

MARKET ANALYSIS NOTE #5

*Grain Market Research Project
Ministry of Economic Development and Cooperation
January 1998*

REVISITING GRAIN MOVEMENT CONTROL AND TAXATION IN ETHIOPIA: A POLICY BRIEF¹

EXECUTIVE SUMMARY

The current sales tax collection system is affecting negatively the producers' income, traders' profit margins and consumers' purchasing power. While the conventional wisdom in Ethiopia is that the tax on grain sales falls on traders, the evidence indicates that in large part these taxes are passed on to farmers in the form of lower producer prices and to consumers in the form of higher retail prices. In some cases, the taxes collected are unregistered and do not appear to be fully channeled to the government treasury. There are regional variations in the rules and regulations regarding the implementation of grain taxation which impose price risks and uncertainty on grain traders in moving grain from one to another region. These costs and risks reduce the amount of grain traded nationally and impede the potential contribution of spatial arbitrage and regional interdependence in improving national food security.

While the objective of collecting tax revenue for regional governments is clearly justified and necessary, during lean grain harvests such as in 1997/98, replacing a grain sales tax with taxes on other commodities produced and consumed more by higher-income groups may be advisable. Grain makes up a large share of poor consumers' expenditures. Further study is advised to identify potentially taxable commodities that are produced and/or consumed disproportionately by relatively middle- and higher-income groups. Moreover, making tax rates more uniform throughout the country may also reduce the uncertainty as to correct tax rates and thereby reduce the scope for unregistered payments that do not contribute to regional tax revenue. On the part of traders, the tradition of compliance to tax rules and regulations is also not well-developed and the traders must be made more aware of why taxes are collected through appropriate information dissemination. Collection of tax revenues from traders may also improve if local governments are more successful in showing that tax funds are in part used to upgrade marketing infrastructure such as the development of new market places for grain trading.

1 INTRODUCTION

The objective of imposing grain sales tax policy by the regional governments was to raise revenue for financing their regional development programs. The fact that the economy of most of the regions is based on agriculture has also reinforced a widely held belief by the local governments that taxing of grain sales provides a considerable revenue to the regional government. While the purpose of this paper is not to argue against the principle of collecting tax revenue on the movement or sale of grain, there are very important policy issues with regard to the current collection of taxes on grain sales. How effective is the current grain tax collection system in meeting the government's objective of revenue generation? What proportion of the actual grain tax collected from taxpayers end up in the government treasury? What is the effect of the grain tax on various market participants: producers, traders and consumers? What is the effect of grain tax collection on grain market performance and national food security?

Some of the effects of grain checkpoint controls and charges on different market participants and grain market performance have been already assessed (Asfaw and Jayne, 1997; and Gebremeskel et al., 1997). Major findings of these studies included the following:

- The number of checkpoint controls on five major grain trading routes from Addis Ababa varied from 8 to 18;
- Traders spent from one hour to three hours at the checkpoint controls before they reach their final destination;
- On average, about 7 birr per quintal was paid as checkpoint tax (Asfaw and Jayne, 1997);
- In a trader survey conducted by GMRP in 26 markets across the country involving 220 traders, about 35% of the traders ranked “kella” as their number one constraint in doing grain business (Gebremeskel et al., 1997);
- Gebremeskel et al., 1997 also found that the number of checkpoints for 13 different trading route varied from 1 to 15 and the “kella” charge averaged about 8 birr per quintal.

Generally, there was a substantial variation in the magnitude of checkpoint taxes along different routes which made spatial arbitrage very risky for the grain traders. Understanding the negative impacts of checkpoint control on grain market performance, the regional governments announced in early 1997 that grain checkpoint controls would be partially, or in some regions, totally banned. This study was a follow-up to the previous GMRP studies to assess the current status of the grain movement controls and taxation in Ethiopia.

2. OBJECTIVES OF THE STUDY

The major objective of this study was to assess the extent of the current grain movement controls and taxation practiced by the different regions in the country. Some of the specific objectives of this study were to: (1) establish whether grain movement checkpoint controls continued to exist and to what extent, (2) identify the various types and amounts of taxes imposed on grain sales; (3) describe the methods of grain movement controls and taxation across regions and within regions, markets and type of grains; (4) assess the impact of grain movement control and taxation on grain market performance, and (5) provide policy recommendations regarding the implementation of grain movement controls and taxation.

3. METHODOLOGY OF THE STUDY

This study was conducted in November and December of 1997 to provide a rapid appraisal of grain movement control and taxation practiced by the different regions of the country. Important grain markets both from the deficit and surplus producing regions of the country were selected purposively and about fifteen markets from Tigray, Amhara, Oromya and SNNP regions were studied. The markets studied include: Mekele, Alamata, Bahir Dar, Gonder, Dessie, Shambu, Nekemete, Dberezeit, Nazeret, Etaya, Asella, Assasa, Dodolla, Shashamane and Hosaenna.

In each market the information on grain movement control and taxation was obtained by interviewing traders, farmers and representatives of the Ethiopian Grain Trade Enterprise (EGTE) working at respective markets. The traders were interviewed using survey checklist either individually or in a group and the selection of traders for individual or group interview was based on random visits to their store or market place. In some cases information was also obtained by interviewing grain transporters and the government officials involved in tax collection, typically in the Ministry of Finance (MoF).

4. RESULTS OF THE SURVEY

The collection of grain taxes at the different checkpoints (“kellas”) through blocking grain passages such as by stretching rope or placing poles to stop vehicles carrying grains has been abolished in most of the markets visited in this survey. In most of the cases the collection of grain sales tax at checkpoint control has been replaced by sales tax collected mainly at the trader’s store at the time of loading and/or unloading of grains. In some cases, sales tax is also collected at strategic locations upon exiting and /or entering markets, however, there is a move back to the checkpoint control as some traders appear to be trying to evade grain tax payments at their stores. This section provides detailed information on how the grain taxation is currently implemented and how it is affecting grain market performance.

(1) Collection of grain taxes: In the markets studied, the Ministry of Finance (MoF) and the city municipality were the two most important regional government offices responsible for the administration and collection of grain sales taxes. For the purpose of tax collection the two offices have their own employees who monitor grain movements, truck arrivals, and departures. They also regularly visit traders’ store and monitor their activity for the purpose of determining grain sales tax and annual fees. In Shambu wereda, the traffic controllers at Harato are also used to stop vehicles and register the type and amount of grain loaded, date and the name of trader and pass this information to MoF in Shambu town for the purpose of collecting sales tax from the traders who escaped tax payment in Shambu.

The grain sales tax is levied on all traders and all types of grains. The amount of sales tax is 5 birr/qt for most of the markets and is also the same for all grains in most markets. However, there are exceptions to this where sales tax is based on grain selling price in destination market such as at Alamata checkpoint control. In Hosaenna market, the sales tax is also different for teff and maize, the sales tax for teff is 10 birr/qt while for maize the sales tax is 5 birr/qt. Traders in Nazeret area market also reported that they pay sales tax of 10 birr/qt for teff. In most markets there is no difference between licensed and un-licensed traders in terms of the amount of sales tax they are required to pay except at Alamata checkpoint control which is discussed under a different section. However, the tax collectors use the fact that the un-licensed traders are involved in illegal trade and according to some accounts intimidate them for higher amount of bribes. The licensed traders complained that un-licensed traders do not pay annual fees and various government contribution fees and this is creating unfair competition.

The municipality charge is also the same in most of the markets. Traders pay flat tax of 1 birr/qt at loading and/or unloading on all grains. However, in markets like Bahir Dar, the grain tax imposed by the municipality varies by the type of grains. For example, the municipality charge was 1 birr/qt for oil crops, 0.75 to 0.80 br/qt for teff and 0.60 for maize. In Mekele market traders pay only 1% tax to municipality at the time of unloading grain and there is no sales tax paid to the MoF. This might be because there is sales tax on most of the grain going to Mekele market which is collected at Alamata checkpoint control, this checkpoint being at a very strategic location and, unless deliberate, traders rarely bypass this checkpoint control for normal commerce into Tigray from other regions. Similarly, in Nekemete market, as opposed to the nearby Shambu market, the traders also pay only 1% tax to the municipality. However, for most of the markets visited in Oromya region traders pay tax both to the MoF and the municipality.

Generally, the actual payment of grain tax to MoF and municipality was made by the traders. However, in some markets like in Deberezeit market the farmers are also forced to pay a tax of 0.50 birr/ 50 kg sack (1 birr/qt) to the municipality whether the grain is sold or not. The farmers are also obliged to pay tax again on

the same unsold grain if they bring it to the market. The farmers pay tax just for the use of open ground and the municipality does not provide any service to the farmers. In Dessie market the farmers who used trucks to bring their grain to the market pay 1% sales tax to the municipality at the time of unloading.

In most of the cases the traders pay their sales tax on the spot to the tax collectors from MoF and municipality. However, in some markets like Shambu the traders can pay sales tax on the spot or be given a deadline. When the grain sales tax is not effected on the spot the tax collectors register the type and amount of grain loaded, date and name of the trader and report this information to the MoF. However, if the traders do not meet the deadline they have to pay double of the original sales tax and there is also 2% interest per month on unpaid sales tax.

(2) Checkpoint controls: For the surveyed markets the places at which the sales tax collected varied and changed over time. In most of the cases, sales tax is collected at the trader's store at the time of loading and/or unloading. However, some traders started loading and unloading during the night and in places other than their store to evade sales tax. To overcome the traders' evasion of sales tax payment, the MoF and the municipality started collecting tax outside the traders store. Tax collectors are escorted by armed police men and collect tax at any time and any place. In some cases there are also checkpoint controls at strategic locations to collect sales tax. The most noticeable grain checkpoint control is at Alamata and there are also other checkpoints such as at Achamo and Doyogana for Hosaenna market and at Tikur Woha to Awassa and other markets in the Southern Regions. The following section provides details of some of the checkpoint controls.

There are still grain checkpoints for the purpose of collecting grain sales tax in different market throughout the country. There is very strict grain checkpoint control at Alamata whereby different taxes are collected on grain entering Tigray region from and to Amhara region. Based on interviews with the officials of the checkpoint control, licensed traders pay sales tax of 5%. In principle, traders who have paid grain sales tax in other places are not supposed to pay sales tax again at Alamata checkpoint control upon presenting a legal document acknowledging tax payment. However, they have to pay for the difference in sales tax calculated based on the average prices used at Alamata checkpoint control.

Un-licensed traders are treated differently in paying grain tax. In addition to sales tax of 5% they also pay what is called "profit tax." The grain tax on unlicensed traders increases from time to time depending on their previous records of grain shipment to Tigray region. All the documents of grain tax payments are dispatched to the traders' respective regions which can subsequently be used in determining other taxes and fees by the regions. The formula used for calculating profit tax for un-licensed traders is given as follows:

$$\text{Profit tax} = (Q \times \text{PPP} \times 0.02) - 120$$

where Q is the total quantity of grain in quintals handled by the trader and PPP is the average price per quintal used as tax base for a particular grain. For example, a licenced trader carrying 100 quintals of teff with tax base price of 220 birr/qt, the sales tax would be 1100 birr ($220 \times 100 \times 0.05$). On the other hand, the unlicensed traders pay sales tax of 1100 birr and profit tax of 320 birr ($100 \times 220 \times 0.02 - 120$). Thus, for 100 quintals of teff there is about 320 birr difference on grain taxes paid between licensed and unlicensed traders. When this survey was conducted the average price used in calculating sales tax for Alamata checkpoint control was 220 birr/qt for teff, 130 birr/qt for maize and sorghum, and 145 birr/qt for wheat. On the other hand, for Mekele market the average price (birr per quintal) for the month of November 1997 was 225, 142.5, 225, and 259.5

for mixed teff, maize, sorghum and wheat, respectively (GMRP, 1997).

The Ministry of Finance of Tigray Region is directly responsible for the checkpoint control at Alamata. The grain price upon which the 5% sales tax is calculated is the average price for different markets in Tigray region and it rarely changes within a year. Thus, the sales tax calculation could be over- or underestimated depending on how the average price for Tigray regions varies. At Alamata checkpoint there is no unloading and weighing of grain, tax collectors use their visual assessment and take traders' word for rough estimation of the amount of grain loaded on the truck. However, there is another checkpoint control at Zala Anbessa on the Eritrean border where the grain weight is taken and the traders are required to pay sales tax on the amount of grain on which sales tax is not paid at Alamata or other places. There is also another checkpoint in Tigray region at Rama along Eritrean border, the grains like sorghum from or via Gonder enter to Eritrea at this checkpoint.

Similarly, there is also checkpoint control at Achamo, 30 km from Hosaenna where wheat and teff leaving Hosaenna area for Addis Ababa and Debrezeit markets are the main tax items. There is also another checkpoint at Doyogana whereby wheat and teff destined for southern regions from Hosaenna market and maize entering Hosaenna market are taxed, sales tax on maize is 5 birr/ quintal. Stone blocks and armed policemen are used to stop trucks carrying grain at different checkpoints. The traders also indicated that sales tax is also being collected in small markets like Jajura, Gimbicho and Morosito, which supply grain to Hosaenna market, and the traders who paid the sales tax at these markets are also asked again by the checkpoint controllers at Achamo and Doyogana.

There is another grain checkpoint at Tikur Whoa whereby grain entering in to Sidamo region from and via Shashamane market is taxed, one trader reported that in taking grain from Shashamane market to Yirga Alem market he paid a tax of 50 birr/50 qt at Tikur Whoa. There are also other checkpoint controls reported by the traders in taking grain from or via Nazeret to Afar and Harar areas, with the amount of tax unknown. Traders in Asella market also reported that there are grain checkpoint control in Ketarfite, Gonde and Sagure markets which are main grain suppliers to Asella market.

(3) Sales tax evasion and enforcement: The traders said that the sales tax is too much for them and as much as possible they try to evade by trying to hide from the tax collectors when they are loading and unloading grain. Traders also openly admit the fact that they bribe the tax collectors and assessors to partially evade sales tax. Thus, the traders get receipts for the lower amount of the actual tax payment made to the tax collectors and the tax collectors apparently retain the difference. It is also possible for the tax collectors to pocket the whole amount of tax collected from traders as some traders tend not to ask for receipts thinking that it affects their future relationship with the tax collectors. Outright opposition to the tax collectors might also entail severe punishment of the traders. Some of the sales tax enforcement measures include: imprisoning the trader, closing traders store or business, detaining the truck, and seizing driver's licenses, and in one case a trader reported being bitten by a policeman.

(4) Impacts of grain market movement controls and taxation on market participants: Most of the traders interviewed think that they are all equally exposed to the grain sales tax and total tax evasion is very difficult because of strict supervision from the inspectors of MoF and municipality.. The traders complained that the tax is affecting their business by lowering their profit margin and grain business activity. When they are charged, the traders usually add up their costs and in buying from the farmers they deduct their costs and as a result the farmers receives a lower price in subsequent transactions with the trader. However, the strategy

of lowering producer price works only if the farmers are in high need for cash, if the price is lowered too much the farmers start decreasing the supply of grain to the market. Because the farmers have limited market outlets, they are usually compelled to accept a lower price offered to them by traders and they do also retail if they are very desperate.

Traders load and unload grain several times before it reaches its final destination or consumer, for assembling and temporary storage for latter on shipment to other places. For example, big traders in Assella market have their storage in Nazeret market and from Nazeret market they ship grain to different directions (like Addis Ababa and Dire Dawa). As taxes are collected at the time of loading and unloading the traders complained that they are exposed to multiple sales tax charges which is also increasing prices to the consumers. The traders in Bahir Dar market also complained about multiple payments of grain taxes as the grain changes hand, the traders pay tax on grain which was already taxed somewhere else.

5. DISCUSSIONS AND POLICY IMPLICATIONS

The objective of imposing grain sales tax policy by the regional governments was to raise revenue for financing their regional development programs. In this regard, at least, there are three important policy questions which need to be addressed very carefully: (1) Does the current way of grain tax collection guarantee the flow of the tax collected to the government treasury? (2) What is the ultimate impact of grain taxes on various economic agents: producers, traders, and consumers? and (3) What is the impact of grain tax collection mechanisms on the grain market performance and national food security? The following sections provide a brief discussions of the survey results in light of the above policy questions and provide their policy implications.

The current sales tax collection system is affecting negatively the producers income, traders profit margin and consumers purchasing power. In some instances, the tax collected does not appear to be appropriately channeled to the government treasury. The traders indicated that the sales tax rate is too much for them and they openly admitted that, as much as possible, they try to avoid grain tax by bribing tax collectors and assessors. In most cases, an effective system of monitoring the activity of the tax collectors is lacking and part of the sales tax revenue collected appears to end up in the pockets of tax collectors. Traders also reported cases where previous tax collectors opened up their own business and left their government job.

To assess the overall impact of grain taxation on various economic agents it is very important to know not only who actually pays the grain taxes to the local governments, but also whose incomes are finally affected by the taxation policy. In other words, what is the incidence of sales tax on various economic agents? In most of the cases the traders interviewed indicated that they compensate for grain tax by reducing the producer price and increasing their selling price. The producers also have two options: either to sale their grain at the on-going lower price due to sales tax or sell their livestock. The bargaining power of farmers is also not the same throughout the year. At harvest when the farmers have to settle most of their financial obligations and the market is flooded with grain supply, they have little options but to accept whatever price the traders offer them. The activity of tax collection is also intense during the harvest period which increases the tax burden on farmers. If the strategies of reducing producer price and/or increasing the selling price are not working the traders have to decrease their profit margin or at worst they make loss.

Grain taxation also has important policy implications for the food security issue of the country. Grain sales tax decreases the income the farmers are getting from the sale of their grain and thus affects the producers incentive to use productivity increasing technologies. On the other hand, the sales tax increases the prices and

limits consumers' access to basic food items and even those of the producers themselves. There are also regional variations in the rules and regulations regarding the implementation of grain taxation which is increasing price risk and uncertainty on grain traders in moving grain from one to another region. Thus, the potential contribution of spatial arbitrage and regional interdependence in improving the national food security is somewhat undermined.

It is very important for the government to establish the costs and benefits of the current policy of grain taxation which might need further detailed study. However, this evaluation indicates that the current grain tax collection system is affecting negatively the producers income, traders profit margin and consumers purchasing power. To overcome the negative impacts of grain movement controls and grain sales tax on the national economy the government has two options: either to abolish grain sales tax or modify the tax collection system. While the objective of collecting tax revenue for regional governments is clearly justified and necessary, during lean grain harvests, such as in 1997/98, replacing a grain sales tax with taxes on other commodities produced and consumed more by higher-income groups may be advisable. Grain makes up a large share of poor consumers expenditures. Especially during lean production years, both producer revenues and consumer purchasing power of low-income households tend to be depressed. Grain shortage is expected in most part of the country and imposition of sales tax increases grain prices and aggravates the food shortage problem of these households. Further study is advised to identify potentially taxable commodities that are produced and/or consumed disproportionately by relatively middle- and higher-income groups.

Many traders indicated that, as much as possible, they try to bribe the tax collectors. This indicates the fact that higher tax rates does not necessarily mean higher revenue for the regional governments. Higher tax rates provides an incentive for the traders to bribe the tax collectors and the tax collectors to be corrupted. Thus, reducing the current grain sales tax might reduce the traders evasion of tax and therefore may even increase tax revenue to the government. Making tax rates more uniform throughout the country may also reduce the uncertainty as to correct tax rates and thereby reduce the scope for unregistered payments that do not contribute to regional tax revenue. On the part of traders, the tradition of compliance to tax rules and regulations is also not well-developed and the traders must be very aware of why tax is collected and for this purpose educating traders is very important. Collection of tax revenues from traders may also improve if local governments are more successful in showing that tax funds are in part used to upgrade marketing infrastructure such as the development of new market places for grain trading.

Note: ¹ This Market Analysis Note is prepared by Asfaw Negassa and T.S. Jayne, Grain Market Research Project, Ministry of Economic Development and Cooperation, Addis Ababa.

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