Media briefing

PANOS LONDON ILLUMINATING VOICES

Tax matters

A media guide to research on taxation and good governance

Media toolkit on communicating research

This is the eighth in a series of briefing documents for the media from the RELAY programme. RELAY works with Southern print and broadcast journalists to communicate the findings of academic research in an accessible way. The briefings set out the main issues around a topic, prompting journalists to pursue ideas and do further story research themselves. These briefings and other resources can be downloaded for free from **www.panos.org.uk/mediahub**

In many developing countries there is little public information or debate about taxation – even at election time. Wealthy and influential people evade tax, and public attitudes to taxation are often overwhelmingly negative.

A growing body of research shows that taxation matters for governance. If governments do not depend on taxpayers for revenue, they have little need to be accountable and responsive to citizens. Likewise, if taxpayers see governments wasting their money or believe that others are unfairly avoiding tax, they will be reluctant to pay.

Research provides a valuable source for journalists to write influential stories that can increase public debate about these critical issues.

The problems of taxation in developing countries

Most states rely to some extent on the broad taxation of citizens and businesses, raising revenue from taxes on income, imports, exports, assets (land and property) and economic transactions. However, developing countries raise a lot less revenue this way than developed countries.

Tax ratios

Higher-income countries tend to have higher tax ratios: the average tax-to-GDP ratio for low-income countries is 18 per cent, compared to 22.5 per cent for middle-income countries and more than 29 per cent for high-income countries. Half of sub-Saharan African countries raise less than 15 per cent of GDP in tax revenues, and the figures are even lower elsewhere: Bird and Zolt (2005) showed that both Bangladesh and Nepal raised less than 10 per cent. Despite repeated attempts at tax reform, these ratios tend to change very little over the short to medium term.

Why is taxing so difficult?

There are many reasons why low-income countries struggle to increase their tax take. Collection costs in poor, agrarian economies are high and farmers' incomes are seasonal and unstable. It is also notoriously difficult to tax the informal sector. Efforts to collect tax therefore tend to focus on a smaller number of people and firms, but these can often avoid taxes because of their power and influence.

Corruption in the Democratic Republic of Congo (DRC)

Although the DRC has some of the world's richest mineral deposits, government revenue from its mines has remained at less than 0.5 per cent of GDP. During the civil war, illegal mining and smuggling contributed to revenue losses. Now the political situation has stabilised, corruption is a more fundamental issue: mineral contracts are extremely generous to foreign firms, providing private benefits to public officials involved. Although the current government has announced it will review and re-negotiate such contracts, the process has lacked transparency. (Christian Aid 2008)

A hairdresser cuts a customer's hair in a makeshift barber shop that he has set up in the abandoned tax department of the derelict National Bank of Liberia.
TIM A HETHERINGTON | PANOS PICTURES

Developing-country governments often have alternative sources of revenue – such as aid and natural resource exports – which may leave them with less incentive to tax their own citizens. However, trade liberalisation and the ensuing global shift away from taxing imports and exports as a principal source of revenue have posed problems for low-income countries, which have been unable to replace the lost income from trade taxes with tax from other sources.

Tax Justice Network research estimates that revenue losses from trade liberalisation far exceed development aid. Potential export revenue is also lost through illegal extraction, smuggling and corruption, with governing elites often enjoying opportunities for personal enrichment from legal and illegal trade in oil, minerals and narcotics. Many researchers point to this as a major cause of bad governance and weak development.

The removal of barriers to cross-border flows of finance under globalisation, along with limited government interest in taxation, has also allowed individuals and companies to transfer assets to overseas tax havens and offshore financial centres, taking advantage (legally or illegally) of the lower tax rates payable there.

Research by Christian Aid (2009) estimates that $160 billion is lost annually to developing-country governments through tax dodging by multinational companies. This can include practices such as falsified invoicing and 'transfer mispricing'. These are difficult for tax authorities to detect and control.

Links between taxation and governance

Much research – including Tilly (1990), Moore (2007), Fjeldstad and Moore (2008) – offers compelling historical evidence of links between taxation and governance. In 17th-to-19th century Europe, rulers needed revenue to fund inter-state wars. This gave them strong incentives to nurture broad-based economic growth and develop effective bureaucracies to assess, collect and manage tax revenues. The effect was both to increase state capacity and prompt citizens to organise to resist or negotiate tax demands and press for more say in the way state revenue was used, which in turn increased accountability. Bargaining over tax eventually led to the creation of a 'social contract': citizens complied with tax demands in return for less arbitrary taxation, more influence over public policy and more scrutiny by representative institutions over public finances.

The resource curse

Research suggests that a lack of bargaining with citizens over tax can lead to governance problems. States with abundant natural resources for export have limited incentives to create institutions to collect or administer tax, or to provide vital services in poorer, more remote areas. While some countries, such as Botswana, have successfully managed their natural resource wealth, there is widespread evidence of bad governance associated with limited state reliance on taxation.

Copper mining in Zambia. Research suggests that states with abundant natural resources have less incentive to rely on taxation of citizens for revenue, and that this can result in poor governance.
GARY JOHN NORMAN | PANOS PICTURES

Bad governance in oil-exporting countries

Michael Ross (2004, 2001, 1999) and others have shown the malign effects of government dependence on natural resource revenues. Because oil is a valuable, physically concentrated resource, benefits remain with a small number of big companies and central states and the individuals who control them. Because governments do not depend on taxpayers, they have few incentives to promote broad economic development in order to create wider sources of wealth and income, and they often use oil revenues to buy off opposition or fund repressive internal security. Taxpayers have little incentive to engage politically, revenues are not transparent in many cases and there is often little oversight from legislatures.

Building good governance

Europe's historical experience is not directly transferable to low-income countries today. Circumstances are different, and relationships between taxpayers and governments more complex. Nevertheless, research suggests that the process of bargaining between governments and citizens over taxation and public spending remains central to the creation of capable, accountable and responsive states, as the following examples illustrate:

- In **Ghana**, government attempts to introduce a new Value Added Tax (VAT) in 1995 led to mass protests and bargaining with the government, in which protesters demanded increased accountability, democracy and political openness. (Prichard, 2009)
- In **Argentina**, provincial governments that depend on broad taxation of citizens have historically been the most democratic. In provinces that relied on central government funds or oil revenue, local politicians were better able to buy off or suppress democratic opposition. (Gervasoni, 2006)
- Researchers in **India** found that ordinary people had a good appreciation of what was legitimate and legally permissible in the use of public funds, concluding that public scrutiny would sharpen as councils increased their reliance on locally generated revenue. (Majumdar et al, 2007)

A way forward?

Widespread tax evasion leads to a narrow taxpayer base and reduced willingness to pay. There is evidence that better-off people and companies negotiate private bargains with the tax authorities, leaving them with less incentive to press for accountability or reform. Corruption and a lack of transparency in public spending further strengthen people's reluctance to pay tax, while coercive and arbitrary tax collection – often a problem in rural areas – makes people resentful of paying taxes. Small and medium-sized enterprises in the formal sector also struggle to compete, undercut by larger firms, which use political influence to evade tax, and informal sector firms able to avoid taxation.

A community meeting in Jamaica. Research shows taxation can lead citizens to come together to demand accountability from local and state officials.
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Tax reform

Some research, such as that of Fjeldstad and Moore (2008), notes that a consensus has emerged among international financial institutions, such as the International Monetary Fund and tax professionals in favour of:

- moving away from trade taxes to more visible taxes including Value Added Tax (VAT)
- abolishing or simplifying taxes and widening the tax net to attempt to make tax systems simpler, fairer and more transparent
- improving administrative capacity to make revenue authorities more effective and less coercive
- relying less on the tax system to pursue specific policy goals such as wealth redistribution between rich and poor or attracting investors. Such systems are complex, can be difficult to administer, and are often undermined by evasion and politicisation, argue 'tax consensus' supporters.

This approach, which has underpinned recent tax reforms in many countries, has been questioned by some analysts. For example, the International Poverty Centre (IPC) (2007) notes that VAT enabled sub-Saharan African countries to recoup only a third of the revenues they lost by cutting trade tariffs. It claims there is evidence to show that numerous countries that did not rigidly follow 'standard advice' on tax reform (such as Uganda) were more successful in raising their revenue/GDP ratio; they did so, says the IPC, by carefully sequencing reforms and relying on a range of direct and indirect taxes. Others note that VAT has the drawback of being unable to cover the informal sector (Keen 2007), which often accounts for more than 50 per cent of the workforce in developing economies.

Tax reform is a complex process, with equity implications and conflicting objectives. Indeed, reducing trade taxes too rapidly can impact on other sectors, while seeking to maximise revenue could increase coercion or encourage revenue authorities to focus on a small group of large taxpayers rather than broadening the tax base.

Changing views on taxation in Tanzania

Research suggests that small changes in tax and public policy can have a swift, positive impact on people's willingness to pay tax. Fjeldstad, Katera and Ngalewa's study of local council taxation in Tanzania (2009) found that people's views on taxation were more positive in 2006 than they had been in 2003. Three factors had led to this change: improvements in government provision of education, health and law and order; tax reform which included abolishing an inequitable flat-rate development levy; and less oppressive revenue collection. However corruption was still perceived as a major ongoing problem, reducing people's trust in government and their willingness to pay taxes. As a result, citizens were demanding tougher action against corrupt officials and increased transparency on revenue collected and public spending.

Family planning clinic, Tanzania. People's attitude toward taxation in Tanzania became more positive when they saw improvements in education and healthcare.
PETER BARKER | PANOS PICTURES

Improving governance through taxation?

Despite these potential problems, Fjeldstad and Moore (2008) suggest that tax reform could improve governance if it results in a larger number of citizens being taxed more fairly, predictably and transparently. Reducing the scope for private deals would encourage taxpayers to organise around common demands for improved public services and accountability.

Some tax professionals have explicitly linked taxation and state building. In 2008 senior African tax officials launched the Africa Tax Administration Forum to mobilise domestic tax bases to help countries escape aid or resource dependency, improve government accountability to taxpayers, and promote effective state administration and good public finance management.

Taxing the informal sector

Research has shown that there may be scope for effective taxation of the informal sector. Since 1987 the Ghanaian government has effectively franchised taxation of income in the large private road passenger transport sector to one of the major trade unions. Studies by Joshi and Ayee (2008) and von Soest (2008) show all-round benefits: revenue for the government; income and authority for the union; and protection against potential illegal levies for the vehicle operators. The arrangement is far from ideal – with high administrative costs and taxes not always reaching the Treasury – but it suggests that providing positive incentives for compliance could work. Research by Kamunyori (2007) in Kenya indicates that informal sector operators would be willing to pay taxes if this reduced harassment by municipal officials and simplified business registration and regulation. For his part, Di John (2008) argues that efforts to expand the tax base within the informal sector must be matched by the provision of incentives such as better access to credit and training for such firms to increase their productive capacity.

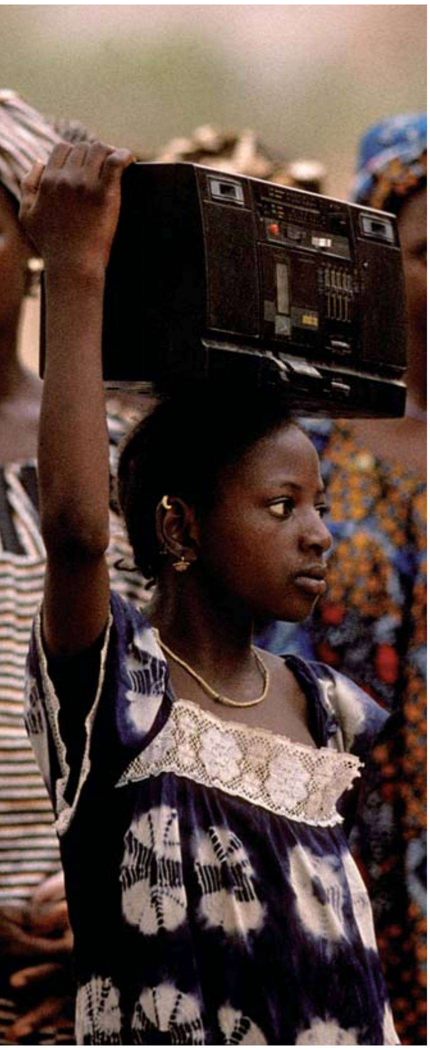
Direct and indirect taxation

Direct taxes are paid directly from taxpayers to the government, and most notably include income taxes, corporate taxes and property taxes. These are highly visible taxes, and thus politically sensitive.

Indirect taxes are paid to the government by someone other than the person who bears the cost of the tax. They include goods and services taxes, excise taxes and trade taxes, all of which are borne by consumers, but are paid to the government by retailers, manufacturers and importers.

Value Added Tax (VAT), a charge on sales and services, is formally an indirect tax, but has high visibility with small businesses who bear a lot of the burden of administering it.

Taxing questions



Listening to the radio in Mali. The media can make links between the interests of taxpayers and public spending.
CLIVE SHIRLEY | PANOS PICTURES

There are no automatic links between taxation and better governance. Much depends on the behaviour of revenue authorities and on public attitudes to taxation. Public information or debate about sources of government revenue – including tax – can be rare in developing countries. While the media regularly discuss wasteful or inadequate public spending and systemic corruption, they seldom explore the links between this and taxpayers' interest in seeing their money well spent. There is, therefore, an opportunity to increase awareness and discussion of these issues.

Reducing inequality

The ability of wealthy taxpayers to organise and engage politically with government over tax, and their much greater influence compared to poorer people, raises questions about the government measures and public action required to ensure fairer taxation. Some research shows that the role of taxation in reducing inequality remains controversial. Christian Aid (2008), Marshall (2005) and others have criticised reductions in income and trade taxes in favour of goods and services taxes (notably VAT) on grounds of their alleged unfairness in placing more tax obligations on the average person. They claim other taxes are needed to widen the tax base to include middle class professionals who have greater ability to pay a share. However, Bird and Zolt (2005) have argued that increasing personal income tax is administratively and politically demanding, and goods and services taxes are therefore a more realistic and reliable source of revenue.

Gemmell and Morrissey (2005) find no evidence that recent reforms have shifted the overall tax burden onto poor people, and many commentators see expenditure as a more effective way of redistributing income, warning against over-complex tax structures. They claim all income groups stand to benefit from more accountable public spending. Others point out that there is scope to tailor VAT to favour poorer groups – for example, by exempting food. Fjeldstad and Moore (2008) argue for greater focus on urban property taxes to increase revenue and equity.

However, research also suggests that taxation is a more predictable source of income than development aid, so more effective taxation could improve government service provision for all.

International action on tax issues

Tax has emerged as a key issue as a result of recent international moves to regulate the global financial system and reduce corruption and criminal activity. Although primarily driven by the financial crisis and concerns about terrorism and climate change, such regulation also controls sources of non-tax revenue, and might therefore increase government interest in taxation.

Initiatives have focused on international tax evasion; money laundering; stolen asset recovery; corruption; and terrorist financing. A range of voluntary programmes have included the extractive industries transparency initiative; the Kimberley process to prevent trading in conflict diamonds; and efforts to reduce illegal logging.

Civil society groups and thinktanks have also made tax a key focus of their action. They have called for international measures – such as country-by-country financial reporting and automatic tax information exchange agreements – to curb the loss of vital revenue needed for development, targeting relevant bodies such as the G20 group of nations and the OECD.

Developing countries and donor agencies are also increasingly debating the need to reduce long-term dependency on aid and avoid undermining the accountability of aid-dependent governments to their own citizens (OECD 2008).

Investigating tax and governance

Tax terms explained

- **Income tax** – paid by individuals or companies on both earned income from employment and self-employment, and unearned income from investments and property
- **Money laundering** – the process of 'cleaning' money from criminal or illicit activities to give it the appearance of legitimacy
- **Offshore** – a term used to describe a jurisdiction which provides tax and regulatory privileges or advantages to companies, trusts and bank account holders on the condition that they do not conduct active business affairs within the jurisdiction. The term is very broad and includes tax havens such as Andorra and Liechtenstein
- **Revenue** – regular income received by a government or company
- **Tax avoidance** – seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud)
- **Tax evasion** – the illegal non-payment or underpayment of taxes, usually by making a false declaration or no declaration. It incurs criminal or civil legal penalties
- **Tax haven** – a country or territory whose laws can be used to avoid or evade taxes due in another country
- **Value Added Tax (VAT)** – charged by businesses on sales and services. Because businesses can claim credit from the government for any tax they are charged by other businesses, the VAT burden falls almost entirely on consumers, although businesses incur much of the administrative cost.

(Sources include Tax Justice Network's Glossary. For more information see www.secrecyjurisdictions.com/glossary)

Key questions for journalists to ask

The media can play a key role in increasing public awareness of and information on tax matters. Key questions to ask include:

- Who pays tax? How much do they pay?
- What terms are governments negotiating with extractive companies?
- What revenue does the government receive? What happens to it?
- What are the links between taxation and public service delivery?
- Who manipulates or evades tax – either by negotiating private deals or holding money offshore?
- What are elected representatives doing to protect taxpayers' interests?
- What are the links between taxation, spending and accountability?
- What are the advantages of more reliable revenue, more efficient spending and more equitable burden sharing?

Ideas for tax stories

Tax education: What is your tax being spent on? Conduct a straw poll among readers to find out levels of awareness; ask listeners to call in. Invite an official to answer questions in print, on air or online.

Expanding public tax awareness: Has there been a tax-awareness campaign in your country? Write a feature on whether it succeeded or failed – and why.

Informal sector taxes: Visit a local market or trading area for quotes, soundbites and personal stories. Why are informal sector traders reluctant to pay tax? Are traders paying more in bribes than tax? Invite politicians and members of the public to discuss how creative and fair ways could be found to encourage informal traders to contribute to and benefit from public spending. Ask a researcher to comment.

Annual budget: What portion of government income comes from tax? Does this affect how the government spends its money? Does it make it more accountable?

The resource curse and corruption: Compare your country's natural resource tax policy with one or two similar countries, or ask a researcher to do this for you. Who is getting the best deal? Are contracts confidential or open to public scrutiny? Can mineral- or oil-rich countries use tax to grow economically while also cutting corruption? Is there evidence of bribes being offered or accepted?

Farmers: How is the tax system helping or hindering farmers' progress? Visit farmers to find out more. Ask an agricultural specialist or researcher to explain how the tax system could encourage agricultural growth.

Tax havens: Ghana is getting one, other countries may follow suit. What are the benefits and disadvantages? Get a researcher to write an opinion piece or on-air column.

Tax reform benefits and options: Are there stories about tax reforms involving better services and less coercive taxation, resulting in taxpayers' greater willingness to pay? What kind of tax reforms are being discussed or introduced by your government? Are they the best options?

Organisations conducting research on tax and governance

Africa

Centre for Governance and Development (CGD), Kenya
Conducts research, capacity building, civic education and advocacy
Tel: +254 72 023 8904
+254 20 273 4576
Email: admin@cgd.or.ke
www.cgd.or.ke

Institute for Economic and Social Research (INESOR), University of Zambia
Conducts applied and theoretical economic and social research informed by the needs of Zambians
Tel: + 260 1 294131
www.unza.zm

Institute of Economic Affairs (IEA), Kenya
Promotes informed debate on economic and political policies, proposes policy alternatives and provides research for policy-makers including MPs
Tel: +254 20 271 7402
Email: irene@ieakenya.or.ke or admin@ieakenya.or.ke
www.ieakenya.or.ke

Kenya Institute for Public Policy Research and Analysis (KIPPRA), Kenya
Provides public policy advice to the government of Kenya and the private sector
Tel: +254 20 271 9933
Email: admin@kippra.or.ke
www.kippra.org

Research on Poverty Alleviation (REPOA), Tanzania
Conducts research on poverty and pro-poor growth, including tax and governance
Tel: +255 22 270 0083
Email: joyce@repoa.or.tz or repoa@repoa.or.tz
www.repoa.or.tz

Asia

National Institute of Public Finance and Policy (NIPFP), New Delhi, India
Conducts research in public finance and policy
Email: mgr@nipfp.org.in
www.nipfp.org.in

South Asia Network of Economic Research Institutes (Sanei), Pakistan
Establishes strong research links among diverse economic research institutes in the region to inform policy
Tel: +92 051 921 3089
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www.saneinetwork.net

Caribbean

Department of Economics, University of the West Indies, Jamaica
Tel: + 876 927 1660
Email: colinb3@yahoo.co.uk
www.mona.uwi.edu/economics

Europe

Centre for Future States, Institute of Development Studies, United Kingdom
Conducts research into the processes involved in building more effective, accountable and responsive governance in poor countries
Tel: +44 (0)1273 915718
Email: A.Randon@ids.ac.uk
www2.ids.ac.uk/gdr/cfs/index.html

Centre for Taxation and Public Governance, The Netherlands
Contributes to the strengthening of governments in the fields of tax policy, tax administration, tax management and legal drafting
Tel: +31 (0)20 638 0136
Email: geerten@michielse.com
www.center4taxation.org

Christian Michelson Institute (CMI), Norway
Conducts research on rights, democracy and development, the state, poverty reduction, and the public sector reform
Tel: +47 47 93 80 00
Email: cmi@cmi.no
www.cmi.no

Organisation of Economic Cooperation and Development (OECD), France
OECD Development Co-operation Directorate (DCD-DAC), Network on Governance. Works on taxation and accountability
Tel: +33 1 45 24 82 00
Email: nicholas.bray@oecd.org
www.oecd.org

Useful websites

Extractive Industries Transparency Initiative
www.eitransparency.org

International Tax Dialogue
www.itdweb.org

Kimberley Process
www.kimberleyprocess.com

Tax Justice Network
www.taxjustice.net

Task Force on Financial Integrity and Economic Development
www.financialtaskforce.org

UN Financing for Development Office
www.un.org/esa/ffd

SOMO Centre for Research on Multinational Corporations
http://somo.nl

Research cited

For a complete list and details of research cited in this briefing, see **www.panos.org.uk/taxmatters-researchcited**

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Cover image:
Hadjira in her grocery shop, Bangladesh. Research suggests that informal sector and small enterprise operators would be more willing to pay taxes if harassment by municipal officials was reduced and there was a simplified system of business registration and regulation.
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