



## Helpdesk Research Report

# Linkages between taxation and stability

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10.03.2016

## Question

*Provide a review of latest thinking/literature (academic and practitioner) on the linkages between taxation and stability*

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## 1. Overview

The Third International Conference on Financing for Development concluded that whilst Official Development Assistance (ODA) remains critical, there must be less focus on aid, and more on how developing countries can generate their own financial resources for development. The Addis Ababa Action Agenda reiterated that countries have primary responsibility for their economic and social development, while committing the international community to create an enabling environment for their development (UNDESA, nd; see also the Malabo and Paris declarations etc. that highlight the importance of national ownership). National governments were urged to tax<sup>1</sup> more effectively, and donors called upon to help build capacity in developing country tax administrations. It was suggested that taxation contributes to state capacity,<sup>2</sup> and that taxation can be a useful indicator of a state's fragility or resilience (Di John, 2010; Tilly, 1990).

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<sup>1</sup> A tax can be defined as "a financial charge or other levy imposed upon a taxpayer (an individual or legal entity) by a state, or the functional equivalent of a state" (Granger, 2013, p. 1). Taxes can include direct taxes on income and wealth (e.g. personal and corporate income taxes, property tax), and indirect taxes on consumption (e.g. value added tax (VAT), excise duties).

<sup>2</sup> State capacity is a term coined by historical sociologists, such as Tilly, and originally referred to the power of the state to raise revenue. Besley and Persson (2009: 2) broaden it to capture the wider range of competencies

Taxation is considered fundamental to sustainable development, supporting the basic functions of an effective state<sup>3</sup> and setting the context for economic growth. Taxation can act as a catalyst for the development of responsive and accountable government, and for the expansion of state capacity thereby contributing to stabilisation<sup>4</sup> and increased stability. Of central importance is the role that taxation can play in enabling citizen engagement, promoting equity, voice, participation and affecting the redistribution of wealth (Di John, 2010). Tax reform is generally undertaken to improve the efficiency of tax administration and to maximise the economic and social benefits that can be achieved through the tax system (Rao, 2014).

Tax reform agendas have traditionally focused on increasing public revenue in an economically efficient manner. However, Prichard (2010) argues that there is a case for linking revenue enhancement more explicitly to broader governance objectives. It should be noted that increased domestic revenue generation will only lead to improved development outcomes if the new revenue is translated into productive public expenditure.

- State of the evidence: there is a large, varied and multidisciplinary body of academic and grey literature that discusses the linkages between taxation and development. The literature on taxation and statebuilding is primarily theoretical and guidance-oriented, with some supportive case study evidence. This rapid review found a more limited academic and grey literature focussed explicitly on taxation in fragile and conflict affected states.
- Latest theory and policy about the role that taxation can play regarding stabilisation/conflict: discussions regarding taxation have predominantly focused on how best to enhance revenue collection to finance redistribution and public goods and services, and the role of tax policy in strengthening incentives for economic growth. Increasingly there is a focus on the role taxation can play in enhancing stability, and fostering improved governance.
- Key theories of change used in a selection of donor funded taxation reform programmes in post-conflict and fragile countries: broadly speaking, donor funded taxation reform programmes share a common logic or theory of change, i.e. that the reform of the tax system and improvement in tax collection are considered critical for the consolidation of the state, peacebuilding and political stability (Ndikumana, 2015). This reform can be accomplished by focusing on a number of key areas: broadening the tax base; managing natural resource revenues better; minimising tax incentives/exemptions for corporate interests; encouraging transparency by multinational enterprises; and building tax morale (i.e. via voluntary compliance).

While there is evidence that donor support can enhance governments to mobilise capacity to tax and mobilise revenue, for programmes to be effective, it needs to (Moore et al, 2015):

- Be responsive to local contexts
- Be designed to prioritise building trust between government and tax payers
- Offer long-term mentoring
- Target the right range of institutions

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that the state acquires in the development process, which includes the power to enforce contracts and support markets through regulation or otherwise.

<sup>3</sup> Though difficult to define, effective states are broadly considered to be those that have the capacities to deliver inclusive development and where there is elite commitment to delivering inclusive development and state effectiveness.

<sup>4</sup> The Department for International Development (DFID) refers to stabilisation as one of the approaches used in situations of violent conflict which is designed to protect and promote legitimate political authority, using a combination of integrated civilian and military actions to reduce violence, re-establish security and prepare for longer-term recovery by building an enabling environment for structural stability (DFID, 2014).

- Facilitate South-South collaboration

The literature considered in this review did not integrate gender considerations or dimensions of gender.

## 2. State of the evidence

There is a large, varied and multidisciplinary body of academic and grey literature that discusses the linkages between taxation and development. The literature includes historical analyses of European state making, war and taxation (Besley & Persson, 2009); the role of tax and taxation reform in enhancing state capacity (Brautigam et al., 2008); the importance of domestic revenue mobilisation for fragile states (OECD, 2014); and the relationship between taxation, tax reform, accountability and responsive government (Di John, 2010).

Taxation is seen to play a pivotal role in mobilising revenue to support statebuilding. In discussions of taxation and developing countries, domestic revenues are viewed both as a way out of aid dependency – but also important for building mutual accountability between citizens and state (IMF et al., 2011). The evidence base for this assertion is, however, mixed.

The literature on taxation and statebuilding is primarily theoretical and guidance-oriented, with some supportive case study evidence (Rao, 2014). This rapid review found a more limited academic and grey literature focussed explicitly on taxation in fragile and conflict-affected states, especially in relation to statebuilding. The evidence which does exist highlights the need for taxation to be a component of post-conflict planning, despite the potential tax revenue being low (Therkildsen, 2008; OECD, 2014).

There is significant theoretical literature, including economic modelling studies, of different tax systems. The International Centre for Tax and Development (ICTD)<sup>5</sup> has emerged as a primary reference point acting as a global policy research network focusing on the political economy of taxation policies and practices in poorer parts of the world.

Much existing work (particularly the grey literature) tends to present tax reform primarily as a technical challenge, with political considerations given secondary attention (Pritchard, 2010).<sup>6</sup> The literature suggests that most efforts at tax reform have been extremely similar across countries and circumstances, owing to the influence of international institutions, but also the growth of a global community of tax professionals (Brautigam et al, 2008; Moore, 2013).

The evidence base is slowly moving beyond a focus on growth and revenue to wider issues such as taxations effects on statebuilding and redistribution (Brautigam et al, 2008; Pritchard). There is an increasing focus on developing countries, with better data becoming available. There is some evidence that measures to increase dialogue, transparency, equity and bargaining are essential to building a culture of tax compliance, contributing to maximising revenue and minimising political conflict (Moore, 2015; Bird, Martinez-Vazquez & Torgler, 2008).

The interrelationship between tax and legitimacy, effectiveness and transparency is subject to much debate. It is broadly acknowledged that an effective tax system requires state legitimacy, transparency and effectiveness. Conversely, these are identified as the areas that tax reform is supposed to contribute to. Pritchard (2010) comments that while tax structures and tax administrations have been transformed

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<sup>5</sup> See - <http://www.ictd.ac/>

<sup>6</sup> Recent work published by the OECD (2015) places political considerations more centrally, though ultimately advocating an apolitical, technocratic approach to implementing reforms.

in many countries, improvements in levels of income tax collection and the redistributive potential of taxation have been more difficult to achieve.

Finally, the relationship between taxation and aid is considered complicated. There remains a great deal of debate in the economic development literature with regard to the overall impact of foreign aid on tax mobilisation. Ndikumana (2015) comments that foreign aid may crowd-out tax revenue mobilisation by reducing the incentives on the part of the government to increase taxation which is both technically demanding and politically costly. Crowding-out effects may also arise from tax exoneration of aid-funded activities, especially given the high presence of the international assistance community. On the other hand, foreign aid may crowd-in tax revenue through its positive impact on the efficiency of the tax system (Ndikumana, 2015).

### **3. Taxation and stabilisation: theory and policy**

There is much debate in the academic and grey literature as to the relationship between taxation, conflict and stability/stabilisation. Donor agencies have highlighted the role of taxation in ensuring sustainability and ownership in the development process with attention focussing on how best to support national governments in generating their own financial resources for development, i.e. via domestic revenue mobilisation<sup>7</sup> and taxation (World Bank, 2010; OECD, 2010; IMF et al., 2011; IMF, 2015).

Whilst donors have identified a relationship between taxation and stabilisation, it is acknowledged that fragile or conflict-affected countries represent challenging environments for implementing taxation reform programmes. The OECD comment that in these contexts, domestic resource mobilisation is challenging for a number of reasons: over reliance on taxing natural resources, low tax morale among citizens, weak institutional capacity and the prevalence of tax exemptions for foreign firms who receive special tax conditions and incentives/exemptions. Despite these challenges, the OECD (2014) concludes that it is imperative for fragile states to mobilise their own revenue in order to:

- Finance human development and recovery
- Reduce dependence on aid
- Build a contract between state and people
- Strengthen the state (i.e. improve state capacity)
- Strengthen intra-society relationships

Academic discussion has also highlighted the beneficial impacts that taxation can have upon economic growth, sustainable revenue mobilisation, the reduction of aid and natural resource dependence, addressing inequality and the promotion of redistribution of wealth and its contribution to statebuilding (Rao, 2014: 1). Discussion has highlighted that taxation is not only a technical issue but also a political process that relies on bargaining between state and citizens. Brautigam et al (2008) comment that taxation is a core governance function, shaping relations between state and society with tax revenues allowing states to provide security and public goods. This is a theme further developed in recent years by Moore (2013; 2015) and Pritchard (2010).

Whilst grey and academic literature highlight the role taxation can play in stabilisation, statebuilding and improving the capacity of the state, it is also important to consider that conflict may have fiscal

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<sup>7</sup> Domestic resource mobilisation (DRM) refers to the generation of savings from domestic resources and their allocation to economically and socially productive investments. Such resource allocation can come from both the public and private sectors. The public sector does this through taxation and other forms of public revenue generation.

dimensions. Addison et al. (2002) comment who gets what (public spending) and who pays for it (taxation) may play a role in the descent into conflict. Once violent conflict has begun, public revenues usually fall to very low levels, and there is a robust negative relationship between tax revenues and measures of conflict.

Fjeldstad (2013) notes that the challenge for developing countries is not only to tax more (i.e. to increase the tax-to-GDP ratio), but to tax a larger number of citizens and enterprises more consensually and to encourage constructive state-citizen engagement around taxation. Fjeldstad (2013) emphasises the importance of local leadership, locally designed solutions and donor approaches that are sensitive to each country specific socio-economic environment.

The complex inter-relationship between taxation, statebuilding, state capacity and stabilisation is of particular interest in this report. As Addison et al. (2002: 1) comment, rebuilding the rules of the game, and people's respect for them (the social contract) is necessary for peace. Whatever form the new rules take, they will invariably have a fiscal dimension; people will expect some new distribution of services and infrastructure. This must be financed and therefore revenue mobilisation, including some measure of political agreement on its scope, is essential.

## **Stabilisation and statebuilding**

The interaction between taxes, public expenditure, and development (including stabilisation and statebuilding) is complex and multi-faceted. Besley and Persson (2014) suggest that political institutions, economic development, and the state's capacity to raise taxes and to support and extend the role of the market mutually interact. Besley and Persson (2009) highlight the historical experience of rich nations, indicating that the creation of state capacity to collect taxes and enforce contracts is a key aspect of development.

It is suggested that low rates of taxation and weak governance structures negatively impact the development of state capacity and the ability of governments (particularly in fragile contexts) to affect developmental change (Mascagni et al, 2014).

Whilst developing countries face substantial constraints in mobilising government revenue, the problem is more pronounced for post-conflict countries due to the deterioration of the functionality of the tax system and the shrinking of the tax base that follows the collapse of economic activity during conflict (Ndikumana, 2015). Government revenue mobilisation is one of the core functions of the state and it is a critical dimension of statebuilding in post-conflict reconstruction.

## ***Taxation and citizen engagement***

Therkildsen (2008: 1) comments that statebuilding involves increasing the capacity of governments to interact constructively with societal interests, to obtain support and resources from those interests, and to pursue public goals and demands. Taxation and tax reform are considered to contribute to statebuilding in a number of ways (Therkildsen, 2008; Di John, 2010: 1-2):

- Governments must be able to ensure sustainable funding for social programmes and for public investments to promote economic growth and development.
- Taxation is the main nexus that binds state officials with interest groups and citizens. Not only can taxation enhance government accountability, it also provides a focal point around which interest groups (such as producers groups, labour unions and consumer groups) mobilise to support, resist and propose tax policies;

- Taxation – particularly in the form of land and property taxes, customs and border collection – can increase the territorial reach of the state. The diversity of the tax base is one indicator of the ability of the state to engage with different sectors and regions, and is indicative of the degree to which state authority permeates society. There is evidence that economic and political development cannot easily happen without a consolidated central state.
- Fiscal capacities are needed to build a legitimate state. Democratic elections alone are not enough to ensure state legitimacy. Neither do ‘quick impact projects’ in which aid agencies seek to fill urgent needs. Legitimacy comes in part from government delivery of services that people want and need. Elections provide an avenue for people to voice demands; responding to those demands requires capacity to mobilise, allocate and spend public resources effectively. Tax collection reflects basic core capacities of states to collect information, essential for the formulation of policy decisions.

Further to this, strong and transparent systems of tax collection encourage citizens to hold the government accountable for the way in which revenue is used, thereby promoting development through better governance and the rule of law (OECD, 2014).

### ***Taxation and technical state capacity***

Taxation expands the financial resources available to provide public goods and services (e.g. security, justice and law enforcement, health and education, and infrastructure). Further, it strengthens the government’s stake in the country’s economic development; it encourages a shift away from inefficient forms of redistributions, for example, based on the creation and allocation of rents, toward more efficient and systematic mechanisms based on taxes and public expenditure. It also increases the government’s incentives to develop other forms of capacity, such as the enforcement of rights (legal capacity) or the provision of undersupplied public goods (collective capacity) (IMF, 2015: 17).

In a similar vein, the literature reviewed identifies a number of channels through which taxation can impact statebuilding (Prichard, 2010; Brautigam et al. 2008):

- Common interest processes: governments dependent on taxes have stronger incentives to promote the prosperity of taxpayers
- State apparatus and processes: dependence on taxes requires states to develop a bureaucratic apparatus, which can lead to broader public administration improvements
- Accountability processes: taxation may engage taxpayer-citizens collectively in politics and lead them to make claims on government for reciprocity, encouraging constructive state-society engagement around taxes
- Adequate revenue: taxation can provide more sustainable resources to support citizen demands
- Appropriate revenue: shifting the distributional impact of taxation to a normatively more appropriate pattern

More broadly, state capacity is an intangible form of public capital, which is accumulated by investing resources in its development. The costs involved, and the incentives to make such investments, depend on political factors and on the level of economic and institutional development. Improving state capacity expands the set of feasible policy actions (such as the level of public expenditure that can be sustainably financed) and enhances their economic impact (Besley and Persson 2009). Hence, governments can drive the development and stabilisation process not only by investing in physical capital like infrastructure, but also by increasing state capacity.

Di John (2010) argues that state resilience is enhanced by its ability to maintain relatively robust levels of tax collection. Greater tax-revenue mobilisation increases the prospects of financing service delivery, and enhances the prospects of financing the security apparatus of the state. It also increases the scope of patronage spending towards political powerful constituents.

## 4. Theories of change and the selection of donor funded taxation reform programmes

Theories of change (ToCs) are considered particularly important to programming in fragile and conflict-affected contexts because of the political dynamics and risks involved in bringing about change. There are few proven approaches or models to tax reform in these cases, and often interventions are based on implicit theories of what makes for an effective and accountable tax system.

ToCs are also important for monitoring and evaluation processes. They can provide feedback on whether programmes are on track to achieve desired changes, and whether the context is evolving as anticipated. ToCs are useful for monitoring assumptions to help determine if the right factors and dynamics were considered in the initial design, if unforeseen changes have occurred in the environment, or if there are gaps in the strategy to bring about change or lessons to be learned (Corlazzoli & White, 2013).

Ndikumana (2015) comments that targeted foreign aid can help build the capacity of the state to mobilise tax revenue by supporting reforms of tax administration and through technical capacity building in post-conflict countries. A range of donors and international organisations provide support for building tax capacity. Prominent actors include the IMF and OECD, alongside a range of bilateral donors such as Germany, Norway, UK, and USA.

More generally, Moore et al. (2015) comment that many organisations that provide capacity building services to tax administrations have their roots in OECD countries and offer training and advice that fits with their own values and priorities. For example, the OECD is keen to provide training on applying its arm's length principle, although there exist alternatives that may be more appropriate for developing countries.

Broadly speaking, donor funded taxation reform programmes share a common logic or ToC, i.e. that the reform of the tax system and improvement in tax collection are considered critical for the consolidation of the state, peacebuilding and political stability (Ndikumana, 2015: 11-13). This includes:

- That ability to mobilise tax revenue is a key prerequisite for establishing state legitimacy. It is a demonstration of competence on the part of the state, as well as evidence of buy-in on the part of the population with regard to the national development agenda. Effectiveness in tax mobilisation is a result of tax compliance, and the latter in turn is a function of effectiveness of service delivery, government accountability and low corruption, all of which are important attributes of a capable state.
- Strong performance in tax mobilisation, which enables the government to deliver public services while limiting its dependence on foreign aid. Thus, effective tax mobilisation helps to consolidate the state-society contract, which consolidates state legitimacy.
- Effective revenue mobilisation expands fiscal policy space, which is key to the government's ability to own the national development agenda. Therefore, effective tax mobilisation can serve as a powerful indicator of progress in statebuilding and development in post-conflict settings.

In turn, the OECD (2014) recommends that donors should adopt the following approaches when supporting tax reform in fragile states:

- Broaden the tax base
- Manage natural resource revenues better
- Minimise tax incentives/exemptions
- Encourage transparency by multinational enterprises
- Build tax morale

Whilst these principles are broadly accepted by the international community, there is an awareness that effective tax reform in fragile states is hampered by severe capacity constraints, requiring different capacity building strategies depending on institutional context (IMF, 2015).

Further to this, the challenges faced in implementing change in practice rather than just in theory are often under-estimated. A tax system is more than a set of laws. It is also a set of modes of behaviour by those working within the tax administration and by the public. It is universally recognised that it is beyond the capacity of any tax administration to rely on simple enforcement to collect tax (Murray et al., 2014).

Tax reform will not take root unless it changes modes of behaviour among the general population. Efficient tax administration requires a high degree of voluntary compliance so that the limited administrative resources can focus on areas of tax avoidance (Murray et al., 2014: 50).

## Case study examples

### *The Tax Administration Project, Afghanistan (2011-2015)*

The Tax Administration Project is a £18.9 million DFID programme spanning four financial years (2011-12 to 2014-15), to ensure domestic revenue collections increase in a sustainable manner and improve fiscal sustainability for Afghanistan. The project builds on the work of the Strengthening Tax Administration Project (STAP), which established a working base for tax administration reforms and improved revenue collection, with the aim of contributing towards a sustainable platform for long-term revenue mobilisation (DFID, 2011).

DFID cited as its priority to help the Government of Afghanistan (GoA) raise and manage its own revenue, reducing its dependence on aid over time. The **impact** of the project is a *fiscally sustainable Afghan state by 2021/22*. Its **outcome** will be *sustainable increase in domestic tax revenue*. The four outputs of the project aim to contribute to the project outcome as follows (DFID, 2011):

- Fully operational zonal large and medium taxpayer offices established and operational in all priority provinces
- Strengthened and embedded management and technical capacity in the Afghanistan Revenue Department (ARD)
- Increased taxpayer compliance with tax obligations
- Preparations completed for implementation of value added tax (VAT)

The reform agenda is considered to have strong and increasing traction within the ARD and the wider Ministry of Finance (DFID, 2011). The Large taxpayer office (LTO) is beginning to be recognised in the business community, following high profile enforcement action and public awareness activity.

The process of putting in place the necessary infrastructure to separate front office taxpayer services from back office processing in both the LTO and the medium taxpayer offices (MTO) is well under way. This physical separation is important in reducing the opportunities for corruption between taxpayers and tax officials. The MTO and small taxpayer office (STO) are under new and impressive managers, who have personal support at ministerial level, reflected in improved recruitment.

Community awareness and perceptions are changing: there is a nascent awareness of the link between taxation and governance. This change is matched in the Afghanistan Revenue Department by the attitudes of new managers who are aware of the central role the Department has to play in moving Afghanistan from its dependence on external aid.

Notwithstanding the successes in strengthening tax administration, there remain gaps:

- The training and overall capacity deficit is considerable
- The roll-out of the Standard Integrated Government Tax Administration System (SIGTAS), which computerises the tax administration process, has been slow, though is now progressing well
- The slow SIGTAS roll-out in turn has affected the MTO roll-out
- The STO remains largely unreformed
- Revenue from the LTO is not fulfilling its potential

The DFID (2011; 2015) project documents concluded that DFID's assistance to revenue-raising through taxation has been effective and efficient, but DFID did not articulate the strategic challenge of how to foster a "social contract", a tangible demonstration of representative democracy. If not balanced with clear evidence of benefits elsewhere in the system, taxation alone risks reinforcing public opinions of a predatory state (DFID, 2015).

### ***Tax reform in the Pacific (2002-2012)***

In an evaluation of taxation reform in the Pacific, Murray et al., (2014) comment that donor support for taxation reform in the Pacific over the past decade appears to have been undertaken in a manner largely consistent with the guidance from the literature. The approach to taxation reform adopted was to build up the capacity of the tax administration so that it can manage the implementation of reforms and then gain community buy-in for the need for reform. Once administration capacity has been developed, the next step is to gain agreement as to the broad parameters of the required reform, followed by consultation and agreement on specific reform options. Only then, with all the foundations laid, would the reform programme commence.

While there is some recognition in the programme documents of tax reform requiring a systematic approach, donor focus was seen to take a fragmented rather than systematic approach. Donors have tended to fund and support discreet projects rather than engaging with host countries in implementing a strategy over time to construct a well-functioning sustainable tax system.

**Tonga** was identified as an example of a country that did not seem to follow best practice but still managed to implement a reform programme with relative success. Part of this success was due to having a clear picture of what it was they wanted to achieve. Interviewees were clear that the reform process was "driven by the then Minister of Finance" in 1999-2002. Indeed the advice from Pacific Financial Technical Assistance Centre (PFTAC) in 2002 was that Tonga's administrative capacity was insufficient to introduce a VAT tax reform. The Minister was nevertheless determined to proceed contrary to that advice.

The catalyst for reform included a requirement to reduce fiscal reliance on tariffs in order to meet WTO requirements and a strained fiscal position under the existing tax system (which had many exemptions). However, it was clear that the direction of reform was determined by the Minister. Administrative staff commented that they “knew what they had to do” rather than convey any sense that they led the process. The private sector similarly, “followed the government lead”. The result was a reform process with clear and unambiguous objectives that were driven through. The weakness seems to be a continued lack of full buy-in as to the reform programme and achievements to date, both in the public and private sectors. Reform was achieved, but at the cost of some fragility in the sustainability of reforms. That is evidenced by frequent comments to the effect that exemptions are being gradually reintroduced.

**Samoa** by contrast has, in the past few years, followed a more textbook line in terms of reform process. Its current reform programme is placing more emphasis on community buy-in and education, and as a consequence, the results seem less fragile. Earlier legislative reforms (in the 1990s) appear not to have been supported by comprehensive reforms to change behaviour by tax payers and administrators, and hence did not achieve its potential, though the structural changes (e.g. introduction of a VAT and lower trade and income taxes) have endured.

Murray et al. (2014) conclude that sustained improvements in tax policy, tax administration and institutional capacity are more likely if:

- There is clarity as to objectives of reform
- Informed and reasonable expectations exist as to what can be achieved
- There is a shared and credible evidence base
- Taxation advice is consistent with good tax design principles and accounts for local conditions and context
- Donor and host country negotiate reform programmes on relatively equal terms and maintain formal and informal dialogue.

### ***Reforms in tax policy and administration Mozambique (1994-2007)***

Beginning in 1994, with assistance from the IMF’s Fiscal Affairs Department (FAD), Mozambique carried out a complete reform of its tax system and its administration. The general objective of the reform, which was implemented in phases, was to modernise the tax system and rectify flaws in the tax and customs administrations, creating modern institutions with the capacity to administer the new taxes in an effective and efficient manner, while also improving revenue collection (IM, 2009).

IMF technical assistance, through the FAD, was provided at three levels:

- Identification and diagnosis of problems
- Proposals and recommendations
- Implementation of solutions

Within this third level, two categories of cooperation can be distinguished: preparation of legal and institutional instruments, and implementation of operational and management practices. The IMF (2009) comment that donors played a critical role in supporting these reforms, either directly (the DFID programme that supported customs reform) or through the establishment of trust funds at the IMF that were the basis for the joint IMF-SECO and IMF-DANIDA technical assistance projects that supported the implementation of reforms.

The IMF has provided technical assistance in identifying problems and in formulating recommendations. While hard to quantify impact, this advice appears to have supported reform in key areas (IMF, 2009). The IMF has played a decisive role in the success achieved in developing modern, effective legal and

institutional instruments. The creation of the Technical Unit for the Restructuring of Customs (Unidade Técnica de Reestruturação das Alfândegas or UTRA) and of the Unit for Tax Reform (Unidade de Reforma Tributária dos Impostos or URTI), and replacement of the National Taxation and Auditing Administration (Direcção Nacional de Impostos e Auditoria or DNIA) with the Directorate of Taxation (Direcção Geral de Impostos or DGI), culminated in the creation of the Mozambique Revenue Authority (Autoridade Tributária de Moçambique or AT). This represents institutional advances attributable directly to the technical assistance provided by the IMF (IMF, 2009).

Technical assistance is considered to have been a success, although it will still be necessary to continue work on reforms. The time sequence chosen for the reform process — and, on occasion, the lack of adequate resources for obtaining computers and developing IT systems — delayed the implementation of some operational and management practices, which in some instances failed to keep pace with changes in the institutional and legal realms. This gap can still be perceived in the operation of the Mozambique Tax Authority (AT). Its mandate specifically includes modernisation of these operational and management practices, as well as the development of modern IT systems to support the core processes of the revenue administration, in the period 2008–2012 (IMF, 2009).

In conclusion, fiscal institutions were strengthened by reforming tax policy, tax and customs administration, and expenditure management. In 1996, in light of acute capacity constraints, the authorities outsourced custom management to a foreign private firm. In 1999, they introduced a value-added tax. This was followed in 2002 by a fiscal incentives code and a public financial management law and, in 2003, by a new income and corporate tax system. By then, customs management was transferred back to the Revenue Authority. In 2005, the Mozambique Tax Authority, a semiautonomous central revenue agency, was established (IMF, 2003). The reforms helped to broaden the tax base within a simplified tax system, taking the domestic revenue-to-GDP ratio from 12 per cent to 21 per cent in just 10 years. On the expenditure side, efficiency was improved by rolling out the government financial management information system and strengthening the budget system. With natural resource projects coming on stream, the focus of fiscal institution building shifted to establish a framework and capacity for the management of natural resource revenues (IMF, 2009).

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## Key websites

- International Centre for Tax and Development – <http://www.ictd.ac/>
- OECD – <http://www.oecd.org/tax/>

## Suggested citation

Avis, W. (2016). *Linkages between taxation and stability* (GSDRC Helpdesk Research Report 1346) Birmingham, UK: GSDRC, University of Birmingham.

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