

## **Taxation and State Building in Developing Countries**

Edited by Deborah Brautigam, Odd-Helge Fjeldstad and Mick Moore

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### **OUTLINE**

#### **Introduction**

Taxation is a core governance function. It has the potential to shape relations between state and society in significant and distinctive ways. Tax revenues allow states to provide security and public goods. “The history of state revenue production,” Margaret Levi declared, “is the history of the evolution of the state (1988: 1).” For these reasons, taxation should be accorded a central role in analyses of state building. There is a large historical literature, relating especially to Western Europe (and a smaller, but conceptually rich, political science literature on the interaction between states and citizens over taxes (Tilly, Levy, Bates, etc.). Yet although the subject of state building is now high on academic and policy agendas, the relationship between state-building and taxation in the developing world has received almost no sustained scholarly attention.

This volume focuses specifically on taxation and state building in a range of contemporary 'developing' countries, from upper-middle income Poland and Russia to ultra poor rural Tanzania and Uganda. These countries both challenge and confirm some of the conclusions reached by earlier scholars who focused on high income countries. Developing countries differ structurally from those in wealthier regions. They are politically and economically dependent on commodity exports; they often have large agrarian and informal sectors; some have recently emerged from central planning systems; they have high levels of exposure to external political and economic influence and to aid donors and international financial institutions. The core social scientific purpose of our volume is to demonstrate how, in those circumstances, taxation systems and politics interact with and shape one another. The core policy position, developed in the final chapter, is that a politically-informed analysis of the relationship between taxation and state formation often leads to recommendations different from those espoused by the “Washington Consensus”.

## **Background**

This book is founded on collaboration between three scholars who have long been researching the topic. Deborah Brautigam, Associate Professor at the American University, Washington DC, is a political scientist. She was one of the first people to put the governance dimensions of taxation on the agenda of international development agencies in a 1992 article written while she was an adviser to the World Bank. Over the past six years, she has been engaged in a long-term comparative study of the development of social democracy in Mauritius, in which issues of taxation loom large. Odd-Helge Fjeldstad, a public sector economist, is Research Director at the Chr. Michelsen Institute, Norway. He has authored several articles on central and local taxation in Africa. Between 1999 and 2004 he held a large research grant from the Research Council of Norway which supported some of the work that appears here. Mick Moore, a political scientist, is a Professorial Fellow at the Institute of Development Studies at the University of Sussex, UK. Since 2000, he has been Director of the Centre for the Future State, a multi-year international research grant worth \$5 million to date. This has financed three research programs, including one on taxation in developing countries.

The initial ideas for this volume were presented in a 2002 issue of the *IDS Bulletin* titled 'The New Politics of Taxation and Accountability'. Several of the contributors to that issue were invited to join the editors in this project. We have held two conferences on taxation and state-building, in 2002 and 2004, and the co-editors have met several times to work together, including a two-week period in August 2005. We began with a large array of potential contributors, and have rejected draft chapters that could not reach the required standard. To improve our regional and thematic balance, we have also commissioned three new contributions from scholars who did not attend either conference. In sum, the volume is the opposite of a set of conference papers. It represents the fruit of a long and careful process of intellectual and editorial critique, interaction, winnowing, and progress. It has been our intention from the beginning to produce a volume that would become the standard source on our major question: *How does taxation contribute to state building in contemporary poor/developing countries?*

## **Substance**

Few social scientists would dissent from the proposition that patterns of state-society interaction are central to the construction of effective and accountable states. There is however less agreement about the identity of the central societal actors and political institutions. Contemporary comparative politics provides two main alternative answers. The first is various categories of mobilized citizens acting through institutions of representation and electoral democracy. The second is mobile capital, acting to constrain and guide the state through the tacit threat of dis-investment or international capital transfer. In the contemporary high-income world, these two sources of constraint on the state are increasingly seen as being in direct conflict with one another. Especially in the context of concerns about globalization, *the* choice for the future is often presented as being between democracy and the power of (mobile and international) capital. Taxpayers are subsumed into one or other of these categories, but are not considered as a separate category of actors. Neither is the taxpaying relationship seen as a potential constraint on state power or a major focus of state-society interaction. The history of state formation in 'historical Europe' encourages us to think differently. At the extreme, and most notably in Britain and the Netherlands, the relationship between taxpayers and the state to a significant degree subsumed or substituted for the relationships with citizen-voters and capitalist investors, respectively. It is the contention of this book that by treating the taxpaying relationship - and its associated institutions - as analytically distinct, we can gain additional purchase in understanding processes of state formation. The book addresses two main questions, broadly in the following sequence:

1. *How do taxation and sources of public revenue affect state building and governance in contemporary developing countries?* A major axis of debate is whether the taxation relationship either (a) is intrinsically coercive and therefore inimical to consensual governance, or (b) as one prominent interpretation of European history suggests, provides an opportunity for the creation of consensual and representative government through 'revenue bargaining' between states and organized citizens. Chapters 2 to 5 focus on this issue. Chapter 2, an analytical review of the debate, provides an interpretation of the

relevance of the European historical experience and an explanation of how contextual factors affect outcomes in the contemporary world. Chapters 3 to 5 deal comparatively with cases of *coercive taxation* (China and East Africa) or more or less *consensual taxation* (Poland and Russia). Today and in recent history, governments of many poor countries have depended heavily for revenue on taxes on primary commodity exports. Such revenues have been almost the defining feature of poor countries from a public finance perspective. Chapters 6 and 7 deal with two contrasting cases of the impact of export taxes on state building. In one case - sugar in Mauritius - there was a great deal of bargaining between sugar producers and successive governments, which in turn contributed to effective state building. In the second case - nitrates in Chile - bargaining between producers and the state took place, but was never institutionalized.

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?* Most industrialized countries have succeeded in creating high levels of both capacity and consent. Their governance rests on fiscal systems that are the subject of policy debate, but rarely thrown into fundamental question or doubt. Developing countries are more diverse and, in most cases, in a far less happy situation. Their tax systems are often regressive and distortionary. Tax administration is usually weak and characterized by extensive evasion and corruption. Coercive modes of taxation are common. In many cases overall tax levels are low, and large sectors of the economy escape the tax net entirely. What represents politically feasible tax reform in contemporary developing countries? While Chapters 1-7 bear on this question, it is the explicit focus of Chapters 8-10. Chapter 8 deals with one of the most problematic issues for tax administrations in contemporary poor countries: the enormous obstacles to levying direct taxes on the large informal sectors of the economy. The authors deal with it from a novel angle: on the basis of case study material from three countries, they explore the political conditions that might make it possible for governments to use private associations to collect income taxes. Chapter 9 focuses on a similarly important issue, from the perspective of Republican China in the early twentieth century: the creation of adequate organizational autonomy for tax administrations to enable them to perform

effectively. It leads directly to Chapter 10, which sets out the main implications of the analysis in the previous chapters for tax policies and tax reform in contemporary developing countries. How might the standard advice of the tax professionals be modified to take account of state building objectives?

### **Location in the literature**

The book builds on a range of existing literature, notably:

- A substantial historical literature on taxation and state building in Western Europe, notably by Charles Tilly; and including some 'extensions' of the analyses developed there into different contexts by, for example, Miguel Centeno.<sup>1</sup>
- A large contemporary literature on state building in peripheral/developing countries, including Robert Bates, Catherine Boone, Peter Evans, Barbara Geddes Jeffrey Herbst, Terry Karl, and Crawford Young.<sup>2</sup>
- A range of work, most of it published in journal articles, oriented around the framework for analyzing capacity and consent in the taxation relationship, as suggested by Margaret Levi.<sup>3</sup>

There is however very little work published in book form that deals with taxation and state building in contemporary developing countries. The most prominent exception is Evan Lieberman's comparative historical exploration of the relationship between direct taxation and citizenship in Brazil and South Africa.<sup>4</sup> There is no competitor to this book currently in the market. To the best of our knowledge - and we collectively have very

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<sup>1</sup> Tilly, C. 1990. *Coercion, Capital and European States, AD 990-1992*. Oxford: Blackwell; Centeno, M. A., *Blood and Debt: War and the Nation-State in Latin America* (University Park: Penn State University Press, 2002).

<sup>2</sup> Bates, R. 1983. *Essays on the Political Economy of Rural Africa*, Cambridge/London: Cambridge University Press.; Boone, C., *Political Topographies of the African State. Territorial Authority and Institutional Choice* (Cambridge and New York: Cambridge University Press, 2003); Evans, P. B., et al., (eds.) *Bringing the State Back In* (Cambridge and London: Cambridge University Press, 1985); Geddes, B., *Politician's Dilemma: Building State Capacity in Latin America* (Berkeley: University of California Press, 1994). Herbst, J., *States and Power in Africa. Comparative Lessons in Authority and Control* (Princeton N. J.: Princeton University Press, 2000); Karl, T. L., *The Paradox of Plenty. Oil Booms and Petro-States* (Berkeley, Los Angeles and London: California University Press, 1997); Young, C., *The African Colonial State in Comparative Perspective* (New Haven and London: Yale University Press, 1994).

<sup>3</sup> Levi, M. 1997. *Consent, Dissent, and Patriotism*. Cambridge University Press; and Levi, M. 1988. *Of Rule and Revenue*. Los Angeles, CA: University of California Press.

<sup>4</sup> Lieberman, E. S., *Race and Regionalism in the Politics of Taxation in Brazil and South Africa* (New York and Cambridge: Cambridge University Press, 2003).

wide contacts among those researching the topic - there is no similar work in process. The relevant literature appears mainly in article form.

### **Readership**

The immediate target reader is either an academic/researcher interested in issues of state building and tax reforms in contemporary developing countries or someone working in a more directly policy-oriented role in one of a large number of organizations dealing with 'development': international organizations of many kinds (World Bank, International Monetary Fund, UN agencies, African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, OECD), about thirty bilateral aid donor agencies, and a very large number of international NGOs. Individuals often move between these organizations. We have very good contacts with those networks. Each of the three co-authors has been involved over a long period of time in working with these agencies over taxation issues - Brautigam with the World Bank, and Fjeldstad and Moore mainly with a range of European agencies. In order to attract media attention to the book, we will organize - through the Centre for the Future State which Moore directs - a series of launch events in both Europe and Washington DC.

We shall also be aiming to place the book on the reading lists of a wide range of graduate classes in comparative politics (especially in the US) and in development studies (especially in Europe). One of us has recent successful experience of placing a very similar type of product - a co-edited book on the politics of poverty in developing countries, published by a leading university press - on a sufficient number of reading lists that it has been published in paperback.<sup>5</sup> In addition to the publicity mentioned above, the main strategy used will be extensive personal networking within these two constituencies.

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<sup>5</sup> Peter Houtzager and Mick Moore (eds), *Changing Paths. International Development and the Politics of Inclusion*, Ann Arbor: University of Michigan Press, 2003.

## **Editors**

*Deborah Brautigam*, a political scientist, is Associate Professor in the International Development Program of American University's School of International Service. Brautigam is the author of two monographs *Chinese Aid and African Development: Exporting Green Revolution* (1997) and *Aid Dependence and Governance* (2000), and several dozen articles and book chapters on foreign aid, the political economy of development, and the politics of economic policy. Her research has been published in *Comparative Politics*, *World Development*, *Economic Development and Cultural Change*, *Studies in Comparative International Development*, *Public Administration and Development*, *The Journal of Modern African Studies*, *African Affairs*, and the *Yale Journal of International Affairs*. She has been the recipient of a Fulbright Senior Regional Research Award for Africa, and a Fulbright-Hays Faculty Research Grant, and has also been awarded residency fellowships from the Council on Foreign Relations and the Woodrow Wilson International Center for Scholars. She is currently working on a book about small states, social democracy, and globalization, with Mauritius as the central case.

*Odd-Helge Fjeldstad* is Research Director at Chr. Michelsen Institute, Norway, and Director of the U4 Anti-Corruption Resource Centre. He holds a PhD (Dr.oecon) in economics from the Norwegian School of Economics and Business Administration. In the period 1999-2004 he directed the research program 'Taxation, Aid, and Democracy'. This was the first comparative study of revenue systems in African countries that explored the evolution and performance of the local and central government tax systems. In 2003, it was ranked by the Research Council of Norway as one of its best performing research programs within development studies with respect to academic publications as well as policy relevance. Fjeldstad has published widely on tax reforms, tax compliance, revenue administration, fiscal corruption and decentralization. His research has been published in *World Development*, *Journal of Modern African Studies*, *Public Administration*, *IDS Bulletin*, *Public Administration and Development*, *Forum for Development Studies*, *Afrique Contemporaine*, and *the International Handbook on the Economics of Corruption*. Fjeldstad has considerable experience in research management, involving long-term collaboration with research institutions in Africa and Europe. He has served as a consultant on fiscal reforms for the

Government of Tanzania, the Government of Zambia, the UK Department for International Development (DFID), the Norwegian Agency for Development Cooperation (Norad), the International Finance Corporation (IFC) and the World Bank.

*Mick Moore*, a political scientist, has previously published with CUP.<sup>6</sup> He is Director of the Centre for the Future State, based at the Institute of Development Studies at the University of Sussex, UK. The Centre, which has been in existence for 6 years, researches issues of state formation and effective governance in contemporary poor countries. Moore has been researching and writing on the connection between state revenues and the quality of governance for several years. One of his early publications on the subject - 'Death without taxes: democracy, state capacity, and aid dependence in the fourth world' [in Mark Robinson and Gordon White (eds.), *The Democratic Developmental State: Politics and Institutional Design*, Oxford University Press, 1998] - has attracted considerable attention and been the reference point for other research and for policy debate. He has a number of other publications on taxation, both scholarly and policy-oriented, and has supported and been strongly involved in the work leading up to this volume for several years. He is currently working with the staff of the UK Department for International Development, the leading European aid agency, especially in respect of issues of politics and governance, on the early drafts of a new national aid policy statement ('White Paper') that will appear in 2006.

### **Practicalities**

The manuscript is about 120,000 words in total. It is complete, and ready for review. There are a small number of tables.

### **Chapters**

Of the ten chapters, four are single-country case studies, three are comparative, and three are thematic. The case material is from the following countries: Chile, China (both contemporary and Republican China in the 1920s and 1930s), Ghana, Mauritius, Peru,



Poland, Russia, Senegal, Tanzania and Uganda. Most of the chapters have a strong historical dimension.

**1. Deborah Brautigam** (Associate Professor, School of International Service, American University) Introduction: taxation and State Building in Developing Countries. [The introduction establishes the rationale for the book, positions it within the relevant literature, and provides an overview of the chapters.]

**2. Mick Moore** (Professorial Fellow, Institute of Development Studies at the University of Sussex, UK) Between Coercion and Contract: Competing Narratives around Taxation and Governance. [There are two competing meta-narratives about taxation and governance. One is that taxation contributes to political development by helping to catalyze 'revenue bargaining', i.e. the exchange of tax revenues (for the state) for institutionalized influence over public policy (for citizens). The other is that the tax relationship embodies a highly coercive relationship between states and citizens. Using a wide range of material from 'historical Europe' and contemporary poor countries in particular, the author provides an analytic summary of what we know about the circumstances likely to nurture 'bargaining' or 'coercion' respectively. This chapter also serves as a specific introduction to the next three chapters in particular].

**3. Gerald M. Easter** (Associate Professor, Department of Political Science, Boston College). Capacity, Consent and Tax Collection in Post-Communist States. [Poland and Russia exemplify the contrasting post-communist state-building processes in East Central Europe and the former Soviet Union respectively. The chapter explores the politics of three sequential processes - the making of revenue bargains in the course of establishing new tax regimes; the consequent attempts to collect taxes; and the eventual remaking of revenue bargains in order to carry out tax reform - and how they helped place regimes on different developmental paths. Compared to the states of the former Soviet Union, the East Central European states exhibit more democratic decision-making, more progress in developing efficient tax administration capacity, and greater societal consent to taxation.]

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<sup>6</sup> *The State and Peasant Politics in Sri Lanka*, 1985.

**4. Tom Bernstein** (Professor, Department of Political Science, Columbia University) and **Xiaobo Lü** (Associate Professor, Department of Political Science, Columbia University). Taxation and Coercion in Rural China. [The dismantling of the central planning system left local governments in the more agricultural areas of rural China seriously short of revenue. At the same time, they have been burdened by higher levels of government with new unfunded mandates. There has in consequence been a substantial revival of the practice of coercive and extractive taxation at local level. This in turn has generated a great deal of localized political unrest, and has led Beijing to intervene to try to abolish local taxes.]

**5. Odd-Helge Fjeldstad** (Research Director, Chr. Michelsen Institute) and **Ole Therkildsen** (Senior Research Fellow, Danish Institute for International Studies) Mass Taxation and State-Society Relations in East Africa. [Poll ('head') tax has been the most common form of direct mass taxation in many sub-Saharan African countries since colonial times. Until very recently it was a dominant source of revenue for local governments. It has been a source of tension and conflict between state authorities and rural people from the colonial period until today, and a major catalyst for many rural rebellions. By tracing the history of poll taxes in Tanzania and Uganda, the chapter examines how these taxes have impacted on state-society relations and why it has taken so long to abolish them. The authors' argue that insofar as poll taxes have contributed to democratization, this is not through the processes of state-society revenue bargaining, but by mobilizing rural people politically to combat a tax practice that they have experienced as repressive. As a result, the resentments caused by coercive local taxation have led central governments to abolish it.]

**6. Deborah Brautigam** Export Taxation and State-Building in Mauritius. [Taxes on agricultural exports have long been associated with urban bias and elite control over the countryside. This chapter uses the case of Mauritius, a high-performing African country, to make an alternative argument: export taxation can be a builder both of state capacity and of constructive state-society relations. During the colonial period, the sugar export

tax directly reinforced demands for democratic accountability and the building of a fiscal state with an unusually high number of Mauritian officials. Targeted resources from the tax were also deliberately used to construct corporatist institutions linking state and society, build a dirigiste but embedded state, solve collective action problems associated with technological change, consolidate the social base of the new democracy, and make foreign assistance into an 'earned' resource, avoiding the deleterious institutional consequences of aid dependence.]

**7. Carmenza Gallo** (Associate Professor, Department of Sociology, City University of New York) Tax Bargaining and Nitrate Exports: Chile 1880-1930. [The author uses the history of the politics around the taxation of nitrate exports from Chile over three sequential phases in the late nineteenth and early twentieth centuries to test general propositions about the conditions under which private exporters and the state might bargain in an institutionalized fashion over taxation. Of the several factors that affect the scope for such bargaining, the one that changed most and shaped the trajectory of relations between the state and exporters were world market conditions for nitrates.]

**8. Anuradha Joshi** (Fellow, Institute of Development Studies at the University of Sussex, UK) and **Joseph Ayee** (Professor of Politics, University of Ghana) Associational Taxation: A Pathway into the Informal Sector? [Potential taxpayers in contemporary developing countries are relatively heterogeneous. Despite a great deal of reform, tax administrations have had little success in taxing large and growing informal sectors of the economy. The chapter starts from a highly innovative mechanism, developed in Ghana, to use a private association of passenger road transport operators to collect income taxes from its members. This may be an effective way of developing a 'tax culture' in the urban private sector more generally. The authors make an analytical comparison between Ghana and similar initiatives in Peru and Senegal to suggest the conditions under which such unorthodox sub-contracting arrangements might be politically feasible.]

**9. Julia C. Strauss** (Senior Lecturer, School of Oriental and African Studies, University of London) Rethinking Institutional Capacity and Tax Regimes: The Case of the Sino-

Foreign Salt Inspectorate in Republican China. [A large number of developing countries are now establishing *semi-autonomous revenue authorities* as a means of improving tax compliance and collection. We know that they are often born into a rather hostile environment, and are often less successful than initially advertised. What lessons can we learn from the history of a rather similar attempt to create an autonomous revenue administration in a hostile environment: *the Sino-Foreign Salt Inspectorate* in Republican China? The first lesson is already implicit in the design of contemporary revenue authorities: the need to establish and preserve the organization's own internal integrity, chiefly through "strategies of insulation." The second lesson is novel, and highly relevant to contemporary revenue authorities: the need for "strategies of goal achievement," to provide buffering from the pressures of a hostile environment.]

**10. Odd-Helge Fjeldstad and Mick Moore** Tax Reform and State Building in a Globalized World. [What does a state-building perspective implies for tax policy and reform in contemporary developing countries. Tax policy is now globalized. There is a powerful orthodoxy, promoted in particular by the International Monetary Fund and transnational organizations of taxation professionals, that has helped animate an impressive process of tax reform virtually throughout the world. That orthodoxy is however driven by economic and fiscal considerations and by the perceived problems and needs of the richer parts of the world. A reform agenda focused on issues of state building in the poorer countries would look substantially different.]

Deborah Brautigam,  
Odd-Helge Fjeldstad  
Mick Moore