

WORKING PAPER 280

How Does Taxation Affect the Quality of Governance?

Mick Moore
April 2007



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Summary

This paper summarises the policy implications of a growing debate about the connections between taxation and the quality of governance in developing countries. Taxation – or the absence of tax – impacts on the quality of governance through two main channels. The first relates to the degree of dependence of governments on general taxation for their financial resources. Many governments do not need to make much tax effort because they have large non-tax incomes from oil, gas and mineral exports or from foreign aid. State elites are then financially independent of citizen-taxpayers. This changes the political incentives that they face, and the ways in which they seek to obtain, use and retain power. The long term consequences for governance are malign: state elites are less responsive and accountable to citizens; and, depending on the sources of non-tax revenue, may have less incentive to build up the political and organisational capacities of the state. States are likely to be simultaneously arbitrary and weak. All else being equal, the dependence of governments on general taxation has positive effects on the quality of governance. But that relationship is not automatic. *How* governments tax also matters. We cannot assume that, because they are fully dependent on taxation for revenues, governments will be capable, accountable, or responsive. They may levy taxes coercively, and thereby damage state-society relations and reinforce poor governance. Public authorities in contemporary poor countries face some incentives to tax coercively. Establishing more consensual taxation practices is an important practical route to improving governance. Aid donors could play a more constructive role.

Keywords: taxation, accountability, responsiveness, state capacity, governance, aid, oil

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1 Introduction: beyond tax policy

Most contemporary governments routinely use their taxation systems to get their hands on, and then spend, between 10 and 40 per cent of national income.¹ That is a lot of money. There is little doubt that taxing is one of the most important things that governments do. Correspondingly, it is widely agreed that it is important that governments should get tax policy right. When people debate and argue about tax policy, they mostly address some aspect of three big questions:

1) *How much money should government gather as tax?* It should be enough to meet public spending needs and contribute to fiscal stability, but not so big as to encourage the government itself to be wasteful or to appropriate money that could be better used in private hands.

2) *How should the tax burden be distributed among actual or potential taxpayers?* This issue may be argued either in terms of fairness in burden-sharing, or in terms of the potential instrumental advantages of using tax policy to help achieve other public policy goals, e.g. encouraging businesses to locate in poorer regions or to invest in particular sectors, or actively redistributing income or wealth from one group of citizens to another.

3) *How can the potential adverse economic costs of taxation be contained or minimised?* Taxpayers tend to be alert to the costs that they directly incur, whether these take the less damaging form of complex and costly paperwork and record-keeping obligations, or the more malign form of harassment, arbitrariness on the part of tax collectors, and the need to pay bribes.² If collectively well organised, taxpayers or their legislators may enquire into the efficiency of the tax administration itself. How much of the money that it raises is absorbed in the collection process? Economists also routinely focus our attention on the indirect costs of revenue raising: the fact that taxing any activity almost inevitably discourages it. If, for example, a government chooses the easy option of raising most of its income by taxing coffee exports, then it may be biasing the whole economy, in an inefficient way, against producing coffee for export. It is probably more efficient simply to spread the tax burden more widely.

These tax policy questions are very important. They will continue to dominate debate about taxation in most countries and to absorb the attentions of tax policy specialists. They are however not the only important policy issues about taxation. In particular, there is a growing debate, focused on poorer countries and on governments enjoying large incomes from aid or from oil, gas and mineral exports, which addresses a different and in some ways more foundational set of questions:

1 In 1995–2000, average tax revenues, as a proportion of GDP, were 13 per cent low income countries, 19 per cent for middle income countries, and 36 per cent for high income countries (Baunsgaard and Keen 2005: 7).

2 For recent survey information on these costs for a typical company in a wide range of countries, see Price Waterhouse Coopers and the World Bank (2006) and World Bank (2006).

not ‘*What is good tax policy?*’ but ‘*How does the taxation relationship between state and citizens itself contribute to the quality of governance?*’ The purpose of this paper is to review this debate, to explain why it has arisen, and, above all, to answer the question: *How does taxation affect the quality of governance?*

2 The rediscovery of the taxation-governance connection

There is a long history to the idea that there is some strong, consistent connection between the ways in which governments are financed and the ways in which they govern. In particular, this is foundational to mainstream Anglo-American interpretations of the emergence of representative government and democracy in Britain and the United States. The British narrative focuses on how, in a series of struggles with the seventeenth Stuart dynasty in particular, Parliament secured its long term dominance over the monarchy through wresting control of public finance and restricting the sources of funding for the government bureaucracy, the armed forces and the monarchy itself to money raised through tax and authorised by Parliament.³ The American story focuses on the rejection of British colonial authority in the 1770s after London violated a core principle of good government, and tried to tax the American colonists without asking for their consent through a legislature in which they were represented. (‘No taxation without representation’). There is also a more theoretical tradition of academic work that links long term changes in society and governance to changes in the ways in which states obtain the resources they need to govern. Its leading exponents also see close affinities between the dependence of governments on general taxation, modern capitalism and liberal democracy.⁴

The notion that sources of government income might significantly shape governance has only recently entered into development policy debates. It is still on the margins. The word ‘taxation’ appears in the development literature mainly in the context of the kinds of economic policy discussions summarised in Section 1. And those issues are generally believed to be specialist and technical, and not to relate to core debates about the development process. Even those aid and development agencies noted for their capacity to generate and use policy research continue to produce major statements on governance that ignore revenue and taxation issues.⁵ One reason is simply the time it takes for a complex issue to be first raised by researchers and scholars, thoroughly debated, and then enter into policy agendas in an authoritative

3 Parliament authorised a quarter of the revenues raised by the British crown between the period 1560 and 1640, and 97 per cent in the period 1689–1714 (Braddick 1996: 13).

4 See especially Goldscheid (1958/1925) and Schumpeter (1918/1991).

5 See, for example, the World Development Report widely believed to have signalled the re-conversion of the World Bank to the importance of effective states (World Bank 1997); and the new aid and development policy paper issued by the British Government (Department for International Development 2006).

way. The earliest mention I have found in a development policy document of the significance of taxation for governance is in Deborah Brautigam's discussion paper for the World Bank in 1991 (Brautigam 1991). That in turn reflected a growing academic literature. Two books have been especially influential in putting the issues on the agenda for academic historians and political scientists respectively. One is Charles Tilly's (1992) comparative study of state formation in Western Europe. Tilly argues that, where, instead of simply taxing coercively, rulers were motivated to bargain over taxation, state financing and public policy with the people who controlled large amounts of capital, states tended to become more capable, especially in war, and more accountable and responsive to citizens. His final chapter on the implications for contemporary poor countries prefigures many of the arguments in this paper. The second book is Kiren Chaudhry's (1997) analysis of the effects of contrasting sources of public revenue – oil rents in the one case, and remittances from citizens working abroad in the other – on contemporary state formation, and especially on the development of state capacities, in Saudi Arabia and the Yemen. Here was a convincing explanation of how, over periods of years rather than of decades or centuries, changes in sources of public revenue could shape the apparatus of government, the ways in which state authorities interacted with societal groups, and state capacity.

It was on the basis of these kinds of evidence that some authors began to make strong claims about the centrality of the tax relationship to governance, with more or less emphasis on the notion that higher levels of taxation would bring forth more capability, accountability or responsiveness on the part of governments.⁶ Like Tilly's bold generalisations about historical patterns of European state formation, these assertions have generated critique and testing by other scholars.⁷ As always, the area studies specialists validly pointed out that generalisations are only generalisations, and the detailed picture is more complex.⁸ More fundamentally, some researchers have responded to the emphasis that I and others have placed on the potential 'governance dividend' from taxation by pointing to the prevalence of more or less directly coercive taxation practices in poor countries.⁹ Recently there has been blending of interests between researchers working on the governance consequences of taxation and those investigating the political impacts of the 'resource curse'. The issues are in many respects the obverse of one another: in some interpretations at least, the central political pathology of states rich in oil, gas and mineral revenues is that they do not need to tax (Section 5).¹⁰

6 See, for example, Guyer (1992), Moore (1998) and a range of literature on the *rentier* state in the Middle East that is mentioned below.

7 The most rigorous attempts at statistical testing are by Ross (2004) and Mahon (2006).

8 For some nuancing of bold claims about European historical patterns, see Ertman (1997) and Rosenthal (1998).

9 See especially Fjeldstad (2001) and also Bernstein and Lu (2003) and Juul (2006).

10 The literature on the *resource curse* and *rentier states* is so large and growing so fast that it is not possible even to list all the main items here. Some of the classic original statements of the argument were by Mahdavy (1970) and Luciani (1994) on the Middle East and Karl (1997) on Venezuela. Ross's (1999) excellent review of the literature is in some respects dated. For a more recent review see Rosser (2006). One of the more interesting recent conceptual contributions is by Collier (2006). Note that this literature is vibrant because the *resource curse* phenomenon became widespread only recently, after the big oil price increases of the 1970s transferred resources and rents on an unprecedented scale to producers of this sub-set of primary commodities.

In sum, there is now a substantial research literature about the connections between taxation and governance. But the issue is still only on the margins of the development policy debate. This is not solely because it takes time for scholarly insight to percolate into policy. Some other causes lie in the ‘politics of knowledge’.¹¹ The reason that concerns me here is the ambiguity of the various overlapping propositions that have been advanced about the governance implications of taxation. The first objective of this paper is to try to present the arguments lucidly. The second is to evaluate their accuracy and relevance to policy. Before doing that, I provide a broad historical sketch of changes in sources of government income.

3 States and revenues

What are states? Most concretely and directly, they are sets of organisations, which typically are complex and differentiated.¹² Those organisations need to be manned, equipped, provisioned and coordinated. Governments need to command the services of a large number of people and acquire substantial material resources. Historically, states have depended mainly on two main kinds of material resources, extracted mainly from the societies over which they rule: conscript manpower, mainly for military purposes; and financial resources to pay the salaries of civilian and military personnel and to meet the other capital and recurrent costs of warfare and government (Levi 1997).¹³ Few present-day militaries depend significantly on conscript soldiers. Trained, experienced personnel are needed to operate modern weapons systems. Contemporary military capacity depends to a high degree on the financial resources to purchase costly equipment and to recruit and train the professionals to operate it. Money is the dominant material resource required by contemporary states.

From where do states obtain their money? Plundering other polities has long ceased to be a routine, significant source. Eight other sources have been important at different points in history:¹⁴

- 1) *Prerogative revenues*: the sale of a wide range of permissions (e.g. to inherit or sell property, install glass windows, encroach on state forest, use the state’s justice system, legalise documents), titles (e.g. peerages, knighthoods), or positions in the civil or military bureaucracies.

11 All the wealthy, democratic states of the OECD have been almost entirely funded from broad taxation for many decades, including most of the period since the end of World War Two. There has not been enough variation among them in sources of government revenue to attract the attention of social scientists to the question of whether revenue sources impact significantly on governance.

12 I like Theda Skocpol’s definition: ‘any set of relatively differentiated organisations that claims sovereignty and coercive control over a territory and its population, defending and perhaps extending that claim in competition with other states’ (Skocpol 1992: 43). It is not very different from many other definitions within the Weberian tradition.

13 For accuracy one might add the extraction of in-kind resources, notably agricultural products. The omission does not affect the argument here.

14 These categories of revenue sometimes overlap at the margin. I am classifying them with an eye more to the underlying political economy than to strict logic. Equally, one can debate the extent to which some of them should be classified as taxes or fees/charges.

- 2) *Seigniorage*: the revenue that governments obtain from their monopoly over the issue of currencies.
- 3) The *surpluses that states obtain from monopoly control over wholesale or retail trade in consumer goods* like salt, alcohol or tobacco.
- 4) *Surpluses from state property*, notably royal estates (in agrarian societies) and, in more industrial societies, public utilities (railways, ports, electricity etc.) and state-owned industrial enterprise.
- 5) The *surpluses that states obtain from monopoly control of the export of valuable agricultural commodities* like cocoa, coffee, tea, cotton and sugar.
- 6) The *surpluses that states obtain, whether through taxation, direct ownership, royalties or other charges, from the location on their territory of enterprises extracting valuable oil, gas or mineral export products*.
- 7) *Aid and subsidies*: direct transfers from other states or international organisations.
- 8) *Broad taxation of citizens and enterprises*, notably taxes on incomes, assets, property, payrolls, imports, exports, the internal movement of goods, persons (poll taxes), production and sale of specific commodities (excises), wealth transfers, business turnover, sales, or business value-added.

There are wide variations, over time and space, in the extent to which states depend on these different revenue sources. We can however make a few useful generalisations about the trends summarised in columns (b) and (c) of Table 3.1:

- 1) Prerogative revenues have rarely been a major source of state income, and especially not in recent centuries. Such devices – and especially the sale of positions in public bureaucracies, which undermines state authority and revenue in the longer term – often have been a last resort in times of crisis. Stamp duties on contractual legal documents represent one of the few remaining significant revenue sources within this general category.
- 2) Governments obtain some revenue from issuing currency (seigniorage). Currency represents a potential claim on the issuer. Not all claims are realised. Seigniorage is a significant income source only for brief periods of time when governments over-print currency and cause inflation. Over the last two decades, most governments have committed themselves to responsible macroeconomic and monetary policies, and therefore cannot access this income source.
- 3) Historically, governments have often obtained some income from monopoly control of the trade in basic consumer goods, including, classically, salt. For example, ‘monopoly revenues’ from alcohol and tobacco provided between 18 per cent and 27 per cent of the Taiwanese national government’s revenues in the 1950s and 1960s (Republic of China, 1982: 160). These income sources shrink as economies become more diverse, complex and open. They are rare today.
- 4) Royal estates were major sources of state revenue in the mediaeval era. Large state-owned railway and postal enterprises funded some continental European states in the nineteenth century (Ferguson 2001: 57–8; Mann 1993: 381–9). Because they are unusually small and prosperous city trading states, contemporary Singapore and Hong Kong have been able to finance themselves largely from state property ownership, urban development, and managing port, transport and other public utilities. Excepting these very unusual cases, ‘own revenues’ tend to decline in importance as incomes

Table 3.1 The changing importance of sources of state revenue

Source	Frequency in later nineteenth century	Frequency in later twentieth century	Extent to which the revenue source typically is 'earned' by the state in terms of organisational effort
(a)	(b)	(c)	(d)
A. Prerogative revenues: the sale of permissions, titles and public offices	Rare	Rare	Low
B. Seigniorage	Significant in some cases	Significant in some cases, but becoming rare by the end of the period.	Low
C. Surpluses from monopoly control of trade in consumer goods	Occasional	Rare	Medium
D. Surpluses from state property	Significant in some cases	Important until recently in centrally planned economies (state-owned industry); currently infrequent	Medium to high
E. Surpluses from monopoly control of agricultural commodity exports	Occasional	Was common in many poor countries in mid-century, and then largely disappeared	Medium
F. Surpluses from export of natural resource products	Rare	Very important for a limited number of states	Low
G. Grants from other states or international organisations	Rare	Important for a large number of poor countries	Low
H. Broad taxation of citizens	Important, especially in wealthier countries	Widespread, and dominant in wealthier countries	High

increase and economies become more complex and inter-related: it becomes relatively easier to obtain revenue through taxation rather than through direct management of productive assets. The main exception in the twentieth century lay in the centrally planned (Communist) economies, where governments funded themselves through direct control of most productive enterprise. Some elements of these systems remain in place in China, Vietnam and North Korea, although the Chinese and Vietnamese governments are increasingly dependent on broad taxation.

5) Between the 1950s to 1980s in particular, the governments of many poorer countries used their control over the marketing and export of a wide range of agricultural commodities, along with exchange rate policies, to extract substantial revenues and other resources from the rural sector (Bates 1977; Lipton 1977). This revenue source largely dried up in the 1980s and 1990s for a combination of reasons: the political economy of those countries that had experienced economic growth changed in favour of rural interests (Bates 1993; Moore 1993); this extraction undermined itself by severely wounding the goose that lay the golden eggs; and the widespread structural adjustment and economic liberalisation that followed a series of international economic shocks in the 1980s deprived governments of many of their extractive tools.

6) Surpluses from extraction or export of natural resource products have long been an occasional source of significant government revenue, but became a major source of funding for a large number of states only after the first oil price shock in the early 1970s. They have remained so since. That in turn reflects the combination of three main trends: (a) the rapid growth in the dependence of modern industrial economies on oil and now gas for energy; (b) declining international transport costs, fuelled partly by containerisation and other innovations, that make it increasingly viable to trade bulk commodities over long distances; and (c) continuing or growing inter-national inequality in productive capacity and incomes. Where it exists, the natural resource sector automatically becomes relatively important to economies that lack the capacity to add a great deal of value in manufacturing or internationally-competitive service industries.¹⁵

7) Grants (or concessional loans) from other polities have been an exceptional mode of financing states for most of history. They have been associated mostly with direct influence of the donor over the recipient state. The picture was transformed in the half-century after the end of World War Two. The big expansion of foreign aid was initially motivated in part with geo-strategic concerns around the Cold War. Strategic motivations have diminished since the end of the Cold War;¹⁶ the number of aid donors and aid channels has proliferated (Acharya et al. 2006; World Bank 2004: 206–7); and aid has increasingly been concentrated on the poorer countries. It now constitutes a major income source for many governments (Moore 1998).¹⁷

15 Conversely, even absolutely large natural resource extraction sectors comprise only a small proportion of national economies, such as those of Norway, that otherwise are very competitive in manufacturing and services.

16 With some conspicuous exceptions, including Egypt, Israel and North Korea.

17 Very high levels of dependence generally reflect large aid inflows following natural disasters or internal conflicts. In 2004, official development assistance exceeded 70 per cent of total government expenditure in Burundi, Sierra Leone, Afghanistan, Malawi, Mozambique, the Democratic Republic of Congo, Ethiopia and Nicaragua (Ben Dickinson, OECD, DAC, private communication).

8) Dependence on broad citizen taxation has steadily become a more important revenue source for most states over recent decades and centuries. It is now the dominant income source for governments, except only for those that enjoy large revenues either from natural resource exports or from aid.

In sum, (a) broad taxation, (b) surpluses from natural resource exports and (c) development aid are the dominant income sources for contemporary states. Most governments depend heavily on broad taxation; some combine this with surpluses from natural resource exports or development aid; and a few live mainly on surpluses from natural resource exports.¹⁸ In column (d) of Table 3.1, these eight main revenue sources are classified in terms of the organisational effort that they require of states. How much energy do they need to devote to recruiting, managing or supervising the agencies that actually collect the revenue, and to re-shaping society and economy to enhance taxability?¹⁹ These simple categorisations indicate a polarising trend in recent decades: contemporary states depend on some mixture of revenue sources that typically either require a high organisational effort (broad taxation) or a low one (surpluses from natural resource exports; and development aid). Those revenue sources requiring an intermediate level of organisational effort have become less significant since the later twentieth century.

4 Taxation and governance?

In contemporary development debates, the term *governance* is used variously to refer to (a) outcomes (the effective provision of collective goods) and to (b) the political processes that generate these outcomes: the manner in which state elites acquire and use their power and authority.²⁰ There is no professional consensus on the operational definition, roots or measurement of good governance. There are two important conceptual and theoretical underpinnings to the argument in this paper.

The first is a powerful, simple, but often implicit, model of the political process – the notion of *state-society tension* and *balance* – that constitutes ‘an important theoretical foundation for much political science’ (Gervasoni 2006: 5). The core proposition is that political regimes are the outcome of tension and conflict between (a) elites who control the state, and wish to remain in power and to exercise that power as freely as possible, and (b) societal actors who want to place restraints on the power of a potentially overweening state, either to protect themselves from despotism and depredation or as a strategy for obtaining power

18 Governments obtain income from resource exports through a number of channels, and official accounts are often incomplete or misleading (Mahon 2006: chapter 2). We do not therefore have a reliable, comprehensive data series.

19 This is a modification of my earlier concept of ‘earned income’, which referred to both the political and the organisational or bureaucratic efforts that states put into revenue raising (Moore 1998).

20 I am not in this paper dealing with non-state governance.

themselves. Revenue is central to this conflict for two reasons. First, it represents a key strategic resource for state elites. If non-state actors can limit and control elites' access to revenue, they enjoy countervailing power in relation to the state. Second, if state elites need to depend on general taxation because they lack alternative, easier revenue sources, they generally have to put considerable organisational and political effort into obtaining the revenue, and face strong incentives to bargain and negotiate, directly or indirectly, with at least some taxpayers, rather than simply to *extract* revenue forcibly. In other words, dependence on general taxation provides incentives for state elites and taxpayers to resolve their differences through bargaining.

The second conceptual-theoretical underpinning to this paper is that, taking into account the realities of patterns of governance in contemporary developing countries, we can usefully think of good governance as having three main operational dimensions, which tend to complement and reinforce one another:²¹

- 1) The *responsiveness* of states to citizens, i.e. an orientation to meeting citizens' needs.²²
- 2) The *accountability* of states to citizens, where this implies the existence of institutionalised mechanisms – of which electoral democracy is the most important and most thoroughgoing – through which state elites both answer to citizens for the ways in which they employ their authority, and may be rewarded or sanctioned by extensions or curtailments of that authority (Schedler 1999).
- 3) The *capability* of states to determine and respond to citizens' needs and wants, which in turn has two complementary dimensions: the *political capability* to determine needs and to frame and nurture bargaining and compromise among competing interests; and the *organisational or bureaucratic capacity* to settle on sensible policies, to deliver public services, and to enforce the authority of the state.

For a range of contextual and historical reasons, many governments in developing countries rank relatively low on all these dimensions of good governance (Moore 2004). Increases in responsiveness, accountability or capability are welcome, and tend to go together: more of one generally means more of the other.²³

There is no one line – or even single paragraph – explanation of how state revenue sources and taxation impact on governance. Why? One set of reasons is essentially methodological: it is hard to get the right data and sort out complex interactive political processes. In particular:

21 This also happens to be the analytic framework adopted in the British Government's new aid and development policy paper (Department for International Development 2006).

22 The concept of responsiveness is silent on the question of how much power citizens might enjoy. Responsive governments are concerned with citizens' 'needs', but have autonomy to shape those needs and to decide to which ones they prefer to respond. The notion that citizens have power to express their wants, as opposed to their needs, is central to the concept of accountability.

23 See, for example, Kaufmann *et al.* (2006).

- 1) Even the simplest models of the political processes around taxation involve two main categories of actors: (a) state (or state elites) and (b) societal groups of various kinds. Some researchers focus more on how states respond to different sources or levels of revenues, and others emphasise the response of societal actors to attempts to tax them.²⁴ Any realistic understanding of the processes requires that we (a) go beyond the initial reactions to taxation of each type of actor, and take into account the ways in which they then interact, whether conflictually, cooperatively, or in more complex ways; and (b) explore the likely diversity of interests and behaviour within our 'state' and 'society' categories.
- 2) Taxation and revenue are but one set of factors that influence the responsiveness, accountability and capability of states. In explaining actual cases, we need also to take account of the other factors, including those that tend to strengthen or weaken democracy.
- 3) We have neither the data on revenue sources nor the clear operational measurements of broad concepts like state responsiveness or state capability that we would need rigorously to explore alternative answers to our central question. It is particularly unfortunate that even basic data on sources and uses of public revenue tend to be especially sparse or unreliable for governments that depend on both foreign aid (Moore 1998: 110–19) and natural resource exports (Mahon 2006: chapter 2).

The second set of reasons for the relative complexity of the taxation-governance connection is that it has several dimensions. We need to examine at least four different issues:

- From where do governments get their revenues? (Section 5).
- How much of their incomes do citizens pay in taxes? (Section 6).
- Who and what is taxed? (Section 7).
- How are taxes assessed and collected? (Section 8).

5 From where do governments get their revenues?

Let us begin with the contrast between governments that depend (largely or entirely) for revenue on *earned income* in the form of broad taxation and those that depend on *unearned income*,²⁵ from either aid or natural resource exports. What are the consequences for governance of being dependent on taxes? We can build up a model of the political implications step by step. It is summarised in Table 5.1.

²⁴ See, for example, Ross's work (2004) and most of the literature he cites.

²⁵ For the basis of this distinction, see Moore (1998).

Table 5.1 The effects on governance of state dependence on broad taxation

Immediate effects	Intermediate effects	Direct governance outcomes
A. The state becomes focused on obtaining revenue by taxing citizens	A. (i) The state is motivated to promote citizen prosperity	More responsiveness
	A. (ii) The state is motivated to develop bureaucratic apparatuses and information sources to collect taxes effectively	More bureaucratic capability
B. The experience of being taxed engages citizens politically	B. (i) (Some) taxpayers mobilise to resist tax demands and/or monitor the mode of taxation and the way the state uses tax revenue	More accountability
C. As a result of A and B, states and citizens begin to bargain over revenues and exchange willing compliance by taxpayers for some institutionalised influence over the level and form of taxation and the uses of revenue (i.e. public policy).*	C. (i) Taxes are more acceptable and predictable, and the taxation process more efficient	More responsiveness, political and bureaucratic capability
	C. (ii) Better public policy results from debate and negotiation	More responsiveness and political capability
	C. (iii) Wider and more professional scrutiny of how public money is spent	More accountability
	C. (iv) The legislature is strengthened relative to the executive (assuming one exists)	More accountability
* Bargaining is especially likely if representative institutions (legislatures) already exist		

Let us first look at two of the more direct effects on the state itself (Section A of Table 5.1):

- 1) First, rulers dependent on taxes have a direct stake in the prosperity of (some or most of) their citizens, because that improves rulers' future income prospects. They therefore have incentives to promote that prosperity.
- 2) Second, dependence on taxes promotes bureaucratic capacity. Broad taxation, to a far greater extent than either aid or natural resource revenues, obliges the

state to invest in the creation of a relatively reliable, un-corrupt, professional career public service to assess and collect dues, and then hand them over to the state treasury.²⁶ Equally, it necessitates the creation of reliable records of taxpayers, their activities and assets, and provides the state with a wide range of information that it might use for a variety of purposes, from improving the quality of policy-making (Brewer 1989: especially chapters 4 and 8) to under-cutting support for rural guerrillas (Odon 1992).

But what about the effect on citizens of being taxed (Section B of Table 5.1)? We cannot say much on this until we know how citizens interact with the state over taxation. But we can assume that the experience of being taxed will engage them politically. They will tend to try to organise to resist taxation or ensure their tax money is well used. Unless the sole response of the state is crushing repression, these reactions will tend to increase the accountability of government.

It is in Section C of Table 5.1 – the interaction between state and society over taxation issues – that we enter into some of the most interesting territory. The primary point is simple: there are several reasons why rulers and taxpayers might enter into productive bargaining around taxation, to their mutual benefit, in ways that improve the overall quality of governance. The potential direct benefits to this *revenue bargaining* are:

- 1) If the state and taxpayers can reach agreements on what taxes will be levied, at what levels, and how, then tax demands become more predictable, taxpayers are more likely to comply with them, and both the economic and the political costs of taxing are reduced. With better knowledge of likely future obligations and revenues, and protection against arbitrary levies, taxpayers could feel more secure in making economic investments, and rulers could undertake long-term fiscal planning more effectively.
- 2) Having a forum in which revenues are exchanged for policies encourages the search for policies that are beneficial to both governments and citizen-taxpayers.
- 3) The degree of effective public scrutiny of how public money is spent is likely to increase.²⁷
- 4) If a representative legislature already exists, it will be strengthened by becoming a major forum for the bargaining about the exchange of revenues for policies. If it does not exist, rulers will be motivated to establish one, in order to find an organisation representing taxpayers with whom they can regularly and reliably negotiate.

The likely outcome of these direct effects of revenue bargaining is a considerable improvement in the quality of governance in all dimensions. But how likely is that

26 Brewer's (1989: 101–14) account of the organisation of the Excise Department in eighteenth century Britain illustrates this line of argument vividly. Perhaps the best contemporary scholarly research on this issue – and on the broader question of how revenue sources shape states – has been done on Saudi Arabia and the Yemen by Kiren Chaudhry (1989, 1997).

27 I like very much Paul Collier's concept of *sovereign rents*: 'that part of public revenue over which there is no effective scrutiny' (Collier 2006: 1484).

outcome? Will the logic in the model translate into reality? I provide later the evidence that it does. But, at least in the contemporary world, it does not translate into reality directly, fully and unambiguously. There is no one-to-one relationship between tax dependence, revenue bargaining and good government. To understand the reasons we can revert to deductive logic. The model I have presented above is too simple. It is based on the history of the emergence of parliamentary government in Western Europe, especially Britain and the Netherlands in the seventeenth and eighteenth centuries. In three important respects, the institutional environment in which contemporary governments tax and spend is more diverse than that faced, for example, by the Stuart kings of seventeenth century Britain:

- 1) In the seventeenth century, taxation was dominantly for purposes of preparing for or fighting wars. Most public expenditure was on the military (Brewer 1989: 40; Mann 1993: 373). The politics around public expenditure were relatively uncomplicated. They focused to a large degree on foreign policy issues about alliances and warfare, because that is what mainly shaped the size of states' revenue demands. Military contractors were an interest group, but not a very large one, and they tended to be very much in the Parliamentary eye. In other words, the activities and concerns of taxpayer-based interest groups dominated fiscal politics. By contrast, most contemporary states routinely spend a great deal of money on a diverse range of activities less immediately pressing than war, including education, health care, roads, electricity and other infrastructure, pensions, social assistance, research, statistics and subsidies of various kinds to industry and agriculture. These expenditures might advantage many people, either in their roles as direct beneficiaries (e.g. state pensioners) or in their roles as public sector employees dispersing these expenditures. Significant, complex interest group politics take place around public expenditure. We cannot easily predict how far, over any public policy issue, Joan Smith will identify with, and therefore vote or campaign in, her role as actual or potential (a) taxpayer (b) a direct beneficiary of public expenditure or (c) state employee. Fiscal politics are more complex than in the seventeenth century, and other concerns might trump taxpayers' 'natural' focus on economy and efficiency in public spending.
- 2) Taxpayers as a category tend to be more diverse in contemporary poor countries than in seventeenth century Britain, and for that reason alone are less likely to engage in collective action on behalf of all taxpayers. Most contemporary states preside over complex taxation regimes, characterised by a diversity of different taxes, a wide variety of rates, an abundance of exemptions, and ambiguity in legislation or assessment procedures. The tax regime itself may influence the potential for taxpayers to engage in collective action, in a variety of ways.²⁸ For example, distinctively different taxes, levied on very different bases, might lead to political conflict between one group of taxpayers (e.g. companies) against another (e.g. individuals liable to income tax). Alternatively, a complex taxation system with a variety of discretionary exemptions might to motivate taxpayers to pass over

28 The underlying analytic framework is polity-centricity: the observation that the nature of public policy arenas, public programmes, and the public organisations that implement those programmes help shape the ways in which citizens engage politically (Skocpol 1992: 47–60).

collective action and to engage instead in individualised strategies to solve their problems, for example through bribery or employing expert tax advisers. In many poorer developing countries, a few large transnational corporations provide a large proportion of the more accessible potential tax bases. They have strong incentives to negotiate individually with government, to influence both tax legislation and its practical application by the tax administration. The political and organisational dimensions of taxation may vary widely depending, for example, whether the target is a few large companies or a myriad of informal petty traders.

3) In 'historical Europe' governments had little scope to resort to loans as a means of avoiding confronting and bargaining with their own taxpayers, because the social contract with taxpayers was the basis of low cost borrowing. Financiers would lend at lower rates of interest to governments that had good prospects of repaying, and governments subjected to parliamentary control of finance were more likely to repay: because their big taxpayers were committed to the revenue-raising system; because parliamentary scrutiny would reduce the chances that revenues would be wasted; and, sometimes, because the people who made the loans also sat in Parliament.²⁹ By contrast, contemporary governments tend to borrow heavily internationally, both in commercial markets and, in the case of the poorest countries, on concessional terms from international organisations like the International Monetary Fund (IMF) and the World Bank. Borrowing on international markets gives governments some autonomy from their taxpayers. By using privileged information about complex financing alternatives, and by shaping perceptions of what economic and financial policies are inevitable or desirable, governments have some scope to present their legislatures with international borrowing agreements that are 'done deals', too complex for legislators to challenge.³⁰ However, this partial autonomy that governments enjoy in relation to their own taxpayers might be bought at the expense of dependence on the International Monetary Fund (IMF). The governments of many poor countries need the approval of the IMF to access international loan markets on reasonable terms. In some cases, the IMF has assumed what many would see as the historic role of taxpayers-in-assembly:

.... one might take the IMF to be acting as a kind of upper house or appropriations committee 'representing' Latin American taxpayers with its combination of sufficient expertise to design tax legislation and sufficient power to deny critical resources to the executive.

(Mahon 2004: 26)³¹

29 Some historians have seen this capacity to raise loans on the strength of a tax base guaranteed by the central role of parliaments as the key to the emergence, in historical Europe, of powerful, successful *fiscal states* (Brewer 1989).

30 I am grateful to James Mahon for giving me access to his draft (Mahon 2006) that deals in detail with this point.

31 Mahon goes on to point out that, as the representative of creditors, the International Monetary Fund has an interest in a strong taxation system, so that creditors can be re-paid. However, it may at times favour the interests of bondholders if they come into conflict with those of taxpayers (Mahon 2004: 26), to the extent that the IMF sometimes appears responsible for 'squeezing' poor country taxpayers by insisting that governments meet demanding revenue targets.

In sum, the material in this Section points toward two conclusions. First, a mixture of historical and deductive argument suggests that the dependence of governments on unearned income is likely to have adverse effects on their accountability, responsiveness and capability. Second, there are other factors that influence this relationship in contemporary poor countries: their fiscal politics are sufficiently diverse and complex that the causal sequences are unlikely to emerge with the same immediacy and clarity as they are sketched out in Table 5.1. What is the evidence for the validity in contemporary poor states of the ‘classic’ causal sequence from dependence on broad taxation to better governance?

For reasons sketched out in Section 4, it is often difficult to test the key propositions in a rigorous fashion. However, the more immediate source of our partial ignorance is that it is only in very recent years that much effort has been put into the testing. We are less ignorant now than we were a few years ago, and have a range of contemporary evidence. This includes:

- 1) Country case studies of the malign governance effects of dependence of states on unearned incomes from resource exports (especially Karl 1997; Chaudhry 1989, 1997; and Vandewalle 1998).
- 2) Strong quantitative evidence, based on cross-national statistical analysis, that large oil and mineral revenues are associated with low levels of democracy and with states unbound by law.³²

32 There is continuing debate about both (a) the possible causal mechanisms between enjoyment of ‘point’ natural resource revenues (oil, gas, minerals) and the quality of governance and (b) the data and statistical methods for testing these relationships. There is no fully adequate survey of the (fast-growing) research literature, although Ross (1999) and Rosser (2006) cover much of the ground very well. I will restrict myself here to comments on two main issues. The first is that there are different underlying hypotheses about how resource wealth impacts on governance. For example, some theories concentrate on the issues discussed in this paper: the implications of not having to tax. Others deal with a complementary but distinct issue: the extent to which governments with large incomes from natural resources can buy off opposition and thus keep themselves in power (Collier and Hoeffler 2005). I suspect the literature has under-played the implications of greed and threat: governments sitting on large mineral wealth want to stay in power, and naturally assume that plenty of other people are keen to displace them, probably by force. That motivates high expenditure on military, police and intelligence services, the general militarisation of politics, and exclusionary governance. These different causal sequences are consistent with one another, and might all be operating simultaneously. It is however very difficult to test that in any rigorous manner. Part of the reason lies in the second issue on which I comment: the problem of measuring the size of the natural resource curse. Most studies use the only data series that have been available until recently: some measure of the value of mineral resource production or exports as a proportion of total national income or exports. But these are not the right things to measure. The theories tell us we should be measuring rents, i.e. the proportion of the sales value of a product that remains after all production and marketing costs, including some allowance for ‘normal profit’, have been accounted for. Rents may be very high on some natural resource extraction activities. It may cost only a couple of dollars – a small fraction of its sales price – to obtain a barrel of oil from beneath a desert. Conversely, a high proportion of the sales price of a barrel of Norwegian oil represents real production costs out there in the North Sea. The proper measure of the likely political impact of natural resource wealth would begin with the rents, not sales value. Collier and Hoeffler (2005) have used World Bank data to create just such a data base. For that reason we should place trust in particular their conclusions, from cross-national statistical analysis, that natural resource wealth tends consistently to depress the level of democracy. However, even studies using the more easily-available measures of resource wealth point in the same direction: Ross (2001) and Mahon (2006).

3) Somewhat more mixed and contested evidence from cross-country statistical analysis about the impact of high levels of aid dependence. For example, Remmer (2004) finds that aid tends to discourage governments from taxing, and Brautigam and Knack (2004) find that high dependence on aid tends to degrade the quality of governance institutions over time. By contrast, Moss *et al.* (2006) review a range of literature on the topic and find unproven the case for the malign effects of aid on governance.³³

4) Easter's (2002) persuasive comparison of the evolution of taxation and governance in Poland and Russia after the end of the Soviet system. The Russian state continues to depend for revenues on a relatively small number of very large enterprises, many of them now private or state-owned energy firms. There is little public political debate around taxation, and certainly nothing like a social contract: most taxes are raised coercively, and 'raids' by tax collectors and tax police are commonplace. By contrast, the Polish government could not depend on a few big taxpaying enterprises. It had to tax employees and small firms, and gradually extended the tax net to a large proportion of the population. Taxation has become a standard topic for political bargaining and debate.

Country comparisons are always hard to interpret: so many other things vary between any two cases. The most convincing evidence on the connections between tax dependence and governance is now emerging from comparisons between sub-national governments within the same countries. Gervasoni (2006) has looked at the political history of 21 of Argentina's Provinces over the period 1983 to 2003. They depend substantially – but with significant inter-Province variations – on fiscal transfers from central government and, in a few cases, local revenues from the oil extraction industry. Gervasoni found that the Provinces most dependent on broad taxation of their citizens had historically been more democratic. Where Provincial governments were most generously supplied with financial transfers from central government or oil revenues, local political leaders had been better able to buy off or suppress competition from democratic oppositions. Hoffman and Gibson (2006) have compared 105 district governments in Tanzania, a country in which local revenue raising is often quite coercive (Fjeldstad 2001). Where district populations have the greatest potential economic mobility, and therefore the widest scope to flee from coercive local taxation, the district governments spend higher proportions of their revenues on providing services for their citizens, and less on themselves. In different ways, both studies provide evidence for the 'balance of power' hypothesis: where local governments face the strongest pressures to finance themselves by coaxing rather than extracting revenues from their citizens, they are more likely to rule democratically (Argentina) or to spend money providing services to citizens (Tanzania).

33 One likely reason for the ambiguity of the statistical results is explored by Collier (2006). Aid has multiple and variable dimensions, that are often disguised when we measure it in aggregate value terms. In some contexts it is validly understood as an inflow of more or less 'free' financial resources into government coffers. In others, it comes in the form of specific goods or services (e.g. technical assistance) and/or hedged with all kinds of conditions, restrictions or injunctions about the ways in which it will be used.

6 How much of their incomes do citizens pay in taxes?

The conclusions of Section 5 are based on an analysis of the effects of alternative sources of government income on the motivations and behaviour of (a) the state (b) taxpayers and (c) the two interactively. The potential causal interactions are many and relatively complex, especially because states face choices between (a) taxing broadly and thus engaging with citizens and (b) exploiting unearned revenues, that require them to engage with a narrow range of other actors – aid donors or a small number of large companies, public or private, in the oil, gas and minerals sector. The question of how heavily governments tax citizens is distinct and conceptually less complex. We need to think mainly of how the level of revenue demand might impact on the political actions of taxpayers. To the best of my knowledge, no one has tried to track in detail this process for individual countries. And we know that the political implications are not straightforward. Increases in the tax take are unlikely to occur in isolation. They will generally result also in increases in public expenditure, which might in turn intensify the processes summarised in Section 6 through which the politics around public expenditure ‘confuses’ the politics around revenue raising.³⁴ However, there are good logical reasons, as summarised in Table 5.1, to believe that, the more of their income they pay in tax, the more citizens are likely to be politically engaged and demanding in relation to government. We also have anecdotal evidence that marked increases in the level of tax burdens mobilise taxpayers (Winters 1996: chapter 4), and some powerful recent statistical evidence that increases in revenue demands precede by only a few years shifts toward more democratic and liberal governance.³⁵

In sum, there is compelling evidence, of various kinds, (a) that the dependence of states on unearned income is likely to have adverse effects on the quality of governance and (b) that the overall level of taxes does help mobilise citizens politically.³⁶ But, before we draw too firm policy conclusions, we need to look at our third and fourth questions: Who and what is taxed? And how are taxes assessed and collected?

34 In addition, one should separate (a) a tax increase that leaves a taxpayer out of pocket from (b) an increase that is more or less compensated by an improvement in the quantity or quality of public services (Ross 2004).

35 See the original research by Ross (2001), and some reformulations with modified data by Mahon (2006).

36 One has to be careful about the kinds of quantitative evidence used to support this argument. The work by Ross and Mahon cited in the previous footnote is valid because it deals with changes over a few years. But one could generate spurious statistical results by looking at cross-national data over longer time periods. We know that income levels are themselves major determinants of (a) the level of democracy (Diamond 1992; Heo and Tan 2001; Huntington 1991; Londregan and Poole 1996; Przeworski *et al.* 1996) and (b) the overall level of the tax take (Section 9). The richer countries are, the more they are democratic and the higher the proportion of GNP their governments raise in taxes. Variations in the tax take are therefore associated statistically with variations in the level of democracy. But it would be wrong to interpret that as a causal relationship when using long-term data series comparing countries at very different income levels.

7 Who and what is taxed?

I have so far talked in rather general terms, using broad categories like ‘taxes’, ‘taxpayers’ and ‘citizens’ that need to be disaggregated to understand specific cases. Many contextual factors affect the extent to which citizens are engaged and politically mobilised by particular taxes. I deal here only with two issues of particular importance to contemporary developing countries.

1) Governments are more accountable and responsive to their citizens when dependent on them for revenue. Does that also imply that governments are only accountable and responsive to taxpayers, i.e. those citizens who pay taxes? Is the policy implication that we should find ways of ensuring the poor are taxed to prevent governments being accountable and responsive only to the non-poor, at the expense of the poor?³⁷ The answer to the last question is ‘no’. There are two reasons. The first is cautionary: we simply do not know enough about the effects of taxation on political behaviour to justify this kind of experimental social engineering. The second is that there is good reason to believe that the entire polity and all social groups normally will benefit from greater state responsiveness and accountability to taxpayers, even if the taxpayers themselves are not poor. Why? Especially in countries with relatively fragile public institutions, politics is rarely the kind of rational choice public finance game that economists love to model, where one particular definable group – for example, farmers – will be calculating in detail the benefits of, for example, exchanging reduced coffee export taxes for a stronger legal commitment to employees’ rights.³⁸ The more that politics is like that, the more we should be concerned about the problem of accountability only to taxpayers, not the poor. However, in most of the countries with which we are concerned – the poorest, and those dependent on aid and mineral resource wealth – the pressure for governments to be accountable or responsive to taxpayers is likely to have more positive effects at a more basic level of the polity, by encouraging the creation of the kinds of stable institutions and predictable political behaviours that are often in deficit. Poor people will normally benefit, and rarely lose out, when ruled by governments that, because they are dependent on general taxes, face incentives to coax rather than simply extract revenues from citizens, and consequently (a) confront restraints on their power; (b) are motivated to protect human and property rights and (c) understand that they and citizens share a common interest in economic growth.

2) If we perceive an intrinsic political value to taxation, through its tendency to engage taxpayers, and therefore mobilise them politically to confront and bargain with the state, should we then not be recommending an emphasis on so-called *direct* taxes, and regret the very rapid recent spread in developing countries of *indirect* value-added taxes (VAT)?³⁹ Another ‘no’. The reason is that, from a political

37 In many poor countries, but especially in Latin America, this is an irrelevant concern, because the poor already pay more tax, relative to their incomes, than do the rich – albeit mainly in indirect taxes.

38 Moore (2003) and Landa and Kapstein (2001).

39 At the beginning of this decade, VAT was in operation in about 130 countries and, despite not being used in the United States, generated around a quarter of the world’s total tax revenue (Ebrill *et al.* 2002).

perspective, VAT is a *direct* tax: it impacts very perceptibly on enterprises. Its introduction has been resisted strongly in some developing countries, mainly because of the visible, continuing book-keeping burden it imposes on small businesses.⁴⁰ Once VAT is introduced, business and tax authorities tend to be in continual negotiation over precise procedures and coverage and, in the case of exporters, timeliness of repayment of VAT export rebates.⁴¹

8 How are taxes assessed and collected?

In Sections 5 and 6, I presented the positive effects of taxation on governance, and in Section 7 suggested that we need have no great concern that the main kinds of taxes employed in poorer countries might be inappropriate to their role of mobilising taxpayers politically in a constructive way. Unfortunately, we cannot leave the story here. Taxation has its dark side: it can be destructive as well as constructive in governance terms. The quality of governance in some countries would be improved if some taxes were simply abolished. In other contexts, major modifications in the ways in which taxes are assessed and collected would be very desirable. The problem is the existence of what I term *coercive taxation*: assessment and collection conducted in ways that are likely to be validly perceived by taxpayers as arbitrary, extractive, unfair or brutal.⁴² Coercive taxation takes many forms. We can usefully think of a continuum, defined in terms of the degree of brutality and arbitrariness involved. At the harsh end of the spectrum, local government employees in rural China swoop on a cluster of houses; drag out the household

40 For example, there was a long resistance from traders in India, including many strikes in the form of closure of retail outlets. It led to large scale protests, and to some riot deaths, in Ghana and Uganda. Some of this resistance stems from a combination of bad political tactics on the part of government and a perception, at least partly accurate, that VAT is being introduced in poor countries at the behest of the international financial institutions. VAT was re-introduced relatively smoothly in Ghana once the government paid attention to political tactics and presentation (World Bank 2001). Even when it was first introduced in Europe, VAT was recognised to impose a heavy burden on smaller businesses because of the additional and relatively complex record-keeping obligations it places on them (Dossier 1981).

41 The broader point is that the conceptual distinction between *direct* and *indirect* taxes was originally political, and has only more recently been re-defined by economists in questionable theoretical terms: the actual burden of direct taxes is alleged to be met by the person or enterprise that hands over the money to the tax-collector, while, it is claimed, the burden of indirect taxes is or can be passed on along chain of economic transactions until it is borne by the final consumer. VAT maybe the first widely used tax that is clearly direct on one criterion and indirect on the other. From that perspective, it is no surprise that, in his statistical investigations of the political dimensions of taxation in contemporary poor countries, Mahon (2006) chapter 6 found no evidence that the political effects of direct taxes were different from those of indirect taxes.

42 The argument in this section is made in more detail in Moore (2006). For contemporary accounts of coercive taxation in developing countries, see Bernstein and Lu (2003), Fjeldstad (2001), Juul (2006), and Prud'homme (1992).

heads; demand that each make a contribution to the development levy, the veterans' fund, the slaughter tax, the road construction fund, the land tax, the bicycle tax, the special products tax, the entertainment tax, the education fund, or any one of dozens of other charges; beat those who cannot or will not pay, and perhaps throw them in jail (Bernstein and Lu 2003). At the milder end of the spectrum, revenue authority officials turn up again at the offices of a large brewery and explain that, while they have indeed collected corporate and payroll taxes once for this quarter, they are behind with the collection targets set by their bosses, that they would like some more money, and that it really would not be in the company's interests to refuse to pay, not least because it can always be shown that the company has been evading some kind of environmental, health or employment regulations. These kinds of coercion are all too widespread. Why? There is a formal-legal answer: taxpayers have few rights. But why do they have few rights? I don't have a complete answer, but can see five reasons why public authorities in developing countries are motivated to tax coercively.

1) Taxation is always potentially coercive: state agents have authority to require citizens to hand over money, with no firm guarantee of reciprocity, in situations where they are perceived to have little or no choice. For a range of historical reasons, states are often powerful relative to most citizens in many poorer countries (Moore 2004). State agencies may face relatively few constraints in the ways in which they treat citizens. To some degree, it is not so much coercion in the tax relationship that demands explanation, but its absence. Why should tax officials generally not ask for 10,000 shillings, and agree then to drop the official demand to 6000 in exchange for a bribe of 1000?

2) The structure and organisation of economies matters. It is difficult (a) actually to collect taxes from low-income agrarian economies organised in small enterprises that lack formal, bureaucratic structure and operate without extensive use of banking systems and written or electronic records of economic transactions; and (b) to collect without resort to arbitrariness and coercion. In low income, agrarian economies, tax gathering tends to be coercive and conflictual, and the overall 'tax take' tends to remain low.⁴³ Look at the logistical advantages enjoyed by tax collection agencies in wealthier contemporary economies. Four factors facilitate their task, and help to explain the historical shifts from levying taxes on specific items (salt, tobacco, carriages, landed property, houses, individuals) to levying them according to accounting categories (especially, income, value-added, sales, turnover, profits, etc., rather than simply asset values):

(i) Extensive written and electronic records of economic transactions help collectors to hunt down their quarry accurately and to create effective checks against misappropriation within the tax bureaucracy itself.

43 That is partly why historians tend quickly to associate taxation with agrarian revolt. One of the more robust statistical findings in social science is that both over time and cross-sectionally, official tax collectors in richer countries, and especially in countries with a relatively small agricultural sector, succeed in capturing higher proportions of national income for the government. For recent statistical evidence on this point, see Cheibub (1998), Fauvelle-Aymar (1999), Piancastelli (2001), Remmer (2004), Ross (2001), Stotsky and WoldeMariam (1997). The statistical relationship was identified and labelled Wagner's Law as long ago as 1877.

- (ii) The relative insulation of most economic transactions and incomes from seasonality or the weather makes it feasible to collect most taxes in regular instalments over the course of a year.
- (iii) The widespread use of banking and other indirect systems of money transfer reduces the need for tax collectors to meet personally with most taxpayers.
- (iv) The prevalence of bureaucratically-organised economic enterprises provides opportunities to place the collection process on the impersonal and quasi-automatic basis that underpins most contemporary company taxation and employees' Pay-As-You-Earn systems.

Compare that process with collecting taxes in poor, agrarian societies. Most taxable units are small, so the overhead costs of collection tend to be high. Farm incomes tend to be seasonal and unstable, so collections are occasional and lumpy. The dearth of records of economic transactions and the limited use of banking systems encourage face-to-face interaction between taxpayer and tax assessor/collector, and oblige the latter to make discretionary decisions about tax liabilities that cannot easily be independently validated. Because a relatively large proportion of revenues are anyway eaten up in collection costs, tax administrations are unwilling to separate the roles of (a) assessing liabilities from (b) actual collection.⁴⁴ The man who tells you what you owe also gets his hands on the money. Because it is not easy to assess tax liabilities according to broad accounting concepts like income, capital, turnover, value-added or profit, taxes tend to be attached to specific goods or services. There is then a very wide range of potential taxes in law, increasing the scope for collectors to squeeze taxpayers.⁴⁵ These logistical factors endow tax collectors with considerable discretionary power; facilitate corruption and perhaps extortion; increase the 'leakage' of tax revenues into private hands;⁴⁶ generate resentment

44 The separation of assessment activities from collection, and the assignment of different offices or people to each, have been central to the construction of non-coercive taxation systems – e.g Brewer (1989: 101–14) and Danton (2001) – and are important components of many contemporary tax reforms. In explaining why the Chilean tax administration is so much more efficient than its Argentinean counterpart, Bergman points out that, in Chile, one department collects and manages the money while another assesses liabilities and enforces the law. In Argentina, all these powers are concentrated in the same department of the tax agency Bergman (2003: 622).

45 Local governments in contemporary agrarian societies often levy a very wide range of taxes and charges (Bernstein and Lu 2003). Central governments have sometimes done so in the past. In 1952, when Taiwan still had a large agricultural sector, a range of relatively minor taxes, including a slaughter tax, a household tax, a salt tax, an amusement tax and a feast tax collectively accounted for 16 per cent of central government revenues. By 1981, when per capita incomes had increased by about 500 per cent, some of these taxes had been abolished, and the remainder accounted for only 2 per cent of revenue (Republic of China 1982: 29 and 159–60).

46 To deal with this problem, there are no satisfactory general alternatives to intra-bureaucratic monitoring. In some contexts, rulers have preferred tax farming, i.e. the privatisation of collection. However, the image of the greedy, oppressive tax farmer has thoroughly penetrated public consciousness, and the practice has almost disappeared from the modern world. In eighteenth and nineteenth century Britain, the use of lay assessors was one means of guarding against extortion by tax bureaucrats (Danton 2001: 200–1), but using taxpayers in these roles would inevitably tend to reduce collection levels (Brewer 1989: 100).

and tax resistance on the part of taxpayers; establish taxation as the issue of choice for political rebels; and make it both practically and politically difficult for governments to appropriate a high proportion of national income through taxation, especially direct taxation.

3) The economic structure of poor, agrarian societies is conducive to coercive taxation for another and more directly political reason. One of the dominant themes in the study of the political economy of taxation is that potential tax-gatherers have strong incentives to bargain with, rather than to coerce, potential taxpayers whose main economic assets are in various senses mobile, and might be either hidden, withdrawn from production, or moved to another political jurisdiction. Poor agriculturalists in relatively densely populated localities are highly immobile in all senses: they cannot easily find land or citizenship elsewhere; it is not easy to sell the land they have; they cannot afford not to produce; and, without education or other capital, their prospects of earning a good living elsewhere are bleak. They are therefore prime victims for predatory tax-collectors.⁴⁷

4) As far as poor people are concerned, the more predatory tax-collectors are often not the central government agencies that raise most of the tax revenue, but the employees of small scale local governments. Along with the police, armies and various unofficial armed groups who man roadblocks, these local government employees are often the only public officials who find it worthwhile putting effort into squeezing pence out of the poor in taxes. Some of the reasons have been given above: the coercive potential inherent in the tax relationship and the paucity of juicy tax bases in poor agrarian societies. We can add in a set of inter-related phenomena characteristic of many poor countries: government is anyway relatively centralised; central tax agencies target the more lucrative tax bases, leaving local rural administrations with little to work with; the recent fashion for 'decentralisation' has justified 'unfunded mandates', i.e. devolving service delivery responsibilities to local governments without providing commensurate financial resources; and local governments are often almost entirely unregulated, and thus free to act tyrannically.

5) Our final point takes us up from the local agrarian environment to the global level. It is sometimes claimed that, in some poorer countries under the influence of the International Monetary Fund (IMF), central government tax administrations raise money coercively because they are under pressure to meet annual revenue collection targets agreed with the IMF (Gloppen and Rakner 2002). The truth is elusive. The IMF has a duty to try to ensure that governments raise revenue to repay loans or to maintain macroeconomic balance. It is however possible that tax administrations choose to exaggerate IMF pressure in order to excuse or justify extractive taxation, especially extraction from those businesses that are

47 Comparing district governments in Tanzania, where coercive taxation is widespread (Fjeldstad 2001; Fjeldstad and Semboja 2001), Hoffman and Gibson (2006) have recently demonstrated that, the more potentially mobile the populations are, the more likely they are to receive services in return for their tax payments.

large enough to constitute juicy revenue sources but do not enjoy special political protection. We know that in many poor countries, national tax administrations tend to focus on a relatively small number of medium and large formal sector businesses, and largely ignore the others, including large and growing urban informal business activities.⁴⁸ It is not clear how true it is that some politically-influential big companies get off very lightly.⁴⁹ There seems to be some kind of vicious circle in operation in some countries at least: tax administrations find it hard to tax the informal sector and the politically-influential wealthy, not least because their staff are reluctant to expose themselves to the dangers and hardships involved;⁵⁰ they therefore focus on the medium and larger companies that are on their books, but not politically-protected; and apparent pressure to meet IMF revenue targets provides a good excuse for ‘squeezing’ their normal ‘clients’, often in the context of emergency campaigns to meet targets at the end of a financial quarter.⁵¹ This dynamic effectively deflects attention away from what should be a major revenue policy objective: expanding the tax base by reducing exemptions and bringing new taxpayers into the net. Those people who do pay tax see the system as unfair, and are more likely in consequence to try to evade. It is not clear how big a role the IMF plays in all this. But it does at least have the potential to worsen the situation. As I explained in Section 6, in some poor countries the IMF in some degree substitutes for organised taxpayers in their traditional role as watchdogs over fiscal policy. The IMF has the power to undermine governance in the long term by encouraging, however unintentionally, tax collection practices that worsen relations between states and citizens. It is not clear how far it does this in reality.⁵²

48 In Tanzania, with a total population of more than 35 million people, 286 large taxpayers pay almost 70 per cent of the domestic taxes. (These data, relating to June 2005, were kindly supplied by the Tanzania Revenue Authority to Odd-Helge Fjeldstad.) The revenue base excludes many professionals, such as lawyers, doctors, and private consultants, as well as the more stereotypical, poor informal sector enterprises. Fewer than 1 per cent of the taxpayers pay more than 85 per cent of the direct taxes levied in Peru (Mostajo 2004).

49 This seems to be part of some standard taxpayers’ narrative about unfairness: we ordinary, decent people pay our taxes, but the big boys with political influence get away with it, as do people operating in the small scale informal sector or the blackmarket.

50 We know from various anecdotal sources that tax agency staff do not like to be given posts that (a) take them away from working in lucrative positions and (b) require them to make a great deal of effort to raise small amounts of money from very reluctant taxpayers. The latter kinds of ‘posts’ are attractive mainly to local government staff who lack alternative income earning opportunities. Staff of central tax agencies want to stay where the money is, preferably working in an office environment. They do not want to tramp around crowded streets trying to locate and identify informal businesses, and face hassle and threats for what are likely to be meagre pickings at the end of the day. I am especially grateful to Anuradha Joshi and Joseph Ayee for information from their research in Ghana.

51 In his comparative study of Argentina and Chile, Bergman demonstrates the long term damage to collection capacity that resulted from repeated ‘emergency’ revenue raising campaigns in Argentina (2003: 623).

52 It is very difficult to research these issues. There is almost no published research on the work practices and strategies of tax administrations. That which does exist relates almost entirely to front line tax collectors, not to their managers, and to local rather than to central revenue agencies. For some insightful recent exceptions, see Jairaj (2005) and Blundo (2006).

There is no clear dividing line between mildly coercive taxation and the firm enforcement of the law. Perceptions of the same event may differ radically. Similarly, there can be genuine differences over whether tax administrations should always try to treat taxpayers gently for fear of generating resentment or whether a very firm hand is not best because it (a) deters non-compliance generally, (b) demonstrates the overall fairness of the system, and (c) engages taxpayers politically and encourages them to mobilise around fiscal policy issues. One of the more successful cases of improved revenue systems in the past decade has been the South African Revenue Authority, which has both considerably increased the overall tax take but also provided a better service to taxpayers. It has used a variety of techniques, including very visible services of the ‘Scorpions’ – a special investigatory and police force focused on corruption and organised crime – to deal with recalcitrant larger companies (Hlophe and Friedman 2002; Smith 2003). The more fair a tax system is generally believed to be, the more it is possible for the tax administration to take a tough approach with problematic taxpayers without doing political damage. In South Africa, there is a widespread and plausible perception that the increased revenue will be put to good use to repay the social debts of Apartheid. Many poorer countries are not in this happy situation: much revenue is raised coercively, for no very convincing purpose, with damaging effects on relations between states and citizens. To some degree, this is an inevitable feature of low income economies. As I explained above, wealth and well-functioning markets make taxation easier. That is however only a part of the story. A range of policy and institutional reforms, including the simple abolition of some types of taxes, could reduce overall levels of coercion in the tax relationship.

9 Conclusion

In contemporary poor countries, there are two big sets of policy questions about the relationship between taxation and the quality of governance. The first set relates to governments that do not need to make much tax effort because they have large non-tax incomes from oil, gas and mineral exports or from foreign aid. The consequent lack of dependence on citizens tends consistently to undermine the quality of governance. The second set relates to coercive taxation. This is widespread and also undermines the quality of governance, and also leads to some rather brutal treatment of some poor people by others almost equally poor.

Fortunately, there are many policy changes that would improve the situation, and they could mostly be made in small steps.⁵³ The greatest scope for immediate change lies with aid donors, especially at the current moment when they are promising greatly to increase the level of aid given to the poorest countries, most of them already highly aid-dependent. The evidence on the effect of high levels of

⁵³ The issues treated in this paragraph are discussed in more detail in Fjeldstad and Moore (2006), where we do make some criticisms of conventional for tax reform policies from a governance perspective.

aid on the quality of governance is ambiguous (Section 4). However, provision of large aid volumes without taking steps to encourage the expansion of (efficient) domestic revenue-raising capacity in the long term is irresponsible. It would be hard for aid donors collectively to acquit themselves of such a charge. While many do support revenue reform projects, they collectively spend very little money on this activity.⁵⁴ None make clear statements linking aid to improvements in domestic revenue performance. Most prefer instead to emphasise the need for improved public expenditure management. One does not have to be a conspiracy theorist to realise that this emphasis on expenditure rather than revenue reform is in the institutional interests of donor agencies themselves. Especially in situations where many donors give general budget support, aid agency managers worry that corruption scandals in aid recipient countries will undermine political support for aid programmes at home. Focusing their resources on scrutiny of public expenditures in recipient countries is a way of reducing this risk. An emphasis on revenue generation has no such political side benefits, and might indeed invite awkward, sceptical questions about the need for aid in the long term. Similarly, despite the efforts of some inter-governmental organisations, aid donors have been successful to date at keeping off the policy agenda the fact that aid inflows into developing countries enjoy exactly the tax exemptions that are decried by the IMF and tax specialists. If donors trust recipient governments enough to give them general budget support, why do they not suggest that tax exemptions for their aid programmes be withdrawn? This would not change the amount of money going to the recipient, but it would help develop the local apparatus for revenue raising, and provide a fine example of practising what one preaches.⁵⁵

Many senior tax administrators in developing countries see themselves as having a professional mission to free their countries from humiliating aid dependence. Value Added Taxes (VAT), which are now in place in most countries, are good instruments for raising more revenue fairly.⁵⁶ A range of other recent reforms provide the basis for making the changes to policy and practice required so that taxation can contribute more effectively to the quality of governance. Stimulated partly by the increasing influence of international associations of tax administrators and related professions, many tax administrations have been reorganising and reorienting themselves to become more effective and more user-friendly, at least as far as larger taxpayers are concerned. The autonomous revenue authorities that have been established in many countries have, like many similar organisational fashions,

54 Ben Dickinson of the OECD Development Assistance Committee has recently calculated that, in 2004, official aid donors, excluding the IMF, spent US\$ 6.6 billion on support to improve government administration, economic policy and public sector financial management, and that only 2.7 per cent of this went to projects that had a taxation component (Ben Dickinson, private communication).

55 The case for removing some of the tax exemptions for aid has been made in detail recently by International Tax Dialogue (2006).

56 VAT remains quite controversial, partly because it is widely believed to be regressive. However, the implementation of VAT is so partial in many poor countries that the evidence suggests no general regressive impact in countries (Gemmell and Morrissey 2005). A more complete and better-managed VAT can be made non-regressive by zero (or low) rating for consumer items that account for a high proportion of poor people's budgets.

not lived up to the original, highly inflated expectations. They have however generally contributed to creating more effective revenue systems. It has been orthodoxy for some time that tax policy should focus on widening the tax net, whether by reducing the number and variety of exemptions or extending registration to a wider range of taxpaying businesses and individuals. More generally, there is already a substantial global expert consensus around possible and desirable tax administration and policy.

There are no great intellectual or organisational wars that need to be fought and won before governments and aid donors are in a position to change tax policies in ways that will improve governance: abolish some taxes; replace them with more modern and effective alternatives that can be levied less coercively; use widely known techniques to make the tax paying experience less coercive; and find national revenue sources to replace aid in the long term.

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