



Taxation, Non-Tax Revenue and Democracy: New Evidence Using New Cross-Country Data

Summary of Working Paper 23 by Wilson Prichard, Paola Salardi and Paul Segal

This paper finds support for the existence of a political resource curse. It draws on improved quality data from the International Centre for Tax and Development's Government Revenue Dataset (ICTD GRD) to re-examine existing econometric tests and significantly improve their robustness.

The challenge, and benefits of the ICTD Government Revenue Dataset

Most previous studies into the political resource curse find that governments that rely more heavily on revenue from natural resources are less likely to be democratic and accountable to citizens. But they have relied on data relating to the total value of natural resource production or "resource income". These fail to capture the key relationship of interest, namely the impact on political outcomes of the composition of government revenue from tax and non-tax sources respectively. Use of the ICTD GRD makes it possible to distinguish consistently between tax revenue excluding revenue from natural resource production (a proxy for revenue that has to be "earned" by bargaining with citizens); and non-tax revenue (dominated by natural resource revenue but including other forms of non-tax revenue, for example from state enterprises). This closely equates to "unearned" income.

The GRD thus provides data that captures the key theoretical propositions underpinning

the political resource curse, including two distinct but related causal mechanisms:

- i) Governments heavily dependent on tax revenue are expected to need to bargain with mobile taxpayers, leading to greater accountability and democracy.
- ii) Governments with access to non-tax revenue, primarily from natural resources, are more autonomous from citizens, and empowered to resist political opposition through repression or expanded public spending and patronage.

The GRD makes it possible to identify the proportion of resource income that governments are able to capture as revenue and use for repression or patronage.

The ICTD Research: approach and methodology

Using the GRD, this research tests the relationship between democracy (the dependent variable) and three measures of government revenue, namely:

- i) Variable 1: total tax collection excluding resource revenue as a share of GDP. ➤

“The evidence for a political resource curse is robust and the effects are large.”

- ii) Variable 2: total non-tax revenue as a share of GDP.
- iii) Variable 3: combines i) and ii) to produce a measure of tax reliance (the share of non-resource tax revenue in total government revenue).

The research focuses on the extent of non-tax revenue in relation to other sources of revenue and the overall size of the economy, on the premise that the impact on incentives and behaviour of political leaders and citizens depends on the relative rather than the absolute size of resource revenue. It looks first at simple cross country correlations between democracy and the three alternative revenue measures: these show that countries that are more reliant on tax revenue and less reliant on non-tax revenue tend to be more accountable. It then moves beyond simple correlations, applying GRD data to several alternative econometric models that draw on the existing literature. The first two offer complementary approaches to estimating the relationship between the composition of government revenue and continuous measures of democracy, controlling for national income per capita, the occurrence of violent conflict, and regional diffusion of democracy. The third approach focuses on the impact of the composition of government revenue on the likelihood of transition from autocracy to democracy, or from democracy to autocracy.

Results

Overall, the research finds strong evidence for the existence of a political resource curse. Across the vast majority of tests it finds both a statistically positive relationship between tax reliance and democracy, and a statistically negative relationship between non-tax revenue (predominantly from natural resources) and democracy. The broad results are robust to alternative control variables and measures of democracy. Moreover, increased non-tax revenue and decreased tax reliance have a very large impact on the likelihood that a country will transition to, or remain, a democracy. The likelihood of a democratic transition is three

times larger in a country with low levels of non-tax revenue as compared to countries with 10% or more of GDP from non-tax revenue.

However, results are sensitive to alternative econometric models and changes in specification. This is particularly the case for results relating to total tax collected exclusive of resource revenue. This variable tends towards having a positive impact on democracy but ranges from positive to negative significance, while most often being insignificant. This may indicate that tax revenue has little consistent impact on levels of democracy, or (quite plausibly) that the relation between taxation and democracy is complex and non-linear, and not adequately captured in the models. For example, any impact of taxation on democracy may occur over the long term, through subtle changes in the levels of political engagement among increasingly burdened taxpayers.

Implications for policy and research

The evidence for a political resource curse is robust and the effects are large. Policymakers concerned to increase accountable governance need to pay attention to the composition of government revenue, and be realistic about the likelihood of a democratic transition in countries heavily dependent on non-tax revenue. They must also be alert to the governance risks posed by discoveries of oil in low income countries, especially the risks of reduced tax reliance in democracies where tax collection is already weak. Links between democracy and increased tax and tax reliance are by no means automatic: policymakers need to pay attention to how complex relationships between government and taxpayers play out over time, and in a particular context. Researchers need to pair cross-country econometric modeling with evidence from alternative, complementary research strategies.

Further reading

Prichard, Wilson; Salardi, Paola & Segal, Paul (2014), *Taxation, Non-Tax Revenue and Democracy: New Evidence Using New Cross-Country Data*, ICTD Working Paper 23, Brighton: September

Credits

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