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CMI BRIEF 2026:07

# When rules become discretionary: Business taxation under democratic decline

AUTHORS | **Odd-Helge Fjeldstad**, Chr. Michelsen Institute & African Tax Institute
**Ingrid Hoem Sjursen**, Chr. Michelsen Institute

## Summary

Across sub-Saharan Africa, democratic governance has weakened over the past decade. While growing attention has been paid to the implications for political institutions and economic performance, less is known about how democratic decline affects taxation and state-business relations.

This brief draws on international research and evidence from mainland Tanzania and Zanzibar to examine how democratic decline influences business taxation. The findings suggest that the most important effects occur not through changes in statutory tax rates, but through changes in how tax systems are administered and experienced by firms. As democratic institutions weaken, businesses often report greater uncertainty, inconsistent implementation of rules, selective enforcement, and declining confidence in the fairness of tax authorities. These dynamics influence compliance, investment decisions, and business formalisation, with important implications for domestic revenue mobilisation and long-term fiscal capacity.

## Key messages

- Democratic decline affects business taxation primarily through changes in tax administration rather than through changes in tax laws or tax rates.
- As democratic institutions weaken, taxation may become more discretionary, less predictable, and less transparent, increasing uncertainty for firms.
- Trust, fairness, procedural integrity, and confidence that other firms are complying are critical drivers of business tax compliance.
- Politically connected firms may benefit from preferential treatment, while smaller and less connected firms face higher compliance costs and greater exposure to arbitrary enforcement.
- Revenue collection can remain stable in the short term despite democratic decline, but erosion of trust and compliance norms may weaken fiscal capacity over time.
- Development partners should assess tax systems not only through revenue outcomes but also through indicators of legitimacy, accountability, and taxpayer trust.

## Context and problem statement

Taxation is central to state capacity, development finance, and the relationship between governments and economic actors. Businesses contribute a large share of tax revenues in most developing countries, yet their experiences with taxation remain underexplored. At the same time, many countries are experiencing democratic decline characterized by weaker judicial independence, reduced constraints on executive power, and declining impartiality of public institutions. While tax systems may continue to generate revenue under these conditions, the quality of tax administration may deteriorate. Increased discretion, weaker accountability, and less predictable enforcement can undermine trust in public institutions, distort competition, and weaken the foundations of sustainable domestic revenue mobilisation.

## Why democratic decline matters for taxation

Research suggests that democratic decline affects taxation primarily through four interconnected channels.

### *Greater administrative discretion*

When institutional constraints weaken, tax authorities often gain wider discretion in interpreting and enforcing rules. Formal tax laws may remain unchanged, but implementation becomes less predictable and more uneven across taxpayers.

### *Erosion of trust and fairness*

Tax compliance depends on more than audits and penalties. Firms are more likely to comply when they perceive tax authorities as fair, competent, and impartial. Democratic decline can weaken these foundations by increasing uncertainty and reducing confidence in institutional integrity.

### *Unequal treatment of firms*

Under more discretionary systems, politically connected firms may obtain exemptions, favourable treatment, or softer enforcement. Smaller and less connected businesses are often less able to navigate such environments and may face disproportionate compliance burdens.

### *Weaker compliance norms*

Businesses respond not only to tax authorities but also to their perceptions of competitors' behaviour. If firms believe others evade taxes without consequences, voluntary compliance becomes increasingly difficult to sustain.

## Evidence from Tanzania

Recent surveys of businesses in mainland Tanzania and Zanzibar highlight several patterns relevant to understanding taxation under institutional weakening.

### *Low trust in tax authorities*

Trust among businesspeople is relatively low and is driven primarily by perceptions of fairness, service quality, transparency, and confidence that other firms are complying with tax obligations.

### *Administrative complexity and uncertainty*

Businesses frequently report challenges associated with overlapping taxes, multiple regulatory requirements, and uncertainty regarding tax obligations. These concerns often influence business decisions more strongly than tax rates themselves.

### *Uneven implementation*

Many firms perceive tax rules as inconsistently applied. Concerns about unequal treatment and unpredictable enforcement affect decisions regarding investment, compliance, and business expansion.

The tourism sector in Zanzibar illustrates these challenges particularly clearly. Firms face numerous taxes, levies, licensing requirements, and reporting obligations administered by different authorities. The resulting complexity increases compliance costs and creates opportunities for discretionary enforcement.

## Implications for fiscal capacity

Democratic decline does not necessarily reduce tax revenue immediately. Governments may maintain or even increase revenue through stronger enforcement and administrative control.

However, the longer-term consequences may be more problematic.

Where trust, fairness, and voluntary compliance erode:

- More firms may operate informally.
- Compliance costs may increase.
- Investment and business expansion may be discouraged.
- Taxpayer resistance may grow.
- Revenue systems may become less stable and less resilient.

As a result, tax systems can appear fiscally stronger in the short term while becoming institutionally weaker over time.

These dynamics also have implications for development finance. Governments may maintain revenue collection in the short term through stronger enforcement or administrative control, creating an appearance of fiscal strength. However, if trust, compliance norms, and investment incentives deteriorate, the reliability of future revenues may weaken. Over time, this can narrow fiscal space, increase reliance on borrowing, and reduce the state's capacity to finance development through domestic resources. Democratic decline may therefore contribute to fiscal fragility even where immediate revenue effects appear limited.

## Policy implications for development partners

The findings raise difficult questions for development partners working on domestic revenue mobilisation (DRM), governance, and private-sector development. Many conventional tax reform programmes assume governments are committed to improving transparency, accountability, and taxpayer services. Under conditions of democratic decline, however, these assumptions may no longer hold. Governments may have incentives to maintain administrative discretion, limit scrutiny, and prioritise revenue extraction over taxpayer trust and long-term fiscal legitimacy.

This does not imply that support for taxation and business development should be abandoned. Rather, it suggests a need to adapt strategies to political realities and place greater emphasis on protecting the institutional foundations of legitimate taxation.

### *1. Monitor taxpayer experiences, not only revenue outcomes*

Development partners should broaden the indicators used to assess tax-system performance. Revenue growth alone provides an incomplete picture of fiscal capacity under democratic decline. Taxpayer trust, perceptions of fairness, transparency, predictability, dispute-resolution mechanisms, and confidence in public institutions should be monitored alongside conventional revenue indicators.

Independent business surveys can provide valuable information on how firms experience taxation and whether administrative practices are becoming more discretionary or politicised.

### *2. Support intermediary institutions*

Where direct influence on government institutions is limited, support for intermediary actors may become increasingly important. Business associations, chambers of commerce, professional organizations, and research institutions can provide channels through which firms collectively articulate concerns about taxation, administrative burdens, and regulatory uncertainty.

Such organizations may help preserve dialogue between taxpayers and the state even when formal accountability mechanisms are weakening.

### *3. Protect transparency and accountability in digital tax reforms*

Many development partners support digitalisation of tax administration. Digital systems can reduce corruption, simplify compliance, and improve revenue collection. However, under conditions of democratic decline, digitalisation may also strengthen state surveillance and increase opportunities for selective enforcement.

Support for digital tax reforms should therefore be accompanied by safeguards related to transparency, oversight, data protection, taxpayer rights, and accessible complaints mechanisms.

### *4. Strengthen the resilience of small and medium-sized enterprises*

Small and medium-sized enterprises are often most vulnerable to administrative uncertainty and arbitrary enforcement. Development partners can help reduce these risks by supporting legal aid initiatives, taxpayer education, business-support services, and platforms that improve access to information about tax obligations and taxpayer rights.

Support for business resilience may become particularly important where formal institutional protections are weakening.

### *5. Invest in independent evidence and research*

One of the most striking findings of this review is how little is known about the effects of democratic decline on taxation and business behaviour. Development partners can play an important role by supporting independent research, business surveys, and long-term monitoring of taxpayer experiences.

Such evidence can provide an early warning system for identifying institutional deterioration before its consequences become visible in revenue statistics or broader economic indicators.

More broadly, the findings suggest that development partners should view business taxation not merely as a technical issue of revenue collection but as an important indicator of institutional quality. How firms experience taxation often reveals broader changes in governance, state capacity, and accountability. In contexts of democratic decline, preserving trust, predictability, and fairness may be as important for long-term development outcomes as increasing revenue collection itself.

## Conclusion

Business taxation provides an important lens through which to understand the economic consequences of democratic decline.

The evidence suggests that democratic decline affects taxation primarily through changes in governance and administration rather than through changes in tax policy. As tax systems become more discretionary, less predictable, and less accountable, firms face greater uncertainty and reduced confidence in public institutions.

Sustainable domestic revenue mobilisation depends not only on collection capacity but also on trust, fairness, accountability, and predictable state-business relations. Strengthening these foundations will be essential for maintaining fiscal capacity, supporting private sector development, and financing long-term development goals.

## Further reading

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**How to cite this publication:** Fjeldstad, O.-H., and Sjursen, I.H. (2026). When rules become discretionary: Business taxation under democratic decline. *CMI Brief*. Chr. Michelsen Institute.
This policy brief is based on the report Business taxation under democratic decline: a literature review (CMI Report 5, 2026).



**CMI (Chr. Michelsen Institute)**
Phone: +47 47 93 80 00
Phone from abroad: +47 55 70 55 65
E-mail: cmi@cmi.no

P.O. Box 6033,
N-5892 Bergen, Norway
Visiting address:
Jekteviksbakken 31, Bergen

ISSN 0809-6732 (print)
ISSN 0809-6740 (PDF)