

## Research Summary #1 - Taxation and the Political Agenda, North and South

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*This paper forms part of a five year research programme under the Centre for the Future State, based at the Institute of Development Studies. Below is a summary of principal findings. Further details are available at [www.ids.ac.uk/gdr/cfs/index.html](http://www.ids.ac.uk/gdr/cfs/index.html)*

### Introduction

The paper draws a contrast between countries in the 'North', where tax features prominently on the public political agenda; and countries in the 'South', where tax is much less prominent. In the South, pressure for fiscal responsibility comes mainly from external sources; and while spending issues are on the political agenda, tax is largely absent. The paper explores the reasons for this and suggests that recent changes in the fiscal environment in the South will encourage a higher degree of political mobilisation around tax. This will help raise the profile of taxation issues on public political agendas. The paper concludes that this is likely to contribute to better governance, and could enhance a progressive agenda.

### Why are Taxation Issues Absent from Public Political Agendas in the South?

In OECD countries, a great variety of interest groups represent taxpayers' interests, which are also espoused by political parties. Why do citizens in the South rarely mobilise as taxpayers? Four broad explanations are offered, all of which relate to the fiscal system and the fiscal environment. First is the low ratio of tax revenue to public expenditure. Unlike OECD countries which depend heavily on tax for revenue, many states in the South depend on unearned rents from oil, gas and minerals. They also have access to external military support and aid. This reduces the need for them to make demands on their citizens for tax, and so gives taxpayers less reason to mobilise. Secondly, governments in the South have long depended for revenue on relatively invisible, indirect taxes from trade and (more recently) from VAT. Direct taxes are levied on corporations, but there is very little direct taxation of personal incomes or wealth. Thirdly, much of the direct tax that is levied comes from a small number of large, corporate taxpayers. The taxation system is complex, changeable and highly discretionary in application. Companies therefore have strong incentives to negotiate with government on an individual basis rather than taking broader, collective action. Finally, historically high levels of inflation have deterred taxpayers from mobilising, since any gains are likely to be quickly eroded.

### Is the Situation Changing?

The paper suggests three broad reasons why this situation is likely to change and will affect taxpayer mobilisation. Firstly, over the long term, the price of oil has declined, and this is making it harder (especially in the Middle East) to sustain the previous political deal of acquiescence in authoritarian rule in exchange for high levels of welfare spending<sup>1</sup>. Secondly, changes in the fiscal environment may encourage mobilisation, including: (i) the spread of VAT (which is very visible to small businesses);

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<sup>1</sup> This argument is less compelling than when the article was written, in the light of recent increases in the price of oil.

(ii) simplification of tax systems following 'Washington Consensus' reforms, including reductions in trade taxes, fewer exemptions and less scope for political and bureaucratic discretion. This could reduce the attraction of trying to negotiate special deals; and (iii) reduced inflation due to a general shift in macro-economic policy. It is difficult to judge how far these changes in tax policy might encourage more broadly based, political mobilisation around tax. But the experience of negotiating a fiscal pact in Chile may illustrate the potential for this. Extended negotiation between a coalition government and organised interest groups produced broad support for increasing taxes and enhancing social spending. Special historical factors made this possible, including a widespread feeling that a 'social debt' was owing to the poor. But a supportive fiscal environment was also important, including simplification of the tax system, and low inflation. The Chilean case suggests that, to a greater extent than in European history, enhanced taxpayer activism is likely to be dominated by business rather than individual wealthy taxpayers. Finally, there is increasing political activism around budgetary transparency (for example participatory budgeting, as exemplified by the case of Porto Alegre in Brazil). This may provide evidence about waste and misuse of funds which could give ammunition to potential taxpayer activists.

### **Is Taxpayer Activism in the South a Positive Prospect?**

Does it matter that the taxpayer groups most likely to be able to organise and engage effectively with the state will be better off, more elite groups, including business? They will, of course, be self-interested, and are unlikely to be directly 'pro-poor' in orientation. The author nevertheless suggests that, given the history of state formation in the South, which has left states excessively powerful in relation to their citizens<sup>2</sup>, any political mobilisation around broad socio-economic interests is likely to be a good thing. It can contribute to more institutionalised and stable political competition, increasing the power of voters and putting policy issues more firmly on the political agenda. There is a natural affinity between taxpayer interests and effective oversight by the legislature over public spending. Without this, the prospects for establishing effective democratic governance are very limited. Historically in Western Europe, wealthy taxpayers played a critical role in forcing rulers to create representative institutions, and subsequently to force through public sector reform in the early Victorian era. Later, progressive groups provided support for the expansion of public welfare activities. While the situation in the contemporary South is different in many ways, there are enough similarities to make it worth exploring the progressive potential of politicised taxpayers.

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<sup>2</sup> See summary #2 "Revenues, State Formation and the Quality of Governance in Developing Countries"