



# What Have We Learned About Taxation, Statebuilding and Accountability?

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The past decade, in particular, has witnessed surging interest in the possibility that improved taxation in lower-income countries may not only be critical for raising revenue to fund public services, but may also be critical to spurring processes of statebuilding and strengthened accountability. This possibility draws on a simple and compelling logic: a state wishing to raise greater taxes will need to invest in the construction of stronger state institutions, across a range of areas, while it will be forced to bargain with citizens, exchanging improved services and governance for expanded tax payments. Put differently, taxation is increasingly understood to lie near the centre of both state function and state-society relations.

However, while arguments linking taxation to improved governance are highly attractive

in theory, their application in practice is likely to be significantly more complex – but research has only recently begun to delve in detail into this empirical complexity. This has two, related, implications.

First, research has until recently paid insufficient attention to understanding the contingency of tax-governance links: that is, the contexts in which such positive links are, but as importantly are not, likely to emerge. It is increasingly clear that these links are not automatic or guaranteed, but depend on key features of national and local tax systems, and the broad social, political and economic environments in which they exist.

Second, and as a result, research has tended to say little about concrete policy implications. A natural extension of the

belief that taxation can be a spur to improved governance has been a belief that expanded taxation should thus be an important policy priority. On balance this is likely good advice. But taxation is not, in and of itself, a positive outcome; it only becomes a positive outcome when taxation is translated into stronger and more accountable states, and improved service delivery. There is thus an urgent need to consider the policy steps that can be taken to strengthen the positive connections between taxation, statebuilding and accountability. ICTD-linked research has played a critical role in advancing these key areas of inquiry.

## Linking taxation, statebuilding and accountability

Arguments linking taxation to broader improvements in governance are increasingly widely known, while recent research has begun to map out what these connections look like in practice in contemporary developing countries.

The argument that taxation may be a spur to *state building* begins from a simple premise: collecting taxes effectively is complex, and requires cooperation across state agencies, and can thus be the leading edge of the broader development of state institutions. These connections between taxation and state building are likely to take three broad forms:

- **Demonstration effects:** investments in modernising tax agencies can set new standards for other parts of the public service with respect to, among others, meritocratic recruitment, opportunities for career advancement and performance measurement.<sup>1</sup>
- **Spillover effects:** a state wishing to tax more will be forced to invest in building a strong tax agency, but also in strengthening parallel

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agencies including, Ministries of Finance, business registration, land registration, property valuation, the police and the judiciary.<sup>2</sup>

- **Information sharing effects:** data gathered by tax agencies can be a critical input for supporting improved economic policy making, targeting of services, and law enforcement, among others.<sup>3</sup>

The argument that taxation can be a spur to the expansion of *governmental responsiveness and accountability* rests on two closely related logics.

First, citizens who are required to pay taxes are more likely to feel ownership of government activities, and to make proactive demands for reciprocity and representation.

Second, a government in need of tax revenue from its citizens will have stronger incentives to make reciprocal concessions to taxpayers, in order to encourage tax compliance.

More simply, the need for governments to raise taxes from their citizens is expected to spur ‘tax bargaining’. This may take the form of relatively explicit government concessions in exchange for tax compliance, but may also occur through more prolonged periods of conflict over taxation

<sup>1</sup> Brautigam 2008, Prichard and Leonard 2010, Prichard 2010.

<sup>2</sup> Brautigam 2008, Prichard and Leonard 2010, Prichard 2010.

<sup>3</sup> Chaudhry 1997.

that nonetheless serve to generate longer-term pressure for expanded responsiveness and accountability. In recent years ICTD researchers have been at the forefront of beginning to understand the details of these processes linking taxation, responsiveness and accountability in practice.<sup>4</sup>

## Evidence of taxation, statebuilding and accountability

While arguments linking taxation to improved governance have been widely made, it is only recently that detailed empirical evidence has begun to emerge – though with a focus primarily on the impact of taxation on responsiveness and accountability.

The most powerful research comes from ICTD Research Director Wilson Prichard, whose book *Taxation, Responsiveness and Accountability in Sub-Saharan Africa* offers the most detailed existing empirical investigation of these links.<sup>5</sup> It provides detailed cross-country econometric evidence of the existence of links between dependence on tax revenue and extent of accountability, and then presents detailed case studies of the evolution of tax systems in Ghana, Kenya and Ethiopia's cases in which taxpayers have responded to taxation with successful demands for reciprocity, and of cases in which governments have made significant concessions in efforts to encourage tax compliance.

As importantly, the book is the first to capture in detail the more indirect ways in which the need for governments to rely on taxation of their own citizens has generated long-term pressure for accountability. In some cases government efforts to tax have spurred the long-term mobilisation and organisation of civil society actors, including business associations, with lasting governance implications. In other cases citizens have aggressively resisted taxation by particularly unpopular governments, thus accelerating pressure for reform, and the likelihood of changes in government.<sup>6</sup>

These conclusions are supported by two recent studies that have provided experimental evidence of the same processes in low-income countries. Laura Paler – another ICTD researcher – has published experimental work from Indonesia indicating that citizens who are required to pay taxes to finance local government activities are more likely to demand accountability.<sup>7</sup> More recently, Lucy Martin has provided similar experimental evidence of the mobilising potential of taxation in Uganda.<sup>8</sup> In turn, mounting evidence – primarily from the ICTD – of the close connections between government performance and tax compliance offers further support for the broad prediction that governments needing to tax will be more likely to make governing concessions to taxpayers.<sup>9</sup> Finally, Joshi et al., again from the ICTD, review arguments about the potential for taxation of

<sup>4</sup> Prichard, W. (2015) *Taxation, Responsiveness and Accountability in Sub-Saharan Africa: The Dynamics of Tax Bargaining*, Cambridge: Cambridge University Press; Moore, M. (2015) Tax and the Governance Dividend, ICTD Working Paper 37, Brighton: International Centre for Tax and Development.

<sup>5</sup> Prichard, W. (2015) *Taxation, Responsiveness and Accountability in Sub-Saharan Africa: The Dynamics of Tax Bargaining*, Cambridge: Cambridge University Press.

<sup>6</sup> See also, Prichard, W. (forthcoming) 'Electoral Competitiveness, Tax Bargaining and Political Incentives in Developing Countries: Evidence from Political Budget Cycles Affecting Taxation', *British Journal of Political Science*.

<sup>7</sup> Paler, L. (2013) 'Keeping the Public Purse: An Experiment in Windfalls, Taxes, and the Incentives to Restrain Government', *American Political Science Review* 107(4): 706-25.

<sup>8</sup> Martin, L. (2014) *Taxation & Accountability: Experimental Evidence for Taxation's Effect on Citizen Behavior*, mimeo.

<sup>9</sup> Ali, M., Fjeldstad, O-H. and Sjørusen, I. (2013) 'To Pay or Not to Pay? Citizens' Attitudes Towards Taxation in Kenya, Tanzania, Uganda and South Africa', *World Development*, 64: 828-42; Jibao, S. and Prichard, W. (forthcoming) *The Local Foundations of Taxation and Statebuilding: Understanding Tax Compliance in District Councils in Sierra Leone*, ICTD Working Paper.

small informal businesses to act as a catalyst for more active engagement, and greater accountability.<sup>10</sup>

Bottom line: there is mounting evidence that taxation can, indeed, be a spur to expanded responsiveness and accountability, driven by its capacity to mobilise citizen demands and the threat of tax resistance by taxpayers. However, the links between tax and accountability are not likely to always take the form of relatively explicit negotiation, but may frequently take longer-term and more indirect forms.

### Applying these lessons at the local government level

While the most prominent work on taxation and governance has thus focused on bargaining over taxation at the national government level, research – again primarily by the ICTD – has increasingly sought to explore these same relationships at the local government level. The motivation for exploring these issues at the local government level is straightforward: local government tax systems are characterised by a wide range of comparatively direct taxes and levies, applied to a broad base of the population, thus creating a context in which relatively direct links between tax and public spending are possible. And, indeed, one of the central promises of decentralisation is that it may generate stronger ties between citizens and states – with bargaining over taxation playing a central role.

Consistent with this possibility, ICTD researchers have begun to provide new evidence of the potential links between tax and accountability at

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the local level. The most compelling evidence comes from Jibao and Prichard, who document experience of reforming the property tax system in Sierra Leone.<sup>11</sup> They provide evidence that in Bo City Council the desire to expand tax revenue drove the government to link new tax collection to specific and popular public services, which, in turn, reinforced government popularity and the sustainability of tax reform. That is, a virtuous circle of taxation and accountability emerged. Looking more broadly, ongoing research in Sierra Leone provides clear evidence that, even in smaller towns and villages, popular willingness to pay taxes has been shaped by broader trust in government – while the extension of local taxation has the potential to act as a spur to clarifying and strengthening coordination between different local levels of government. This remains a fruitful area of research, with ICTD research along these lines continuing in

<sup>10</sup> Joshi, A., Prichard, W. and Heady, C. (2014) 'Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research', *Journal of Development Studies*, 50 (10): 1325-47.

<sup>11</sup> Jibao, S. and Prichard, W. (forthcoming) 'Rebuilding Local Government Finances After Conflict: Lessons from a Property Tax Reform Program in Post-Conflict Sierra Leone', *Journal of Development Studies*; Jibao, S. and Prichard, W. (2015) 'The Political Economy of Property Tax Reform in Africa: Elites, Political Competition and Tax Bargaining in Post-Conflict Sierra Leone', *African Affairs* 114(456): 404-431; Jibao, S. and Prichard, W. (2013) *Rebuilding Local Government Finances after Conflict: The Political Economy of Property Taxation in Post-Conflict Sierra Leone*, ICTD Working Paper 12, Brighton: Institute of Development Studies.

Sierra Leone and the Democratic Republic of the Congo, while close ICTD partners are launching similar work in Uganda and Tanzania.

## Contingency, policy and a governance-focused tax reform agenda

While there is mounting evidence of the potential for taxation to spur improvements in governance, recent research has a second, equally important, message: while such positive connections are possible, they are far from guaranteed. Taxation is a fundamentally coercive act, and is only likely to be a social benefit if paired with specific strategies to ensure that money is used effectively, and that taxation can contribute to broader statebuilding. There is thus a clear need to focus more actively on how to encourage positive links between tax and governance – while minimising the prevalence of more strictly coercive forms of collection.

The most ambitious effort to address this question again comes from Prichard, who seeks to understand the conditions that have been most conducive to the development of strong links between tax and accountability – and, in turn, to offer relevant policy advice.<sup>12</sup> He focuses on four broad areas for policy action:

1. **Enhance the political salience of taxation – including via direct taxes.** Taxpayers will be able to demand reciprocity in exchange for taxes and to resist taxes by unpopular governments more effectively when they are clearly aware of the taxes that they pay. This, however, is often not the case for the majority of taxpayers, who pay primarily indirect taxes that are hidden in the prices of goods. There are two major ways to increase the political salience of taxation. First, strengthen direct taxes, including income taxes, property taxes, and presumptive taxes on smaller businesses. Second, work with civil society, the media and other groups to actively raise awareness of existing taxes, and support public engagement.
2. **Focus on horizontal equity in tax enforcement.** Where enforcement is very uneven – with some taxpayers paying and others not – the dominant incentive for many taxpayers will be to seek to avoid taxes, rather than collectively demanding reciprocity from governments. By contrast, where governments focus on ensuring consistent tax enforcement among all taxpayers, this shifts incentives for taxpayers away from seeking narrow benefits or avoidance, and in favour of working collectively to ensure fairness, responsiveness and accountability. Thus, measures like selective tax exemptions, or international methods for wealthy taxpayers to avoid taxes, may not only be economically damaging, but may also have significant political consequences.
3. **Expand transparency around taxation and budgeting – including, possibly, earmarking.** Taxpayers will be better able, and more likely, to demand reciprocity from governments when they have access to information about how, and how much, revenue governments collect, and how that money is used. We have significant evidence, for example, that taxpayers have been more willing to pay taxes when they have had clear information about the use of that money for popular public services. A particular possibility surrounds the potential usefulness of earmarking tax revenue for key public initiatives: while tax earmarking is widely opposed by public finance experts because it reduces budget flexibility, in contexts of low trust between governments and taxpayers it

<sup>12</sup> Prichard, W. (2015) *Taxation, Responsiveness and Accountability in Sub-Saharan Africa: The Dynamics of Tax Bargaining*, Cambridge: Cambridge University Press.

may be a useful short-term route to improved trust and accountability – and for increasing overall popular engagement with tax and budgeting issues.

**4. Directly support popular engagement, including the creation of inclusive institutional spaces for tax bargaining.**

Finally, governments and donors can work directly to strengthen the scope for bargaining in two broad ways. First, direct support for the types of groups that can support broad popular engagement with tax issues, including the media, civil society and business associations. Second, the creation of specific institutional spaces in which such bargaining can happen. In both cases it is essential that these efforts be relatively inclusive, in the sense of involving a wide range of taxpayers, and not only larger taxpayers, as there is a significant risk of processes of tax bargaining being dominated by these larger taxpayers.

Moore has drawn specific attention to this last risk: that bargaining over taxation between taxpayers and governments may be dominated by elites, who are the largest taxpayers, to the exclusion of broader-based accountability.<sup>13</sup> He has argued that while the creation of autonomous revenue authorities (RAs) in Africa has had some positive implications for the quality of revenue collection, one risk has been the development of a very close relationship between RAs and the business community – with potential consequences for the inclusivity of tax bargaining. In particular, larger taxpayers have continued to seek – and receive – significant tax incentives and exemptions, which have undermined tax systems and the broader potential for

accountability enhancing tax bargaining.

This reflects a broader concern in the literature that, because a large share of taxes in Africa are paid by a relatively small number of large businesses and (sometimes) wealthy individuals, tax bargaining may serve their interests, but exclude broader constituencies of small taxpayers. Consistent with this concern, Prichard and van den Boogaard draw attention to the major barriers to small businesses and market traders organising in response to taxation, owing to problems of collective action and the frequent weakness of informal sector business associations.<sup>14</sup> These studies thus support the conclusions in Prichard (2015): if tax bargaining is to be a route to broad-based responsiveness and accountability, policy attention needs to be turned to how to ensure that such bargaining includes a broader group of taxpayers.<sup>15</sup>

While less has been written about the connections between tax and the expansion of state capacity, the same overarching message almost certainly holds: it cannot be assumed that taxation will drive broader gains in state capacity unless policymakers explicitly seek to foster these connections. Based on relatively limited existing evidence, Prichard suggests several principles that may usefully guide these efforts: (1) build strong links between tax agencies and related branches in government; (2) focus emphasis on effective data gathering, and on sharing data across government; (3) emphasise bureaucratic reforms that could be replicated elsewhere in government – like meritocratic hiring, or performance evaluation – rather than making RAs islands within government; and (4) focus on strengthening links between central

<sup>13</sup> Moore, M. (2014) 'Revenue Reform and Statebuilding in Anglophone Africa', *World Development* 60: 99-112; Moore, M. (2015) Tax and the Governance Dividend, ICTD Working Paper 37, Brighton: International Centre for Tax and Development.

<sup>14</sup> Prichard, W. and van den Boogaard, V. (2015) *Norms, Power and the Socially Embedded Realities of Market Taxation in Northern Ghana*, IDS Working Paper 30, Brighton: Institute of Development Studies

<sup>15</sup> Prichard, W. (2015) *Taxation, Responsiveness and Accountability in Sub-Saharan Africa: The Dynamics of Tax Bargaining*, Cambridge: Cambridge University Press.

and local administrations, to extend potential benefits.<sup>16</sup> In turn, the emphasis on building strong links between tax agencies and other branches of government is also emphasised in an ICTD review by McCluskey of strategies for improving tax-related capacity-building support.<sup>17</sup>

Finally, recent ICTD work has placed particular emphasis on the potential for strong tax-governance linkages at the local government level, but has in parallel stressed that there may also be particularly severe barriers to such connections emerging at the local government level. It is, more simply, an area that is 'high risk, high reward' for fostering tax bargaining. This is particularly important in post-conflict areas, where strengthening local taxation has been viewed as a potential strategy for rebuilding accountability from the ground up. However, in these contexts it seems clear that much more attention needs to be paid to the conditions necessary to facilitate the emergence of positive links between taxation, statebuilding and accountability. Four issues stand out, and are the subject of ongoing ICTD research:

1. **Local governments often have very little capacity, and weak incentives to collect revenue.** Not only do local government often lack technical capacity, but because they rely very heavily on financial transfers from central government they generally have limited incentives to collect revenue locally. Indeed, some observers have suggested that central governments have sometimes designed local fiscal systems precisely to limit local fiscal autonomy and engagement between citizens and governments. In these circumstances efforts to increase local tax collection are more

“Measures like selective tax exemptions, or international methods for wealthy taxpayers to avoid taxes, may not only be economically damaging, but may also have significant political consequences.”

likely to be relatively ad hoc, and reversed in the face of political opposition, thus reducing the potential for sustained links between taxation, statebuilding and accountability.

2. **Local government taxation can be predatory, amidst low-income populations, weak controls and elite domination.** Where taxation systematically targets those who are most vulnerable, and application of tax rules – particularly to elites – is inconsistent, this undermines the potential for productive bargaining over taxation.
3. **There are significant barriers to collective action in response to taxation at the local government level.** The weakness, fragmentation and politicisation of potential taxpayer representatives – including local business associations or market associations – as well as the lack of institutional spaces for taxpayers to engage with governments, may make it difficult for taxpayers to make collective demands for reciprocity from governments.<sup>18</sup>

<sup>16</sup> Prichard, W. (2010) *Taxation and State Building: Towards a Governance Focused Tax Reform Agenda*, IDS Working Paper, Brighton: Institute of Development Studies.

<sup>17</sup> McCluskey, R. (forthcoming) *Strengthening capacity building for international taxation in African revenue authorities*, mimeo.

<sup>18</sup> Prichard, W. and van den Boogaard, V. (forthcoming) 'Norms, Power and the Socially Embedded Realities of Market Taxation in Northern Ghana', *African Studies Review*.

4. **Extensive systems of informal taxation at the local government level may complicate the potential for bargaining and statebuilding.** Most existing research and policy advice has focused on formal tax systems, but recent research – primarily by the ICTD – has revealed that informal taxes, including to non-state actors, are pervasive. This implies a need to rethink strategies for fostering positive links between taxation, statebuilding and accountability.<sup>19</sup>

In light of these challenges, there is a need for continuing research into how to support the creation of positive tax-governance linkages at the local government level. This is a major focus

of ongoing and proposed future ICTD work.

## Looking forward

On balance, existing research has been very successful in establishing the potential for taxation to be a spur to statebuilding and the expansion of accountability. The next phase in this research agenda is to focus on concrete strategies for translating these potential benefits into practice. ICTD research over the past five years has led this effort, both in highlighting concrete policy options for strengthening tax-governance links, and in identifying directions for further investigating these relationships at the local level and in post-conflict environments.

<sup>19</sup> Jibao, S., Prichard, W. and van den Boogaard, V. (forthcoming) *The Pervasiveness and Relative Prosperity of Informal Taxation in Post-Conflict Sierra Leone*, ICTD Working Paper.

### Further reading

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### Credits

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