



The 2019 Draft for a Syrian Constitution

Analysis of the Taxation, Natural Resources and Fiscal Equalization

By Johanna Jean-Petit-Matile, Raphael Pammer, Romain Giovavola

Revised by the European Center for Kurdish Studie



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1 Taxation

1.1 General aspects of the taxation system

Article 105 (Financial Autonomy) of the draft constitution of 2019 states that all three state levels, the federal state level, the regions and the municipalities shall all be financially autonomous and responsible for their own budgets. According to paragraph 4, taxes, charges and other fees can only be charged on the basis of laws or provisions. Government agencies can therefore only act on a legal basis. The legal determination of a law, the derivation of constitutional norms and the rule of law in general, are of outstanding relevance in the establishment of a functioning tax system. Article 102 (4) is underlining this point. It is therefore strongly related to article 7 of the draft constitution, which deals with the rule of law and states that all state action has to be based on legal decisions. Hence, the draft constitution emphasizes a clear and determined tax legislation. The exact tax structure should be put into the hand of legislative bodies and therefore enable the governing parties to implement their economic policy and decide about the economic structure of the state. The need for the legislative branch to introduce taxes by law, is pointed out in several other constitutions as well. A similar formulation can be found in article 34 of the French Constitution which states that *“Statutes shall determine the rules concerning: (...) the base, rates and methods of collection of all types of taxes”*.

In article 16, the draft constitution mentions the individual’s obligation to pay taxes. Article 16 (2) says, *“Everyone shall, in accordance with his or her economic capacity, fulfill his or her obligation to pay charges and taxes.”* Not all constitutions include a similar provision, but in some the duty to pay taxes is pointed out. Article 53 of the Italian Constitution, for example, says *“Every person shall contribute to public expenditure in accordance with their capability. The tax system shall be progressive.”* The reference to the individual citizens’ economic capacity can be seen as an indication that the establishment of a progressive tax system would be preferred. A progressive tax system, in contrast to a flat tax system, consists of several tax rates. According to this system, citizens pay taxes according to their individual income bracket. In several countries, particularly in Eastern Europe, flat tax systems are used. In this system all tax payers pay a similar amount of taxes.¹ Economists, however, regularly argue that a flat tax enhances inequality. In a survey on tax officials that was being held in 2011 a broad consensus existed that their respective taxation system is not fair.² A progressive tax system can either be implemented as income taxation, or as a consumption tax. The wording of article 16 (2) might, however, not indicate the intention for a progressive tax system, but instead suggests that people under a certain level of income should be offered a reduced tax rate.

1.1.1 Tax registration

Article 61 talks about the legislative powers and the responsibilities of the municipalities. According to 61 (i), municipalities are supposed to manage not only the registration of citizens in general but should also be responsible for maintaining tax registries. Looking at other states discloses the variety of possibilities to organize the tax registration system. In Germany, the registry is legislated on the federal level, while the regions are determining the administrative body that is responsible for the

Besham/Mitchel, p 108.¹

Marc P. Berenson²

implementation of the registration law. Austria uses the registry of citizens as a taxation registry. Some countries like the UK do not have a registration system that obligates citizens to register when moving to a different part of the country and are therefore not able to use the municipal registry for their taxation system. Giving the municipalities the responsibility to implement a registration system, as laid down in the Syrian draft constitution, seems to be suitable, though a standardized registration system might be important in order to ensure coherence between the municipalities and regions.

1.1.2 Taxing competences

Article 103 (1) ascribes the responsibility for customs duties, value added tax and special consumption taxes to the federal government. In cooperation with the local level, the regions are responsible for charging direct income taxes. The municipalities levy municipal taxes and fees for services. According to article 55, of the draft constitution all tasks that are not explicitly attributed to the federal government lie in the responsibility of the regions. Since the constitution does not include a general clause of taxation types and attributes it to a certain level of government, the regions possess the right of taxation on all other tax-types that are not mentioned in article 103 of the draft constitution.

Custom duties

Customs are taxes and fees for the importation and exportation of goods into a certain economic region. The vast majority of countries have their custom duties assigned to the federal level. The Russian constitution (article 71), for example, states that basic legal principles should be established for the country in order to ensure a unified market within the state. This includes also custom regulations. In view of the development of international custom unions, it might seem advantageous to attribute the collection of custom duties to the national level, as the draft constitution does, and not to shift it to lower levels. However, the primary objective in having a country-wide custom duty is to encourage trade between subnational regions, thereby creating an internal market.

Value added tax

The value added tax (VAT) or also called goods and services tax (GST) is a general taxation instrument on goods and services. In 2012 it constituted 31 percent of total tax revenue of OECD countries (OECD 2014: 9). It is very usual that this consumption tax is charged by the federal level. Germany, France, Australia and also Nepal are examples where the federal states are enabled to charge value added taxes. According to the List of Federal Power of the Nepalese Constitution (Schedule 5/9), the central state is eligible to levy the following taxes: *“Customs, excise-duty, value added tax, corporate income tax, individual income tax, remuneration tax, passport fee, visa fee, tourism fee, service charge and fee, penalty.”*³

Since the draft constitution assigns the income tax to the regional level, it seems to be useful to assign the VAT to the federal level. On the one hand, it could be unpractical to have multiple VAT taxes in one economic union. The VAT is a consumer-oriented tax, so citizens could partially reclaim the tax if the product was purchased in another region. On the other hand, if regional VAT systems will be introduced, most of the tax revenue would flow to the regional level. The federal state would therefore, most probably, not have enough budget to fulfill its tasks, which are often cost-intensive. This again would require complex fiscal equalization mechanisms between the regions and the federal state.

Particular excise duties

According to article 103 (1), the particular excise duties are also attributed to the federal level. Particular exercise taxes are taxes on particular products such as tobacco, alcohol or fuel. Economists categorize these taxes as Pigouvian taxes.⁴ They are meant to encourage positive behavior by citizens and are often related to health or environmental policies. While Canada and the United States enable the states to add taxes on gasoline and alcohol in addition to the federal particular excise taxes, other countries like Germany attribute the collection of particular excise taxes only to the federal level.

1.1.3 Income tax and tax on net profits of legal entities

The principle that regions should be given taxation rights on income, can be found in several federations. It is, however, uncommon that regions are the only state level imposing income taxes. Some federations such as Switzerland and the United States impose a federal and a regional income tax, while Austria, also a federal state, has only a federal income tax. Even in Sweden, where most taxes are raised either on the communal level or on the state level, a regional as well as a federal income tax exists.⁵ An example of a region with broad taxation rights is the Basque region in Spain. Due to a historically grown autonomous status, the Basque region does have a broad variety of taxation rights including the right for imposing taxes on income (Section I Art. 1 of the Basque economic agreement). According to the draft constitution of 2019, the regions possess the right to not only impose income taxes on natural persons but also net income taxes on corporations. According to this regulation an economic competition between the regions is likely to occur. There is evidence for a race to the bottom in tax competition between different countries due to the goal of enhancing investment and business settlements.⁶ It is a reasonable assumption that this could also happen between the regions of a state.

1.1.4 Municipal taxes and service fees

In many states municipalities are enabled to collect taxes by themselves. Taxes are not related to a certain service, which is the difference to the collection of service fees. Service fees are collected based on the same principle in many states: You use a service and pay for it. A classic example is the garbage disposal system. The most common form of local taxes is the property tax. Actually, municipal taxes are often understood as equivalent to property taxes, though there is no clear definition. Property tax is often allocated on the municipal level, because real estate cannot be moved. Hence, tax competition between local municipalities is not directly affecting the tax giving entity. Only a few countries like Chile and Latvia use property taxes on the federal level.⁷ Some constitutions, like the Nepalese (provision 57 (4)), define which taxes are to be imposed by the local level: “*property tax, house rent tax, fee on registration of houses and land, vehicle tax*”. Different states have a broad variety of taxes collected by the local level. In Germany, the municipality collects property taxes and business license taxes (*Gewerbesteuer*).

The economist⁴
Milek, p. 39.⁵
Quak, p. 5.⁶
Bird/Slack, p. 34.⁷

2 Natural Resources

Syria is a country with various natural resources, such as iron ore, crude oil, phosphate rock, manganese ore, asphalt, marble, rock salt and gypsum. The resources produced by the mining sector include amongst others cement, marble and natural crude asphalt. Having a direct influence on the country's wealth and economic development, natural resources are an important factor for politics. The more a country is depending on the exploitation of natural resources, the more the state tries to keep control over this economic sector.⁸ Even though Syria was in 2010 a small oil producer and did not export large quantities of oil, the oil industry is a major pillar of Syria's economy, generating more than 25 percent of the state's revenue. Yet, the distribution of oil fields among the country is very uneven. Therefore, it is important to constitutionally ensure the provisions of ownership, the allocation of power and the sharing of revenues in order to fulfill the objectives set in this constitution. Tensions over resources can occur either along vertical lines, between different state levels, or horizontal, between different regions.⁹

2.1 Natural resources: To whom do they belong?

Article 15 (1) states that natural resources belong to the federal state and to the regions. Paragraph 2 continues that *"All natural resources which are not privately owned shall be public property of the state and shall be used in a sustainable manner for the good of the people."* Article 15 foresees a joint ownership of natural resources by the Syrian federal state and the Syrian regions. It could be problematic if several players express strong proprietary claims. On the one hand, regions where natural resources are situated could claim ownership. On the other hand, there might be claims by national politicians and citizens to share the natural resources, since they are regarded as national treasures. Ownership of natural resources must, however, not necessarily be coherent with the power of resource management and resource revenue collection and determination. In most countries, the ownership of natural resources is with the constituent units. However, in Brazil, Mexico, Nigeria and Venezuela, it lies with the federal government. Only Pakistan and Russia have a joint ownership by the federal state and the regions as it is foreseen for Syria.

The draft constitution does not only clarify the ownership of natural resources but also refines how they should be managed. The management is, according to Article 104 (1), a competence of the regions: *"The regions shall manage natural resources in the best interest of the entire state."* Paragraph 2 states that the regions should receive a *"fair and reasonable portion"* of the revenue, while part of the income should be used for social security (paragraph 3). Article 104 thereby sets regulations on how natural resources should be managed (1) and what the income should be used for (2 and 3).

As already mentioned, the management of a natural resource is not necessarily executed by the owner of the resources. In India, Malaysia, Pakistan and Russia natural resources belong to the regions or are jointly owned by the federal government and the states. However, in these countries, it is the federal government's responsibility to manage the usage. In most federal systems which are characterized by a high dependence on the resources' revenues, there is a strong central control of this sector. In this regard, the Syrian solution envisaged by the draft constitution is exceptional. The competence of the Syrian regions to manage their own resources must however be seen in the overall context of the

Anderson, p. 21.⁸

Anderson, p. 2.⁹

constitution, in particular the duty of regions to respect central rules and to share the income generated.¹⁰

2.2 Usage in the interest of the entire state

The wording “*best interest of the entire state*” in article 104 (1) of the draft constitution is a vague formula and therefore open for a large range of definitions. It could be assumed, for instance, that more sustainable methods should be developed to manage the natural resources. Almost all countries share revenues between regions, but for the revenues of natural resources, most resource-rich countries do foresee a set of distinct rules. One can distinguish between three different sets of rules to share revenues of natural resources: The *derivation-based transfer system* (1), the *indicator-based formula* (2) and mixed systems (3). The majority of countries enacts a *derivation-based* intergovernmental transfer system (1). This means that revenues from natural resources are collected by the central government and transferred back to the regions. The amount can be based e.g. on production volume or value of the production generated in a certain territory.¹¹ Examples for this system are Indonesia, Nigeria, Peru and Brazil. According to article 20 of the constitution of Brazil, the natural resources are owned by the federal state. The federal ownership does however not mean that the federal level gets the biggest share of the profits. A derivation-based intergovernmental transfer formula ensures that the revenues are shared between the federal state, the producing and the non-producing regions as well as the municipalities. The latter two receive even a larger share in comparison to the federal government.¹² Yet, based on this system, the producing states of Brazil get a share of all resource revenues, which leads to a growing horizontal imbalance between the states.¹³ Another system to share the income of natural resources is the so-called indicator-based formula (2). In this case, natural resource revenues are assigned to subnational governments on the basis of measurable indicators such as population, poverty rates or regional output. This system does not take into account from where the resource was exploited. Examples for the indicator-based system are Bolivia, Ecuador and Mexico. Indeed, this system ensures that revenues reach areas where they are needed most and helps to reduce regional inequalities. There is a third category, so-called mixed systems (3). Many countries established systems where intergovernmental transfers are considering both, the natural resource’s place of origin and indicators for measuring the regions’ needs. Examples are Nigeria, Uganda and Mongolia.¹⁴ Article 104 (2) of the draft constitution regulates that the income from natural resources shall be used to meet the needs of all Syrian regions. Yet, the exact procedure is kept vague. It is not clarified whether a derivation-based intergovernmental transfer system or an indicator-based formula should be implemented.

The power to impose taxes on revenues from natural resources can have a crucial influence on the amount that is actually shared between the different levels. In Argentina, for example, resources are owned by the provinces, which levy royalties and license fees.¹⁵ Yet, the federal government has the right to impose export taxes, which it is not obliged to share with the provinces. By imposing high export taxes the central state captures a high share of the income from resources. This has led to a reduction in royalties for the provinces and increased tensions between the federal government and

Anderson, p. 21.¹⁰

Bauer et al., p. 33¹¹

Anderson, p. 5; Bauer et al., p. 37.¹²

Anderson, p. 14.¹³

Bauer et al., p. 33¹⁴

Idem, p. 13.¹⁵

the provinces.¹⁶ Coming back to the draft constitution of 2019, one has to keep in mind that article 103 (1) assigns the responsibility for custom-duties to the federal level. Argentina exemplifies which implications this provision might have.

2.3 A fair and reasonable portion for the region

The second part of article 104 (2) states that the region, in which a given natural resource is found, should receive a “fair and reasonable portion” of the revenues. First, this sentence does not specify if the portion is understood as a compensation, e.g. for local environmental damage or infrastructure costs.¹⁷ Second, it is not clear if the portion of the income for the region with the given natural resource should be bigger than the share for the central government or for other regions.

In this context, a look on the current situation in the federal state of Nigeria seems to be useful: In Nigeria the federal government owns and controls the natural resources. However, the regional governments’ share of the revenues is larger than the one of the central government and the producing regions are especially favored (article 104 (2) of the draft constitution could be interpreted in a similar way). The producing states in Nigeria get a certain amount of resource revenue based on derivation. The remaining revenues are pooled with all other revenues and allocated according to population, equality of states, internal revenue generation, land mass, terrain and population density. Based on this system, the producing states receive over fifty percent of all revenues. This generates a high inequality between producing and non-producing states regarding the average per capita allocation. Yet, it has to be mentioned that also corruption and a lack of accountability of the state governments’ expenditures prevent a sustainable use of the resource revenues and have led to environmental destruction as well as lacking infrastructure and public services.

2.4 Revenues for Social Security

Article 104 (3) of the constitution foresees “*a fair and reasonable portion of the generated income by natural resources to be set aside for social security*”. According to articles 56, 59 and 61 of the draft constitution and the principle of subsidiarity, which the constitution is based on (article 9), social security falls only into the competences of the federal state if the regions’ responsibility is not explicitly outlined. The draft constitution remains however unclear on how a “*fair and reasonable portion*” should be indicated and by which level the revenue should be collected. Yet, the draft constitution is not exceptional in this regard, since few constitutions include detailed revenue sharing rules. Exceptions are the constitutions of Bolivia, Nigeria and South Sudan.¹⁸ Article 368 of the Bolivian Constitution included fixed percentages of royalties of the departments’ production of hydrocarbons. This is similar to the constitution of Nigeria, which includes a revenue-sharing formula that sets percentages for each state level. The constitution of South Sudan has initiated the establishment of a national petroleum and gas corporation (article 176), which operates on behalf of the central government and is regulated in more details by law.

Further topics such as the commissioning of companies for the exploitation of natural resources or regulations for foreign investors, cannot be outlined in this paper. Nevertheless, these are important issues for the future of Syria and should also be considered in discussions on constitutional content.

3 Fiscal equalization

Fiscal equalization is a transfer of tax resources from one region to another in order to compensate for differences in public service costs or fiscal capacity. Fiscal equalization enables regions with little resources to receive benefits from other regions which are better off and assist them to provide their citizens with a similar quality of public services.¹⁹ Fiscal equalization agreements or intergovernmental

Anderson, p. 13.¹⁶

Anderson, p. 9.¹⁷

Bauer et al., p. 42.¹⁸

Fiscal equalization in OECD countries, 2007.¹⁹

transfers can be found in federal countries such as Italy, Switzerland, Australia, Austria, Germany or Canada, as well as in unitary countries such as Japan, Turkey, Norway and Portugal. In Switzerland, for example, the canton of Valais has, in economic terms, a rather disadvantaged geography. The mountains of Valais make it difficult to travel and to build e.g. transport infrastructure. Additionally, the geography restricts the areas for settlements. The geographic and demographic conditions make Valais dependent on the reception of financial support from the Swiss Confederation or other cantons such as Zurich, Geneva or Basel. In most cases, the principles and objectives of fiscal equalization are determined in the countries' constitutions and therefore constitute a central pillar of national tax policies.²⁰

Considering Syria's great regional disparities regarding its economic, geographical and demographic structure, the implementation of an effective fiscal equalization system seems to be necessary. This necessity was also taken into account in the Syrian draft constitution. The draft constitution determines a fiscal equalization between the regions and the state in article 101 and 105. Article 105 (1) states that *"Equalisation payments between the federal and regional levels as well as those at an interregional level shall ensure that the federal state and all its regions dispose of the financial resources required to perform their functions"*. The equalization should be implemented according to certain criteria, laid down in article 105 (2). An equalization should also take place between the regions and their municipalities (article 105 (3,4)). Article 101 (1) of the draft constitution provides that a commission for finance *"shall oversee the state finances and shall compile proposals on the equalization payments between the regions ("horizontal equalization") as well as between the federal state and the regions ("vertical equalization")"*. According to this provision, it is not the parliament that elaborates fiscal equalization, but an independent commission for finance composed of *"independent experts in public finance"* (article 100 (1)). The parliament is, however, provided with the possibility to indirectly influence the financial commission. On the one hand, draft equalization laws have to be submitted to the parliament (article 101 (1)). On the other hand, the two chambers decide partly on the commission's composition (article 71 (1) and 100 (2)). The draft constitution provides for vertical equalization between the central state and the regions as well as horizontal equalization between the regions. This system is identical to many others countries such as Switzerland, Canada and Germany.

So far, the Syrian draft constitution does not provide precise numbers or percentages for financial equalization. In comparison, article 135 (3) of the Swiss Constitution provides that *"the funds for the equalization of financial resources shall be provided by those Cantons with a higher level of resources and by the Confederation. The payments made by those Cantons with a higher level of resources shall amount to a minimum of two thirds and a maximum of 80 percent of the payments made by the Confederation"*. It might be considerable to discuss if the Syrian draft constitution should offer more clarity regarding the amount or percentage of payments for interregional financial equalization.

Members of the financial commission, which is drawing the proposal for fiscal equalization, must consider the criteria that provided in article 105 (3) of the draft constitution: *"responsibilities and costs associated with the performance of official functions, population, social and economic development status, the need for reconstruction and compensation for past injustices"*. In this respect, the Syrian draft constitution differs from other constitutions. The German Basic Law (article 107 (2)), for example, does not include criteria for financial equalization but leaves it to a federal law, which requires the consent of the second chamber, the Bundesrat. Article 107 (2) of the German Basic Law stipulates that *"The conditions for granting additions and imposing reductions as well as the criteria governing*

the amount of these additions and deductions shall be specified in the law."²¹ Moreover, the French, Swiss and Canadian constitutions do not provide criteria for equalization payments. Article 72 (2) of the French Constitution creates merely the obligation for the central state to promote equality between regional authorities. The Canadian Constitution Act of 1982 provides in article 36 (2) that "*Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation*". Thus, there are constitutions that do not refer to specific criteria and delegate the determination of financial equalization to federal law. So, generally speaking, the advantage of setting certain criteria in the Syrian draft constitution is disputable. A final interesting point to look at is the question if constitutions restrict recipient regions in expending means from financial equalization. In Switzerland, the cantons that receive financial resources can freely decide about their usage. The same is true for the provinces of Canada. Considerations are recommended if a specification on this issue should be included into the Syrian draft constitution of 2019.

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