

Explaining Informal Taxation and Revenue Generation: Evidence from south-central Somalia

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Summary of Working Paper 118

Most people in low-income countries contribute substantially to the financing of local public goods through informally generated revenue – that is, non-market payments that are not required or defined by state law and are enforced outside of the state legal system. However, very little is known about how revenue is informally generated in practice. By relying on original data from surveys with over 2,300 households and 117 community leaders in the Gedo region of south-central Somalia, this paper offers novel evidence on the magnitude and regressivity of informal revenue generation and its relationship with the state.

Over 70 per cent of households surveyed reported paying at least one informal fee in the previous year, representing on average 9.5 per cent of their annual income. Among households that contribute, poorer ones contribute greater amounts than richer ones in relation to their income—in line with evidence elsewhere on the regressivity of informal taxation. Moreover, informal payments have inequitable effects at the community-level, with individuals in wealthier communities making more informal payments than in poorer ones and, correspondingly, having access to a greater number of public goods. The paper finds that informal revenue generation can be more efficient and effective than formal taxation and can be complementary to district-level state governance.

This research reinforces the importance of informal revenue generation to everyday citizens, to public goods provision in weak formal institutional contexts, and to policymakers attempting to extend the influence of the federal state in south-central Somalia. Foremost, future analyses of taxation, service delivery, social protection, and equity need to incorporate informal tax institutions within their research scope. At the same time, these findings have important implications for understanding statebuilding processes from below.

State Taxation in south-central Somalia

Effective direct taxation from a centralised authority has been a persistent challenge throughout south-central Somalia's history. Prior to colonisation, much of the ethnic Somali population did not fall under a state-like authority, but rather was politically decentralised. Upon colonial

intervention, colonial authorities remained either unable or unwilling to institute an effective system of direct taxation.

From the unification of Italian and British Somaliland and the independence of the Somali republic, through to the Barre regime and the civil war, the central state and its taxing capacity has remained weak. Limited capacity and the presence of armed group's parallel tax systems have led to a situation wherein the federal government only collects revenue from the Benaadir (capital) region in practice, with formal central state taxation non-existent outside of Mogadishu and key ports of entry.

Informal Revenue Generation in South-Central Somalia

In the context of persistently weak centralised statehood, and building on a history of precolonial decentralised authority, south-central Somalia is characterised by a rich network of local governance institutions and practices. Citizens pay a range of informal taxes, fees and contributions to clan elders, community leaders, religious leaders, and NGOs to support:

- 1. Clan governance and conflict resolution:** While having undergone substantive changes under colonial rule and post-colonial statebuilding, clans remain a cornerstone of social and political organisation among nomadic-pastoralist Somalis. Within the clan structure, there are a range of payments and contributions collected by elders to manage local governance and conflicts, underpinned by customary laws.
- 2. Security provision:** Given the underlying context of insecurity, in some areas clan elders levy informal taxes to finance community-based security. Outside of security taxes levied by clan leaders, there is a long history of protection payments and taxes being levied by armed actors, including Islamist militants.
- 3. Social welfare and local public goods provision:** Clan, religious, and village leaders – often working in collaboration – are central in providing social welfare and emergency relief in the absence of assistance from the state.

Explaining Informal Taxation and Revenue Generation

Our evidence supports several non-mutually exclusive theories for the prevalence of informal taxation, including informal taxation's ability to fill gaps left by the state. We consider four explanations for the prevalence of informal revenue generation, finding that:

1. Informal revenue generation clearly **fills gaps left by weak state capacity**. Relatedly, we show that informally generated revenue can bolster perceptions of the legitimacy of the state, indicating that sub-national governments may actually benefit from informal taxation.
2. Informal taxing authorities are **more effective tax collectors than the state**, with informal taxing authorities having greater legitimacy and taxpayers perceiving informal payments to be fairer than those levied by the state.
3. Dispelling the possibility that informal payments should be classified as user fees, **taxpayers overwhelmingly expect nothing in return** for their contributions.

4. In contrast to hypotheses that informal payments may be voluntary, **taxpayers associate informal payments with punishment and informal institutions of enforcement**.

Implications

This research contributes to what is a limited but growing body of knowledge on informal taxation, pointing to the ways in which informal revenue generation may complement or even strengthen local government taxation. More research is needed in order to understand the mechanisms underpinning this association and to further consider how this varies across cash and labour contributions.

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Further reading

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Credits

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