



Taxation and Governance in Africa: Take a Second Look

By Deborah Bräutigam

Despite decades of reform and foreign aid, the quality of public institutions in most African states remains poor.¹ Colonial powers did not leave behind strong, indigenous institutions that could tackle the development challenges of modern states. Economic crises, wars, and political instability have also taken their toll. Yet one entry point for improving governance on the continent has received little attention: taxation. Well-designed tax systems can consolidate stable institutions in developing countries, increase revenues, refocus government spending on public priorities, and improve democratic accountability. The political economy of taxation offers important lessons for the developing world.

Taxation is an underrated tool in the effort to build more capable and responsive states. In 1963, as one African country after another emerged from colonial rule, economist Nicholas Kaldor threw a spotlight on the link between state capacity and taxation: “No underdeveloped country has the manpower resources or the money to create a high-grade civil service overnight. But it is not sufficiently recognized that the revenue service is the ‘point of entry’; if they concentrated on this, they would secure the means for the rest.”²

The role of taxation as a central force in the development of democracy resonates strongly in Anglo-American history. The duty of paying for government legitimizes demands for services and accountability. When eighteenth-century American rebels declared “No taxation without representation!” in Boston Harbor, they were echoing convictions developed in earlier struggles between rulers and revenue-producers on British soil. Democracies are built not only on periodic elections but also on a social contract based on

bargaining over the collection and spending of public revenue.

Without the ability to raise revenues effectively, governments are limited in the extent to which they can provide security, meet basic needs, and foster economic development. Yet the political importance of taxation extends beyond the raising of revenue. Taxation can stimulate calls for more representative and accountable governments, while the need to increase revenues can stimulate institution-building. Both have the potential to bolster the legitimacy of the government and enhance democracy. Foreign aid can be a substitute for absent revenue, allowing critical development functions to be performed. But funding state expenditures primarily through resources that are raised without much effort (foreign aid or revenues derived from oil and other natural resources) does little to stimulate the development of state capacity.

In Europe, taxes not only helped create the state, they also helped make it democratic. The origins of representative government are intimately bound up with the evolution of taxation.³ When parliaments began taxing their citizens, governments became more skilled at collecting

Deborah Bräutigam (dbrauti@american.edu) is an associate professor of international development at American University.

the information they needed to respond to popular demands for accountability. Over time, the need for revenue fostered reform of tax systems, shifting from simple systems of “tax farming” (in which governments delegate the collection of taxes to private individuals who are allowed to keep a percentage) and customs duties to permanent, modern bureaucracies. The bargain between taxpayers and monarchs encouraged a rule of law that protected private property rights. Backed by taxation, rulers were able to sell bonds in private capital markets. Formed originally to finance wars, these revenue authorities became essential supports for European economic development. History provides good reasons to look more closely at the governance dimension of taxation and revenue generation in developing countries today.

Discussions of taxation’s potential contributions to state-building are largely absent from the practical concerns of the aid community, which tends to focus on increasing aid (or cutting expenditures) rather than on raising revenues. The state-building role of taxation should be a far more central issue for those concerned with the problem of collapsed states, weak governments, and the lack of democracy across the developing world.

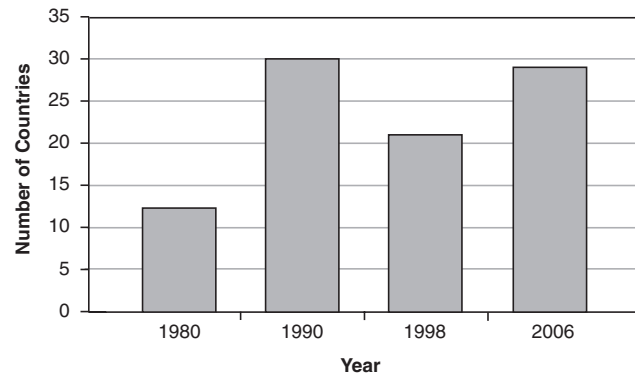
Foreign Aid and Dependence

Foreign aid as a formal government activity began in 1947 with the Marshall Plan. Almost immediately, concerns arose over the impact of large amounts of aid on the behavior and attitudes of recipient governments. Worried that the European countries were relying too much on external funding and not mobilizing their own resources for recovery, a State Department official cabled the U.S. team negotiating the terms of the plan in Paris: “Too little attention is being paid by the participants to the elements of self-help.”⁴ In the 1960s, as foreign aid expanded across more developing countries, practitioners began to emphasize that foreign aid must involve “partnership,” not dependence.

Yet over decades, beset by waves of economic crisis and state failure, aid became increasingly detached from any notion of maximizing self-help. In 1980, thirteen African countries were receiving net aid (aid inflows minus principal repayments) at levels above 10 percent of GNP.⁵ By 1990, that figure had more than doubled worldwide to thirty countries. In 1998, twenty-one countries continued to receive aid at that level, and in

2006, the total number increased to twenty-nine (see figure 1). Aid’s share of GDP in sub-Saharan Africa in the 1990s was five times as high as in the 1960s and three times as high as in the 1970s.⁶

FIGURE 1
NUMBER OF COUNTRIES RECEIVING NET AID
AT LEVELS ABOVE 10 PERCENT OF GNP



SOURCE: World Bank, *World Development Indicators 2006* (Washington, DC: World Bank, 2006).

Aid and Governance

The institutions of government in most of Africa have never been particularly strong. The newly independent nations of Africa were not well-prepared for self-government, and many faced ethnic tensions that had been exacerbated by colonial rule. In the past decade alone, at least a quarter of the countries on the continent have been involved in wars.

Furthermore, reliance on natural resource revenues, tariffs, and other kinds of “unearned” rents led to stunted institutions. With easy access to reliable revenues from taxing foreign corporations, resource-rich states never needed to penetrate their own societies and organize them to raise revenues. They did not need to bargain with domestic producers over taxes; establish fiscal accountability; or build autonomous, capable bureaucracies that could make policy and direct resources to support independent producers. Rulers whose revenue came without much effort found themselves making decisions mainly about largesse, or the distribution of the “national cake,” as Nigerians put it.

High levels of aid have the potential to improve governance when donors insist on accountability, but

they can also work against it, in much the same manner as natural resource rents. On the positive side, high levels of aid channeled to governments with clear development agendas can be used to improve the quality of the civil service, strengthen policy and planning capacity, and establish strong institutions. In East Asia, South Korea and Taiwan are good examples of this, while Botswana shows that the same processes can also work in sub-Saharan Africa. For governments committed to development, aid can relieve to some degree the binding constraint of low revenues. Some researchers have found that high levels of aid (even at levels of around 40–45 percent of GDP) promote growth when given to countries with sound macroeconomic policies.⁷ Positive levels of economic growth, in turn, can also generate new revenues for funding improvements in government institutions.

High levels of aid can create incentives for donors and governments that make it more difficult to build a more capable and responsive state.

Yet high levels of aid can also delay governance improvements in at least two ways. First, the way large amounts of aid are delivered can weaken institutions rather than build them. This can happen because of the high transaction costs that accompany aid, the fragmentation that multiple donor projects and agendas promote, the problems of poaching key talent for aid projects, the obstruction of opportunities to learn by doing, and the effects of aid projects on national budgets. Less directly, but just as important, high levels of aid can create incentives for donors and governments that make it more difficult to build a more capable and responsive state.

Institutional Destruction. The institutional impact of aid in weak African states can be quite significant. In one study from Ghana, one of the most heavily aided African countries, senior officials each spent as much as forty-four weeks a year facilitating or participating in donor supervision missions—time they were unable to devote to their ministries' own priorities. In one country that was suffering from economic crisis, a donor study recommended reducing the eight hundred existing aid projects to a "more manageable" three or four

hundred. Three years later, however, the number of aid projects had climbed to two thousand. With multiple projects to administer, donors require local staff, and in many countries, trained personnel are scarce. Donors consequently bid up the price of capable staff, pulling them from both the private (productive) sector and the government. This poaching weakens institutions as it creates resentment and lowers morale for those left behind.

The donor community recognizes the problems of aid's institutional impact. Indeed, the Organisation for Economic Co-operation and Development recently brought donor and recipient country representatives together to agree on guidelines that would enable aid to be better coordinated and harmonized, one of the pledges made under the Millennium Development Goals.⁸ Yet donors told me during visits to Tanzania and Zambia earlier this year that the effort to harmonize and rein in disparate donors continues to be a struggle.

Tax-Free Benefits. Aid may also reduce tax receipts directly, contributing to a cycle of low revenues and rising fiscal deficits. Aid projects can be a very important part of a local economy. Yet traditionally, donors, NGOs, and contractors are allowed to import equipment such as vehicles and goods for their staffs without paying duties. Expatriate personnel working for aid agencies and NGOs are rarely required to pay local income taxes. At one point in Tanzania, the total for government wages and salaries (which are taxed) was \$100 million, while the salary bill for technical assistants supplied under aid programs (and not taxed) was \$200 million.⁹ To the extent that untaxed aid experts and their untaxed vehicles and property substitute for the government workers or for the private sector (which would be taxed), tax revenues are reduced.

Creating Moral Hazard. Moral hazard implies a situation in which having an insurance policy (or, in this case, access to external resources) actually induces riskier, counterproductive behavior. As noted earlier, the fear that aid might make governments less likely to put in place the policy framework, local funds, and trained personnel needed for development underpinned the early emphasis on self-help both in the Marshall Plan and in early bilateral aid programs. If aid was clearly a supplement to the government's own efforts in a project or program, moral hazard would be less likely to arise, and the aid would be more likely to be a true

partnership, supporting programs “owned” by governments. Over time, however, the emphasis on self-help dwindled, and problems of moral hazard arose.

When revenues do not depend on the taxes raised from citizens and businesses, there is less incentive for government to be accountable to them.

The moral hazard problem operates on two levels. First, a history of high levels of aid may make it more likely that a government will allow corruption in the customs bureau or an ineffective internal revenue service to continue or more likely that credible constraints on overspending and monetizing the deficit will be postponed, particularly if these reforms will eventually lead to a decline in tax revenues. Second, aid-dependent countries may be inclined to underuse their available sources of tax revenues. Middle-income countries increased tax revenue as a percentage of GDP from an average of 16.5 percent (1972–76) to an average 21.1 percent (1995–99), but low-income countries (which receive more aid on average) saw their tax revenue fall from an average of 17 percent to 14.3 percent over the same period.¹⁰ Seventy-one percent of the African countries receiving more than 10 percent of GDP in aid in 1995 were also in the group of countries judged by an International Monetary Fund study to have made a less-than-expected tax effort.¹¹ In Africa, a recent study showed, higher aid levels are associated with larger declines in the quality of governance. A similar relationship existed for taxation: higher aid levels were associated with lower revenues as a share of GDP.¹²

Restructuring Accountability. Finally, large amounts of aid can reduce incentives for democratic accountability. Taxpayers who believe that their interests are represented in a democracy may be more willing to pay taxes, but they also begin to believe that their payment of taxes gives them the *right* to representation. When the American colonists complained about taxation without representation, they were speaking to a colonial government that had long accepted this principle. Representation, however, is only one element of the fiscal contract. The bargain might also involve services: public goods (such as defense, schools, or roads) or semi-public goods

(benefits provided to producers or consumers). And it involves pressure on governments to be accountable to taxpayers for the use of their money.

Bargaining over revenues and taxation may be critical for the development of accountability, as it was historically in Europe. However, aid as a source of revenue parallels other “nonearned” revenue sources—particularly the rents from mineral extraction—when it comes to making governments accountable. As political scientists have long argued, *rentier* states face fewer internal pressures to improve state capacity and accountability.¹³ When the flow of revenue is not affected by government efficiency, there is little incentive to improve state capacity. When revenues do not depend on the taxes raised from citizens and businesses, there is less incentive for government to be accountable to them. Aid dependence structures accountability as something between the executive branch of government and aid donors, rather than between state and society, thus weakening this important aspect of governance. But when citizens have little idea of the domestic budget or of the total loan obligations being undertaken by their government, the basic information necessary for accountability is missing.

Many believe decentralization enhances the delivery of aid to citizens. In particular, it should (in theory) stimulate local governments to improve the quality of the services they deliver in exchange for taxes. A study in Uganda noted that, as expected, the district with the lowest tax compliance was also one with very substantial donor funding.¹⁴ Others have concluded that when donors demand that local councils raise matching funds for donor-assisted projects (something that is supposed to promote local ownership and accountability), incentives for local governments to use coercion to ensure tax compliance seem to intensify; there is little evidence of reciprocity or “revenue bargaining.”¹⁵ Alternatively, a study by Barak D. Hoffman and Clark C. Gibson demonstrated that local governments in Tanzania and Zambia tended to budget significantly more funding for public services if they received relatively more funding from local taxes.¹⁶ Those with more funding from donors or from central-government transfers budgeted less money for services and more for their salaries and administrative expenses. This would suggest that local politicians do have incentives to offer services in exchange for revenues.

A study in Peru provides more evidence for this point by noting that Peruvian street traders and informal transportation operators were more willing to pay taxes

to local governments when the government earmarked a portion of the revenues for a fund to pay for services for informal sector operators.¹⁷ Villagers in at least one Chinese county agreed that some taxes (particularly those earmarked for social support services) were legitimate, but they objected to others, such as those for infrastructure and for the training of party members. Chinese at the local level began to conclude that, as Thomas P. Bernstein and Xiaobo Lü put it, “when citizens fulfill their duties as taxpayers, they have a right to make claims on the state for provision of public goods and public services.”¹⁸ Taxation might indeed be a pathway to a more legitimate and responsive state at the local level, but there is also a danger of increased coercion. Without a responsive state at the *central* level, the risk of local-level coercion can be high.

Conclusion and Implications

Are developing countries today simply at an earlier stage, poised to follow the experience of Western European modernization in using taxation to develop stronger, more capable states that can support social services and economic growth? Will taxation lead to calls for rights and representative governance?

In many ways, the weaker states of much of the developing world do look like European nations at an earlier time: their economic structures are based more on agriculture than industry, their informal sectors and shadow economies are large, and they have fewer “tax handles”—that is, opportunities for taxation. Yet several factors complicate the easy assumption that developing countries will follow the leaders. First, many developing countries are highly dependent on the export of one or a few natural resources; this was never the case in the countries that are today’s advanced industrial democracies, even in their early histories. Second, compared with the richer countries, developing countries face a different set of global pressures and influences. They are often recipients of aid, something that substitutes for taxes but is likely to have different political results. They have higher levels of debt and weaker positions in the global economy. All of these factors complicate the relationship between taxation and governance and should cause us to pause before assuming that when it comes to the political economy of taxation, developing countries are simply poorer versions of today’s advanced economies.

Taxation can be coercive, it can be entwined with corruption, and it can be excessive. It is not a

unilaterally positive force for governance, as peasants have pointed out in tax revolts around the world and throughout history. Yet it is an exceptionally important force, and it shapes governance in direct and sometimes unexpected ways. State capacity and democracy may both be strengthened by taxation, creating pathways to more responsive, effective, and self-reliant states. More explicit attention to the political dimensions of taxation in the developing world may produce a governance dividend. In practice, this attention would be reflected in renewed efforts to engage taxpayers and governments in bargaining over taxation. Revenues should be part of a system of accountability between states and citizens, not mainly between governments and donors.

Mauro De Lorenzo is the editor of AEI's Development Policy Outlook series. AEI research assistant David Peyton worked with Mr. De Lorenzo and Ms. Bräutigam to edit and produce this Outlook.

Notes

1. In this *Outlook*, “Africa” refers only to sub-Saharan Africa. For more on this topic, see Deborah Bräutigam, Odd-Helge Fjeldstad, and Mick Moore, eds., *Taxation and State-Building in Developing Countries: Capacity and Consent* (Cambridge: Cambridge University Press, 2008).
2. Nicholas Kaldor, “Will Underdeveloped Countries Learn to Tax?” *Foreign Affairs* 41 (January 1963): 410–19.
3. Charles Tilly, “War Making and State Making as Organized Crime,” in *Bringing the State Back In*, ed. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol (Cambridge: Cambridge University Press, 1985).
4. Michael Hogan, *The Marshall Plan: America, Britain, and the Reconstruction of Western Europe, 1947–1952* (Cambridge: Cambridge University Press, 1987): 72–73, cited in John Orme, “The Original Megapolicy: America’s Marshall Plan,” in *Great Policies: Strategic Innovations in Asia and the Pacific Basin*, ed. John D. Montgomery and Dennis A. Rondinelli (Westport, CT: Greenwood, 1995), 23.
5. World Bank, *World Development Indicators 2006* (Washington, DC: World Bank, 2006).
6. Jean-Paul Azam, Shantayanan Devarajan, and Stephen A. O’Connell, “Equilibrium Aid Dependence” (unpublished manuscript, 2002).
7. Ramesh Durbarry, Norman Gemmill, and David Greenaway, “New Evidence on the Impact of Foreign Aid on Economic Growth” (research paper 98/8, Centre for Research in Economic Development and International Trade, University of Nottingham, Nottingham, England, 1998), 17, available at

www.nottingham.ac.uk/economics/credit/research/papers/cp.98.8.pdf (accessed April 9, 2008).

8. See Organisation for Economic Co-operation and Development, "Paris Declaration on Aid Effectiveness" (High Level Forum, Paris, March 2, 2005), available at www.oecd.org/dataoecd/11/41/34428351.pdf (accessed April 9, 2008).

9. Elliot Berg, *Rethinking Technical Cooperation: Reforms for Capacity Building in Africa* (New York: United Nations Development Program, 1993).

10. Deborah Bräutigam and Steven Knack, "Foreign Aid, Institutions, and Governance in Sub-Saharan Africa," *Economic Development and Cultural Change* 52, no. 2 (January 2004).

11. Countries with less than 10 percent of GDP in aid in 1995 were almost evenly divided between lower-than-expected and higher-than-expected tax efforts (54 percent had lower tax efforts, 46 percent higher). This analysis is based on Janet G. Stotsky and Asegedech WoldeMariam, "Tax Effort in Sub-Saharan Africa" (working paper 97/107, International Monetary Fund, Washington, DC, September 1997), available at www.imf.org/external/pubs/ft/wp/wp97107.pdf (accessed April 9, 2008).

12. Deborah Bräutigam and Steven Knack, "Foreign Aid, Institutions, and Governance in Sub-Saharan Africa." Each percentage-point rise in aid/GDP is associated with a fall of about one-third of a percentage point in tax revenues/GDP. This highly significant tax-displacing impact of aid is smaller than that estimated by Tarhan Feyzioglu, Vinaya Swaroop, and Min Zhu, "A Panel Data Analysis of the Fungibility of Foreign Aid." *World Bank Economic Observer* 2, no. 1 (1998): 29–58.

13. On the *rentier* state, see Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley: University of California Press, 1997); and Michael L. Ross, "The Political Economy of the Resource Curse," *World Politics* 51, no. 2 (January 1999): 297–322. For an extension of this argument to foreign aid, see Deborah Bräutigam, "Governance, Economy and Foreign Aid," *Studies in Comparative International Development* 27, no. 3 (Fall 1992): 1–25.

14. Anne Mette Kjær, "Institutional History or 'Quid-Pro-Quo'? Exploring Revenue Collection in Two Ugandan Districts" (paper presentation, annual meeting, American Political Science Association, Chicago, September 2–5, 2004).

15. Odd-Helge Fjeldstad and Ole Therkildsen, "Mass Taxation and State-Society Relations in East Africa," in *Taxation and State-Building in Developing Countries: Capacity and Consent*.

16. Barak D. Hoffman and Clark C. Gibson, "Fiscal Governance and Public Services: Evidence from Tanzania and Zambia" (Department of Political Science, University of California, San Diego, September 2005), available at www.sscnet.ucla.edu/polisci/wgape/papers/9_GibsonHoffman.pdf (accessed April 9, 2008).

17. Anuradha Joshi and Joseph Ayea, "Associational Taxation: A Pathway into the Informal Sector?" in *Taxation and State-Building in Developing Countries: Capacity and Consent*.

18. Thomas P. Bernstein and Xiaobo Lü, "Taxation and Coercion in Rural China," in *Taxation and State-Building in Developing Countries: Capacity and Consent*.