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Governance · Social Development · Humanitarian · Conflict

# Tax Reform

## Topic Guide

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## About GSDRC

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## Contents

# Executive summary

Tax reform is usually undertaken to improve tax administration or to provide economic or social benefits. This topic guide provides an overview of the limited, but growing, evidence on tax reform in developing countries.

There is increasing recognition of taxation's role in statebuilding, in addition to greater understanding of its impacts on growth, inequality and the sustainability of revenues for expenditure. The key debates in tax reform centre on the trade-offs involved in achieving these sometimes incompatible objectives, and on which local, national or international tax issues reform efforts should prioritise. Specific evidence on taxation's impact on development outcomes is as follows:

- **Economic growth:** There is robust evidence in high- and middle-income countries, and emerging evidence in low-income countries, that significant use of personal income taxes can dampen growth, and a shift towards the use of consumption and property taxes can in some cases be beneficial for growth. Such relationships are context-specific, modest in overall impact on growth, and mitigated by *de facto* implementation of tax policy. Tax incentives (i.e. tax exemptions) do not spur investment and growth, according to existing evidence.

- **Sustainable revenue and reducing aid and natural resource dependence:** Tax revenue (excluding that from natural resources) is arguably more sustainable, and has been more resilient during the 2008 financial crisis, than aid and natural resource tax revenue in developing countries. Though past evidence has found a negative relationship between aid and tax revenue and effort, emerging evidence, with newer data, finds no relationship.

- **Statebuilding:** There is some evidence to confirm taxation's impact on statebuilding through improving state apparatus, incentivising citizen-state accountability, and providing expenditure revenue. Some local administrations that improved public administration so as to tax more, have gone on to deliver better quality public services. Increases in taxes have been linked to improvements in services or to democratic reforms; and states that tax the poor tend to prioritise basic public services over property rights, whereas states that tax the rich do the reverse.

- **Inequality and redistribution**: Emerging evidence finds that reducing inequality can create improved and more sustainable economic growth in the long term. However, income taxes in developing countries have been found to be relatively ineffective in reducing inequality, politically challenging to implement, and potentially harmful to growth. The poorest countries have insufficient resources to alleviate poverty through domestic income redistribution. Taxes, and in particular income and consumption taxes, can be gender-biased.

On approaches, interventions and tools the literature highlights the following:

- **Understanding and working with the political economy context:** Reform has been successful, in particular, in situations of fiscal crisis or political transition. Strategies that have helped to minimise resistance to reform and to align reform with the political economy context include: phasing in tax increases gradually; obscuring the impact of tax reforms; appealing to fairness and equity; linking reform to specific benefits; engaging with networks and institutions; building reform coalitions; and using a flexible, pragmatic approach.

- **Supporting a culture of paying appropriate taxes:** Tax morale, and in turn tax compliance, is linked to socioeconomic factors (e.g. age, gender, education), public perceptions of the fairness of the tax system, and the belief that tax revenue will be well spent. Efforts to support a taxpaying culture include outreach and education, improving payment and processing services, and credible measures to deter evasion and ensure payment.

- **Taxing the informal sector:** Taxing the informal sector, through business registration and formalisation or indirect taxation, may not increase revenues substantially. However, formalisation can encourage business growth, create a better business environment, and help build a culture of tax compliance. Firms choose to formalise largely based on cost-benefit calculations, which consider taxes and profits. Taxing firms while they remain informal can involve taxing what they buy and sell, 'presumptive' taxes, withholding taxes, or delegating the role of taxation to work associations.

- **Local taxation** (taxes, fees and charges collected to be spent locally): Local taxation can provide substantial and reliable revenue, separate from central government transfers. Local taxation has, in some cases, improved state-society relations at the local level. Suggested local taxation reforms include: simplifying processes; increasing transparency; improving payment compliance; and improving information provision.

- **Aid modalities and aid-funded goods and services:** No single aid modality is always most effective in shifting tax-related incentives, or in reinforcing tax systems and tax culture. Guidance suggests combining different aid modalities, adjusting them to local conditions. There is consensus that tax exemptions on aid-funded goods and services are undesirable as they can undermine tax compliance norms and systems, and increase tax administration costs.

- **Capacity development for taxation:** Proposals for international actors include deepening support for tax system development and for South-South cooperation on taxation issues, improving the transparency and tax compliance of multinational enterprises, and strengthening efforts to measure progress.

- **Monitoring and evaluation (M&E):** M&E for project evaluation and for benchmarking tax agencies tend to use *ad hoc* mixtures of resources and indicators. The literature suggests that indicators are best chosen in collaboration with stakeholders to ensure they are in line with tax agency priorities and are feasible to implement. Two new tools (Integrated Assessment Model for Tax Administration, IAMTAX; Tax Administration Diagnostic Assessment Tool, TADAT) provide potential indicators, as do other governance measures (e.g. OECD Tax Administration, PEFA Framework, the Diagnostic Framework for Revenue Administration).

## Summary of evidence reviewed in section two of this topic guide, on taxation, tax reform and development outcomes

### *Limitations of the evidence base*

The evidence base on tax reform is limited, but has been growing significantly recently. The evidence is mostly secondary non-systematic reviews, though there are some systematic reviews, such as on the impact of tariff reductions on employment and fiscal revenue in developing countries[1] and on tax and behaviour change, such as on diet.[2] The remaining evidence comes from observational, mostly econometric, studies. A small number of experimental studies look at behavioural responses from actions that mimic taxpaying, and quasi-experimental studies such as natural experiments have also been conducted.

Until the end of the last decade, relevant evidence on tax reform primarily consisted of econometric studies of high-income countries, which looked for relationships between taxation and factors such as growth and revenue. There is also a significant theoretical literature, including economic modelling studies of different tax systems. In 2010 the International Centre for Tax and Development (ICTD) was set up as a "global policy research network focusing on the political economy of taxation policies and practices in poorer parts of the world"[3] funded by the UK (DFID) and Norway (Norad). While producing significant amounts of evidence and analysis on tax reform in developing countries, the ICTD's dominance in this field means that the current evidence base is primarily limited to a small group of researchers associated with the centre. The evidence base is increasingly moving beyond a focus on growth and revenue to wider issues such as effects on statebuilding and redistribution. It is increasingly focusing on developing countries, with better data on them becoming available.

### *Evidence summary*

The tables on the following two pages summarise the findings of the evidence selected for inclusion in Section 2: Development outcomes. It is not a comprehensive review of the entire body of evidence on this topic.

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[1] The systematic review finds that, based on econometric evidence, overall employment is likely to decrease slightly in the short term following tariff reductions, but there may be an expansion of employment in the export sector in the longer term. Tariff reductions are likely to reduce trade tax revenue in the short term, but the impact in the medium term could be positive, especially if complementary tax policies and increases in customs tax collection efficiency are implemented. Source: Cirera, X., Willenbockel, D., Lakshman, R. (2011). *What is the evidence of the impact of tariff reductions on employment and fiscal revenue in developing countries?* Technical report. London: EPPI-Centre, Social Science Research Unit, Institute of Education, University of London. http://r4d.dfid.gov.uk/PDF/Outputs/SystematicReviews/TariffReductions2011Cirerareport.pdf

[2] One 2014 systematic review finds that taxes and subsidies are likely to be an effective intervention to improve consumption patterns associated with obesity and chronic disease, with evidence emerging showing a consistent effect on consumption across a range of tax rates. Source: Thow, A. M., Downs, S., & Jan, S. (2014). A systematic review of the effectiveness of food taxes and subsidies to improve diets: Understanding the recent evidence. *Nutrition reviews*, 72(9), 551-565. http://dx.doi.org/10.1111/nure.12123

[3] International Centre for Tax and Development: About us http://www.ictd.ac/en/about-us-1

| | *Activities affecting economic growth* | | | | *Activities affecting revenue sustainability* | |
|---|---|---|---|---|---|---|
| | **General tax increases** | **Shift from trade and consumption taxes to income taxes** | **Corporate taxes** | **Tax exemptions to promote investment** | **Domestic taxation (excluding natural resource taxation)** | **Aid** |
| Evidence of **positive** impacts in: | | | | | Low-income countries (F) | |
| Evidence of **neutral** impacts in: | | Latin American (high- and middle-income) countries (B) | | Multiple countries (E) | | Multiple countries (G, H) |
| Evidence of **negative** impacts in: | High- and middle-income countries(A) | High- and middle-income countries (A, C); Low-income countries (D) | Argentina, Mexico, Chile (B) | | | Multiple countries (I) |

| | *Activities affecting statebuilding* | | | *Activities affecting equality* | |
|---|---|---|---|---|---|
| | **Building state apparatus for taxation** | **Greater public demands following taxation** | **Local taxation** | **Personal income taxes** | **Targeted consumption tax reforms** |
| Evidence of **positive** impacts in: | | Multiple countries (K, L) | Sri Lanka (M) | | Multiple countries (O) |
| Evidence of **neutral** impacts in: | Multiple countries (J) | | | Multiple countries (N) | |
| Evidence of **negative** impacts in: | | | | | |

*Letters in parentheses refer to studies listed on the following page.*

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**C** [P&E; OBS] Acosta Ormaechea, S., & Yoo, J. (2012). *Tax Composition and Growth: A Broad Cross-Country Perspective*. Working Paper 12/257. Washington, D.C.: IMF. https://www.imf.org/external/pubs/ft/wp/2012/wp12257.pdf

**D** [P&E; OBS] McNabb, K. & LeMay-Boucher, P. (2014). *Tax Structures, Economic Growth and Development*. ICTD Working Paper 22. International Centre for Tax and Development (ICTD). Brighton, UK: Institute of Development Studies. http://www.ictd.ac/sites/default/files/ICTD%20WP22.pdf

**E** [S; OR] ActionAid. (2013). *Give us a break: How big companies are getting tax-free deals*. ActionAid. http://www.actionaid.org/sites/files/actionaid/give_us_a_break_-_how_big_companies_are_getting_tax-free_deals_2.pdf

**F** [P&E; OBS] Prichard, W., Cobham, A. & Goodall, A. (2014). *The ICTD Government Revenue Dataset* . Working Paper 19. International Centre for Tax and Development (ICTD). Brighton, UK: Institute of Development Studies. http://www.ictd.ac/sites/default/files/ICTD%20WP19.pdf


**Key to research descriptors**

*[P&E] Primary and Empirical*

[EXP] Experimental

[OBS] Observational

*[S] Secondary*

[SR] Systematic Review

[OR] Other Review


**G** [P&E; OBS] Clist, P. (2014). *Foreign Aid and Domestic Taxation: Multiple Sources, One Conclusion*. International Centre for Tax and Development (ICTD). Brighton, UK: Institute of Development Studies. http://www.ictd.ac/sites/default/files/ICTD%20WP20.pdf

**H** [P&E; OBS] Morrisey, O., Prichard, W. & Torrance, S. (2014). *Aid and Taxation: Exploring the Relationship Using New Data*. International Centre for Tax and Development (ICTD). Brighton, UK: Institute of Development Studies. http://www.ictd.ac/sites/default/files/ICTD%20WP21%20FINAL.pdf

**I** [P&E; OBS] Benedek, D., Crivelli, E. & Gupta, S. (2012). *Foreign Aid and Revenue: Still a Crowding Out Effect?* Working Paper 12/186. Washington, D.C.: IMF. https://www.imf.org/external/pubs/ft/wp/2012/wp12186.pdf

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**M** [P&E; OBS] de Mel, S., McKenzie, D. & Woodruff, C. (2013). The Demand for, and Consequences of, Formalization among Informal Firms in Sri Lanka. *American Economic Journal: Applied Economics, 5*(2), 122-50. http://dx.doi.org/10.1257/app.5.2.122

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**O** [P&E; OBS] Grown, C., & Valodia, I. (Eds.). (2010). *Taxation and Gender Equity: A Comparative Analysis of Direct and Indirect Taxes in Developing and Developed Countries*. Routledge. http://www10.iadb.org/intal/intalcdi/PE/2011/08031.pdf

# 1 Concepts and debates

## 1.1 What is tax reform and why does it matter?

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. A tax itself 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).

There has been increasing global and donor interest in developing country domestic revenue mobilisation, and in particular taxation (Mascagni et al., 2014; Fjeldstad, 2014). There is growing recognition of the role of taxation in statebuilding, in terms of enhancing state capacity and state-society relations (see section 2.3). The 2008 financial crisis brought about a temporary fall in aid levels, and a renewed focus by donors on aid effectiveness and ensuring that donors support rather than discourage developing countries' own revenue-raising efforts. Some activists (e.g. Byanima, 2014) also argue that the current international tax regime is dysfunctional, creating a race to the bottom to offer favourable, but infeasible, tax conditions to attract investment, which further exacerbate inequality.

Tax reform can reduce tax evasion and avoidance, and allow for more efficient and fair tax collection that can finance public goods and services. It can make revenue levels more sustainable, and promote future independence from foreign aid and natural resource revenues (see section 2.2). It can improve economic growth (see section 2.1) and address issues of inequality through redistribution and behaviour change (see section 2.4).

This topic guide looks at the key issues in relation to supporting tax reform in developing countries. Section 2 looks at the key development outcomes from tax reform and Section 3 looks at the emerging lessons learned and recommendations in terms of approaches, interventions and tools for tax reform in developing countries.

**Key reading**

**Mascagni, G., Moore, M., & McCluskey, R. (2014).** ***Tax revenue mobilisation in developing countries: Issues and challenge*****s. Luxembourg: European Union.**
https://www.ids.ac.uk/files/dmfile/TaxRevenueMobilisationinDevelopingCountries.pdf

This literature review, written for the European Parliament, highlights the rising prominence of domestic revenue mobilisation in development policy debate and provides recommendations for European and international actions to improve revenue mobilisation in developing countries. The gap between what developing countries could collect with efficient systems and what they do collect is estimated at three times foreign aid receipts. Significant contributors to these 'tax gaps' include tax evasion and avoidance, tax exemptions, and inequitable rent-sharing in the extractive sector. The report recommends: supporting and pushing forward existing international initiatives to reform the global tax system; providing increased financial and technical assistance to support local capacity in tax administrations; and supporting existing regional organisations like the African Tax Administration Forum in developing shared principles on issues such as tax exemptions, and tax regimes for natural resource contracts.

**Fjeldstad, O. H. (2014). Tax and development: Donor support to strengthen tax systems in developing countries.** ***Public Administration and Development, 34*****(3), 181-192.** http://dx.doi.org/10.1002/pad.1676

This peer-reviewed journal article reviews literature on aid and tax reform in developing countries, with a particular focus on Sub-Saharan Africa. The article argues that considerable and sustained efforts are required by all actors before the tax systems in most low-income countries will be significantly broadened and perceived as legitimate by the majority of citizens. Donors should complement the traditional 'technical' (i.e. administration-focused) approach to tax reform with measures that encourage constructive engagement between governments and citizens over tax issues. The article concludes by cautioning against donor duplication and fragmentation, which may weaken reform efforts by diverting local capacities, reducing local ownership and undermining the coherence of reform programmes.

**Granger, H. (2013). *Economics Topic Guide: Taxation and Revenue* (EPS-PEAKS Topic Guide). EPS-PEAKS.**
https://partnerplatform.org/?c158bbx3

This literature review of quantitative and qualitative evidence provides an overview of taxation and other revenue sources and their role in the economy. The guide provides a summary of key economic concepts, definitions and theories related to taxation and revenue function. This includes the principles of tax design (e.g. Optimal Tax Theory; impacts on producers, consumers, revenue mobilisation and behaviour change) and the links between revenue and growth (e.g. tax implications of growth theory, tax effort and the role of tax in good governance).

## 1.2 What are the current debates on the agenda for tax reform?

The key debates on tax reform relate to the development outcomes of tax reform, the tax mix to achieve these outcomes, and whether there should be greater focus on taxation at the local, national or international level.

In addition to the revenue raising capacity of taxation, emerging literature emphasises its impacts on growth, state building, and inequality (see section 2). Different tax reform efforts impact differently on these development outcomes, and not always in a positive way across all outcomes. For example, while a shift towards progressive taxes can reduce inequality, there is evidence that this can undermine growth (see section 2.1). At the same time there is evidence that high levels of inequality undermine growth in the longer term (see section 2.4).

There are debates about which levels taxation should focus on. Some advocate focusing on local taxation as an overlooked source of revenue and a way to improve state-society relations (see section 3.5). At the national level there are criticisms of the use of tax incentives, in that they are relatively ineffective, but still undermine tax revenue levels (section 2.1). Some experts argue for a greater focus on taxing the informal sector, arguing that although this will not be a significant source of revenue, it can provide knock-on benefits for firms and support economic growth (see section 2.3). At the international level there is concern about illicit flows and tax evasion (OECD, 2014). There are debates about how to respond to the use of tax havens that can undermine governance and taxation revenue in developing countries by facilitating criminality and tax evasion (ActionAid 2013, Schjelderup et al., 2009). There are also debates about the increasing prominence of transnational corporations in a system designed for businesses with a physical presence in one country. Some experts advocate a unitary tax system that would treat them as single firms, not as a loose collection of separate entities (Picciotto, 2013; 2014).

**Key reading**

**Bird, R. (2013). *Taxation and Development: What Have We Learned from Fifty Years of Research?* (IDS Working Paper 427). Brighton: Institute of Development Studies.**
http://dx.doi.org/10.1111/j.2040- 0209.2013.00427.x

Based on a review of quantitative and qualitative literature, this paper provides an overview of shifts in thinking about taxation in developing countries over the last fifty years. In the 1950s and 1960s, the prevalent academic and public finance literature view was towards countries introducing comprehensive progressive personal income tax systems. Increasing evidence from theoretical and empirical studies of taxation led to a second model, prevalent from the early 1980s, which was a shift towards broad-based value-added taxes (VAT) with much lower rate personal and corporate income taxes. The current model for taxation is arguably more of a framework. It gives more consideration to taxation's distributional (i.e. between rich and poor) objectives, the potential for behavioural changes through taxation, and the state-society impact of taxes – how taxes need public support and how they affect and are affected by government legitimacy. In terms of tax reform, this has led to a shift away from global best practice models to 'custom built' components of tax with greater emphasis on local actors implementing tax changes, and with external actors (i.e. experts and aid agencies) supporting rather than leading reform.

*See also* Bird, R. (2013). *Foreign Advice and Tax Policy in Developing Countries* (Working Paper 13-07). International Center for Public Policy. Georgia State University.
http://www.ictd.ac/sites/default/files/TaxAdvice-DevelopingCountries.pdf

**Prichard, W., Brun, J., & Morrissey, O. (2013).** ***Donors, Aid and Taxation in Developing Countries: An overview*** **(ICTD Research in Brief Issue 4) Brighton: Institute of Development Studies.**
http://www.ictd.ac/sites/default/files/ICTD_RiB_%234_3.0.pdf

This research brief, based on a literature review, highlights the emergence of a global tax reform agenda and the convergence of tax policy and administration across a range of developing countries. The brief notes, however, that this agenda and formal changes in tax regimes have only led to modest gains in revenue mobilisation and improved practice, which have been hard to sustain. To improve the impact of donor-supported tax reform efforts and to ensure that donor policy strengthens developing country tax systems and collection, the brief recommends: (1) supporting local leadership of reform efforts; (2) incorporating political economy analysis into the design and implementation of programmes; (3) designing tax reform programmes to foster broader linkages between taxation, state building and governance; (4) paying attention to the complexity of the relationship between aid and tax effort; (5) improving the design of tax-related conditionality and performance indicators; (6) coordinating donor interventions more effectively; and (7) paying greater attention to the international policy context and its impact on local tax systems.

*See also* Prichard, W., Brun, J. &, Morrissey, O. (2012). *Donors, Aid and Taxation in Developing Countries: An Overview* (ICTD Working Paper 6). Brighton: Institute of Development Studies.
http://www.ictd.ac/sites/default/files/ICTD%20WP6.pdf

# 2 Development outcomes

## 2.1 Economic growth

The relationship between taxation and economic growth is complex and contentious. This relationship has been most rigorously studied empirically in high-income countries, especially the US, where there is consensus that general tax increases have dampened growth (McBride, 2012). The smaller body of empirical evidence on the relationship between tax and growth in developing countries is inconclusive, probably because of confounding factors such as weaker tax administration and enforcement (Acosta-Ormaechea & Yoo 2012).

There are different impacts from the tax mix of progressive (e.g. corporate and personal income), proportional (e.g. property) and regressive (e.g. consumption, trade taxes) taxes. Quantitative analyses of high- and middle-income country data suggest that income taxes tend to be more harmful to growth, and that a shift towards generally less harmful consumption and property taxes (while keeping overall tax revenue unchanged) can modestly increase growth (McBride, 2012; Acosta-Ormaechea & Yoo 2012). McBride (2012) suggests that this may be because progressive taxation reduces the returns and therefore the incentives to work and invest, which in turn undermines growth. Most analyses fail to find similar clear trends in low-income countries (McBride, 2012; Acosta-Ormaechea & Yoo 2012) but a 2014 econometric analysis finds that a shift from trade and consumption taxes to personal income taxes, while keeping overall revenue unchanged, is also harmful to low-income country growth (McNabb & LeMay-Boucher, 2014). The same 2014 study finds no evidence, however, that a shift towards consumption taxes has been good for growth. The impact of taxation on growth is ultimately country context-specific and mediated by the implementation of tax policy. An observational study of Latin American countries finds that personal income tax has not undermined growth, probably due to poor collection levels (Canavire-Bacarreza et al. 2013). The study also concludes that corporate income tax has a small negative effect on growth across all countries, and that reliance on consumption taxes has positive effects in most, but not all, countries.

The limited developing country evidence on company tax incentives (tax exemptions) does not find that they spur investment and growth, even though they can significantly reduce the overall tax collected (Curtis, 2014). Survey responses suggest they do not affect investors' decisions, and nascent empirical analysis finds they have no effect on total investment or economic growth (ActionAid, 2013).

**Key reading**

**McBride, William. (2012). *What Is the Evidence on Taxes and Growth?* (Special Report no. 207). Washington, D.C.: Tax Foundation.** http://taxfoundation.org/article/what-evidence-taxes-and-growth

This meta-review by a conservative US think-tank examined 26 studies on the relationship between taxation and growth. Twenty-three of those studies find a negative effect of taxes on growth and the last 3 find no overall effect. Corporate income taxes appeared to be the most harmful, followed by personal income taxes, consumption taxes and property taxes. Most studies were of OECD members, although some larger studies also included developing countries. The paper cites one 1997 study[4] of developing countries, which found that tax-financed spending reduces growth in high-income countries but increases growth in developing countries. This seems to be because in developing countries, financing government expenditure through tax is more growth-enhancing than financing expenditures through debt.

[4] Miller, S. M., & Russek, F. S. (1997). Fiscal structures and economic growth: international evidence. *Economic Inquiry, 35*(3), 603-613. http://dx.doi.org/10.1111/j.1465-7295.1997.tb02036.x

**Acosta Ormaechea, S. & Yoo, J. (2012).** ***Tax Composition and Growth: A Broad Cross-Country Perspective*** **(Working Paper 12/257). Washington, D.C.: IMF.**
https://www.imf.org/external/pubs/ft/wp/2012/wp12257.pdf

This econometric analysis looked at the relation between changes in tax composition and long-run economic growth using a dataset covering 69 countries with a wide range of income levels. The paper finds that for middle- and high-income countries, higher income taxes (personal income tax and social security contributions) seem to undermine growth, whereas higher consumption taxes (value-added and sales taxes) seem to improve growth. Corporation tax does not have a significant relationship with economic growth. In low-income countries there was no significant association between growth and any particular kind of tax, apart from trade taxes which seemed to worsen growth. The authors suggest that the lack of significant association between taxation and growth in low-income countries is due to poorer quality tax administration and enforcement.

**Canavire-Bacarreza, G., Martinez-Vazquez, J., & Vulovic, V. (2013).** ***Taxation and Economic Growth in Latin America*** **(IDB Working Paper Series No. IDB-WP-431). Washington, D. C.: Inter-American Development Bank.** http://www10.iadb.org/intal/intalcdi/PE/2013/12729.pdf

Using econometric analysis and modelling, this paper estimates the effects on growth of increases in the main taxes in Argentina, Brazil, Mexico, and Chile. The paper finds that personal income tax has not had any significant negative effects on economic growth in these middle- and high-income countries. This can be explained by the low collection levels in the region. For corporate income tax, the effects are inconsistent, with negative, positive or no effects on different countries. Use of consumption taxes has generally been a source of economic growth in Latin America. The authors conclude that reducing tax evasion and improving collection rates may boost economic growth in the region as a whole.

**ActionAid. (2013).** ***Give us a break: How big companies are getting tax-free deals*****. London: ActionAid.**
http://www.actionaid.org/sites/files/actionaid/give_us_a_break_-_how_big_companies_are_getting_tax-free_deals_2.pdf

This literature review and advocacy paper explores the use of tax exemptions as 'tax incentives' for investment and economic growth in developing countries. The paper provides an overview of types of incentives, the growth in the use of incentives and proposals for ending tax breaks. Based on investor survey data and empirical evidence, the paper concludes that these tax exemptions fail to act as incentives, can 'crowd out' local investors, and reduce revenue for public services.

## 2.2 Sustainable revenue and reducing aid and natural resource dependence

Due to the relative volatility of aid and natural resource revenues, many experts argue that changing the revenue mix from these revenue sources towards greater domestic non-resource taxation revenue would allow for more financial stability, predictability and control (e.g. Mascagni, Moore, & McCluskey 2014; Von Haldenwang et al. 2013). One econometric analysis finds support for this contention, finding that non-resource tax collection in developing countries was more resilient than their aid and natural resource revenues during the 2008 financial crisis (Prichard et al., 2014). Overall, however, there is little conclusive evidence to support this argument.

There is uncertainty about the relationship between aid and tax revenue. The question of whether aid undermines tax effort and revenue has been rigorously researched, but with conflicting conclusions. The paucity of data is a key constraint and there is debate on the methodology of the studies, with researchers failing to replicate findings. An influential econometric analysis found a negative association between aid grants and tax revenues, though the authors note that this relationship has become weaker over time and can be moderated by policymakers focusing on strengthening tax collection (Benedek et al., 2011). Two further econometric studies using a revised methodology and dataset fail to find a consistent significant relationship between aid and tax revenue (Clist 2014; Morrisey et al., 2014). The authors of one of these studies conclude that there are high levels of heterogeneity amongst countries and types of aid, which would prevent a robust relationship at an aggregate level (Morrisey et al., 2014).

**Key reading**

**Morrisey, O., Prichard, W., & Torrance, S. (2014).** ***Aid and Taxation: Exploring the Relationship Using New Data*****. Brighton, UK: Institute of Development Studies.**
http://www.ictd.ac/sites/default/files/ICTD%20WP21%20FINAL.pdf

This econometric analysis paper uses the new ICTD dataset, which the authors argue is more accurate than earlier datasets. It finds that there is no consistent, significant relationship between aid and tax performance. In general the authors find a positive, though not significant, relationship between net aid and government revenue. In sub-Saharan African countries they find a significant relationship between tax revenue and aid when given as loans.

**Prichard, W., Cobham, A., &Goodall, A. (2014).** ***The ICTD Government Revenue Dataset*** **(ICTD Working Paper 19). Brighton, UK: Institute of Development Studies.**
http://www.ictd.ac/sites/default/files/ICTD%20WP19.pdf

This paper presents a new government revenue dataset which the authors argue is more complete and consistent than previous efforts. Econometric analysis using this data finds that tax collection in developing countries has improved markedly and consistently across income groups and regions. Progress has been most rapid among low-income countries, most notably in Africa. Non-resource tax collection has increased but still remains at a low level and is not sufficient to produce all of the necessary revenue. The data suggest that for developing countries, non-resource tax collection was more resilient than other revenue streams to the 2008 financial crisis. The authors speculate that this may reflect less integration of low-income economies into the global economy.

**Benedek, D., Crivelli, E., & Gupta, S. (2012).** ***Foreign Aid and Revenue: Still a Crowding Out Effect?*** **(Working Paper 12/186). Washington, D.C.: IMF.**
https://www.imf.org/external/pubs/ft/wp/2012/wp12186.pdf

This econometric analysis finds a negative relationship between ODA grants and tax revenue. These results are reasonably robust across income levels and different geographical regions, and appear to be stronger in low-income countries. However, the impact of ODA grants on tax revenue appears to be weakening over time when compared with earlier studies. The authors argue that policymakers can manage the negative impact of grants by giving adequate attention to strengthening domestic capacity for revenue mobilisation.

## 2.3 Statebuilding

The literature on taxation and statebuilding[5] is primarily theoretical and guidance-oriented, with some supportive case study evidence. There is little literature specifically on taxation in fragile and conflict-affected states, especially in relation to statebuilding. That which does exist highlights the need for taxation to be dealt with during the early stages of post-conflict planning, despite the potential tax revenue being low (Therkildsen, 2008).

[5] Defined by the OECD as 'an endogenous process to enhance capacity, institutions and legitimacy of the state driven by state-society relations'. For further information on statebuilding see Haider, H. (2014). *Statebuilding and peacebuilding in situations of conflict and fragility* (Topic Guide Supplement). Birmingham: GSDRC, University of Birmingham.
http://www.gsdrc.org/go/topic-guides/statebuilding-and-peacebuilding

The review literature identifies a number of channels through which taxation can impact statebuilding (Prichard, 2010; Fjeldstad & Moore, 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, and more sustainable, resources to support citizen demands; and
- *Appropriate revenue*: shifting the distributional impact of taxation to a normatively more appropriate pattern.

A number of observational and econometric studies show these channels in operation. An observational study in Nigeria found that regions under different tax regimes during colonial times developed different local government capacities (Berger 2009). One influential econometric analysis finds that increases in taxes are associated with improvements in services or with democratic reforms (Ross, 2004). A 2014 econometric analysis supports this conclusion, finding that increases in non-tax revenue result in a reduced likelihood that a non-democratic state will transition to democracy, and that there is a generally positive association between tax reliance and democracy (Prichard, Salardi & Segal, 2014). Another such study finds that states that tax the poor prioritise basic public services over property rights, while states that tax the rich do the reverse (Timmons 2005). An experimental study in Uganda finds that actions that mimic taxation cause greater demands on those designated as leaders in the experiment (Martin, 2013).

**Key reading**

**Prichard, W. (2010). *Taxation and State Building: Towards a Governance Focused Tax Reform Agenda* (Working Paper 341). Brighton, UK: Institute of Development Studies.**
https://www.ids.ac.uk/files/dmfile/Wp341.pdf

This literature review argues that particular tax reforms can generate gains in state capacity and trigger the expansion of responsive and accountable government through common interest processes, state apparatus processes, and accountability processes. Governments and donors can strengthen taxation-governance links by reforming tax administrations to catalyse bureaucratic reforms, reorienting existing tax reform programmes towards greater emphasis on how collecting taxes can contribute to statebuilding goals, and supporting civil society actors to engage in tax debates.

**Fjeldstad, O-H. & Moore, M. (2008). Tax Reform and State Building in a Globalized World. In Brautigam, D., Fjeldstad, O.-H., & Moore, M. (eds). *Taxation and State Building in Developing Countries* (ch. 10). Cambridge : Cambridge University Press.**
http://www.cmi.no/publications/publication/?2771=tax-reform-and-state-building-in-a-globalized

This book chapter, a literature review on statebuilding and taxation, concludes that tax reform may contribute to statebuilding by providing adequate revenue, shifting towards more appropriate revenue sources, creating more effective tax administrations, and encouraging constructive state-society engagement around taxes. The authors argue that tax reform has been successful in producing more effective and efficient tax administrations, but that some important opportunities have been missed. These include involving poorer countries in designing reforms; taxing the informal sector, property, and aid agencies; and considering links across government when promoting centralised revenue authorities. The authors argue for greater attention to politics and citizen participation.

**Therkildsen, O. (2008). *Taxation and state-building with a (more) human face*. Copenhagen, Denmark: Danish Institute for International Studies (DIIS).**
http://www.diis.dk/files/publications/Briefs2008/PB_2008_10_Taxation_state-building.pdf

This policy brief, based on a review of literature, argues for a push for broader-based taxation in fragile states. The brief notes that key features of taxation and governance in post-conflict and fragile states are: low tax to GDP ratio; high dependence on trade taxes; very high aid dependence; off-budget donor-funded programming; and private contractors providing security and public services. The brief argues that taxation issues should be dealt with at early stages of planning in post-conflict states, even if revenue yields may be modest to start with. Taxes that suit local circumstances should be identified and prioritised over current global 'best practice'. There should be attempts to reduce or abolish tax exemptions for donors and their contractors, such as NGOs.

## 2.4 Inequality and redistribution

There is a significant body of literature on the issue of inequality and redistribution, but it provides conflicting evidence and conclusions, in particular relating to the impact of progressive taxation on economic growth. On the one hand, there is quantitative and qualitative evidence that a shift towards progressive taxes can be harmful to growth (see section 2.1), though growth is good for the poor, according to some econometric analyses (Dollar, 2013). On the other hand, econometric analysis shows that reducing inequality can create improved and more sustainable economic growth in the longer term (Ostry et al., 2014).

Bird and Zolt (2014) argue that in many developing countries personal income taxes have done little to reduce inequality and are not a viable means of redistribution. Such taxes are also politically challenging to implement (Ardanaz & Scartascini, 2013). In countries where annual consumption per capita is under $2,000, redistribution through taxation would require placing politically infeasible tax burdens (marginal tax rates in excess of 100 percent) on the richer citizens (Ravallion, 2010).

Bird and Zolt (2014) suggest focusing on improving the design of consumption taxes, and adjusting expenditure programmes to compensate for the impact on the poor. Lustig et al. (2012) advocate more cash transfer programmes over tax reform to address inequality. Other experts suggest that when designing tax policy, there is a need for a balance between growth objectives and redistribution objectives, and for the poorest countries to shift towards redistributive tax policies only once a sufficient income per capita has been reached (Ravallion, 2010).

Evidence suggests that taxes, and in particular income and consumption taxes, can be gender-biased (Grown & Valodia, 2010). Women and men tend to consume different goods and services and influence and manage household income and expenditure differently. Targeted consumption tax reform measures can address consumption patterns to improve gender equality outcomes (e.g. through zero-rating on children's clothes, which tends to impact women) as well as to change behaviour (e.g. through higher taxes on private transport fuel, which impacts men).

**Key reading**

**Ostry, J., Berg, A., & Tsangarides, C. (2014). *Redistribution, Inequality, and Growth* (IMF Staff Discussion Note). Washington, D.C: International Monetary Fund (IMF).**
https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf

This literature review and econometric analysis of OECD and non-OECD country data finds that: (1) more unequal societies tend to redistribute more; (2) lower net inequality is robustly correlated with faster and more durable growth; (3) redistribution appears generally benign in terms of its impact on growth, except in extreme cases where it may have direct negative effects on growth. The authors highlight the importance of looking at longer term (i.e. at least five-year) growth in analysis of growth impacts of redistribution and inequality, and conclude it is a mistake to focus on growth and ignore inequality. This is not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable.

**Bird, R. M., & Zolt, E. M. (2014). Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries. *Annals of Economics and Finance, 15*(2), 625-683.**
http://down.aefweb.net/AefArticles/aef150204Bird.pdf

This article reviews quantitative and qualitative literature on the benefit of relying on income tax, as opposed to other taxes, for redistribution in developing countries. In high-income countries, the personal income tax has long been viewed as the primary instrument for redistributing income and wealth. The study finds that personal income tax plays a small role in the tax systems of developing countries, has done little to reduce inequality in many developing countries, and involves significant administrative, compliance, economic efficiency and political costs. The authors argue that it is unrealistic to believe that personal income taxes can have a meaningful impact on distribution and that countries should instead reform expenditure programmes to target resources to the poor. In particular they should consider the distributional impacts of consumption taxes, which dominate the tax structures of developing countries.

**Grown, C., & Valodia, I. (Eds.). (2010). *Taxation and Gender Equity: A Comparative Analysis of Direct and Indirect Taxes in Developing and Developed Countries*. Abingdon: Routledge.**
http://www10.iadb.org/intal/intalcdi/PE/2011/08031.pdf

This book reviews evidence on the gender dimensions of personal income taxes, value-added excise and fuel taxes in Argentina, Ghana, India, Mexico, Morocco, South Africa, Uganda, and the UK. It finds that tax codes may be biased against women, and contemporary tax reforms can increase the incidence of taxation on the poorest women while failing to generate enough revenue to fund the programmes needed to improve these women’s lives. To promote gender equality in taxation, policy-makers need to consider how taxes reinforce or challenge current gender and other social inequalities and how to design tax instruments so that such inequalities are overcome. The book advocates specific and targeted usage of the tax system to improve gender equality outcomes, such as making children's clothing zero-rated for VAT, and increasing private vehicle fuel taxes but making household fuel zero-rated for VAT.

# 3 Approaches, interventions and tools

## 3.1 Understanding and working with the political economy context

Tax reform can encounter strong resistance from vested interests, especially from elites who may bear the greatest burden of taxation. Political economy analysis[6] can help to identify opposition to reform from powerful elites and lobbies (de Souza, 2013), and to identify 'windows of opportunity'[7] for reform such as those that can occur during periods of fiscal crisis or political transition (Prichard et al., 2012).

There is significant literature on political economy analysis in general, but relatively limited evidence specifically on how to understand and work with the political economy of tax reform.

Emerging evidence from regional and country case studies suggests several strategies that have helped to minimise resistance to reform, and to align reform with the political economy context (Fairfield, 2013; Hassan & Prichard, 2013; Jibao & Prichard, 2013; Booth, 2014; Fjeldstadt, 2005):

- phasing in tax increases gradually
- obscuring the impact of tax reforms
- appealing to fairness and equity
- linking reform to specific individual, general, and/or elite benefits
- engaging with both formal and informal (e.g. family) networks and institutions
- modest and targeted international support
- central government support in the case of local taxation
- high-level leadership to overcome opposition from powerful elites
- building reform coalitions
- strategies of negotiation and bargaining with taxpayers rather than simply relying on coercion
- focusing on flexible goals and feasible reforms, rather than pursuing ideal reforms and predetermined blueprints.

**Key reading**

**Fairfield, T. (2013). Going Where the Money Is: Strategies for Taxing Economic Elites in Unequal Democracies. *World Development, 47*, 42-57.** http://dx.doi.org/10.1016/j.worlddev.2013.02.011

This peer-reviewed journal article, based on a literature review and qualitative analysis, identifies six strategies that help facilitate tax reform by mobilising popular support or moderating economic elites' antagonism: (1) a 'foot-in-the-door' approach of gradually phasing in taxes or incremental increases; (2) reducing taxpayers' awareness of the tax burden by using taxes with less visibility, such as social security taxes deducted at source rather than direct income taxes; (3) emphasising fairness or equity, such as implementing progressive and targeted taxes and ensuring that everyone of similar means bears similar

[6] 'Political economy analysis aims to situate development interventions within an understanding of the prevailing political and economic processes in society – specifically, the incentives, relationships, distribution and contestation of power between different groups and individuals – all of which greatly impact on development outcomes. ' (Mcloughlin, 2012, p.5). For further information on political economy analysis see Mcloughlin, C. (2012). *Topic Guide on Political Economy Analysis*. Birmingham, UK: GSDRC, University of Birmingham. http://www.gsdrc.org/go/topic-guides/political-economy-analysis

[7] ''Windows of opportunity' occur when political economy factors align so as to enable progress' (Rao, 2013, p.14). For further information on 'windows of opportunity' see section 4.2 Flexibility, pragmatism, and being vigilant for opportunities in Rao, S., (2013). *Civil service reform: Topic guide*. Birmingham, UK: GSDRC, University of Birmingham. http://www.gsdrc.org/go/topic-guides/civil-service-reform

tax burdens; (4) linking tax reforms and increases to the provision of popular benefits; (5) linking reforms to broad public goods such as national security or prestige, socio-political stability, or economic stability; and (6) compensating elites by providing targeted benefits such as tax cuts or subsidies that benefit them.

Case studies of reforms in Latin America provide some evidence about how these strategies have played out in reality. In Chile, the success of reforms in 2001 and 2005 that broadened the tax base was attributed to successful appeals to legitimacy, in spite of businesses' strong political power. In Argentina in the 1990s, obfuscating the impact of taxes helped build support to circumvent resistance from financial-sector elites, although not permanently. In Bolivia in 2003, failure to adequately emphasise fairness and equity contributed to confusion and eventually anti-tax protests. The study concludes that in general, reforms are more likely to succeed if they are incremental rather than comprehensive, if they are supported by multiple strategies applied simultaneously, and if they are tailored to the particular context at hand.

**Hassan, M. & Prichard, W. (2013). *The Political Economy of Tax Reform in Bangladesh: Political Settlements, Informal Institutions and the Negotiation of Reform* (ICTD Working Paper 14). Brighton: Institute of Development Studies.** http://www.ictd.ac/sites/default/files/ICTD%20WP14.pdf

This literature review and case study of Bangladeshi tax reform over the last two decades emphasises the importance of understanding both informal and formal institutions, as well as the micro-level incentives that shape tax negotiation. The study finds that the Bangladesh tax system is characterised by high levels of discretion and corruption underpinned by robust informal institutions. These serve the core interests of political, economic and administrative actors across society and include elites, as well as rank and file revenue staff. The paper notes there are risks for certain actors from the continued informality, and that recent shifts in the influence of informal networks, and instances in which the tax system has been used against political opponents, may strengthen support for tax reform.

**Jibao, S. & Prichard, W. (2013). *Rebuilding Local Government Finance After Conflict: The Political Economy of Property Tax Reform in Post-Conflict Sierra Leone*. (ICTD Working Paper 12). Brighton: Institute of Development Studies.** http://www.ictd.ac/sites/default/files/ICTD%20WP12.pdf

This literature review and case study of relatively successful local property tax reforms in the four largest city councils in Sierra Leone highlights three key messages about the determinants of successful reform. The paper argues that: (1) modest and targeted support from the international community and the central government has been critical; (2) success is dependent on high-level leadership to overcome resistance, particularly from large property owners; and (3) reform strategies that are comparatively contractual (i.e. characterised by institutionalised, negotiable methods of assessing and collecting revenue) can contribute to a virtuous cycle of improved governance, and help to build sustainable political support for continued reform. The paper also notes that tax reform depends on long-term, hands-on local-level partnerships.

**Booth, D. (2014). *Aiding Institutional Reform in Developing Countries: Lessons from the Philippines on what works, what doesn't and why*. The Asia Foundation and the Overseas Development Institute.** http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8978.pdf

This literature review and case study of the effects of reforms to alcohol and tobacco taxes and property law in the Philippines in 2012 highlights the role of reform coalitions. The paper argues that a core group of actors within and outside government were able to address the coordination problems that normally afflict broad-based campaigns, make tactical decisions about how to divide the opposition, and make alliances without the need for consensus other than on the reform objective itself. Key recommendations from the paper are building tacit coalitions in a pragmatic way, avoiding being trapped in a predetermined blueprint of reform, avoiding reforms that are likely to meet greatest resistance, and pursuing the best possible policy changes given the context.

**Fjeldstad, O-H. (2005).** ***Corruption in Tax Administration: Lessons from Institutional Reforms in Uganda*** **(CMI Working Paper 2005:10). Bergen: Chr. Michelsen Institute**
http://www.cmi.no/publications/2005/wp/wp2005-10.pdf

A case study in Uganda looked at why tax reform efforts failed to remedy falling revenue levels and increased perceptions of corruption in the Ugandan Revenue Agency. Reforms that stressed monetary rewards and incentives may have failed because of the importance of family networks. Increased salaries may mean officials pay out more to meet extensive social obligations, and in some cases actually result in a net loss to the individual. Effective reforms may need to work with, or interrupt, the influence of kin-based networks. One such approach could be in-kind benefits which the author suggests are popular with civil servants partly because they are harder to share.

## 3.2 Supporting a culture of paying appropriate taxes

Tax morale[8] is significantly correlated with tax effort and tax compliance in both high-income and developing countries (Daude et al., 2012; OECD, 2013a). Evidence on increasing tax morale to create a culture supportive of taxpaying is primarily based on econometric analysis using public opinion surveys, with few rigorous evaluations of efforts to create a taxpayer culture.

Public perceptions of the fairness of the tax system and the belief that taxes will be well spent are highlighted in many studies as being important to tax morale and compliance (Fjeldstad & Heggstad, 2012; Ali, Fjeldstad, & Sjursen, 2013; OECD, 2013a). Tax morale tends to be correlated with support for democracy, age, claiming a faith or religious identity, higher education, and being employed full-time; there is also weak and contested evidence that women may have higher tax morale than men (OECD, 2013a). Afrobarometer survey data in Kenya, Tanzania, Uganda and South Africa show that tax morale and compliance are positively associated with credible enforcement, satisfaction with public service provision and avoidance of payments to non-state actors, perceptions of other people's compliance, a sense that one's ethnic group is fairly treated, and tax knowledge and awareness (Ali et al., 2013). However, the significance of these factors varies from one country to another. Another study in Mozambique, Tanzania, and Zambia also noted the importance of: a sense of a moral obligation to pay; the magnitude of the tax burden; ease of compliance; speed and accuracy of detection of non-compliance and corrective measures; and severity of deterrent measures (Fjeldstad & Heggstad, 2012). Many of the factors associated with compliance are interconnected.

Key measures to improve compliance are outreach and education, improving payment and processing services, and credible deterrence and enforcement (OECD, 2013a; 2013b). Outreach can be through business or civil society associations which enable discussion or bargaining between government and citizens on tax issues. Education can be through different forms of media and schooling, and can involve teaching taxpayers their responsibilities, how to pay their taxes, and how tax money will be spent. Modernising tax administration can improve tax-related processes; credible deterrence requires accurate identification of tax evaders and appropriate punishment. Identifying the range of citizens' attitudes towards taxation can improve targeting of tax compliance programmes.

**Key reading**

**OECD. (2013a).** ***What drives tax morale?*** **(Draft for consultation). Paris: OECD.**
http://www.oecd.org/ctp/tax-global/TaxMorale_march13.pdf

This draft policy brief is based on a literature review and econometric analysis using global public opinion surveys. The brief suggests that civil society, business organisations and the international development community could support the efforts of governments to improve tax morale and tax compliance by:

[8] 'The motivation of a country's citizens to paying taxes, in addition to legal obligations' (Daude et al., 2012, p.9).

strengthening and clarifying the links between revenue and expenditure; analysing citizens' attitudes and perceptions towards tax; understanding the informal sector better; increasing the transparency of tax policymaking; modernising tax administration procedures; and aligning efforts in different areas to avoid negative interactions among the drivers of taxpayer compliance behaviour (opportunity, economy, social norms, fairness and trust, and deterrence).[9]

**OECD. (2013b). Overview: A new era for taxpayer education. In *Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education* (ch. 1). Paris: OECD.**
http://www.oecd.org/ctp/tax-global/sourebook-taxpayer-education.pdf

This chapter is based on a review of academic and policy literature, and is an introduction to a book of 28 case studies on taxpayer education, mostly from developing countries. Taxpayer education includes government programmes to encourage tax-compliant behaviour, efforts by business organisations to mobilise and represent the interests of their members, and civil society initiatives to bring citizens into tax policy debates. To build a tax culture, it is important to teach taxpayers how to file their taxes, keep them informed of changes in tax laws, encourage people to pay their taxes, and educate schoolchildren and university students in tax literacy. Taxpayer education can be conducted via internet-based technologies, television and entertainment media, and outreach to the informal sector. The chapter recommends exchanging knowledge and sharing best practices on taxpayer education; measuring the impact of taxpayer education initiatives in terms of enhanced compliance; expanding regional co-operation following the Latin America and Caribbean model; and increasing development co-operation support for taxpayer education.

**Fjeldstad, O-H. & Heggstad, K. K. (2012). *Building taxpayer culture in Mozambique, Tanzania and Zambia: Achievements, challenges and policy recommendations* (CMI Report R 2012:1). Bergen: Chr. Michelsen Institute.**
http://www.cmi.no/publications/publication/?4499=building-taxpayer-culture-in-mozambique

This study, based on a literature review and interviews, examines citizen attitudes to tax, taxpayer education, and government-citizen tax engagement measures. Enhancing compliance is generally though taxpayer education and outreach to ensure that taxpayers are aware of their obligations; taxpayer services to ensure that tax payment and processing are easy; and credible deterrence and enforcement. The paper does not evaluate these approaches. Factors affecting compliance include: people's sense of moral obligation to pay; the extent to which taxpayers believe that the government spends their tax money wisely; fair and transparent treatment of taxpayers; the magnitude of the tax burden; the ease of tax compliance; the speed and accuracy of detection of non-compliance and corrective measures; the severity of deterrents; perceptions of whether others are paying their fair share; and taxpayer knowledge.

**Ali, M., Fjeldstad, O.-H., & Sjursen, I. H. (2013). *To pay or not to pay? Citizens' attitudes towards taxation in Kenya, Tanzania, Uganda and South Africa*. (Afrobarometer Working Paper no. 143). Afrobarometer.** http://www.afrobarometer.org/files/documents/working_papers/Afropaperno143.pdf

Based on the 2011/12 Afrobarometer survey data, this econometric analysis identifies factors that determine citizens' attitudes towards tax compliance in Kenya, Tanzania, Uganda and South Africa. The factors varied between countries, but attitudes to paying taxes were found to be more favourable when people: perceive enforcement to prevent tax evasion as credible; are satisfied with the provision of public services that they feel are important; do not have to pay non-state actors (e.g. criminal gangs) for services; perceive others to be tax-compliant; and have tax knowledge and awareness. Citizens'

[9] For further information the drivers of taxpayer compliance behaviour see Forum on Tax Administration: Small/Medium Enterprise (SME) Compliance Subgroup (2010). *Information Note Understanding and Influencing Taxpayers' Compliance Behaviour*. OECD. http://www.oecd.org/ctp/administration/46274793.pdf

perception of how their ethnic group is treated by the government was associated with tax compliance in South Africa and Tanzania, but not in Kenya or Uganda. The study found no strong evidence of a relationship between tax compliance and trust in government and political legitimacy.

## 3.3 Taxing the informal sector

The informal sector consists of firms and individuals who are not fully registered and regulated, and therefore not in the standard tax net. Taxing the informal sector can be through registration and formalisation to push these firms and individuals into the tax net, or it can be through taxing them indirectly. In most countries there are several types of business registration and varying degrees of formalisation.

Formalisation can encourage business growth, create a better business environment, and help build a culture of tax compliance (Joshi, Prichard & Heady, 2014). An economic modelling study suggests that full enforcement of taxation on the informal sector would increase labour productivity and output by reducing economic distortions (Leal Ordóñez, 2014). However, it is unlikely that taxing the informal sector through formalisation of all firms would bring in significant tax revenues, at least in the short- and medium-term (de Mel, McKenzie & Woodruff, 2013; Bruhn & McKenzie, 2014; Joshi et al., 2014). In general, a firm's decision about whether to formalise is based on an analysis of the costs (which can include higher taxes) and benefits (such as growing the business through official advertising and access to credit markets) (de Mel et al., 2013). For some firms, especially small firms and microenterprises, formalisation would not be beneficial (McKenzie & Sakho, 2010), even if it were cheap and straightforward. Simplifying and lowering the cost of registration has little or no effect on getting small firms to formalise, according to a review of econometric evidence (Bruhn & McKenzie, 2014).

To tax firms while they remain informal, the guidance literature, based on econometric analyses and literature reviews, suggests taxing the goods and services that they buy and sell (through sales or value-added taxes) or through 'presumptive'[10] or withholding[11] taxes (Joshi et al., 2014). Another approach is to delegate the role of collecting tax to trade unions, and to business or other associations (Joshi & Ayee, 2008). Tax administrations may need to reorganise, as the informal sector can be difficult to reach through large bureaucracies (Joshi & Ayee, 2008).

**Key reading**

**Joshi, A., Prichard, W., & Heady, C. (2014). Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research. *The Journal of Development Studies.* Advance online publication.** http://dx.doi.org/10.1080/00220388.2014.940910

This literature review provides an overview of the benefits and challenges of informal sector taxation through formalisation, taxing goods and services, withholding taxes and presumptive taxes. A 'growing body of research' suggests that formalisation of firms, which allows them to be taxed, may have 'significant benefits for growth, or, at the very least, may not hinder growth' (p. 5). Formalisation can enable access to credit, offer opportunities to engage with larger firms and the government, reduce harassment by police and government officials, and improve access to training and support programmes. Taxing the goods and services informal sector firms trade, for example through import and export taxes, may undermine country comparative advantage but would not impose compliance costs on informal sector firms. Neither would there be difficulties imposed by limited education on tax matters and limited

[10] Examples of presumptive taxes include fixed lump sums depending on the tax entity's occupation or sector, a minimum tax based on the assumed minimum income level, or a lump-sum minimum plus a percentage of gross receipts (TJN-A, 2012).

[11] Where 'larger firms [are] required to withhold taxes on their transactions with small firms, which is then remitted to government and credited against the future tax liabilities of those small firms' (TJN-A, 2012, p.3)

capacity to deal with tax issues. While some countries gain significant revenue from withholding taxes, these can be administratively burdensome, create incoherence in the tax system and discourage tax reform. A presumptive tax regime can mean firms pay substantially lower tax rates than under the standard regime. This can reduce revenue as well as discourage firms from moving onto the standard regime.

**Joshi, A. & Ayee, J. (2008). Associational taxation: a pathway into the informal sector? In Brautigam, D., Fjeldstad, O.-H. & Moore, M. (Eds).** ***Taxation and State-Building in Developing Countries: Capacity and Consent*****. Cambridge: Cambridge University Press.** http://shebacss.com/ndsp/docs/cases/ndsp042.pdf

This literature review outlines the associational taxation approach – delegating tax collection to unions, business or other associations – and identifies ways to improve informal sector taxation. Using this approach depends on the type of tax, the extent of revenue pressure on the government, the degree and nature of associationalism within the informal sector, and the channels of interaction with state institutions. To improve compliance it may help to shift away from organising tax administrations by locality and type of tax (sales, property and income taxes), towards organisation by type of taxpayer (e.g. large, middle and small taxpayers). Compliance can also be improved by reducing rates or offering rewards to firms that maintain effective records.

**de Mel, S., McKenzie, D. & Woodruff, C. (2013). The Demand for, and Consequences of, Formalization among Informal Firms in Sri Lanka.** ***American Economic Journal: Applied Economics, 5*****(2), 122-50.**
http://dx.doi.org/10.1257/app.5.2.122

This randomised controlled field trial in Sri Lanka looked at incentives for companies to register formally and the impacts of formalisation. The study found that providing informal firms with information about the registration process and reimbursement of direct costs did not increase registration. On the other hand, larger payments to informal firms in return for formalisation (equivalent to one-half to two months of profits) did lead to increased registration. The authors concluded that formalisation is attributable to rational cost-benefit calculations. Land ownership issues were the most common reason for not registering. Follow-up surveys found that the firms that formalised only showed modest profit increase (except for a few rapidly growing firms which profited more), but their owners had a more favourable attitude towards government as a result of formalisation.

**McKenzie, D. & Sakho, Y. (2010). Does it Pay Firms to Register for Taxes? The Impact of Formality on Firm Profitability.** ***Journal of Development Economics 91*****(1), 15-24.**
http://dx.doi.org/10.1016/j.jdeveco.2009.02.003

Using a quantitative analysis, this paper estimates the impact of tax registration on firms in Bolivia, the country with the highest levels of informality in Latin America. The study finds that tax registration can increase mid-sized firms' profits, but lowers profits for smaller and larger firms. The mechanism seems to be that registration allows firms to issue tax receipts, which attracts customers who can claim tax refunds. Very small microenterprises often benefit least from tax registration, as registration costs often outweigh potential profits.

## 3.4 Local taxation

Local taxation – local government collecting and spending locally revenue from taxes, fees and charges – has until recently received little attention from the national tax agencies, aid agencies, and international organisations that have shaped the tax reform agenda (Moore, 2013). Local governments generally receive most of their funds from central government, but property taxes, business licenses, market fees and user charges can provide substantial and reliable revenue (Fjeldstadt, Chambas & Brun, 2014). Furthermore, local taxation can improve state-society relations, at least at the local level. For example, a Sri Lankan randomised controlled study found that business owners whose firms formalised and paid local taxes showed increased trust in the provincial and municipal governments with whom they interacted during registration, but no change in trust in central government (de Mel et al. 2013).

There is little robust evidence of the impact of local taxation reform on revenue and statebuilding processes, or of the factors supporting reform efforts. Suggested approaches to reform include: (1) simplifying systems and processes (e.g. property valuation, business licences, fee structures); (2) increasing transparency; (3) improving payment compliance (e.g. of user fees); (4) improving provision of information on taxation and fees; and (5) adopting a more pragmatic approach to local taxation, such as through segmentation[12] (Fjeldstadt et al., 2014; Fjeldstadt & Heggstadt, 2013). It is important to consider the limited capacity of urban councils to undertake valuation and enforcement, and to ensure harmonisation between central and local government so as to avoid double taxation and inconsistent policies (Fjeldstadt et al., 2014; Fjeldstadt & Heggstadt, 2013).

**Key reading**

**Fjeldstad, O-H., Chambas, G. & Brun, J. (2014).** ***Local government taxation in Sub-Saharan Africa: A review and an agenda for research*** **(CMI Working Paper WP 2014:2). Bergen: Chr. Michelsen Institute (CMI).** http://www.cmi.no/publications/file/5098-local-government-taxation-in-sub-saharan-africa.pdf

This literature review on local government revenue systems in Africa concludes that there is a need for consistent domestic tax legislation, a clear boundary between local and central taxation, and the principle of segmentation to be applied in local taxation as it has been at the national level. There is potential to increase local revenues from other types of taxes (e.g. consumption of utilities) and non-tax revenue sources (e.g. fees, levies), but tax legislation must be kept as simple as possible to prevent overburdening local governments. Sharing revenues between local and central government can ensure better service provision, but this must not introduce uncertainties for local governments on the amounts they expect and/or on the timing of the transfers.

**Fjeldstad, O-H. & Heggstad, K. (2013).** ***Local Government Revenue Mobilisation in Anglophone Africa*** **(ICTD Research in Brief Issue 5). Brighton: International Centre for Tax and Development (ICTD).** http://ictd.ac/sites/default/files/ICTD_RiB_%235_3.1.pdf

This literature review examines opportunities and constraints facing local revenue mobilisation in Anglophone Africa. The paper finds that local government taxation not only brings in revenue, but can also play an important role in shaping state-society relations because it brings many people into direct contact with public authorities. The main sources of revenue for urban municipalities, other than central government transfers, are usually property taxes, business licenses, market fees and various user charges. For property tax, constraints include weak capacity to implement accurate valuation practices; poor collection; lack of clear ownership titles; and lack of political support for enforcement. Business licenses create high compliance costs due to complex procedures; may not reflect ability to pay; provide opportunities for rent seeking; and are often poorly administered. User fees may encourage efficient use of public sector resources but also suffer from defects including inequitable burdens on low-income users, ineffective collection and billing arrangements, poor quality services and persistent resistance to payment.

[12] Tailoring legislation and administration of tax collection to different segments of the tax base. For example, if the tax base is segmented by firm size, small enterprise tax collection can involve simplifying related legislation and adapting administration to be as cost-effective as possible keeping in mind that revenues are likely to be comparatively small (Fjeldstadt et al., 2014).

**Moore, M. (2013).** ***Obstacles to Increasing Tax Revenues in Low Income Countries*** **(ICTD Working Paper 15). Brighton: International Centre for Tax and Development)**
http://ictd.ac/sites/default/files/ICTD%20WP15.pdf

Why do the governments of low-income countries not raise more tax revenues? This literature review looks at various approaches, particularly highlighting the potential of property taxes, which globally are the dominant form of local taxation. Property taxes do not significantly distort investment decisions, and tend to fall on those better able to pay. They are consistently underused in low-income countries, and have been declining in relative importance even in those countries where they were historically relatively important. There are challenges in implementing property taxes as they tend to fall most on politically active and influential social groups.

**Case Study: (Semi-)autonomous revenue authorities ((S)ARAs): Mixed outcomes**

A study on local tax collection in Peru found that municipalities with semi-autonomous revenue agencies (SARAs) collect more revenue than those with conventional tax administrations (von Haldenwang et al., 2014). The results also indicate that local revenue is more stable in municipalities with SARAs, which is good for budget policy and planning.

Evidence, overall on (S)ARAs has been mixed (Fjeldstadt, 2013). While some have made impressive advances, other revenue authorities have seen little progress, or initial progress followed by stagnation. This is attributable to (S)ARAs being quite diverse in terms of revenue authority model; being mostly new and evolving; and having been introduced in part at the urging of aid donors and international financial institutions.

von Haldenwang, C., von Schiller, A., & Garcia, M. (2014). Tax Collection in Developing Countries – New Evidence on Semi-Autonomous Revenue Agencies (SARAs). *The Journal of Development Studies, 50*(4), 541-555. http://dx.doi.org/10.1080/00220388.2013.875534

Fjeldstad, O-H. (2013). *Taxation and development: A review of donor support to strengthen tax systems in developing countries* (UNU-WIDER Research Paper WP2013/010). http://www.cmi.no/publications/file/4720-taxation-and-development.pdf

## 3.5 Aid modalities and aid-funded goods and services

Aid can either reinforce or undermine tax systems and tax culture, depending on how it is channelled. International guidance suggests that donors should combine different aid modalities, adjusting them to local conditions (OECD, 2013). These should be coherent and coordinated, and ensure ownership and alignment with partner country government preferences. Guidance also suggests that donors ensure transparency within the recipient country regardless of the aid modality employed, and make more use of graduated funding mechanisms with revenue-related triggers (variable tranches, cash-on-delivery) (OECD, 2013). Donors should be prepared to disengage when aid for tax support does not achieve results, but there should be realistic expectations to avoid suddenly cutting off support. No single aid modality is always most effective in shifting elite incentives in relation to taxation. There are concerns that general budget support may weaken incentives for revenue mobilisation, although empirical evidence of this is inconclusive.

Tax exemptions on aid-funded goods and services have long been discussed in the international community (UN, 2005; ITD, 2006) and there is a strong consensus that they are undesirable (Diallo, 2013; Prichard et al., 2012; Fjeldstadt, 2009; MFA, 2013). While there is evidence on the impact of tax exemptions in general (see section 2.1) there is limited evidence specifically on tax exemptions of aid-funded goods and services. Prichard et al. (2012) argue that by paying tax on aid-funded goods and services, donors can reinforce the norm of tax compliance, reinforce the quality of tax systems and reduce administration costs in developing countries. Diallo (2013) notes that removing tax exemptions could help to make tax systems simpler, reduce management costs, minimise the risk of tax fraud and strengthen the neutrality of sales taxes, such as VAT. On the other hand, tax exemptions for aid funds can help ensure that the funds achieve their intended purpose, and removing them would require coordinated action by all donors to avoid price, cost and access disadvantages that would affect development outcomes (O'Brien, in International Development Committee, 2012). At present, some bilateral (Denmark, Norway) and multilateral (World Bank) donors no longer require tax exemptions (MFA, 2012).

**Key reading**

**OECD. (2013). *Tax and Development: Aid Modalities for Strengthening Tax Systems*. Paris: OECD.**
http://dx.doi.org/10.1787/9789264177581-en

This publication provides practical guidance for policy makers and practitioners based on the results of a literature review, a survey of aid agency officials and six country case studies (Ghana, Guatemala, Liberia, Mali, Mozambique, and Tanzania). The study examined seven aid modalities for supporting tax programmes and highlights the following strengths and weaknesses: (1) General budget support is useful in conditions of good public financial management capacity, it aligns support with national priorities, but may weaken incentives for domestic revenue mobilisation. (2) Sector budget support has similar strengths and weaknesses to general budget support, it creates direct links between funding and PFM performance, and is highly effective for coordinating donor work on revenue issues. (3) Basket financing is well suited to coordinating multi-donor funding for tax programmes, but is less closely aligned with country systems than budget support. (4) Other multi-donor instruments such as multi-donor trust funds can be used for coordination, though basket funding is preferable where there is adequate local management capacity. (5) Bilateral projects or programmes carry risks of lack of coordination among donors, and of being donor- rather than country-led, but can be effective if the recipient country exercises strong ownership and leadership. (6) Triangular cooperation can be comparatively lower in costs than other forms of technical assistance, although there are limits to countries' absorptive capacity. (7) In-kind support can be more responsive to recipient country needs than donor-led interventions.

**Diallo, I. (2013, March 14). Tax exemptions for aid-funded projects: reasons for change [Blog post]. Brighton: International Centre for Taxation and Development.**
http://www.ictd.ac/en/tax-exemptions-aid-funded-projects-reasons-change

This opinion piece by a Senegalese tax official outlines the use of, and problems with, tax exemptions of aid-funded goods. Tax exemptions for aid-funded projects are mainly VAT, customs duties, excise duties, and registration fees. For recipient countries, granting tax exemptions are effectively a conditionality tied to aid rather than a political choice. While the aid helps provide public goods with economic and social benefits, there is still a forgoing of significant tax revenue. Tax exemptions, including those for aid-funded projects, result in more complex tax systems, additional management costs both for tax payers and tax administrations, risks of tax fraud, and restrictions on the right to refunds affecting the neutrality of VAT. Paying taxes on aid-funded goods and services essentially acts as budget support, which is widely agreed by donors to be the preferable modality as it allows funds to be used to finance national priorities and reinforces public financial management systems. The official concludes that reviewing tax exemptions for aid-financed projects should be a priority.

## 3.6 Capacity development for taxation

International guidance on capacity development for taxation broadly parallels the wider literature on capacity development (e.g. UN, 2013a). There are also a number of country case studies on capacity development for taxation (Holmes, Ndihokubwayo, & Ruvakubusa, 2013; Bennet, 2012; Danida & Bhutan Department of Revenue and Customs, 2011; UNDP, 2008).

A joint report by the IMF, OECD, UN and the World Bank recommends deepening international co-operation, improving the transparency and tax compliance of multinational enterprises, and strengthening efforts to measure progress (International Monetary Fund et al., 2011). Draft proposals for strengthening tax administration capacity from the Effective Institutions Platform (EIP, n.d.) include: basing efforts on comprehensive analysis; adapting to context; supporting national priorities, ownership and leadership; addressing international, national and sub-national levels; engaging with a broad range of stakeholders both inside and outside government; and supporting principles of accountability, transparency, and participation. The EIP highlights training, South-South cooperation, and natural resource taxation as being particularly relevant for developing countries.

Interest in South-South cooperation for capacity building in tax administration has been growing. A recent OECD report describes South-South cooperation as a 'low-cost, high-value channel' and recommends 'strong support from the international community', but notes potential limits to partners' absorptive capacity (OECD, 2013, p. 15). The UN's South-South Sharing of Successful Tax Practices for Development (S4TP)[13] initiative aims to identify and disseminate successful Southern practices in tax policy and administration, identify opportunities for cooperation, and build awareness of the value of South-South exchange, particularly in working on illicit financial flows, tax training, transfer pricing, and taxation and climate change. The Capacity Development Programme on International Tax Cooperation is another UN programme, overseen by the Financing for Development Office, for strengthening the capacity of ministries of finance and national tax authorities in developing countries (UN, 2013b). It organises training and guidance material on international double taxation agreements, broadening the tax base and transfer pricing (UN, 2014). Many other bilateral and multilateral agencies and other organisations also provide capacity development assistance for tax reform: reports commissioned by GIZ and the UN have each identified more than 40 such agencies (Köhnen, Kundt, and Schuppert, 2010; Michielse and Thuronyi, 2010).

**Key reading**

**Holmes, K., Ndihokubwayo, D., & Ruvakubusa, C. (2013).** ***For State and Citizen: Reforming Revenue Administration in Burundi*** **(Policy Voices Series). London: Africa Research Institute.**
http://www.africaresearchinstitute.org/newsite/wp-content/uploads/2013/10/For-State-and-Citizen-Reforming-revenue-administration-in-Burundi-Final.pdf

This case study was produced by current and former senior officials of the semi-autonomous tax collection institution of Burundi (Office Burundais des Recettes, OBR), which was set up in 2009. The paper describes how tax collection and administration was reformed in Burundi to reduce corruption, improve services, implement legislative reforms and widen the tax base. Recommendations for the OBR are: work more closely with local authorities to widen the tax base in the regions; collate and re-examine provisions for offering revenue exemptions; improve OBR communications; support a comprehensive transparency and anti-corruption campaign, with government agencies; diversify its external funding to help in pursuing multiple objectives simultaneously; and deny access to public services and tenders to anyone who is not tax compliant.

**Bennet, R. (2012).** ***A Change Agent in the Tax Office: Nigeria's Federal Inland Revenue Service, 2004-2009*** **(Innovations for Successful Societies Policy Note ID184). Princeton University.**
https://www.princeton.edu/successfulsocieties/policynotes/view.xml?id=184

This case study examines the reform of the Nigerian Federal Inland Revenue Service in 2004. A new executive chairperson was appointed and tasked with reforming the agency and diversifying tax collection to reduce dependence on oil revenue. The case study describes how the chairperson overcame

[13] For further information see S4TP. (2014). *About S4TP*. South-South Sharing of Successful Tax Practices for Development (S4TP). http://www.s4tp.org/about-s4tp/

opposition from private consultants who benefited from the existing system, defeated institutional inertia, and reduced corruption. Steps toward capacity development included: establishing control over staff recruitment independently from the Federal Civil Service Commission; improving training using a mix of domestic and international consultants; reorganising and integrating departments and offices; simplifying interactions with taxpayers; increasing automation; working with banks to process payments; upgrading computer equipment; and setting up a new internal unit to fight corruption.

**Danida & Bhutan Department of Revenue and Customs (2011). Bhutan: Building capacities to build revenues. In Woodhatch, T., Casazza, A., Lucas, B., & Werter, F. (Eds.), *Capacity Results: Case stories on capacity development and sustainable results*. (pp. 7-9). Learning Network on Capacity Development and IBON Foundation.**
http://www.lencd.org/files/group/busan/document/2011/Capacity_Results:_Case_stories_on_capacity_development_and_sustainable_results/Capacity-Results-web.pdf

This short case study covers Bhutan's attempts to broaden the tax base by introducing personal income tax and improving collection of other direct taxes. The Bhutan Department of Revenue and Customs achieved efficiencies through decentralisation to regional offices, training, upgrading IT systems, and public education on compliance. Intensive in-country training and professional development in revenue administration, and the introduction of a new IT system for tax and customs have improved tax administration. Capacity development efforts have been supported by strong and stable leadership within the Department, by Danish financial support which was aligned with the national-driven strategy, and by technical assistance to support the drafting of legislation and the introduction of new IT systems.

**UNDP. (2008). *Revenue's Role in the Quest for Inclusive Development, What Works and What Can Work Better?* UNDP.** http://ww2.s4tp.org/wp-content/uploads/2010/10/InclusiveDev.pdf

This publication includes a meeting report and case studies presented at a 2008 conference on 'South-South Sharing of Successful Tax Practices' by experts and administrators from different countries, international organisations and campaigning organisations. The meeting report highlights a number of focus areas for capacity building including: developing a database of recognised tax experts in particular fields; promoting practical case-study-driven training sessions; disseminating successful practices effective in developing skills and keeping expertise within tax administrations; promoting the need to fully understand the impact of tax incentives designed to attract investment; and promoting ongoing beneficial exchange of experiences, both what has worked and what has not. The meeting highlighted a need to improve developing country capacity on issues such as transfer pricing, comparative tax law, and countering cross border tax evasion. An international tax appeal tribunal was suggested in place of arbitration clauses in Tax Treaties.

## 3.7 Monitoring and evaluation

Tax reform monitoring and evaluation (M&E), both for project evaluation and for benchmarking tax agencies, has tended to use *ad hoc* mixtures of resources and indicators, as there is little specific guidance on M&E for tax reform. Past capacity development efforts have lacked rigorous benchmarking components (Oxford Policy Management, 2006) and a key challenge is the lack of accurate and comparable data (Murray et al., 2014).

Literature on M&E in tax reform emphasises the need to look at the 'soft' elements of organisational culture (e.g. management philosophy, behaviours and style; degree of empowerment and ownership) as well as the 'hard', quantifiable indicators (e.g. changes in revenue levels) (Vázquez-Caro & Bird, 2011). Progress in tax reform has been judged by improvements in processes (clear reform objectives, reasonable expectations, evidence base, high-quality taxation advice, good donor-partner relations) (Murray et al., 2014), or changes in revenue agency performance (Kariuki, 2012a; 2012b). Tools used for M&E include literature reviews, (semi-) structured interviews and questionnaires, and other data collection and analysis (Murray, Oliver, & Wyatt, 2014; Kariuki, 2012a; 2012b). Performance indicators have been chosen in collaboration with stakeholders so that they are in line with tax agency priorities and likely to be implemented (Kariuki, 2012a; 2012b). The likelihood of implementation can be affected by pragmatic factors (e.g. data availability, processing capacity) as well as political economy factors.

Two new tools have been designed recently specifically for M&E of tax reform and tax systems. The *World Bank's Integrated Assessment Model for Tax Administration (IAMTAX)*[14] is a web-based tool to identify and assess tax administration performance over time (World Bank, 2011). Performance is assessed by analysing the legal and regulatory framework, the institutional set-up, and core business processes. The *IMF's Tax Administration Diagnostic Assessment Tool (TADAT)*[15] is designed to identify administrative strengths and weaknesses, to construct a shared assessment among all stakeholders, to set the reform agenda, to facilitate the management and coordination of external support for reforms, and to provide a basis for monitoring and evaluating progress (IMF, 2013). It has nine performance outcome areas[16] with corresponding indicators. TADAT was modelled on the Public Expenditure and Financial Accountability (PEFA) framework and is designed to be the revenue counterpart to PEFA's public financial management assessments. As both of these are relatively new tools (TADAT will launch the final version of the assessment tool in mid-2015[17]), there is as yet a lack of literature which critiques them and their indicators.

Other sources of indicators to monitor tax systems in developing countries include the OECD Tax Administration (formerly the Comparative Information Series),[18] the PEFA Framework,[19] the European Commission´s Fiscal Blueprints,[20] USAID´s Collecting Taxes Database,[21] and the World Bank's Diagnostic Framework for Revenue Administration.[22]

Relevant Value-for-money (VFM) literature is focused on governance programming generally, rather than specifically on tax reform. Key recommendations include: noting that VFM can be measured without quantification of all variables; thinking early about VFM during programming; breaking down the Theory of Change and Results Chain into constituent parts (inputs, outputs, outcomes, impacts and assumptions) and considering all parts in VFM analysis; and not treating VFM analysis as separate from project design (DFID, 2011, 2013).

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[14] See http://www.iamtax.org/

[15] See http://www.tadat.org/

[16] The TADAT performance outcome areas are: (1) integrity of the registered taxpayer base (i.e. information about the taxpayers); (2) extent of understanding about the compliance risks in the tax system; (3) quality of support provided to taxpayers to promote voluntary compliance; (4) extent to which taxpayers meet their filing obligations; (5) extent to which taxpayers meet their payment obligations; (6) accuracy with which taxpayers declare their tax obligations; (7) adequacy of tax dispute resolution; (8) efficiency of tax administration; and (9) level of accountability and transparency to the government and the public.

[17] As noted in: IMF. (2014, March 5). *New Tool to Improve Tax Administration*. IMF Survey Magazine: In the News. IMF. https://www.imf.org/external/pubs/ft/survey/so/2014/new030314a.htm

[18] See http://www.oecd.org/tax/administration/tax-administration-series.htm

[19] See https://www.pefa.org/

[20] See http://ec.europa.eu/taxation_customs/resources/documents/common/publications/info_docs/taxation/fiscal_blueprint_en.pdf

[21] See http://egateg.usaidallnet.gov/collecting-taxes

[22] See http://siteresources.worldbank.org/INTTPA/Resources/DiagnosticFramework.pdf

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