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Taxation, aid and democracy

An agenda for research in African countries

Odd-Helge Fjeldstad and Ole Therkildsen
with Lise Rakner and Joseph Semboja

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An agenda for research in African countries

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Abstract. *Taxation, aid and democracy are closely related in poor aid-dependent African countries. The way they tackle the issue of domestic revenue mobilisation significantly influences their potential for economic growth and democratic consolidation. This proposition is based on the reading of historical, political and economic literature, and it forms the general basis for an ongoing research programme. Namibia, Tanzania and Uganda are the case countries. The research aims to contribute to a better understanding of the evolution of tax systems in African countries. Furthermore, it aims to explore the constraints and options available for policy making on revenue mobilisation and democratisation. This paper presents the general outline of the research programme, and the major areas of research to be dealt with.*

1 Motivation and research objectives

This research programme is motivated by the trilemma facing most sub-Saharan countries with respect to taxation:[1] (1) There is an urgent and obvious need for more revenues to enable resource poor states to provide and maintain even the most basic public services. (2) The reality is, however, that those with political power and economic ability are few and do not want to pay tax. (3) Moreover, those without political power are many, have almost nothing to tax, and do also resist paying taxes.

The trilemma is amplified by three trends common to many African countries. One is a recent process of *democratisation*, which, if Western experiences hold, will have profound implications for taxation. It is likely that governments, seeking power on the basis of popular consent, face restrictions in their use of coercion in tax collection. The other is that *aid flows*, which presently constitute more than half of state budgets in some countries, are declining, making tax revenues even more important for state incomes. Aid flows are, furthermore, increasingly conditioned on improved domestic revenue mobilisation. The third trend is that *globalisation* leads to increasing integration of the world's goods and capital markets. Countries have to adhere to international trade and investment agreements. These

[1] The research programme is entitled 'Taxation, aid and democracy: the evolution of tax systems in Namibia, Tanzania and Uganda'.

developments impose severe constraints on the ability of developing economies to choose their own tax policy directions.

It follows that the challenge for taxation is to raise domestic revenues from consenting citizens in poor and increasingly open economies. It should be added that most of these economies are not growing rapidly. Elected governments in African countries are therefore facing hard choices about taxation. These decisions will most likely have profound impacts on the future of democratisation itself and on public service provision. They will also have considerable implications for the politics and sustainability of aid. This situation forms, in short, the basic motivation for the research on the evolution of tax systems in Namibia, Tanzania and Uganda. Our main proposition is that the way the new and evolving democracies in Africa tackle the issue of domestic revenue generation will significantly influences their potential for economic growth and democratic consolidation.

The research programme will analyse the evolution of tax systems in three selected African countries in order to seek a deeper understanding of the present tax system, how it came to be, and what historical, political, economic, and institutional forces have shaped it. The research will seek to identify key features explaining commonalties and differences in the tax systems of the selected countries. We believe that international and domestic processes affect one another and thus shape the actual outcome of tax policies. Furthermore, we assume that the way tax systems evolve have deep historical roots that sometimes are peculiar to a given country. The research is therefore longitudinal and comparative and it includes both the political, institutional and public finance dimensions of taxation.

We are not aware of any similar comparative study on Africa. This is surprising given that taxation is considered essential for state formation (Tilly, 1992); economic growth (Gemmel, 1987); for shaping state-citizens relations (Levi, 1988; Moore, 1998); and for developing state capacity to deliver services (Semboja and Therkildsen, 1995). These considerations are reflected in the exploratory focus of the first research objective:

- To understand the key features influencing the evolution of tax systems (tax policies and implementation arrangements) since independence in the three countries.

Based on this work the second objective is more policy oriented, namely:

- To understand the present and future major tax policy and implementation options available for governments in the three countries in light of current political, economic and administrative reforms.

This paper presents the general outline of the research programme, and the major areas of research to be dealt with. The paper is organised as follows: Section 2 discusses the key areas of research and identifies the major research questions. The theoretical framework for the analysis is presented in section 3. In section 4 the methodology and empirical work is briefly discussed. Section 5 concludes.

2 Comparative perspective on taxation in Africa: Research questions

Comparative studies of taxation in industrialised countries indicate that existing tax systems tend to reflect the politics of taxation (Brennan and Buchanan, 1980; Lane, 1995) and tax administration (Slemrod, 1990; Slemrod and Yitzhaki, 1996) more than public finance recommendations about efficient tax structures (Atkinson and Stiglitz, 1980; Myles, 1995). Moreover, a comparative longitudinal study of taxation in Sweden, the United Kingdom and the US shows that even though these countries were faced with similar problems and pressures they developed very different tax systems due to different political and administrative institutions (Steinmo, 1993: 9-11). The extent to which these observations are also valid for African tax systems we cannot, at present, give a precise answer to. However, the colonial past and the influence of the international donor community add new dimensions to the developments in African countries compared to those of Western countries. The political, economic and administrative reforms now being implemented concurrently across Africa is also an unique feature of the present situation. Thus, the evolution of tax systems in Africa has most likely followed different paths compared to the experience of Western countries.

Present tax systems in African countries reflect, we assume, the impacts of and changes in seven key features: (1) the colonial heritage; (2) socio-economic structures; (3) post-independent warfare and democratisation; (4) rural-urban tensions; (5) political and administrative institutions; (6) development aid; and (7) global, economic integration. With this frame of reference, the evolution of tax systems in African countries most likely differ significantly from each other because of divergent impacts of the various key features. Below we briefly discuss each area of research and identify the major research questions:

1. Namibia, Tanzania and Uganda share a common but yet different *colonial past*. While Namibia only achieved its independence in 1990, Tanzania and Uganda got their independence in the early 1960s. We hypothesise that the form and length of colonial rule have contributed in shaping the various countries' tax systems. One key research question follows: *To what extent is the colonial heritage reflected in the present tax systems (for instance, major tax bases, exemptions and the tax administrative apparatus)?*

2. Tax systems inevitably reflect the *socio-economic structure* of the country in question (Fjeldstad, 1995). Before engaging in a detailed analysis of tax policy it is therefore important to consider some fundamental characteristics of the African economies which may contribute to explaining the present tax system. Key features which may be of particular relevance in this respect are: income per capita and literacy levels; economic growth rates; ownership patterns in the private sector; and the relative size and characteristics of (a) the agricultural sector, (b) the mining sector, (c) the informal sector, and (d) the public sector. Thus, an important question of research is: *How is the economic structure and characteristics of the countries reflected in the politics and administration of taxation?*

3. In contrast to Western countries, the birth of *democratisation* in Africa was not related to inter-state war but to insurgency against, or negotiation with, colonial rulers. These conflicts did not contribute to increased tax extracting capacity of the state as they did in the West. Nor did they fundamentally change the relations between the new rulers and the ruled (Mamdani, 1996). The first wave of democratisation was not long lived either. Relations of accountability between the state and citizens remain weak – perhaps because most states in Africa depend only partly on their citizens to mobilise revenues. They rely more on foreign aid instead (Moore, 1998; Rakner, 1998). Despite the latest wave of democratisation in Africa one should therefore – compared to Western countries - expect different types of institutions involved in tax policy formulation and extraction, and different relationships between these institutions and civil society. Furthermore, present tax systems may reflect financial requirements generated by post-independence civil wars (Uganda) and border conflicts (Namibia, Tanzania and Uganda), and subsequent tax exemptions for military personnel and equipment. Surprisingly the tax linkage is simply neglected in most writing on conflicts, democracy and civil society in Africa. Two broad research questions emerge out of this: *What effects have post independence warfare had on taxation in African countries? Has the recent process of democratisation had any significant impact on tax systems?*

4. Historically, taxation of activities in the *rural* areas has differed in scope, extent and methods from taxation in *urban* areas (Mamdani, 1996), and this continues to be the case (Sah and Stiglitz, 1992). The establishment and survival of crop authorities, agricultural parastatals and co-operatives have been important for the generation of state incomes and hence for the understanding of the evolution of tax systems in Africa. Also extra-economic compulsion of peasants – and self-help activities - have remained important methods for resource mobilisation in rural areas after independence. Tax revolts in the rural areas have occurred intermittently for decades as a reaction to heavy tax burdens and extortion (Bates, 1983; Young, 1994; Fage and Roland, 1987). With the recent introduction of value-added-tax (VAT) in many countries, tax riots are now also an urban phenomenon, which may indicate a shift in tax burdens from rural to urban areas. Given the historic differences in the scope and methods of resource extraction between urban and rural based activities in most African countries a key research question is: *How has the direct and indirect taxation of rural and urban activities evolved over time?*

5. Non-compliance and corruption in relation to taxation are relevant issues in the African context (Mamdani, 1996; and Fjeldstad and Semboja, 2000). Tax officials tend to focus on compliance problems, while taxpayers obviously are more concerned about service provision and corruption in *tax administration*. Key features of the economies amplify these problems: Small-scale agriculture dominates in the countryside, while informal activities characterise the urban areas. People are mobile and have many intermittent sources of income. This makes taxation an extremely difficult and expensive undertaking for bureaucracies with limited capacity for information collection and surveillance. Furthermore, alternative tax systems may differ greatly in the costs of operation, including the costs of fiscal corruption and tax evasion. Transaction costs of implementing and enforcing taxes, therefore, become important considerations (Levi, 1988). For instance, certain policies, such as a general income tax, are unthinkable until the costs of tax collection are made low by the existence of an appropriate economic structure and administrative capacity (Webber and Wildavsky, 1986; and Levi, 1988). Two important research questions follows: *What are the major transaction costs of the main tax bases, and have these changed significantly over time? To what extent are differences in the ease of administering various taxes a critical determinant of tax-policy choices and attempts to reform tax systems?*

6. Dependence on aid is likely to have significant public finance implications, specifically for how and how much revenue needs to be raised domestically. Development aid should therefore be analysed on par with other state incomes, including tax revenues (Moore, 1998).

Consequently, aid effectiveness and domestic revenue mobilisation are closely linked, although this connection is not yet generally acknowledged in the literature (Adam and O'Connell, 1997). As aid flows to Africa now tend to diminish, the pressure on domestic revenue mobilisation increases so as to sustain public sector expenditures. The already questionable sustainability of many donor funded projects and programmes may, therefore, be in even more serious jeopardy. Indeed, the International *Monetary Fund (IMF)* now condition its loans to African countries on the attainment of specific – and possibly unrealistic - tax revenue targets. A key research question is therefore: *What impacts on tax policy and administration has aid had since independence?*

7. The broader processes of globalisation in which the potential to levy taxes on trade has diminished in the face of trade liberalisation and increased economic openness, put new pressures on tax policy and administration at country level (Grunberg, 1998). In an African context reliance on import and export duties have been significant in the past. Here global economic integration will certainly force policy makers to look at new ways to generate revenues – and possibly to embark on major reforms of tax bureaucracies. In the short run, however, a low income developing country cannot undertake such reforms without seriously considering the consequences on their public expenditures, since tariffs are such an important revenue source. Two research questions follow: *What aspects of globalisation are especially important for taxation? How do countries respond to this?*

3 Theoretical framework

This research is concerned with evolution and change in tax systems in sub-Saharan Africa, and in particular with how they are shaped by the colonial heritage, political and administrative institutions, economic structures and international relations. As already argued our main proposition is that institutional factors are crucial for the understanding of the evolution of tax systems and tax options.

One reason is political. Policy makers everywhere are influenced by popular demands – albeit to different degrees. In industrial countries comparative research shows that such demands are deeply ambiguous: people want better services *and* lower taxes (Steinmo, 1993). We assume that the same is the case in the three selected countries. In this situation the policy decisions with respect to taxation are highly influenced by the structure and relationships of the institutions that make them: who participate, what interests are excluded, the stability of institutions over time, the incentives and disincentives for compromises, etc.. Moreover, institutions and decisions are strongly influenced by the broader political, economic and social setting in which they are embedded. The influence of donors and the very substantial revenues they provide to poor states are especially important. To the extent that states (central and local) do not depend on domestic resource mobilisation to obtain revenues because aid is available, controllers of the state may not need to enter into reciprocal agreements with citizens about provision of services in exchange for tax contributions (Moore, 1998). This possible link between taxation and aid in shaping state-society relations provides an important theoretical perspective for the study.

The other reason why institutions are important in relation to taxation is associated with the administration and implementation of tax systems. These issues will primarily be analysed through the lens of the new institutionalism, which has developed within various disciplines over the last decade or so (Coase, 1997; Eggertsson, 1990; North, 1990, 1981; and Williamson, 1986). Focusing on the issues of transaction costs, limited (or asymmetric) information and collective action, institutions are perceived as both expanding individual choice by influencing the availability of information and choices (Ostrom et al., 1993), and as constraining individual actors' scope of choice (Moe, 1990; North, 1990; Bates, 1989). This approach acknowledges the fact that the preferences of social actors, bureaucrats, politicians and representatives of interest groups may change as the ongoing political, economic and administrative reform processes in the selected countries alter the economic and political structure in which actors find themselves. The transaction cost approach is particularly relevant to use in the study and assessment of tax policy options.

In the context of African countries such as Namibia, Tanzania and Uganda, it must further be acknowledged that social and political institutions are weak, and easily penetrable both by domestic and external actors (Berry, 1993). Consequently, the combined influences over time of domestic and international factors must be analysed. Although many scholars since the late 1980s have recognised the interdependence of domestic and international politics, explicit theories of this interaction are fairly underdeveloped (Milner, 1997). The most cited work attempting to systematically link processes of domestic and international relations is Robert Putnam's notion of "two-level games" (Putnam, 1988). Putnam hypothesises that a reforming government is faced with two sets of constraints and options when formulating a given tax policy: Firstly, its national constituency represented by interest organisations. Secondly, its international partners represented by international organisations or other governments. Neither "game" can be ignored by a national government. The two level game analysis will be employed in the study as it offers a rich analytical framework for analysing how international and domestic processes interact in a given case.

4 Methodology and empirical work

We will focus on three countries, i.e., Namibia, Tanzania and Uganda. The countries have been selected on the basis of differences with respect to: (a) their colonial history, (b) transition to multi-partyism; (c) involvement in border conflicts and civil wars after independence; (d) extent and scope of public sector reforms since independence, including tax reforms; (e) socio-economic structure; (g) foreign aid dependency and aid history. Furthermore, the programme co-ordinators have established long-term professional relations to social scientists and senior civil servants in Tanzania and Uganda.

The empirical studies will be carried out as a combination of (i) desk/archive studies (including national accounts and statistics of taxation, reports by tax commissions, budget speeches, historical documents, World Bank and IMF studies); (ii) key informant interviews (in order to obtain important documents and perceptions); (iii) surveys (to analyse specific topics, and organised as a combination of interviews and questionnaires).

However, the potential research agenda outlined above is considerable. Thus, it is necessary to focus attention on specific aspects of it. Figure 1 presents a first attempt at narrowing the scope of the research. It is based on the theoretical considerations presented above and on discussions with researchers, policy makers and donors in the three case countries during 1999. Six interrelated research components are identified in the figure:

- Tax structure and administration.
- Tax compliance.
- The politics of tax policy.
- Accountability in taxation.
- Aid, taxation and accountability.
- Globalisation/regionalisation.

For each component, a number of research items are listed. The arrows between components indicate interrelations. The bolded box – labelled "revenue changes over time" – indicates that this is an important variable to explain. But revenue yield is not the only consideration in taxation, just as the links between components (and the research items noted for each of these) are only indicative.

The empirical work will be organised on the basis of these six components. Studies of the specific components and their interdependency will then be linked together into an overall analytical framework in order to seek a deeper understanding of how the present tax system came to be and what forces have shaped it (synthesis). On this basis we will seek to identify key features explaining commonalties and differences in the tax systems of the selected countries (results).

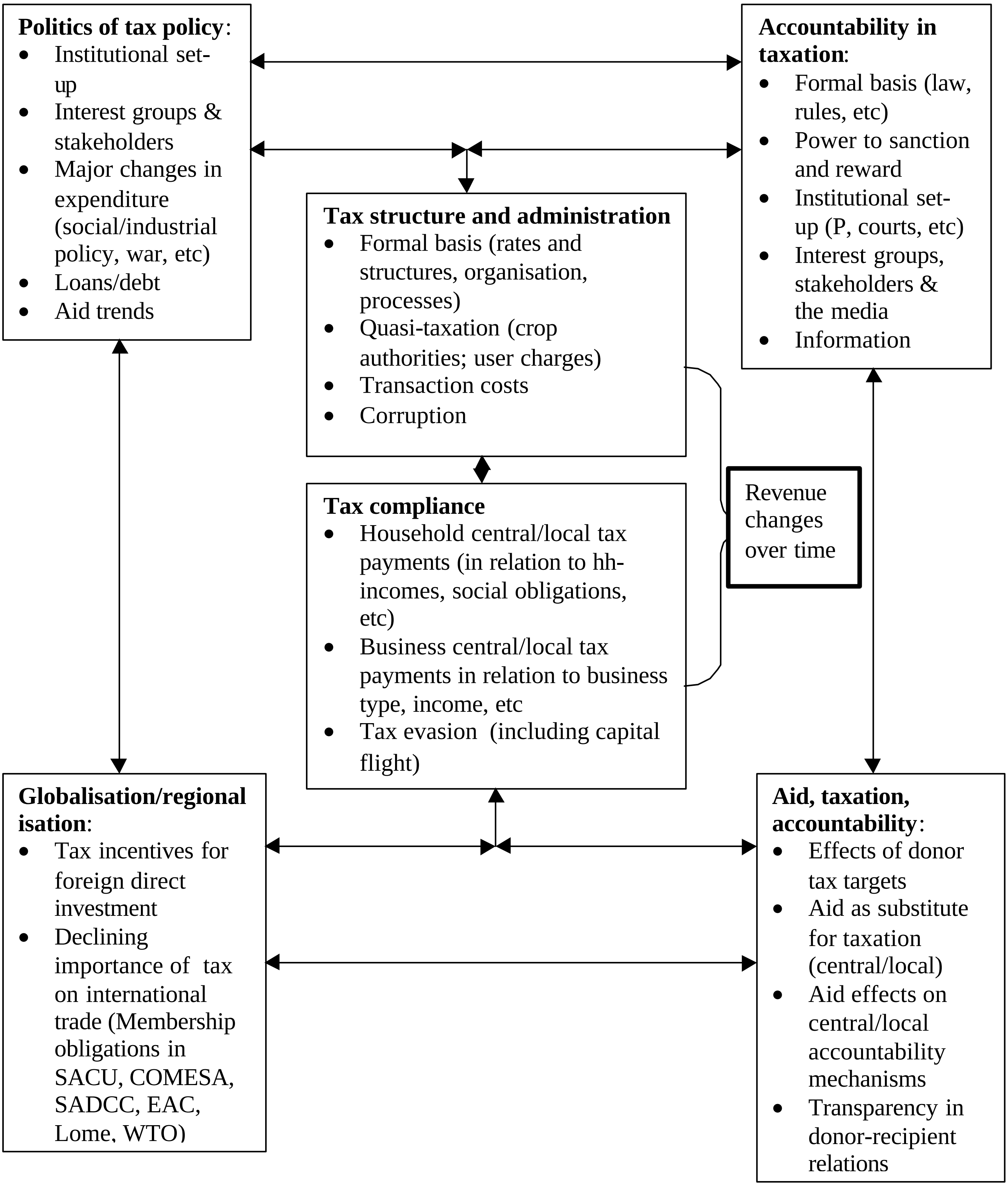
5 Concluding remarks

Our aim is to conduct the research interdisciplinary. The research, including methods and theoretical perspectives, will be based primarily in the disciplines of economics and political science, but also involves public administration and economic history. We are aware of the methodological challenges facing this endeavour. We do believe, however, that by utilising an historical comparative approach, within the framework of new institutionalism, this research has the potential of contributing both empirical and theoretical insights to inform further debates in the fields of public sector and tax reforms in poor countries.

Considerable work remains to be done before an operational research framework is in place.[2] The further development of this framework is therefore the first step in the research process. As work progresses, the results of the research will be presented as working papers and, eventually, as academic publications.

[2] Funding for a three-year period has been secured from the Research Council of Norway; the Ministry of Foreign Affairs (Danida), Denmark; Chr. Michelsen Institute, Bergen; and Centre for Development Research, Copenhagen. The research programme will be carried out as a joint study by Chr. Michelsen Institute (CMI); Centre for Development Research (CDR), Copenhagen; Makerere University, Kampala; the Namibian Economic Policy Research Unit (NEPRU); the Norwegian School of Economics and Business Administration (NHH); and REPOA/Economic Research Bureau, University of Dar es Salaam.

Figure 1. Taxation, aid and democracy.
Interrelated research components



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Summary

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