local-level statebuilding and accountability.

In order to understand the importance of the expanded study of informal taxation, it is useful to draw a contrast with dominant narratives around taxation and development – particularly at the local government level. There is now a powerful narrative around taxation, representation and statebuilding in low-income countries, and particularly in post-conflict countries – built around three main ideas. First, local taxation can serve as an important, even if modest, source of revenue for financing basic local initiatives, and engaging citizens with local governments, whereas at present citizens in local government areas are largely outside of the tax net. Second, taxation can serve as an entry point for (re)building state capacity, including local inter-governmental relations. Third, taxation can provide incentives for citizens to demand accountability, and incentives for governments to bargain in return for tax compliance. This narrative is attractive in part as it localises local level development and post-conflict reconstruction, and focuses attention on organic local processes of statebuilding and bargaining driving change. This narrative has been reflected in ICTD work under the theme ‘extending the reach and inclusiveness of taxation’, which was initially focused on how to

strengthen taxation at the local government level, and of the informal sector – particularly in conflict-affected states.

However, subsequent research in Sierra Leone and elsewhere has made clear that while this narrative is extremely important, it also risks oversimplifying the realities and developmental implications of local taxation because of a narrow focus on formal tax systems – and a consequent inattention to extensive systems of informal taxation. This inattention to informal taxation may result in, among others: (a) underestimating the actual tax burden borne by local citizens; (b) failing to identify important challenges facing potential tax reform; (c) misunderstanding the potential, or not, for local government to spur statebuilding and expanded accountability; and (d) failing to fully capture the complex, and often strained, relationship between citizens and local governments.

To be clear, the study of informal taxation is not, in and of itself, new. Seminal early research by Prud'homme and others initially drew attention to the extent, and diversity, of informal taxation in some parts of Africa.¹ This has been followed more recently by a number of excellent 'thick' anthropological and qualitative studies of informal taxation, particularly, though not exclusively, in border regions.² Building on this foundation, ICTD research has sought to pursue two broad goals:

- First, to develop a broad and inclusive understanding of informal taxation, drawing on both qualitative and quantitative methods. ICTD research has correspondingly centred on a broad definition of informal taxation: 'All payments—whether cash or in kind, including labour time—that are made outside of the household and as a result of the exercise of political power, social sanction or armed force (as opposed to market exchange)'. More

¹ Prud'homme, R. (1992) 'Informal local taxation in developing countries', *Environment and Planning C: Government and Policy* 10 (1992): 1-17.

² e.g. Barkan, J. and Holmquist, F. (1989) 'Peasant-State Relations and the Social Base of Self-Help in Kenya', *World Politics* 41, no. 03: 359–80; Beard, V. (2007) 'Household Contributions to Community Development in Indonesia', *World Development* 35(4): 607–25; Raeymaekers, T. (2010) 'Protection for Sale? War and the Transformation of Regulation on the Congo- Ugandan Border', *Development and Change* 41(4): 563–87; Tegera, A. and Johnson, D. (2007) 'Rules for Sale: Formal and Informal Cross-Border Trade in Eastern DRC', *Regards Croisés* 19; Titeca, K. (2012) 'Tycoons and Contraband: Informal Cross-Border Trade in North-Western Uganda', *Journal of Eastern African Studies* 6(1): 47–63; Titeca, K. and Kimanuka, C. (2012) *Walking in the Dark: Informal Cross-Border Trade in the Great Lakes Region*, International Alert and UN Women.

simply, all non-statutory tax-like payments made to state or non-state actors, where ‘taxes’ is treated broadly to include payments that may formally be labelled taxes, fees, levies, rates and similar. With this broad definition the initial goal has been to map *all* of the informal taxes that citizens pay, across a wide range of locations, in order to build a more complete picture of the realities of local taxation.

- Second, to more explicitly connect our research to specialist communities interested in taxation, governance, and the policy implications of informal taxation. While the first goal has been to map the empirical realities of informal taxation, particularly in post-conflict settings, the longer-term goal is to ask what an understanding of the complex reality of formal and informal taxation implies for understanding local livelihoods, tax reform, statebuilding and broader state-society relationships.

The most important study to date saw ICTD researchers conduct a large-scale taxpayer survey in late 2013 in Sierra Leone, aimed at capturing all of the taxes – formal and informal – that households pay, as well as the ways in which taxpayers perceive different types of taxes. This data was complemented by other efforts to understand empirical realities, including via focus groups and key stakeholder interviews. The first of its kind, this study does not provide us with conclusive answers, but highlights initial insights and an empirical starting point to guide subsequent research into taxation and governance in areas where the state is weak.³

Drawing on the data, the research delineates four broad categories of formal and informal taxation: formal state taxes, which are clearly mandated by law; informal state taxes, which can take a range of forms and nomenclatures, including bribes or goodwill payments to state actors, groups or state security agents at checkpoints; informal taxes to traditional authorities, which may take the form of cash, in-kind or labour payments for specific community projects or for private gain; and informal non-state taxes, which are often enforced through social sanction and can take the form of community levies, with payments made to community groups, self-help groups, or other autonomous governing structures, or of protection payments to armed groups. Evidently, informal taxes exist along a spectrum of coercion and consent,

³ Jibao, S., Prichard, W. and van den Boogaard, V. (forthcoming) *The Pervasiveness and Relative Prosperity of Informal Taxation in Post-Conflict Sierra Leone*.

with the balance determined by context-specific factors, including who levies the tax, how fairly that tax is levied, and what is received in exchange for the tax.

While much about informal taxation is likely to differ according to context, there are two key findings from this initial study in Sierra Leone. First, informal taxes are extensive, making up a significant proportion of the taxes people pay, while both formal and informal taxes tend to be highly regressive in their incidence. At a broad level, this runs counter to narratives suggesting that local citizens, outside of big cities, pay very few taxes; there is, in fact, a significant tax burden relative to low incomes, but only a portion reaches state coffers, and the burden is often concentrated among lower-income individuals. In turn, this raises important questions about service delivery, statebuilding and accountability at the local government level. On the one hand, extensive informal taxation may be seen, through the taxation-as-statebuilding narrative, as missed opportunities for the formal state, undermining revenue, statebuilding and the construction of more accountable relationships with citizens. On the other hand, the prevalence of informal taxation may be seen as an effective alternative to ineffective formal states: a means for citizens to circumvent coercive or unaccountable state apparatuses. Further empirical work will be necessary to determine which narratives may usefully guide our understanding of informal taxation in different contexts.

Second, we find that taxpayers have significantly greater trust in informal taxes than in formal taxes, across a range of measures. Most directly, taxpayers believe that informal non-state and chieftdom taxes are more likely than formal or informal state taxes to be used to benefit the community some or most of the time. We find a similar division in perceptions of formal and informal taxes across a range of indicators, including the fairness and transparency of rate-setting, the fairness of collection, and the likelihood of taxing actors misusing tax revenues or revenues intended for a development project. These findings reflect broader evidence that in Africa there is a low level of confidence and trust in formal local government,⁴ and thus offer an important empirical lens through which to explore the complexity of state-society relations at the local level. Again, the implications of these findings are not entirely clear, but the data

⁴ e.g. Bratton, M. (2012) 'Citizen Perceptions of Local Government Responsiveness in Sub-Saharan Africa', *World Development* 40(3): 516-527; Logan, C. (2009) 'Selected chiefs, elected councillors and hybrid democrats: popular perspectives on the co-existence of democracy and traditional authority', *The Journal of Modern African Studies* 47(1): 101-128.

raises compelling possibilities. The most provocative possibility is also the simplest: greater local trust in informal taxation may be reflective of greater trust in more local, informal, authorities, of the greater effectiveness of those informal authorities in delivering services, and of the potential value of alternative approaches to local tax collection, potentially including closer collaboration between the formal state and these informal actors in delivering local services. Alternatively, taxpayers may express greater trust in informal taxes because they are more proximate and more closely resemble user fees. Yet this too could have important implications for thinking about appropriate models of revenue collection and service delivery at the local level, including by the formal state.

Ultimately, research on informal taxation remains at a nascent stage, but research in Sierra Leone in particular makes clear the importance of this research area, and the potentially very important implications. First and foremost, informal taxation is important to livelihoods and well-being. Informal taxation is a prevalent reality in many areas where states are weak; it is accordingly necessary to widen our analytic lenses to capture the full range of taxes paid by citizens in order to understand the impact of taxes on poverty and development. Second, understanding informal institutions is critical to thinking about reform of the formal, and to understanding why formal institutions generally underperform at the local level. In Sierra Leone this is well illustrated by the fact that chiefs – who are major informal tax collectors at the local level – have also played a decisive role in shaping the viability, or not, of formal state tax reform efforts. Third, in some cases informal institutions or processes may be more effective in meeting citizen needs. There may thus be cause for exploring second-best or hybrid strategies. Indeed, our findings suggest some advantages to community-driven development models, though being cautious of strengthening local institutions that may be unaccountable or unrepresentative. Hybrid solutions may achieve the best of both scenarios. Finally, if we wish to understand the ways that revenue-raising may contribute to statebuilding and the expansion of local accountability we almost certainly need to pay closer attention to the ways in which informal taxation shapes these processes.

Complementary ICTD research further reinforces these messages, while aiming to explore the implications of informal taxation in still greater depth. Research on taxation of market traders in Northern Ghana reveals high levels of informality in state taxation, the barriers to establishing greater formality in the context of small businesses and limited state revenues,

and the complex social and political dynamics shaping the existing system.⁵ Critically, Prichard and van den Boogaard (forthcoming) note the ways in which informality can in some cases yield better, more equitable, outcomes, but can in other cases exacerbate existing inequalities. More recently, research similar to that undertaken in Sierra Leone has been launched in the Democratic Republic of the Congo (DRC), led by ICTD researchers and building directly from the pioneering ICTD work in Sierra Leone.⁶ The goals, among others, are to gain a still more fine-grained understanding of formal and informal tax payments, and to better understand variation in these systems across locations. As importantly, the surveys in both Sierra Leone and the DRC will act as invaluable starting points for more in-depth, mixed methods research in the future, seeking to better understanding the dynamics of informal tax systems, their interaction with formal tax systems, their broader implications for statebuilding and accountability, and what this means for thinking about fiscal decentralisation reforms more broadly, particularly after conflict. The bottom line is that recent research has made clear that better understanding informal taxation is critical to better understanding a wide range of tax and development questions.

⁵ Prichard, Wilson and van den Boogaard, V. (forthcoming) 'Norms, Power and the Socially Embedded Realities of Market Taxation in Northern Ghana', *African Studies Review*.

⁶ Prichard, W., Paler, L. Sanchez de la Sierra, R. and Samii, C. *Informal Taxation in the Democratic Republic of the Congo*.