

Tax administration – an entry point for reforms

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From curse to development: natural resources,
institutions and public revenues

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- *No underdeveloped country has the manpower resources or the money to create a high-grade civil service overnight. But it is not sufficiently recognized that the revenue service is the 'point of entry'; if they concentrated on this, they would secure the means for the rest.*

Nicolas Kaldor (1963). 'Will underdeveloped countries learn to tax?'
Foreign Affairs 41 (January).

- The political importance of taxation goes far beyond providing income to finance the public sector, investments, and the basic needs of the population

“The tax blessing paradigm”

3 main processes through which taxation might improve the quality of governance (Braütigam et al 2008; Moore 2004):

1) **Common interest processes**

- Governments dependent on taxes, will be inclined to pursue policies to expand the economy and thus the tax base

2) **State apparatus process**

- Dependence on taxes requires states to develop tax raising capacities
- The development of an effective tax administration may stimulate the development of institutions in other parts of the public sector

3) **Accountability and responsiveness processes**

- The tax burden engages taxpayers-citizens collectively in politics, leads them to make claims on government for reciprocity, and thus enhances accountability and responsibility

Taxation and accountability

- Bargaining over taxes is central to building relations of accountability between state and citizens based on mutual rights and obligations
 - *Social fiscal contract (Levi 1988, 2006; Tilly 1992)*
- For taxation to have a positive effect on accountability taxes must be ‘felt’ by a majority of citizens

The negative proposition:

- Governments which do not need to tax their citizens have little incentive to be accountable, responsive or efficient

- Non-tax revenues whatever their source tend to leave regimes more free to make whatever expenditures they wish without their having to be concerned about the likely reactions of citizens
 - Morrison (2009)
- Rentier states have limited incentives to build up institutions to collect and administer tax, or to extend the reach of the government to poorer, more remote regions
- In particular, large oil and mineral revenues are associated with low levels of democracy and states unbound by law
- Bad governance is often correlated with limited state reliance on revenues from taxation of its citizens and businesses

Taxation in democracies and dictatorships: Empirical evidence

- **Cheibub (1998)**: Regime type has no independent effect on the government's ability to tax
- **Boix (2001)**: Taxation grows more rapidly in democracies
- **Ross (2004) and Mahon (2005)**: Find support for the fiscal contract idea: Statistical evidence between increases in tax burden and, within a few years, increases in the degree of democracy
- **Prichard (2009)**: Evidence that in Ghana over the period 1981-2008
 - Tax conflicts have been a driver of key political processes
 - Conflicts over taxation have catalysed the formation or strengthening of important civil society bodies from business associations to radical protest movements
 - The formal business community the single most important lobby in favour of broadening the tax base

Taxation and Governance

Two main questions:

1. *How do taxation and sources of public revenue affect state building and governance in contemporary developing countries?*
 - Coercion versus consent
2. *What are the key political considerations involved in constructing arrangements that enable governments of contemporary developing countries to tax more effectively, more equitably, and more sustainably?*

Tax reforms may contribute to state-building in poor countries through four main channels:

1. Providing revenue
2. Shifting towards more appropriate revenue sources
3. Creating more effective tax administrations
4. Encouraging constructive state-society relations around taxes

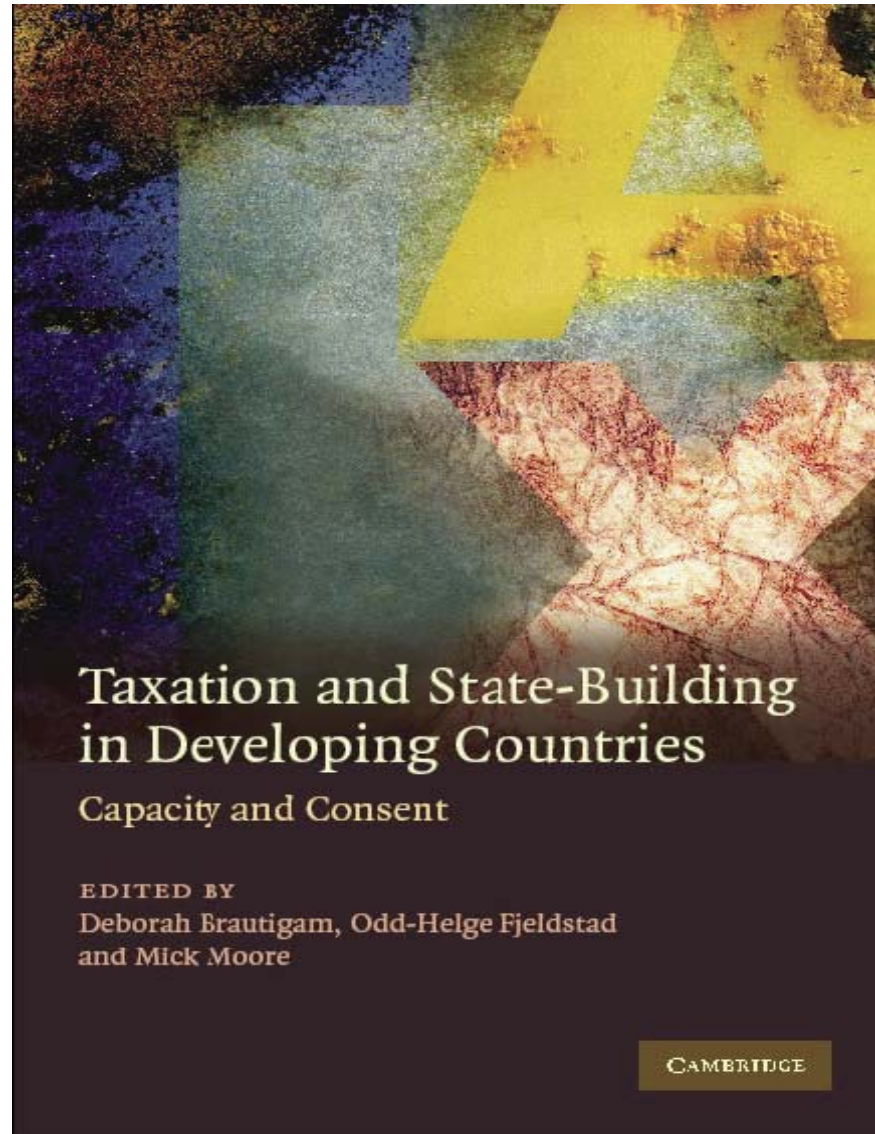
The tax reform agenda since the 1990s

- There are a large number of good things to report
 - Simplification of the tax system
 - Improved tax administrations at the central government level
 - SARAs: Integration of tax departments under one common leadership/management has facilitated better co-ordination, sharing of data etc
 - Improved attitudes of tax administrations towards taxpayers
- but also worrying problems in the poorest countries
 - Extremely narrow tax bases
 - Large informal sectors
 - The political and economic elite often not part of the tax base
 - Extensive/increasing tax exemptions
 - Massive revenues from natural resources not accounted for
 - Illegal capital flows contribute to entrenching existing tax structures

- but, considerable opportunities to build on the existing tax reform agenda with a view to:
 - Making it more responsive to the needs of poorer countries
 - Engaging a broader range of citizens in politics by mobilising them as taxpayers, and so contributing to the legitimacy of the state

- How:
 - Finding more effective ways to tax the informal sector
 - Reducing/eliminating tax exemptions
 - Strengthening tax administrations
 - Professional learning networks (e.g OECD's Outreach Progr)
 - South-South cooperation (e.g. ATAF)
 - Strengthening tax auditing functions
 - Build expertise/capacity on mineral and oil taxation

- Technical reforms do not work in the absence of political support
 - How to make the political elite accountable to citizens?
 - EITI
 - Peer pressure (e.g. APRM)
 - Capital flight may have reduced the interest of the political elite in local economic growth and development
 - International initiatives required to address the damaging impacts of illegal capital flows and tax havens on poor countries
 - “Convention for transparency in international economic activity”
- Reformers need to look more systematically into the political economy of taxation: the diversity of different country situations and different tax arrangements matter



<http://www.cambridge.org/us/catalogue/catalogue.asp?isbn=9780521888158>

Braütigam, Deborah, Odd-Helge Fjeldstad and Mick Moore. (eds). 2008. *Taxation and state-building in developing countries: Capacity and Concent.* Cambridge University Press.

Purpose of the book:

- To demonstrate how tax systems and polities interact with and shape one another in developing countries

Core policy position:

- A politically-informed analysis of the relationship between taxation and state formation often leads to recommendations different from those espoused by the “Washington Consensus”

<http://www.cmi.no/publications/publication/?2598=taxation-and-state-building-in-developing>