

Taxation, Governance and Growth

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Historically, tax research has been dominated by two questions: how to enhance revenue collection in order to finance redistribution and public goods and services, and how to design tax policy to strengthen incentives for economic growth (Joshi et al. 2014; Moore 2013). However, the past decade has witnessed surging interests in a third possibility: that taxation may also play a critical, but more indirect, role in the development of improved governance (Prichard 2016, 2010).

This governance-focused research agenda has focused on three broad processes linking taxation and governance:

1. **Common interest:** Governments that depend on tax revenue have an incentive to promote economic growth, as a route to increasing revenue.
2. **State apparatus:** The need to raise taxes is complex, and efforts to strengthen the tax administration can ‘spillover’ to other areas of public administration.
3. **Accountability and responsiveness:** The need to raise taxes creates incentives for governments to be responsive and accountable to citizens in order to encourage compliance, while spurring taxpayers to make greater demands on governments.

The latter two are particularly critical. Expanded tax collection is only developmentally beneficial if it is accompanied by statebuilding, responsiveness and accountability, and translated into public goods and services (Prichard 2016).

Interest in the potential connections between taxation and governance has expanded more rapidly than concrete empirical research, owing largely to the complexity of the processes. There is now little doubt that these



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processes exist but it is equally clear that they are not guaranteed. The key questions are three-fold (Prichard 2015).

How are positive tax – governance linkages likely to emerge in practice?

Positive links between taxation and state-building are likely to take three broad forms:

1. Demonstration effects. Tax agencies pioneer new processes which are later adopted elsewhere in government (e.g. meritocratic recruitment, performance management, IT systems).
2. Spillover effects. Improving taxation requires parallel improvements elsewhere in government, thus generating pressure and support for broader reform (e.g. streamlining judicial processes, improving land and business registration).
3. Information sharing effects. Tax data can be a critical input to broader economic and social policy making, while data from other government agencies strengthens tax collection.

Positive links between taxation and accountability may take the form of relatively explicit “bargaining” and reciprocity between taxpayers and governments, but also often take more indirect and implicit forms:

- Direct tax bargaining: Governments make explicit commitments of services or accountability to taxpayers in order to encourage compliance or respond to popular resistance.
- Sustained tax resistance: Sustained resistance to unpopular taxation undermines the fiscal position of unpopular governments, thus generating long term pressure for reform and/or changes in government.
- Strengthened civil society: Taxation spurs organising and engagement by taxpayer groups – including taxpayer associations and business associations – who become important actors pushing for improved governance.

How can policy support strong tax – governance linkages?

These benefits are, however, far from assured. Taxpayers struggle to mobilise collectively, governments often refuse to make concession to taxpayers – or make concessions only to larger taxpayers – while gains in tax administration often do not spill over to the rest of governments (Prichard 2015; Brautigam 2008; Moore 2014). Recent research has sought to highlight specific policy options to underpin a governance-focused tax reform agenda.

For strengthening links between taxation and state-building these include: stronger links between tax agencies and related government branches, as well as between central and local administration; sharing data across government; and emphasising bureaucratic reforms that could be replicated elsewhere in government (e.g. meritocratic hiring or performance evaluation) (Prichard 2016, 2010).

For strengthening links between taxation and accountability, governments and other actors research has highlighted the need to:

- Enhance the political salience of taxation, via direct taxes, greater transparency and efforts to engage the public with tax debates;

- Focus on horizontal equity in tax enforcement, in order to encourage taxpayers to pursue collective engagement with government in seeking reciprocity;
- Expand transparency around taxation and budgeting – including, possibly, some earmarking – in order to encourage popular engagement and build trust
- Directly support popular engagement, including inclusive institutional spaces for tax bargaining, in order to facilitate engagement in tax issues by a broader constituency of taxpayers, and more inclusive outcomes.

In some cases the recommendations are clearly consistent with existing advice, though they argue for a greater emphasis on process related aspects of tax reform, including transparency and inclusion, clearer links between tax and expenditure, and improved data sharing and cooperation across government.

In other areas there is greater disagreement. Economists are generally more wary of expanding taxation to small informal businesses, owing to high costs, limited revenue and concerns about growth (Joshi et al. 2014). Fiscal economists have long been wary of tax earmarking because it creates budget inflexibility – though it may be warranted where trust between taxpayers and governments is particularly limited (Prichard 2010, 2015, 2016). Finally, while there is agreement that stronger enforcement of direct taxes is desirable, the VAT is often given priority by economists focused primarily on economic efficiency.

What are the opportunities and risks at the local government level?

The links between taxation, statebuilding and accountability have been studied mostly at the national level. However, the greatest potential may exist at the local government level where the links between taxation and spending are potentially more direct, taxpayers are closer to government, and tax reform can be the leading edge of needed construction of state capacity. This offers important opportunities. However, there are also potentially larger barriers to strong tax-governance linkages at the local level: weak government incentives and capacity to collect revenue; significant risk of elite capture and coercive taxation; the difficulty of local level collective action; and the frequent pervasiveness of informality in local tax systems – including “informal taxation” by non-state actors. As such, local reform efforts demand careful attention to the details of local contexts (Jibao & Prichard 2015).

Key readings

Reading 1: Prichard, W. (2016). *Taxation, statebuilding and accountability: A synthesis*. ICTD Summary Brief 4. Brighton: International Centre for Tax and Development.
<http://www.ictd.ac/publication/7-policy-briefing/117-ictd-summary-brief-4-what-have-we-learned-about-taxation-statebuilding-and-accountability>

Reading 2: Prichard, W. (2010). *Towards a governance focused tax reform agenda*. IDS Working Paper 341. Brighton: Institute of Development Studies.
<http://www.ids.ac.uk/files/dmfile/Wp341.pdf>

Reading 3: Brautigam, D. (2008). Introduction: taxation and state-building in developing countries. In: *Taxation and State-Building in Developing Countries* (D. Brautigam et al. eds). Cambridge, UK: Cambridge University Press.
<http://s1.downloadmienphi.net/file/downloadfile3/161/1394891.pdf#page=13>

Reading 4: Moore, M. (2015). *Tax and the governance dividend*. ICTD Working Paper 37. Brighton: International Centre for Tax and Development.
<http://r4d.dfid.gov.uk/pdf/outputs/taxation/ICTD-WP37.pdf>

Reading 5: Joshi, A.; Prichard, W.; & 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
<http://www.tandfonline.com/doi/pdf/10.1080/00220388.2014.940910>

Reading 6: Prichard, W. (2015). Looking forward: broader messages, policy lessons and directions for future research. In: *Taxation, responsiveness and accountability in Sub-Saharan Africa: The dynamics of tax bargaining*. Cambridge: Cambridge University Press.
<http://www.gsdrc.org/document-library/looking-forward-broader-messages-policy-lessons-and-directions-for-future-research/>

Questions to guide reading

- A major concern surrounding arguments linking taxation, responsiveness and accountability is that these processes may be captured by elite interests, as “tax bargaining” will give disproportionate influence to small groups of large taxpayers. How can this risk be minimised?
- Which measures to strengthen the links between taxation, responsiveness and accountability are most viable, and most important, in low-income contexts?
- Which measures to strengthen the links between taxation and statebuilding are most viable and important?
- What are prospects for strengthening tax-governance links in challenging environments where governance is weak, such as in fragile and conflict-affected states?
- What is the right approach when “traditional” and more “governance-focused” approaches to tax reform are in conflict? Specifically:
 - When, how and how much should donors focus on direct taxes?
 - To what extent should taxing the informal sector be given greater emphasis on governance grounds – and should it, perhaps, be left increasingly to local governments?
 - When might tax earmarking – either explicitly or more flexibly – be appropriate?
 - To what extent should efforts be made to insulate semi-autonomous revenue agencies from the rest of government, and to what extent (and how) is it important to sustain links in order to facilitate learning, data sharing and spillovers?

Further resources

Jibao, S. & 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.
http://r4d.dfid.gov.uk/pdf/outputs/taxation/60813_The-political-economy-of-property-tax-in-Africa.pdf

Moore, M. (2013). *Obstacles to increasing tax revenues in low-income countries*. ICTD Working Paper 15. Brighton: Institute for Development Studies.
<http://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/4666/ICTD%20WP15.pdf?sequence=1>

Moore, M. (2014). Revenue reform and statebuilding in Anglophone Africa. *World development* 60, 99 – 112.
<http://www.sciencedirect.com/science/article/pii/S0305750X14000862>

Prichard, W. (2015). Understanding tax bargaining: complexity and contingency. In: *Taxation, responsiveness and accountability in Sub-Saharan Africa: The dynamics of tax bargaining*. Cambridge: Cambridge University Press.

Available here: <http://www.cambridge.org/gb/academic/subjects/politics-international-relations/political-economy/taxation-responsiveness-and-accountability-sub-saharan-africa-dynamics-tax-bargaining>