Taxation perspectives

– a democratic approach to public finance

in developing countries

Seminar Report

Prepared by Ricardo Sabates and Aaron Schneider

Published by the Institute of Development Studies at the University of Sussex,
Brighton BN1 9RE, UK
Tel: +44 1273 678269; Fax: +44 1273 621202 / 691647
Email: publications@ids.ac.uk

ISBN 1 85864 480 1

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Introduction: Taxation, accountability, and capacity

The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases. He who knows how to listen to its messages here discerns the thunder of world history more clearly than anywhere else.

(Joseph Schumpeter 1918)

Taxation is central to our notions of democratic governance. There are those that associate taxation with accountability, largely drawing on an interpretation of Western European history in which monarchs ceded representation to finance their military efforts. Simultaneously, others associate taxation with state capacity, often referring to resource mobilisation for development or international competition. The net of relationships that links taxation, accountability, and capacity is complex, and as a result, we are often hard-pressed to make theoretical generalisations and policy prescriptions.

To begin, we must understand the defining characteristics of taxation. As a first cut, we consider taxes as opposed to the absence of taxes. The absence of taxes describes at least two kinds of state: first a state with low revenues in which few resources are mobilised for public purposes; second, low taxes may describe a state that depends on non-tax revenues, such as natural resource windfalls, "rents" – typically domainal revenues, and/or strategic boons from a particular geopolitical and historical position. These low tax states are qualitatively different from each other and from those states that depend on taxes, and we are curious to study the forms and degrees of governance associated with these distinctions. In addition, we wish to know the impact of more, rather than less, taxation. Do citizens that pay more to the state demand more in return? Does the kind of taxation matter? If the amount and kinds of taxation prompt citizen demands, what do citizens demand more of? Above all, we are interested in studying the way changes in taxation lead to (a) changes in the accountability of government, and (b) changes in state capacity to pursue public purposes.

The literature drawing on the Western European experience highlights the relationship between taxation and accountability. Briefly, the stylised story is that European monarchs seeking revenues to finance military competition ceded power to elite holders of wealth. This process generated a range of state-society relationships, and some of them were formalised in institutions of democratic accountability, such as parliaments. We seek to understand how bargaining over taxes changes state-society relations, in particular, who gets taxed and to whom the state is accountable. Do variations in taxation relate to the breadth of representation and the degree of democracy of institutions of accountability? Does the fiscal authority of these institutions vary with the nature and degree of taxation? How does this process proceed, and how long does it take? Is it an inevitable and one-way process, or can it be halted or reversed? For that matter, can purposive changes in taxation initiate the process?

Another set of literature has focused on taxation from the perspective of state capacity. A brief summary of the argued connection is that taxation captures under-utilised private surplus to mobilise resources toward development or international competition. If governments are able to secure a predictable and sufficient stream of revenues, other resources may also become available, such as those drawn from international capital markets. Of course, governments can only accomplish this task if there is an available surplus to extract and if they have some degree of autonomy from the private interests that control the surplus. Still, state actors must walk a fine line between securing enough wealth to finance public goods, and leaving enough in private hands to encourage investment. How do state actors gain the information and effectiveness that allows them to balance these potentially conflicting exigencies? Further, the twin goals of accountability and capacity raise their own potential conflicts. How do state actors pursue autonomous capacity to monitor and extract private surplus and, at the same time, create embedded institutions of accountability to negotiate and legitimise this extraction?

The literature dealing with these questions is rich but narrow. It has largely been of a technical nature and focused on the experience of developed countries. As a result, it has been relatively absent from most academic radar screens. We intend to bring taxation back in. To do so, we have joined the forces of three research teams. One team is based at the Institute of Development Studies in England; one is from the Chr. Michelsen Institute in Norway, and a third is from the Centre for Development Research in Denmark. The teams collaborated on an IDS *Bulletin* that was issued in June of 2002, and from 28 to 29 October, we gathered for two days of discussion with leading researchers on taxation from diverse regions and disciplines. The researchers had done research on developing countries in Africa, Asia, and Latin America; they hailed from nine different countries, and they were drawn from economics, political science, sociology, history, journalism, and development studies.

Our methodological aim was to democratise the study of public finance by taking it beyond the narrow and technical focus drawn from developed country experience. Our theoretical aim was to understand the links between taxation, accountability, and capacity. The immediate output of our gathering is this report, and spin-offs are planned in conference panels and an edited volume in the future. The structure of the report reflects the structure of the seminar. Each seminar session included several papers, the titles and abstracts of which follow. During each session, subsequent to the presentation of each paper, we also held a discussion. The highlights of that discussion are also included.

Theme 1: Taxation concepts and theory

i) Abstracts

Taxation Data as Indicators of State-Society Relations: Possibilities and Pitfalls in Cross-National Research
Evan Lieberman, Princeton University

This paper discusses key conceptual and measurement issues associated with the study of taxation in comparative perspective. First, it highlights the ways in which taxation has been studied as a rich and varied concept, including as a component of the state-building process, as a collective action problem, and/or as a problem of distributive justice. Second, the article identifies the central trade-offs associated with the construction of taxation indicators used to measure such ideas. It discusses considerations such as which forms of revenue should be included and which should not, whether and how to standardise taxation measures, and how to fine-tune measures through a clear specification of units, universes, and measurement calibration. These choices have important implications for the "scoring" of countries, and for making valid inferences about the relationship between states and societies.

Tax Policy in Developing Countries: What Can be Learned from the OECD Experience?
Christopher Heady, OECD

The purpose of this paper is to examine what developing countries should and should not learn about tax policy from the recent experience of OECD countries. This examination is composed of two parts: a discussion of whether developing countries would be wise to follow recent tax trends in OECD countries, and an analysis of the relevance of current tax policy debates for developing countries.

The general tax trends in OECD countries have been: (i) a reduction of personal and corporate income tax rates, accompanied by substantial base-broadening; (ii) an increase in social security contributions; (iii) a switch away from traditional sales and excise taxes towards VAT. The paper analyses the justification for, and consequences of, these trends and considers whether they apply to the different circumstances in many developing countries, in terms of both theory and practical experience.

As well as experiencing these trends, governments and citizens of OECD countries have been engaged in debates on a number of tax policy issues, including the desirability of environmentally-related taxes, the scope for increasing property taxes, the effect of the tax system on international trade and investment and the desirability of establishing special tax incentives for particular economic and social purposes. These are important issues for developing countries, and the paper considers what they should learn from these debates.

Two Public Finance Problems of Political Reform
John Toye, University of Oxford

At the end of the Cold War, a political reform agenda was added unexpectedly to the agenda of economic reforms which many developing countries initiated in the 1980s. This brief note points out two ways in which the demands of the political reform agenda conflict with the economic requirement for macroeconomic stabilisation. One conflict arises from the opportunistic behaviour of incumbents who face electoral contests. Recent research documents the existence of an electoral cycle in public savings, but interestingly one driven by variations in public expenditure rather than in tax revenue. The reasons for this choice remain unclear. The other conflict arises from fiscal decentralisation, which may also cause loss of budgetary control and higher inflation. Although more stringent testing of these potential conflicts is required, it is premature to conclude that political reform and sound public finance sit easily together, at least in the short and medium term.

ii) Highlights

- Taxation is a contested concept and this has an impact on the ways taxation is measured.
- State-society relations vary depending on the types of taxation being applied, for example, income taxes, customs taxes, and property taxes produce different state-society relations. Further, some of these taxes may be more corruptible than others.
- In order to study taxation, researchers and policy-makers should think about how taxes relate to politics. In particular, this calls for a new way of conceptualising and measuring taxes. Questions about the visibility, the degree of irritation, the degree of administrative difficulty, and the degree of interaction between state and society, must be added to our armoury of tax measures.
- Even our traditional measures of taxation deserve greater attention. Tax/GDP ratios are widely used to indicate governments' achievements in revenue collection. However, this is an imperfect proxy, usually affected by a number of factors such as the economic structure of the country, the size of the informal economy, and the degree of civic organisation of the country, among others. Attached to this issue is the question of whether the increase in tax/GDP ratio in OECD countries is due to improvements in tax administration and fewer options to evade taxes or to an increase in state-society interaction?
- This focuses us more directly on the politics of taxes. We can look at historical patterns in England, where it was the elite who voiced their concerns about taxation, not the masses. The groups that organise, and their organisational resources, influence the connections between taxation and representation and also the shape of the tax structures that emerge.
- It is important to remember, however, that conceptual and theoretical statements should not be taken for granted and applied to every country and in every circumstance. For example, the free-rider problem of who should pay for public goods may operate differently in late-developing countries in the current era. For example, individuals in East Asia may have a different connotation of public goods than individuals in Europe, hence understanding the relationship between state and society may go beyond the rational choice calculations which serve as a baseline for measuring taxation.

Theme 2: Taxation and accountability

i) Abstracts

Does Taxation Lead to Representation?
Michael Ross, University of California in Los Angeles

Are governments forced to democratise by their need for greater tax revenue? Most research on contemporary democratisation says little about the effects of taxation. Yet there are good reasons to believe that taxation led to representation in the past: representative government first came about in early modern Western Europe when monarchs were compelled to relinquish some of their authority to parliamentary institutions, in exchange for the ability to raise new taxes; similarly, the war for independence in the United States began as a rebellion against British taxes. Some scholars argue that a comparable process is occurring today, by which tax revolts are producing heightened demands for democracy. These claims have never been carefully tested. This paper explores the "taxation leads to representation" argument and tests it using pooled time series cross-national data from 113 countries between 1971 and 1997. It finds that one version of the argument appears to be valid, while another does not.

Accountability through Tax Reforms? The Case of sub-Saharan Africa
Lise Rakner, Chr. Michelsen Institute

Can improved revenue collection and tax policies provide for more democratically accountable government? There is a complex relationship between taxation and accountability in the context of tax reforms currently undertaken in a number of sub-Saharan African countries as part of larger structural adjustment programmes. In order to assess whether the tax reforms have provided a "governance bonus" in terms of greater responsiveness in state-society relations, we focus on three interrelated issues affecting the relationship between taxation and accountability. First, we consider the *internal accountability* of the tax system and ask whether the tax-reforms have resulted in a system of taxation with greater reach, and a higher level of efficiency and transparency. Second, we ask whether the tax reforms have created closer links between African governments and their citizens and thereby increased *democratic accountability*. Third, we discuss to what extent and in what ways *external accountability* relations between African governments and international donors affect domestic accountability relations.

ii) Highlights

- In thinking about the relationship to taxation, the concept of accountability requires further unpacking. Internal accountability related to tax administration differs from democratic accountability between state and citizens. In addition, external accountability refers to the relations between governments and donors.
- We must also consider whether the accountability sub-type, democratic accountability, requires formal institutional processes or could include informal representation and consultation. In Tanzania, for example, citizens ask the government about the uses of tax revenues in open forum. Still, democratic accountability appears to require certain administrative reforms that create closer links between state and society.
- We began with a mandate to study the link between taxation and accountability, which grows out of the early work of Schumpeter and Tilly. They focused on the long-term structural relationships between these two concepts. We also consider another possibility: that the relationship between these concepts occurs over a range of time periods, including very short ones.
- Most arguments suggest that taxation strengthens the relationship between states and societies. If this is true, it may open important avenues for improvements in developing countries, where (a) the state has limited ability to collect taxes and (b) the accountability of governments has been severely lacking.
- There are number of relationships between state and society that are articulated through taxation. One possibility is that relationships are mediated by an "anti-tax model", in which individuals seek to minimise taxes. Alternatively, there is the "exchange model", in which individuals consider the relationship between taxes paid and services provided. A third possibility is that people operate on a "more-for-less model," in which citizens want both better services and lower taxes.
- In the analysis of the relationship between taxation and accountability, we must not forget issues of inequality and power. There are governments that are accountable, but to whom are they accountable? Is it enough to be accountable to taxpayer associations or powerful economic interests? How can taxation and tax administration be made accountable to the poor?
- This issue is especially important in developing countries, where donors are often the major source of revenues. In terms of conditions associated with taxation, donors usually focus on increasing the tax/GDP ratio, lowering trade taxes, simplifying tax structures, etc. The failure to differentiate across contexts, and ignoring accountability, may have long-term deteriorating impacts for the country.
- To whom the state is accountable brings additional considerations with respect to state capacity. Accountability to narrow groups can mean capture, exemptions, and allowing powerful actors to escape the tax net. Alternatively, accountability to a variety of interests, especially those that favour public action and redistribution, may counterbalance powerful groups and expand state capacity to collect taxes. Further, accountability mechanisms that expand state legitimacy may enhance both popular willingness to pay taxes and state ability to call on popular contributions.

Theme 3: Taxation and intergovernmental finance

i) Abstracts

Decentralisation and Local Revenue in Africa
James Wunsch, Creighton University

During the last 15 years, many African states have pursued substantial decentralisation reforms. These reforms sought to strengthen locally accountable political entities as mechanisms to deliver services and to encourage local development. However, the cost of such goals, as well as the goal of enhancing local accountability, requires that local revenue raising capacity be substantially enhanced. The paper explores two theories explaining revenue performance at localities in seven African states which have engaged in significant decentralisation, one focusing on local resources and the other on local institutions and incentive structures. Data used was gathered by the author in fieldwork, and by secondary analysis of other research. The paper finds neither model explains the variance in a simple way, but once the impact of national grants-in-aid is taken, each does fit the data. The institutional incentives model is the closer fit of the two. The paper concludes that there is evidence that attention to these factors can lead to greater levels of revenue raised locally. In broader theoretical issues, it suggests that while the "taxes lead to democracy" thesis has some empirical validation, also a thesis that suggests that democracy leads to a willingness to pay more taxes has evidence to suggest that further attention to it is warranted.

Implementing Property Taxation Policies in Developing Countries: A Stakeholder Analysis
Bamidele Olowu, Institute of Social Studies

For a variety of reasons, many developing countries have embarked on programmes of democratic decentralisation. The literature suggests that sources of independent local government revenue are few in poor countries. As a result, most countries design decentralisation programmes that depend heavily on intergovernmental transfers from national to local governments. The problem is that many central governments are engulfed in a systemic financial crisis and are desperately exploring strategies for reducing their expenditure commitments. Many analysts view this development as fatally aggravating the problem of urban/local governance. This paper suggests a different and more positive view. It reviews the literature that concedes that property taxation remains largely untapped and might be progressive in developing countries. The paper undertakes an analysis of the key stakeholders in implementing successful property taxation policies based on research conducted in four countries – India, Nigeria, Republic of South Africa and Zimbabwe – in the early 1990s. The paper suggests that willingness, opportunity and capacity remain critical factors, and demonstrates how opposition to the tax can be overcome by partnerships between central and local governments, public and private, and domestic and external factors.

Degrees of Decentralisation and Tax Takes: A Political Approach to the Leviathan Hypothesis
Aaron Schneider, Institute of Development Studies

This paper studies patterns of decentralisation and tax capacity in 68 countries in 1996. Seven indicators of decentralisation clustered around fiscal, administrative, and political dimensions, and these dimensions had independent and surprising relationships with tax capacity. First, politically decentralised regimes taxed less. Second, administrative and fiscal decentralisation showed no systematic relationships to tax capacity.

This study offers some unique policy advice to those interested in the efficiency gains of administrative decentralisation: the greatest possible gains may be accessible by centralising on the political dimension while decentralising on the other dimensions. On a more abstract level, the negative association between political decentralisation and tax capacity suggests a need to look deeper into the way political decentralisation influences state-society interactions and the ability of political interests to advance demands.

ii) Highlights

- Many developing countries are moving from highly centralised to decentralised regimes. This underscores the case for a greater emphasis on local government and taxation. Still, far too little is understood about (a) the difference between centralised and decentralised regimes, and (b) local government institutions versus national government institutions.
- There appears to be empirical evidence that political decentralisation leads to less tax capacity. One way to understand this result is that local elites use their political influence to decrease taxation, writ large. Of course, even as they lower overall tax capacity, they may actually be more willing to pay local taxes, where they are paying only for services in their immediate community and to authorities that they can influence.
- This is consistent with the results of the other studies, which showed that individual local jurisdictions were able to mobilise a wide range of resources. Increasingly, individuals make contributions for services, contribute to informal user-committees, or pay user-fees. The actual amount that people pay for services at the local level may not be recorded in national (or even local) tax statistics, and informal mechanisms may be especially important where the institutions of formal authority are weak.
- The formal structures of governance at the local level are different than those for the central government. We must look at these two sets of government structures to discern whether there are differences in their dynamics, operations, and relations.
- South Africa presents a curious example. There, strong national parties and strong party discipline operate to centralise politics and determine the tax decisions taken even at the local level.
- Other countries, like Tanzania, offer a different dynamic. There, the important problem when considering local taxation is the lack of harmonisation between central and local revenue authorities. Among other problems, this can lead to double taxation and inconsistency of tax policies, for example local taxes on products promoted for export by national policies.
- The intergovernmental story entails further complexities. The mechanisms for transferring funds between central and local governments can determine local government tax behaviour and overall tax outcomes. Transfers can be block grants, matching grants, conditional grants, or ear-marked grants. Each is likely to send different messages and create different incentives.
- It is also important to analyse the intergovernmental politics of setting taxes. Actors in the central government may seek to adjust the rate of local taxes to decrease the political relevance of actors powerful at the local level.
- In considering local governments, there are important methodological issues to keep in mind. The size of local jurisdictions may vary across and within countries; also, urban jurisdictions may be qualitatively different from rural ones. This second issue is increasingly important as many developing countries rapidly urbanise. These issues raise substantive implications for tax collection and administration, and methodological issues for comparison.

Theme 4: The politics of taxation policy

i) Abstracts

The Politics of Federalism in Brazil: The Role of Governors in the Brazilian Congress
José Antonio Cheibub, Yale University

Part of Brazil's problems of governability, it is widely believed, stem from the fact that national legislators respond to state or local rather than to partisan or national pressures. Governors are said to strongly influence national decisions because of the control they exert over their states' legislative delegations. In this paper we investigate the empirical validity of this view. We first examine legislative behaviour through roll call votes in the Brazilian Lower House on a set of measures that redefined the federalist pact established in 1988 in favour of the central government (such as the creation of new and the reform of old taxes, the curbing of the states' fiscal autonomy and the transfer of policy responsibilities to the states and municipalities). We then examine the impact of political and partisan variables on the distribution of the federal investment budget to the states. We show that Brazilian legislators do not behave any differently when they vote on measures that are likely to generate a clash between governors and the central government. We also show that even though governors do matter for the allocation of budgetary funds to the states, this is due not to their institutional position, but to their political and partisan identity. We conclude the paper with a discussion of the mechanisms that explain the ability of the central government to change the federal status quo in an environment that is, at the surface, completely hostile to any changes.

Taxation and Revenue Reform in Conflict-Affected Countries
Tony Addison, World Institute for Development Economics Research (UNU/WIDER)

Conflict has fiscal dimensions: who gets what (public spending) and who pays for it (taxation) may play a role in the descent into conflict. Once violent conflict has begun, public revenues usually fall to very low levels, and there is a robust negative relationship between tax revenues and measures of conflict, including its intensity. Rebuilding the rules of the game, and people's respect for them (the social contract) is necessary for peace. Whatever form the new rules take, they will invariably have a fiscal dimension; people will expect some new (often radically different) distribution of services and infrastructure. This must be financed and therefore revenue mobilisation, including some measure of political agreement on its incidence, is essential. Aid can reduce the trade-offs and buy time, but if political actors delay action then they store up trouble for the future when aid to reconstruction tails off. Above all, revenue mobilisation must be used to achieve a recovery that is *broad-based* in its benefits and not one simply confined to a narrow segment of society. However, revenue reforms that threaten elite interests may stumble: therefore building a functioning democracy that represents the interests of the majority is crucial to the effectiveness of any reform that aims to achieve a broad-based recovery from war. The paper concludes that reducing the intensity of conflict has a positive pay-off for revenue mobilisation and increases the effectiveness of donor assistance.

Viability of Developing Democratic Legal Frameworks for Taxation in Developing Countries
Florens Luoga, University of Dar es Salaam

Taxation is an indispensable lever for securing effective democratisation in developing countries. This function of taxation cannot be achieved if tax reforms, which are undertaken as part of market reforms and good governance, neglect to address the democratisation of legal frameworks for taxation. The paper attempts to highlight the pitfalls of tax reforms undertaken within undemocratic legal frameworks, suggests basic principles required to sustain democratic legal frameworks for taxation, and assesses their viability by examining the experiences in the changing socio-politico and economic relations in Tanzania.

ii) Highlights

- The politics of taxation focused on the issue of state capacity. A capable state is one that has both autonomous authority and embeddedness in society. Achieving embeddedness is a politically complicated task requiring a social contract between actors in civil society and the state.
- Creating this social contract is not easy, however, and states go about it in different ways. Political fragmentation or volatility, for example, may complicate the task of creating a social contract. In Brazil, tax reform required acquiescence within Congress. Presidents sought legislative coalitions, especially among delegates from states in which the governor was a partisan ally of the president. As a result, the tax structure had to respond to regional and partisan concerns, and perhaps excluded those interests that were not represented in the legislature or part of the governing coalition.
- This points to questions about who has to be included for a social contract to be sustainable. The actors who are party to the contract both provide the embeddedness the state requires and also have a say in what the tax structure looks like. To achieve an equitable and efficient tax structure, a social contract may have to include far more actors than are normally included in political processes in developing countries.
- The difficulty of forging a social contract to underpin a tax structure is particularly difficult in conditions of conflict. In past eras, conflict served as a selection process by which only the capable states survived. Now, global norms allow states with low capacity to survive, even as they fail to maintain a monopoly on the use of force within their territories.
- Still, conflict depletes the capacity of the state, at the very least by closing portions of the territory to state extraction. To regain this capacity, and to penetrate society, the end of conflict is a starting point, but not sufficient. Once again, a social contract is key. Those who were involved in conflict will require access to any new institutions that join state and society, and peace often requires negotiation over tax structures and shares of future tax revenues.
- Natural resources can provide a boon to solidify post-conflict social contracts, yet forming such a social contract requires that peace provides greater dividends to combatants than war.
- Of course, it would be wrong to infer individuals' incentives by simply looking at a specific set of institutions. To understand behaviour, one also has to understand the system as a whole. This includes the principle and norms that underlie both tax systems and social contracts.
- Legal structures both express and formalise these norms and principles. Norms such as equal taxation of equals, ability to pay, and rights to redress are basic norms that can be codified in law. The legality of taxation itself is important, as it implies the democratic and legislative creation and maintenance of tax structures. This in itself confers legitimacy.
- It is important to remember, however, that legitimacy is conceptually different from popularity. With respect to taxation, legitimacy refers to a more far-reaching culture of compliance. A tax regime's degree of legitimacy may be affected by narrow policy changes, such as eliminating certain kinds of taxes and imposing others. The recent trend to eliminate trade taxes and impose VAT has not been examined in this light. Perhaps we should consider policies of income distribution and equity within tax regimes as a means to influence taxpayers' perceptions of government legitimacy.

Theme 5: Revenue authorities in Africa

i) Abstracts

Controlling Fiscal Corruption: Lessons from the Tanzania Revenue Authority
Odd-Helge Fjeldstad, Chr. Michelsen Institute

Over the last decade several African countries have undertaken comprehensive reforms of their tax administration to increase revenue and curb corruption. This paper examines recent experiences in the fight against corruption in the Tanzania Revenue Authority. Two lessons of broader relevance are highlighted. Firstly, even with relatively high wages and good working conditions, corruption may continue to thrive. In a situation where there is high demand for corrupt services, it is unrealistic to provide tax officers with pay rates that can compensate for the amount gained through bribery. Without extensive and effective monitoring, wage increases may produce a highly paid but also highly corrupt tax administration. Secondly, hiring and firing procedures may lead to more corruption. Corrupt tax officers often operate in networks, which also include external actors. These corruption networks seem to have been strengthened because many of those fired were recruited to the private sector as "tax experts". This partly explains why the positive process experienced in the initial phase of the new revenue authority was later reversed.

Riding the High Wave: Is South Africa's High Revenue Collection Sustainable?
Dumisani Hlophe, Centre for Policy Studies

Taxation is one of the issues where the South African democratisation process seems to be performing remarkably well. In the last two years in particular, 2000/2001 and 2001/2002, The South African Revenue Services has recorded an increased revenue collection. However, this appears to be a general trend whenever there is an institutional transformation of the tax administration. Usually this is followed by a period of stagnation and ultimately a slump. The Ugandan Revenue Authority is a case in point. This paper attempts to establish the sustainability of the current high levels of tax collection in South Africa. It draws upon two central pillars in the taxation discourse: legitimacy and institutional capacity. The paper poses some questions on the official version that tax collections are high. And that, whilst the current levels of taxation may be sustained, that may be based on many other reasons than the state legitimacy in the perception of the citizenry.

Taxation and Bureaucracy: The Case of the South African Revenue Service (SARS) in South Africa
Leslie Dikeni, Centre for Policy Studies
Verbal presentation.

ii) Highlights

- The discussion of revenue authorities raises various dimensions of tax regimes. These dimensions included corruption, evasion, tax resistance, administration, and legitimacy. Institutional and structural factors of the tax authorities play an important role in how countries score on these dimensions. A current trend to create independent revenue authorities has produced varied results, even at this early date.
- One has to ask, however, if it is reasonable to expect that semi-autonomous revenue authorities, like those in Uganda, Tanzania and Zambia, can operate completely autonomously from highly politicised settings. Political and economic elites will continue to seek interventions, and access to tax administration will continue to play a role in political competition.
- Still, tax collection appeared to increase in many sub-Saharan African countries after administrative reforms. Possible explanations include a rise in voluntary compliance, efficient and cohesive tax administration, and greater autonomy from powerful interests, among others. Understanding temporary or lasting rises in tax collection may contain valuable information about the relationship between taxation and accountability.
- In South Africa, taxation is viewed as an administrative matter, specifically getting neutral institutions in place to undertake the managerial tasks of collecting taxes.
- At the same time, there appears to be a differentiated process of legitimising taxation in South Africa. The appeal to white citizens is to "*contribute according to the norms of compliance and morality*". This differs from the appeal to black citizens based on "*contribute to our new democracy; this is our state*". The inherited institutions and practices of prior periods significantly shapes the ways in which people approach taxes.
- Tanzania and Uganda, by contrast, may not be tax states in the same way. A significant portion of their revenues comes from non-tax sources, and the basis of government legitimacy is drawn from a different cultural legacy.
- In sum, the cultural legacy that defines government legitimacy deserves greater attention, as it varies by state. Standard measures to tackle corruption and increase tax revenues, such as independent revenue authorities and higher wages for public servants, will fail to achieve their goals unless there is a clear understanding of these cultural legacies. In addition, it is possible that there is a generational dimension to current corruption levels, in which the discipline and compliance of early nationhood has given way to more venal practices.
- There may also be structural conditions that influence the effectiveness of tax administration. For example, rapid urbanisation may be correlated with an increase in production in the formal sector, which can ease administration and increase the tax/GDP ratio. On the other hand, large metropolitan areas concentrate large informal sector activities and complicate administration.

Theme 6: The tax state

i) Abstracts

Taxes, Consultation, Accountability and Democracy in Export Led Economies
Carmenza Gallo, Queens College

This paper examines the role of taxation in promoting formal and informal consultation and representation. It argues that, in the case of taxation of exports in export-dependant economies, taxation leads to several formal and informal political practices that involve consultation and various types of representation. These political practices depend on the relative power of both states and taxed groups, on the changing international economic conditions under which taxed resources are produced, and on previous institutions. The paper examines taxation in Chile from 1880 to 1930. While consultation and "particularistic representation" were indeed outcomes of the economic interdependence of state authorities and taxed groups, the continuity of such political practices was contingent on international conditions that were out of the direct control of either the state or the taxed groups. The role of taxation in generating consultation and representation was temporary and limited, and had ambiguous consequences on democracy.

Contingent Capacity: The Politics of Revenue Institutions
Deborah Brautigam, American University

How does a democratic tax state develop? Research on the rise of the tax state in Europe suggests that war and revenue-raising were intimately connected in Europe's history. However, in the former colonies of the European powers, no such relationship existed. This paper suggests that understanding the development of a democratic tax state in the developing world may require a closer look at its colonial origins. This is not a new idea; the colonial origins of institutions has been a theme in studies of democracy and in the relative quality of infrastructure and education. Using archival research to explore the case of Mauritius, a relatively successful democratic tax state, the paper shows how formal and informal institutions – including bureaucratic capacity, a hard budget constraint, and the link between fiscal accountability and representation – were established relatively early in the colonial period, and shaped the ability of independent Mauritius to match revenues with expenditures.

ii) Highlights

- The concept of a tax state entails more than the identifying the major source of revenues. It also includes a syndrome of characteristics including administrative capacity to penetrate society and extract resources, a formalised and functioning market-economy, and political legitimacy rooted in mechanisms of accountability between state and society. The question at stake here is how countries that are not tax states can develop a set of institutions that will serve as a base of legitimacy and move them towards the tax state ideal type.
- Traditional thinking viewed good policies as sufficient to promote the tax state. More recent research goes to the source of policies, and suggests that institutions produce both good policies and also form part of the tax state. The range of institutions is wide, however, and tax states include both formal and informal institutions and norms. For example, an informal norm is citizens' willingness to pay taxes whereas a formal norm is the enforcement mechanism of tax payments.
- Historical trajectories play a role in defining institutions, which often follow path dependent patterns. As a result, one must trace current institutions backward over time to understand how they operate. The relevant period of time is unclear, however. Institutional legacies develop only over long periods while medium-term policy changes may alter path dependence.
- Time also plays a role in tax capacity. Governments learn over time how best to tax citizens. The state learns to raise taxes; the bureaucracy learns to administer them; and the taxpayer learns to contribute. Of course, it is possible that over time "forgetting" occurs. Such might be the case if taxation is lowered suddenly and capacity to extract is not renewed.
- The causal relationship between extraction and the democratic tax state is complex. Taxation is powerfully connected to consultation, representation, and state capacity. Still, the connection is not automatic. In Latin America representation came first, and tax capacity remained low. By contrast, in East Asia, tax capacity grew early, while representation only came later.
- The link between taxation and democracy remains unclear. Consultative institutions allow the state and taxed groups to informally bargain and negotiate policy, and do not require democracy. Representative institutions are more formalised though even representation can occur in the absence of democracy. Thus, although consultation and representation may be necessary for democracy, they are not sufficient, nor do they always result in democracy.
- Taxation and state capacity have an even murkier connection. For example, economists tend to distinguish between tax capacity and tax effort. The former deals with the ability to raise absolute tax levels, whereas the latter deals with the ability to raise tax levels in comparison to other sources of revenue.
- The relationship between tax levels and overall economic activity raises additional considerations. It takes economic resources to improve the tax administration, yet the balance between financing an administration and stifling an economy is tenuous. Increasing long-term tax capacity may not always imply raising tax levels. The question however, is how to lower current taxes in ways that generate higher future ones.
- This brings up the issue of aid and the tax state. Countries that did not inherit capable institutions from earlier periods may find it especially difficult to "grow" them if they are dependant on aid. Aid donors may be unable to encourage the growth of domestic institutions, and it could be better that the ownership of the institutional change comes from inside the country.

Theme 7: Taxation, accountability, and capacity in developing countries

Traditional approaches to taxation are unsuited to the developing country context. One limitation, in general, is that politics of taxation are different in poorer countries. Second, governments in less developed countries have limited choices about tax policies. Lastly, there are very important questions about the links between taxation and the construction of state-society relations in late developing countries. When we refocus our attention on the specific issues facing developing countries, structural, historical, and political factors come to the fore.

Generally, in most OECD countries the distributional politics of expenditures and taxation are an important part of day-to-day political debate, and governments try to use fiscal policy to persuade voters in various ways. This is not always the case in developing countries, where much of the population is outside the tax net and tax systems are often cumbersome and complex. Expenditures are perhaps more malleable and subject to public scrutiny, but neither tax nor expenditure issues have generated sufficiently accountable institutions in developing countries.

One reason why tax policy debates rarely exist in developing countries is the influence of external actors. Donors, lenders, and international investors often have significant weight over developing country tax decisions. Much of tax policy debate and decision-making takes place outside national borders, and this undermines the discussion that occurs among local tax experts and citizens. One particular result may be to eliminate perfectly reasonable policy options. Property tax, for example, has been politically taboo in developed countries, but it may be an important, progressive, and under-utilised source of revenue in developing countries.

i) Highlights

- We have primarily been interested in whether taxation generates long-term changes in institutions of accountability. Different comparisons can be made to examine this relationship: (a) comparison of the tax state versus the non-tax state; (b) comparisons between low tax and high tax regimes; and (c) the dynamic changes in citizen attitudes related to long-run changes in institutions.
- The relationship between taxation and accountability assumes behaviour and incentives facing the state. We should be asking why state actors would be willing to make the concession of offering institutions of accountability. In what circumstances will governments cede representative institutions in return for tax resources?
- One circumstance in which this calculation would make sense is if accountability actually increases tax capacity. According to many analyses of Western political development, mechanisms of accountability were introduced precisely to expand state capacity to finance military enterprise. The types of accountability granted, the groups incorporated, and the social contract that emerged were defined by a more capable state that could extract more wealth in its efforts to manage itself and to compete with other states. In fact, those states that did not expand capacity were doomed to disappear.
- We should also examine these processes from the perspective of citizens. Advancing demands of accountability is risky and requires collective action. Episodes of such collective action in developing countries exist, but they are rare. Under what conditions will citizens organise to demand accountability? It is possible that certain configurations of existing institutions create the possibility to organise demands for further accountability.
- Not all mechanisms of accountability are democratic, of course. Democratic accountability is a special type of accountability in which decision-makers can be removed by electoral procedures.

Formal democratic institutions may not develop and informal accountability can persist. Questions remain, however, about whether informal institutions are sufficient without formal mechanisms that enforce contracts and lower transaction costs.

- In tracing the rise of formal and open institutions, one possibility is that informal accountability to a specific group grows into universal accountability to all. The sequence might follow stages, in which government extracts from one group, prompts a reaction, and is forced to open an informal consultative process. The resulting discussion generates a formal rule that survives as law. Eventually, organisation around that law extends it to the status of a right, and we can speak of universal accountability.
- This raises the broader issue of rights. The way in which taxes are extracted depends critically on taxpayer rights. Rights to appeal and protection from arbitrary extraction require a developed system of accountability within taxation, backed by a functioning judicial system.
- For the tax state to function, it must be able to apply these rights universally, without risk of capture by one interest or another. This challenge calls for unpacking the idea of the state along more dimensions. The central-local distinction discussed above is a start, but clearly different branches and capacities of the state are also important.
- The need to remain autonomous from powerful interests is particularly difficult in developing countries. Several African countries have established revenue authorities meant to be autonomous from political processes. Still, for them to be held to universal standards of accountability and legality they must also be connected to political processes.
- The nature of late development brings up complicated additional issues with regard to accountability and autonomy. Historically, Western European states had to negotiate extraction from national holders of capital. Late developers, by contrast, have to negotiate extraction with extremely mobile multinational capital. This dynamic may create wholly different considerations when it comes to the relationship between taxation, accountability, and capacity.
- It may also be the case that late developers have followed a different trajectory and faced higher hurdles. Early developers transited from pre-tax states to tax states, raising enough through taxes to provide a predictable stream of revenues. This predictable revenue stream made them credible borrowers from international capital markets, and they could transit from tax states to fiscal states – they financed themselves through a combination of taxes and reasonable loans.
- Late developers, by contrast, started farther behind in terms of their predictable revenue streams, and they transited very early to dependence on loans. As a result, they pay much more dearly to borrow on international capital markets and they have never developed tax capacity.

Appendices

Participant Biographies

Tony Addison is Deputy Director of the World Institute for Development Economics Research (WIDER) of the United Nations University, located in Helsinki. He was previously director of the programme in Quantitative Development Economics at the University of Warwick, UK, and has been on the economics faculties of the universities of Warwick and London (School of Oriental and African Studies). He has also been a research fellow at the Overseas Development Institute (ODI), London, and has acted as consultant for Department for International Development (DFID), International Labour Organisation (ILO), United Nations Children's Fund (UNICEF) and the World Bank. He began his career as an economist (ODI Fellow) in Tanzania's Ministry of Trade and Industries. His current interests are in reconstruction from conflict (his book *From Conflict to Recovery in Africa* will be published by Oxford University Press in 2003), as well as macroeconomic policy in low-income countries. He has also published in the *Journal of African Economies*, *Journal of Development Economics*, *Journal of International Development*, *Journal of Peace Research*, and *World Development.*

David Bevan studied economics at Cambridge. Since 1975 he has been a Fellow of St John's College, Oxford, and is one of the founders of the Centre for the Study of African Economies. His main research interests are in the fields of public economics and macroeconomic policy analysis and his research includes studies of Ethiopia, Indonesia, Kenya, Nigeria, Tanzania, Uganda and Zambia. Publications include *Peasants and Governments* (1989) and *Controlled Open Economies* (1990), both published by Clarendon Press and co-authored with Paul Collier and Jan Willem Gunning.

Dr Deborah Brautigam is an Associate Professor in the International Development Programme at American University's School of International Service in Washington, D.C. Her book, *Chinese Aid and African Development: Exporting Green Revolution*, was published in 1998, and she is also the author of a monograph *Aid Dependence and Governance* (2000) and numerous book chapters and articles in *Comparative Politics, World Development, Journal of Modern African Studies, Current History* and other political science and development journals. Her current research, supported by a Fulbright Senior Research Award and a resident fellowship at the Woodrow Wilson International Center for Scholars, focuses on small developing states and globalisation, highlighting the case of Mauritius in comparative perspective.

José Antonio Cheibub received his PhD in 1994 from the University of Chicago. His research and teaching interests are in comparative politics, political economy, democratic institutions and Latin American politics. He is co-author of *Democracy and Development: Political Institutions and Material Well-Being in the World, 1950–1990* (Cambridge University Press, 2000, winner of the 2001 Woodrow Wilson Foundation Award given by the America Political Science Association for the best book published in the United States on government, politics or international affairs). He has published in several edited volumes and in journals such as *World Politics, Comparative Political Studies, Politics and Society, Journal of Democracy* and *Studies in Comparative International Development.* His current research includes a study of the institutions of democratic stability, and a study of the relationship among economic performance, elections and alternation in power in democratic regimes.

Leslie Dikeni is a Senior Researcher at the Centre for Policy Studies, South Africa. He is an urban sociologist and social researcher, specialising in globalisation and public administration (bureaucracies).

Odd-Helge Fjeldstad is an Economist and Senior Research fellow at Chr. Michelsen Institute (CMI), Bergen, Norway. His research interests are public finance, tax reforms, fiscal decentralisation and corruption. His working experience is mainly from Eastern and Southern Africa, particularly Namibia, South Africa, Tanzania, Uganda and Zambia, and the Middle East (Palestine). He is coordinating CMI's programme on 'Corruption and reform' and the research programme 'Taxation, aid and democracy'. His recent publications include 'Taxation, coercion and donors. Local government tax enforcement in Tanzania' in *The Journal of Modern African Studies* (2001); 'Why people pay taxes: the case of the development levy in Tanzania' (with Joseph Semboja) in *World Development* (2001); and 'Fiscal corruption: a vice or a virtue?' (with Bertil Tungodden) in *World Development* (2003, forthcoming).

Steven Friedman is Senior Research Fellow at the Centre for Policy Studies, an independent policy research institute based in Johannesburg, South Africa. He is also co-convenor of the 'Resourcing the State' component of the IDS Development Research Centre on the Future State, which seeks to understand the sociology of taxation in the South. His current research interests centre primarily on the relationship between inequality and democracy in the South. He is the author of a book on the South African trade union movement and editor of two studies of South Africa's negotiated transition from apartheid.

Carmenza Gallo is an Associate Professor of Sociology at Queens College and The Graduate Center of the City University of New York. Her publications include *Tax and State Power: Political Instability in Bolivia 1900–1950*. She is working on taxation and citizenship and on political identities.

Christopher Heady is an economist and currently Head of Tax Policy and Statistics at the OECD. Before joining OECD, he was Professor of Applied Economics at the University of Bath after holding academic positions at Yale University and University College London. He has written widely on the economics of developing countries and on public finance, frequently combining the two. He has also provided tax policy advice in China, the Czech Republic, the Slovak Republic and Pakistan.

Dumisani Hlophe is the Executive of International Liaison at the South African Independent Electoral Commission (IEC). He has been researching and writing on Taxation and Democracy in South Africa from the time he worked at the Centre for Policy Studies (CPS) as a senior researcher. Until his departure from CPS, he was the Project Manager of the taxation programme.

Evan Lieberman is Assistant Professor of Politics at Princeton University, where he specialises in the study of comparative politics in developing countries. He is the author of *Race and Regionalism in the Politics of Taxation in Brazil and South Africa* (forthcoming, Cambridge University Press), and articles on causal inference in historical institutional analysis, citizen attitudes towards fiscal responsibilities in South Africa, conceptual analysis, and other topics. He was a Fulbright fellow in South Africa in 1997–8, a Robert Wood Johnson policy scholar at Yale University in 2000–2, and has received funding from the Social

Science Research Council, the National Science Foundation, and the Macarthur Foundation. In 2002, he won the American Political Science Association's Gabriel A. Almond award for best dissertation in the field of comparative politics, and the Mary Parker Follett award for the best article or book chapter that year.

Florens Luoga is Senior Lecturer in Law, Faculty of Law, University of Dar es Salaam and Principal Partner, FK Law Chambers, Dar es Salaam, Tanzania.

Mick Moore is Professorial Fellow at the Institute of Development Studies, University of Sussex. He was Visiting Professor at Massachusetts Institute of Technology (MIT) from September 1994 to December 1995. During 1996–2000 he was convenor of two large research programmes on poverty located at the IDS. He is now Director of the Centre for the Future State at IDS. He has extensive field research experience in Asia, and is the author of two books and numerous book chapters and articles on the political and institutional dimensions of economic policy and performance in developing countries, anti-poverty policy, and governance in "the South".

Bamidele Olowu was formerly Professor of Public Administration and Local Government, Obafemi Awolowo University, Ile-Ife, Nigeria (1991–1996) and, adviser on governance and capacity building at the United Nations Economic Commission for Africa (1995–1998). He currently teaches at the Institute of Social Studies, The Hague, Netherlands where he serves as the Convenor of the Public Policy and Administration programme. His recent publications have included *African Perspectives on Governance* (2000, edited with Goran Hyden and Okoth-Ogendo, Africa World Press), *Better Governance and Public Policy* (2002, edited with S. Sako, Kumarian Press) and *Local Governance and Democratic Decentralization in Africa* (2003, co-authored with J. Wunsch, Lynne Rienner) – besides many other articles, books and monographs. He led major research into property taxation in developing countries with a grant from the (Canadian) International Development Research Centre in the early 1990s.

Lise Rakner is a Senior Research Fellow at the Chr. Michelsen Institute in Bergen, Norway. She holds a PhD in Political Science. Thematically her work has focused on issues of democratisation and human rights, economic reform, taxation, institutional change, and international aid. Currently she is involved in research collaboration with the Danish Centre for Development Research on Taxation, Aid and Democracy in Uganda, Namibia and Tanzania. She also collaborates with the Department of Comparative Politics, University of Bergen, on research on political institutions in Africa.

Michael Ross received his PhD in Politics from Princeton University in 1996. From 1996 to 2001 he was an Assistant Professor in the Political Science Department at the University of Michigan, Ann Arbor. He also spent the 2000 calendar year as a Visiting Scholar at the World Bank in Washington, D.C., and Jakarta, Indonesia. Most of his research has to do with political economy, natural resources, and the problems of developing states – particularly (but not exclusively) in Southeast Asia.

His main project at the moment is a book on the "resource curse", that explains why countries with lots of natural resource wealth tend to do worse than countries with less.

Ricardo Sabates has recently completed his PhD in Development Economics at the University of Wisconsin-Madison. His main research has been on migration and urbanisation in Mexico. He will work full-time as a Quantitative Social Scientist at the Institute of Education, University of London.

Aaron Schneider is a Research Fellow at the Institute of Development Studies at the University of Sussex where he specialises in federalism, party systems, and public finance. He is currently conducting research for the Centre for the Future State on Brazil and India, and has written on decentralisation, social policy, and political parties in Brazil, as well as other topics. He is the author of *Federalism Against Markets: Local Politics and Fiscal Adjustment in Brazilian States*, PhD U.C. Berkeley, 2001.

Ole Therkildsen is a Senior Research Fellow at the Centre for Development Research, Copenhagen. He has done research and published on public sector reform, decentralisation and service provision since the early 1990s, and on issues of taxation since 1998 – mainly in East Africa. He is a member of the Taxation, Aid Democracy Research Programme details of which can be found on www.cdr.dk

John Toye was educated at Cambridge, Harvard and London. He has served in the UK Treasury and as a Director of United Nations Conference on Trade and Development (UNCTAD). He has held professorial appointments at the Universities of Wales, Sussex and Oxford. He was Director of the Institute of Development Studies between 1987 and 1997.

Professor James Wunsch holds a PhD in Political Science and African Studies from Indiana University. He is currently Professor of Political Science and African Studies at Creighton University in Omaha Nebraska, where he is also Head of Department. His research has focused on democratic reform, decentralisation, local governance and field administration in Africa, with an emphasis on Ghana, Nigeria and Uganda. He has also done fieldwork in Thailand and the Philippines. His current publications include *Local Governance in Africa: The Challenge of Democratic Decentralisation* (2003, Rienner).

CENTRE FOR THE
FUTURE STATE

Taxation perspectives: a democratic approach to public finance in developing countries

Agenda

IDS Seminar 28 October 9.30 am – 29 October 3.30 pm

Monday 28 October

9.30–10.00 **Registration**

10.00–11.20 **Panel 1**
Taxation concepts and theory

- Evan Lieberman (Princeton University), '*Taxation Data as Indicators of State-Society Relations: Possibilities and Pitfalls in Cross-National Research*'
- John Toye (University of Oxford), '*Two Public Finance Problems of Political Reform*'
- Christopher Heady (OECD), '*Tax Policy in Developing Countries: What Can be Learned from the OECD Experience?'*

Discussant: Mick Moore (Institute of Development Studies)

11.20–11.40 ***Coffee***

11.40–1.00 **Panel 2**
Taxation and accountability

- Michael Ross (University of California in Los Angeles), '*Does Taxation Lead to Representation?'*
- Lise Rakner (Chr. Michelsen Institute), '*Accountability through Tax Reforms? The Case of sub-Saharan Africa'*

Discussant: Odd-Helge Fjeldstad (Chr. Michelsen Institute)

1.00–2.00 ***Lunch***

2.00–3.20 **Panel 3**
Taxation and intergovernmental finance

- James Wunsch (Creighton University), '*Decentralisation and Local Revenue in Africa'*
- Bamidele Olowu (Institute of Social Studies), '*Implementing Property Taxation Policies in Developing Countries: A Stakeholder Analysis'*
- Aaron Schneider (Institute of Development Studies), '*Decentralisation and Interest Groups: A Political Approach to the Leviathan Hypothesis'*

Discussant: Lise Rakner (Chr. Michelsen Institute)

3.20–3.40 ***Coffee***

3.40–5.00 **Panel 4**
The politics of taxation policy

- José Antonio Cheibub (Yale University), '*The Politics of Federalism in Brazil: The Role of Governors in the Brazilian Congress'*
- Tony Addison (World Institute for Development Economics Research (UNU/WIDER))*, 'Taxation and Revenue Reform in Conflict-Affected Countries'*
- Florens Luoga (University of Dar es Salaam), '*Viability of Developing Democratic Legal Frameworks for Taxation in Developing Countries*'

Discussant: Aaron Schneider (Institute of Development Studies)

Tuesday 29 October

10.00–11.20 Panel 5
Taxation in Africa

- Odd-Helge Fjeldstad (Chr. Michelsen Institute), '*Controlling Fiscal Corruption: Lessons from the Tanzania Revenue Authority*'
- Leslie Dikeni (South Africa), '*Taxation and Bureaucracy: The Case of the South African Revenue Service (SARS) in South Africa*'
- Dumisani Hlophe (Centre for Policy Studies), *'Riding the High Wave: Is South Africa's High Revenue Collection Sustainable?'*

Discussant: Steven Friedman (Centre for Policy Studies)

11.20–11.40 Coffee

11.40–1.00 Panel 6
The tax state

- Carmenza Gallo (Queens College), '*Taxes, Consultation, Accountability and Democracy in Export Led Economies*'
- Deborah Brautigam (American University), '*Contingent Capacity: The Politics of Revenue Institutions*'

Discussant: David Bevan (Oxford University)

1.00–2.00 Lunch

2.00–3.20 Discussion
Where do we go from here?

Chair: Mick Moore (Institute for Development Studies)