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Taxation and Development: What Have We Learned from Fifty Years of Research?

This paper contributes to the broader ICTD research objective of gaining a better understanding of how to improve tax policy and administration across a range of diverse developing country settings. It offers reflections on the interplay between tax research and actual policy over the last fifty years in order to throw light on the processes of tax reform, and to offer insights into how research could become more relevant and effective in shaping tax policy to support development.

Fifty Years of Fiscal History

In the decades following World War II, economic tax advice offered to developing countries was based on what had worked in developed countries, with a strong emphasis on increasing overall levels of tax collection and on broad-based, progressive personal income tax. However this advice had little impact: few countries increased tax / GDP ratios; income taxes (both personal and corporate) became relatively less important; and there was a shift towards increasing reliance on VAT. These changes were informed by research but it was not the main or only influence; indeed shifts in theory and practice took place in parallel. A central role for VAT, and lower, flatter income taxes became the accepted tax policy model. However despite a perception of widespread tax reform, tax levels and structures have proved quite "sticky": for example, the overall importance of consumption taxes has shifted little as increases in VAT have been offset by reductions in customs duties.

Processes of tax reform

Experience suggests that countries didn't change tax policy (a focus on VAT, and general lowering of income tax) because of persuasive theory or empirical evidence but as a reaction to real-world issues. For example VAT was in part a response to WTO-linked pressure for lower and more uniform import tariffs; reduction in marginal tax rates was in part a response to international competition for capital. Even where policymakers buy into economic arguments and evidence, they often do so because this coincides with elite interests: for example lower, flatter income tax. Experience also suggests that policymakers are much more influenced by distribution and equity ➤

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issues than researchers often recognise, albeit by their narrow impact on a specific locality or group rather than by broad poverty alleviation goals. In short, tax policy and administration are shaped not just by economic structures and concern for economic efficiency, but also by ideas, interests and institutions in a specific country context, as well as by more intangible factors such as the perceived legitimacy of government and levels of trust between the state and its citizens. None of this means that there is not scope for objective advice about sensible policy; but it does suggest that researchers need to understand the political as well as the economic factors that affect tax policy, and the complex social and political interactions at play within a specific institutional context.

Custom-built solutions

Research has yielded little broadly relevant, practical guidance on how to improve tax systems. However, many problems that are hard to solve in the abstract can be solved by policymakers in a real-world context. Moreover debates about taxation are often about quite fundamental issues relating to the kind of society and governance that people want. Governments need to secure an adequate degree of compliance from taxpayers, and tax systems need to reflect basic values of at least a minimum supporting coalition if they are to be sustainable over time. All this means that tax reform needs to be custom-built to fit the requirements of a particular policy context, while drawing on some standard structural components (such as VAT and income taxes). Moreover the process of reform is more important than the precise configuration of the package. Sustainable reforms need to be developed in-house by countries themselves. Local ownership, leadership, adequate resources and a coherent strategy are all important, as is political support and sufficient administrative capacity.

Implications for researchers and external policymakers

Tax researchers need to keep focused on efficiency issues since these are of critical importance in poor countries, and will otherwise be neglected. But they also need to become much more effective at communicating research findings to local politicians, officials and opinion makers; and to offer a menu of options, not pre-cut solutions. More specifically, they should:

- Pay more attention to the political economy of taxation, and to the real constraints and objectives facing policymakers in a given context. They should engage with issues that appear to motivate local politicians and administrators: good ideas can have an impact when they coincide with elite interests and incentives.
- Pay more attention to tax administration. How revenue is raised, including its impact on equity, economic welfare and levels of public trust in government is as important as how much revenue is raised.
- Adopt a long-term strategy, and focus on building up local institutional capacity – including support for think tanks and university studies – to articulate relevant ideas for change. More support over a longer timeframe is needed to build capacity for data gathering and analysis both within and outside government, as well as capacity to assess and criticise the effects of policy change.

Further reading

Bird, R.M. (2012) *Taxation and Development: What Have We Learned from Fifty Years of Research?* ICTD Working Paper 1, Brighton: IDS, April

Credits

This ICTD Research In Brief was written by **Richard M. Bird**, Professor Emeritus of Business Economics at Rotman School of Management and Senior Fellow of the Institute for Municipal Governance and Finance, Munk School of Global Affairs, University of Toronto. It was edited by **Sue Unsworth**, Principal with The Policy Practice and ODI Board Member. She was formerly Regional Director for Asia and subsequently Chief Governance Adviser at the Department for International Development.

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