Taxation, aid and democracy
Research Programme 2000-2003

Final Report
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**Introduction**

Taxation, aid and democracy (TAD) 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 this research programme that started in late 1999. Namibia, Tanzania and Uganda were the case countries. To our knowledge this is the first comparative study of revenue systems in African countries that explores the evolution and performance of the local and central government tax systems. The research aimed to understand and explain the performance of the tax systems in the three case countries. The concept of tax system performance was made explicit: Performance is not just about increasing revenues, but also about implementation efficiency, accountability and taxpayer perceptions. Constraints and options available for policy making and implementation on revenue mobilisation were explored in light of current political, economic and administrative reforms.

Further information on the outline of the research programme and the major areas of research, including findings and publications, can be found on the programme’s web-site:

- CMI: [http://www.cmi.no/research/tax/](http://www.cmi.no/research/tax/)

The CMI web-site also includes links to relevant web pages dealing with Namibia, Tanzania and Uganda, as well as internet links to research on taxation and governance in Africa.

**Major findings**

Although the three countries included in this research programme – Namibia, Tanzania and Uganda – are quite different in terms of history, economic structure, economic wealth and political regime, they also share some common features from a taxation point of view. Thus, over the last 10-15 years, all three countries have:

- embarked upon a democratisation process;
- begun to change the size, functions and operational modalities of the public sector;
- started a reform of central government tax systems and tax administration;
- maintained status quo with respect to local government taxation despite substantial decentralisation reforms;
- placed increasing emphasis on raising the revenue-to-GDP ratio; and
- being put under increasing pressure by donors for raising taxes

The research, including methods and theoretical perspectives, was based primarily in the disciplines of economics and political science, but also involved public administration, law and economic history. The multidisciplinary project design helped us approach the research tasks from different angles, and contributed to generate new insights on taxation in poor countries relevant for future tax reforms. Among the key findings are: Coercion, conflicts and methods of tax collection - rather than politically negotiated contracts about services in exchange for taxes between citizens and rulers (‘democracy’) – are central for the size of revenue mobilisation in poor countries. Administrative problems and political interference in the actual implementation of tax policies are often bigger obstacles to increased revenue than lack of political will to change tax policy. While central government taxes in the poorest countries affect only relatively few people directly (perhaps less than 5 percent of the total population), local government taxation affect many more (perhaps 30 percent, largely men). To the extent that state-citizens
relations are influenced by taxation (which is the experience in Western countries), local government taxation is therefore central to a better understanding of state-citizen relations.

The politics of taxation
Taxation is generally not high on the domestic political agenda in Namibia, Tanzania and Uganda. This contrasts remarkably with the situation in most rich countries, where taxation issues – especially around elections - are often central and important. The politics of taxation in our case countries are limited, involve a few specialised interest groups, and tend to take place in non-public arenas.

Typically, small lobby groups pressure for exemptions, for rate reductions on imports, or bargain with officials or ministers about tax liabilities. Moreover, in many heavily aid dependent countries such as Tanzania and Uganda donors, and especially the World Bank and IMF, are pushing hard to get aid recipients to meet specific revenue targets. They also provide technical assistance for that purpose. Major debates in Parliament about tax issues or about tax reforms are rare – as are statements by political parties (where they are allowed) about their tax policies. Central government taxation is therefore shaped by technical staff (from the Ministry of Finance, the revenue authorities and among donor advisors) rather than by Parliament.

Local government taxation is a major exception to this. Around election time, this form of taxation is often high on the political agenda of both national and local politicians. This politicisation of local government taxes does not increase tax compliance among citizens. To the contrary, it often undermines local government tax collection efforts.

Taxation and accountability
Western historical experience with taxation has been that a greater dependence of government on tax revenues may generate governance benefits, because it encourages the accountability of the state to its citizens. Explicit or implicit agreement about who should pay tax, at what rates and for what purposes was reached through bargaining between the ruler and the potential taxpayers. In the process, the effectiveness and legitimacy of the state increased: the consultations reduced the need for coercion to get people to pay taxes; the bargaining helped to create acceptance about national policies; and taxpayer status became a valid platform for claming political influence.

Obviously, this is a highly schematic presentation of Western historical experience. It may not be generally valid for present day poor countries. Nevertheless, the experiences do provide a framework for asking questions about the link between revenue generation and governance in countries that are not only poor, but also aid dependent and in the process of democratisation.

Aid has certain similarities with oil (as a form of revenue) and there is clear empirical evidence that oil (and mineral rich) countries tend to be less democratic than states which depend on taxation of citizens for their fiscal base. Everything else equal this would imply that aid may undermine the accountability of the state to its citizens. Yet, revenues from aid have significantly different features from those of oil. From a taxation point of view, the main difference between oil and aid income is that donors are increasingly directly involved in recipient country tax policy making and administration. Typically, donors push for ambitious overall revenue targets. The research concludes that this may, in some contexts, have significant but unintended negative influences on (i) taxpayers’ rights through coercive tax enforcement, and (ii) accountability by empowering the bureaucracy at the expense of elected politicians. Although it is quite complicated to sort out the specific effects of taxation and donor
Interventions in concrete situations, it is clear from the research that fiscal relations between states, donors and citizens do affect accountability relations in direct and indirect ways. Thus, a better understanding of the fiscal relations in society is important when seeking to promote more democratic and accountable government.

Reform of tax administration
Reforms of the tax administrations in Tanzania and Uganda in the 1990s, in the form of the establishment of semi-autonomous and well-funded revenue authorities, resulted in short term revenue increases. But these achievements have proved to be difficult to sustain in the long run. After the initial success, revenues in percent of GDP decrease and the level of fiscal corruption seems to increase. The research has explored factors that may explain this trend. Two factors are highlighted; the limits of autonomy and patterns of fiscal corruption.

Firstly, when the autonomy of a tax administration is compromised, revenue collection performance suffers. The establishment of a proclaimed autonomous revenue authority with comparatively generous remuneration packages and substantial budgets does not protect the authority from political interference. To the contrary, as observed in Uganda, it may make it a more attractive target because the authority offers both relatively well paid jobs and considerable rent-seeking opportunities. Consequently, such an authority is vulnerable to political interference, especially in personnel matters.

With relatively high wages and good working conditions, corruption may continue to thrive. In a situation where there is high demand for corrupt services, it is unrealistic to provide tax officers with pay rates that can compensate for the amount gained through bribery. Without extensive and effective monitoring, wage increases may produce a highly paid but also highly corrupt tax administration. Hiring and firing procedures may lead to more corruption. Corrupt tax officers often operate in networks, which also include external actors. These corruption networks seem to be strengthened because many of those fired are recruited to the private sector as ‘tax experts’. In Tanzania, this partly explains why the positive process experienced in the initial phase of the new revenue authority later was reversed.

Local government taxation
Despite recent and major central government tax reforms, local government tax systems have remained largely unchanged. Our research shows that the local tax systems often are distorting, costly to administer, and exacerbate inequity. In all three case countries little or no co-ordination with respect to taxation was observed between various levels of government. This has partly to do with lack of capacity at all levels. At the local level the serious shortage of qualified staff at the treasury and planning departments is particularly critical. But also at the ministerial level there are only few tax experts. This has led to double-taxation of the same revenue base, as well as inconsistencies between local and central government tax policies. In Tanzania, for instance, some local governments impose high taxes on export crops, inconsistent with the national government’s policy to encourage export production. Also in Namibia there seems to be little co-ordination between the Ministry of Finance and the ministry responsible for regions and local governments with respect to taxation. While central government taxes affect only relatively few people directly (perhaps less than 5% of the total population), local government taxation affects many more (perhaps 30%, largely men). To the extent that state-citizens relations are influenced by taxation (which is the experience in Western countries), local government taxation is therefore central to a better understanding of state-citizen relations.
Foreign aid and fiscal reforms
In 1997, aid represented 10 per cent or more of GDP in 21 African countries. Without aid, governments would have to cut spending, raise taxes, or borrow from other sources. The donors’ recipe for reducing aid dependence is straightforward: increase domestic revenue generation in the recipient countries. The assumption is that the current tax effort is low. There is some statistical evidence in favour of this view. On average, the tax-to-GDP ratio in sub-Saharan Africa is around 16%, compared to the OECD average of about 32%. In Tanzania and Uganda the tax share is as low as 11%.

Such simple statistical comparisons ignore substantial differences in economic structure, degree of commercialisation and urbanisation, size of the peasant population and poverty. By adjusting for such structural differences and thereby estimating a more realistic revenue potential, Tanzania’s tax share is above the average of sub-Saharan Africa. Furthermore, historical data show that the tax share of many European countries did not reach 15% of GDP until World War II - when incomes were substantially higher than they are in many African countries today.

The research concludes that there is undoubtedly room for improved fiscal and financial management in the public sector in the case countries as well as improved co-ordination between the different levels of government. But, attempts to squeeze additional revenues from poorly designed taxes may exacerbate the negative effects of the tax system on the economy and the society in general. It is unlikely that a substantial widening of the tax base can be achieved without increasing the tax burden of the poorer segments of the population. Thus, the IMF’s and donors’ push for ambitious overall revenue targets (measured as the tax-to-GDP-ratio) may have negative impacts on income distribution.

Improved tax administration cannot compensate for bad tax design. Excessive and arbitrary taxation are major constraints for economic and social development. Export agriculture is an especially easy target for revenue collection by local governments. In Tanzania, overall tax burdens of 20-60% of the major traditional export crops are not unusual. This has led to disincentives for production and incentives for smuggling of agricultural products between countries, and in some cases also between districts within countries due to varying local government tax regimes. Thus, high taxation retards the growth process and induces tax evasion. The build-up of the taxable base and fiscal sustainability are also delayed. Thus, reforming the tax structure should precede the reform of tax administration, since there is not much merit in making a bad tax system work somewhat better. In redesigning the tax structure, the following options should be considered (1) abolition of unsatisfactory taxes; (2) improvements to remaining revenue bases; and (3) cost recovery through user charges.

Continuation of tax research
Funding from the Research Council of Norway expired in 2003. Several articles are in the referee-process, and one edited book on taxation and development is being developed in collaboration with IDS-Sussex. In addition, several working papers will be developed into articles. Furthermore, at the last annual workshop of the TAD-programme (held in Windhoek, April 2002), there was broad agreement among the involved researchers to aim for a Phase II of the programme.

The proposed Phase II is titled Taxing rich and poor: taxpayer-tax authority relations in Tanzania and Uganda. A short summary of the proposal is as follows:
“How is taxation and poverty linked in the political, social, institutional and economic contexts of poor African countries? In-depth knowledge and conceptualisation of those who actually are caught and escape the tax net - and how relations between taxpayers and tax authorities are affected by revenue mobilisation efforts - is limited. This is surprising, given the fact that taxation practices affect all three dimensions of the concept of poverty espoused by the international community: (i) deprivation of income; (ii) vulnerability to natural and man-made changes; and (iii) powerlessness arising from ignorance and political marginalisation. By focusing on selected central and local government taxes, the research will seek to identify how and why taxation affects the poor along these three dimensions of poverty. The main proposition is that tax administration decisions and practices - as much as declared tax policies and legislation - shape how taxation affects different groups of taxpayers. Such knowledge is relevant for a better theoretical understanding of the political, social and economic dimensions of taxation in poor countries. It is also relevant for poverty oriented aid policy.”
Publications and other forms of research dissemination

Table 1 summarises the written outputs of the programme by December 2003. It also indicates the number of papers under preparation, including those which are in the referee process in international journals. A detailed account of publications, conference papers and work-in-progress is presented in the following sections.

### Table 1: Types and number of publications of the TAD-programme (by December 2003)

<table>
<thead>
<tr>
<th>Type of publication</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Articles published or forthcoming in international journals and edited books</td>
<td>21</td>
</tr>
<tr>
<td>Articles published in journals and books in Denmark, Norway and Tanzania</td>
<td>8</td>
</tr>
<tr>
<td>Articles submitted for publication in international journals</td>
<td>5</td>
</tr>
<tr>
<td>Working papers (DIIS, CMI, NEPRU)</td>
<td>12</td>
</tr>
<tr>
<td>Papers presented at international conferences, workshops and seminars</td>
<td>30</td>
</tr>
<tr>
<td>Popularised feature and debate articles in newspapers and newsletters</td>
<td>10</td>
</tr>
<tr>
<td>Papers under preparation (including working and conference papers)</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>105</strong></td>
</tr>
</tbody>
</table>

### Articles in journals and book chapters


• Rakner, Lise 2000. ”Namibia. Landprofil” In Fellesrådets Afrika Årbok 2000/01 (pp. 303-304, in Norwegian). Oslo.


Reports, working papers and other publications


• Schade, Klaus 2001. “The Revised Budget 2001/02.” *NEPRU Viewpoint* No. 41


**Papers presented at conferences, workshops and seminars**


Other


• Hansohm, Dirk et al. 2000/01. A series of “Press briefings” on various tax-related issues in Namibia, including the introduction of VAT, capital gains tax and taxpayer charter. Windhoek: NEPRU.


Research networks
Publications from the programme and participation at workshops, seminars and conferences have contributed to help us build an extensive research network on taxation in developing countries during the project period. Researchers from 9 different research institutions in 6 countries have been directly involved in the research at different stages. The research collaboration with IDS-Sussex was strengthened during 2002 with joint publications and conferences. In October-November 2002, researchers from the TAD-programme participated with papers at two international conferences in Sussex. One conference gathered tax researchers from across the world, while the other targeted tax practitioners and officials from donor agencies. Representative from all the major bilateral donor agencies in Europe, the IMF and the World Bank participated. In addition, private tax consultants, senior officers from Ministries of Finance and revenue authorities in Europe and Africa took part. As a following up, NORAD invited us to present key findings from our research at a taxation seminar in Oslo in April 2003, which gathered senior officials from NORAD and SIDA, as well as officials from the Ministries of Finance and the Revenue Authorities in Norway and Sweden.

In October 2003, the programme organised a workshop entitled ‘Taxation, accountability and poverty’ at the Annual Conference of the Norwegian Association for Development Research (NFU), which took place in Oslo. These events provided us with unique opportunities to discuss key findings from the research programme with colleagues, practitioners and decision-makers. The programme has received substantial attention from the media. In addition to the Norwegian, Danish and Namibian press, our research has been presented by the BBC-London, by the Paris-based Indian Ocean Newsletter, and by The Economist Intelligence Unit.
Funding and research partners

Funding from the Research Council of Norway (a total of NOK 3.2 million) became available in October 1999, and the DANIDA funds (a total of DKK 1.72 million) were approved in March 2000. The DANIDA funding covered expenses for the participation of Tanzanian and Ugandan researchers in the programme. The Research Council of Norway funded inputs from Namibia and Norway. In addition, the involved institutions (DIIS- CDR, CMI and NEPRU) have put substantial resources into the research programme in the form of research assistance, library services etc. NEPRU also obtained funding from the African Capacity Building Foundation (ACBF).

By December 2003, twenty-four researchers from six countries had been engaged in the research programme, although none on a full time basis and some only provided minor inputs. Names, discipline and institutional affiliation of participating researchers are presented in table 2. The programme has been co-ordinated by senior researchers Odd-Helge Fjeldstad (CMI) and Ole Therkildsen (DIIS). Several institutions have collaborated. By end 2003, they were:

- Chr. Michelsen Institute (CMI), Norway
- Danish Institute for International Studies (DIIS) – formerly CDR, Denmark
- Economic Policy Research Centre (EPRC), Uganda
- Faculty of Law, Makerere University, Uganda
- Faculty of Law, University of Dar es Salaam (UDSM), Tanzania
- Institute of Economics (IE), Makerere University, Uganda
- Namibia Economic Policy Research Unit (NEPRU), Namibia
- Norwegian School of Economics and Business Administration (NHH), Norway
- Research on Poverty Alleviation (REPOA), Tanzania
- Uganda Debt Network (UDN), Uganda

Individuals from Uganda Prison Services and Uganda Parliament have also been involved in the research. In addition, close co-operation with three other institutions took off in 2001. Namely IDS Sussex (The Development Research Centre on the Future State headed by professor Mick Moore); Centre National de la Recherche Scientifique (CNRS), Paris (Dr. Alice Sindzingre) and Centre for Policy Studies (CPS), South Africa (Dr. Steven Friedman). Recently, the collaboration with IDS-Sussex has been strengthened through joint conferences and publications, while that with CNRS has come to an end.
Table 2: Researchers involved in the TAD-programme (2000-2003)

<table>
<thead>
<tr>
<th>Name</th>
<th>Institution</th>
<th>Discipline</th>
<th>Job title</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anena, Christine</td>
<td>UDN</td>
<td>Dev. Studies</td>
<td>Researcher</td>
<td>Uganda</td>
</tr>
<tr>
<td>Bebi, Hoster+</td>
<td>NEPRU</td>
<td>Economics</td>
<td>Researcher</td>
<td>Namibia</td>
</tr>
<tr>
<td>Bwire-Mahande, Job++</td>
<td>Parliament of Uganda</td>
<td>Pol. Science</td>
<td>Assistant Clerk</td>
<td>Uganda</td>
</tr>
<tr>
<td>Chekwoti, Caiphas</td>
<td>Makerere University</td>
<td>Economics</td>
<td>Researcher/lecturer</td>
<td>Uganda</td>
</tr>
<tr>
<td>Endjala, Rosa</td>
<td>NEPRU</td>
<td>Economics</td>
<td>Researcher</td>
<td>Namibia</td>
</tr>
<tr>
<td>Fjeldstad, Odd-Helge</td>
<td>CMI</td>
<td>Economics</td>
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<td>Hansohn, Dirk</td>
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<td>Director</td>
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<td>REPOA/ESRF</td>
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<td>Tanzania</td>
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<td>Kange, Adam</td>
<td>TRA</td>
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<td>Principal</td>
<td>Tanzania</td>
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+ Died, December 2000.
Summary

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 represents the general basis for a research programme that started in late 1999. The programme studied the evolution of tax systems in three African countries; Namibia, Tanzania and Uganda. Constraints and options available for policy making and implementation on revenue mobilisation were explored in light of current political, economic and administrative reforms. This note summarises key findings and provides an overview of publications and other forms of research dissemination between 2000-2003. The researchers and institutions as well as the research network participating in this elaborate research programme are presented.