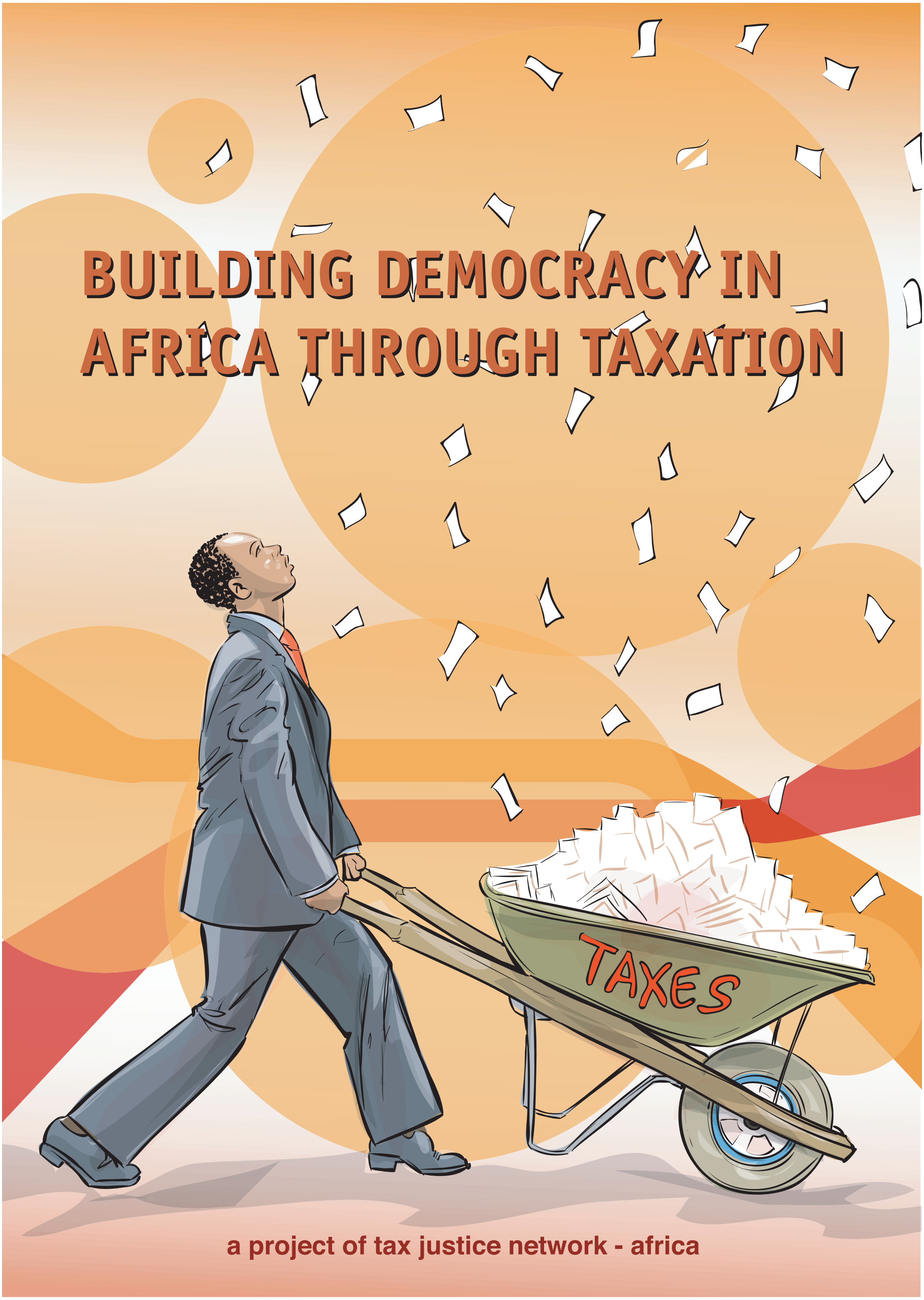
BUILDING DEMOCRACY IN AFRICA THROUGH TAXATION



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Building Democracy in Africa through Taxation

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This first set of popular educational materials on taxation is produced by the Tax Justice Network-Africa.

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Executive Summary

What is the link between taxation and democracy? How does taxation affect the relationship between governments and their citizens? What is the role of taxation in building state capacity? How can decentralisation and local taxation lead to increased level of political participation from citizens? And what is the role of civil society organizations, faith-based organizations, the media, citizens and elected leaders in formulating tax policies which would ultimately lead to democracy?

The objective of this educational material is to bridge the knowledge gap on taxation-related issues among elected and civil leaders, civil society organizations and the African public at large. This material aims at increasing the information about taxation and its importance in strengthening the relationship between governments and their citizens.

Taxation and Democracy: Overview

Although taxation is the major source of government revenue in most developed and developing countries, it is a widespread conception in Africa that taxation is a complex field that is best left to experts. Not only is taxation in general poorly understood in Africa, it is also underutilized and underrated as a tool to establish capable and responsive states (state-capacity building role of taxation) and for the development of representative democracy in Africa (Bräutigam 2008a).

This lack of information and understanding with regard to taxation among several stakeholders in Africa (elected leaders, citizens, civil society organizations, the media, faith-based organizations, etc.) constitutes, on the one hand, an impediment to greater tax resource mobilization by African states needed to finance their development agenda in a context of global financial crisis and shrinking official development assistance (ODA) (African Economic Outlook 2010). On the other hand, it is also an impediment to the advocacy for sound tax regimes that are also crucial to building representative democracy, good governance and accountability in Africa.

Democracy is a political form of government where governing power is vested in the people and exercised by them either by direct referendum (direct democracy) or by means of elected representatives (representative democracy).

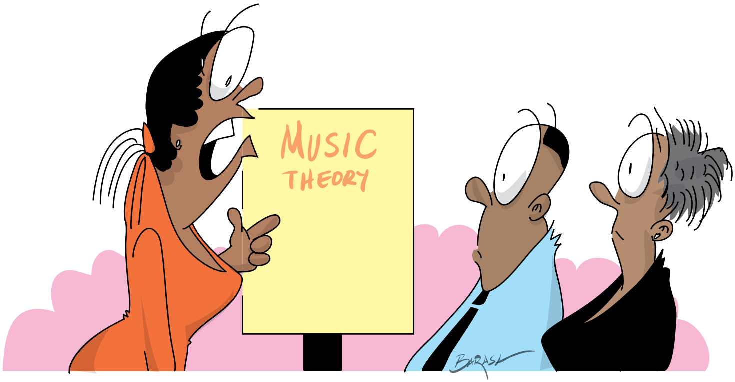
Highlighting the link between taxation, state-capacity building and democracy in Africa

From a historical perspective mainly drawn from Europe and America, it was determined that governments' dependence on domestic revenues through a broad based taxation is conducive to a participatory political process based on negotiations, bargaining and balancing conflicting interests. Citizens as taxpayers would come together to negotiate tax demands and oversee the collection and use of tax revenues through public expenditures, thus making government more accountable. Their political representation would have a greater say in public policy in exchange for citizens' quasi-voluntary tax compliance.

As tax compliance increases, governments would develop strong and capable tax administrations with the ability to collect and administer taxes effectively, thus building and improving state capacity. As revenue streams from domestic broad-based taxation become stable and predictable, governments would have incentive to foster their citizens' prosperity, thus generating more revenues (Moore 2008, OECD 2008).

Although it is worth the while to learn from the historical experience in the North about the link between taxation, state building and accountable governance, this material does not attempt to suggest that it is a model trajectory that should and could be followed in Africa. Indeed, various factors inherent in African states would increase the risks of attempting to duplicate that model trajectory in Africa: resource-based economies, historical legacies, socio-economic structure, and foreign aid. Without a doubt, some sub-Saharan African countries are heavily dependent on natural resources and other rents, they are the product of a colonial system that influenced their revenue bureaucracies, and are aid dependent. These factors create incentives different from those countries' that have to rely for their revenues on taxes from their taxpayers.

This reliance on natural resources rents and foreign aid rather than taxation in most of Africa is not conducive to revenue bargaining commonly associated with more representative, responsive and effective governments (Moore 2008, OECD 2008). Natural resources rents and foreign aid inflows in Africa



"Like music is food to our souls, so are taxes food to our economy."

are in general associated with low levels of tax revenues due to limited support for revenue- raising efforts, low quality of government institutions, and ineffective and unaccountable governments characterised by an absence of representation for taxpayers in the tax policy process. These arguments lead to the conclusion that taxation is a necessary condition for the quality of governance (Moore 2008, OECD 2008).

What we generally observe in a number of African countries is a "state society imbalance", where the state has considerable power over society because it mainly gets its revenues from a source largely independent from the domestic or local economy; as such, it could therefore resist democratic pressure and could afford to be unresponsive to its citizens. Reactively, citizens' willingness to pay taxes decreases as they perceive that governments are not responsive to their needs and as poor service delivery becomes prevalent. Furthermore, citizens as taxpayers lose the motivation to be politically interested and participatory. Some avenues to economic development and political stability in developing countries might thus be compromised (Gervasoni 2006, OECD 2008).

Citizenship, representation, good governance and accountability

Historically, the bargaining process between citizens and states over taxing and spending led to the creation of a virtual "fiscal social contract" that was crucial to the emergence of representative government and democracy and a path to better governance in Western Europe and the United States. Specifically, in that "fiscal social contract", citizens would willingly accept to pay their tax obligations in exchange of rights to be represented in decision-making processes about how tax revenues are raised and spent2, accountability, and effective provision of public goods and services. This would create incentives for governments to put in place strong bureaucracies capable of collecting and administering taxes effectively as well as information systems enabling bureaucracies to carry these functions efficiently. Additionally, strong incentives to generate more revenues would compel states to foster economic growth that results in the well-being, the quality 2 Moore (2008) called it an "institutionalized influence over public policy." of life and prosperity of their citizens. Concurrently, taxpayers in Parliaments would implement structures to oversee revenue-raising and hold states accountable for the use of tax revenues (OECD 2008).

To put it more succinctly, this would amount to a non-zero-sum game where both parties, state and citizens, could win: because of their citizenship and mainly because they have accepted their obligations to pay taxes, taxpayers are entitled to express their views on public policies directly or through their elected representatives and therefore advocate for better service delivery from states.
Fiscal Decentralisation, citizens' participation and accountability Revenue mobilisation at the regional and local levels has been an important aspect of decentralisation efforts in Africa over the past twenty years.

Key features of a successful fiscal decentralisation system in Africa, which entails the transfer of tax authority to sub-national governments (i.e. the power to raise local taxes), can lead to greater downward accountability to local people and increased levels of citizen representation which effectively plant the seed for democracy.

First, if local government officials are appointed by higher levels of government rather than popularly elected, they will be accountable to the centre rather than to local populations. Therefore, popularly elected local councils would ensure true downward accountability and persuade public officials to be responsive to the needs and interests of their constituents. Furthermore, if budgets are locally approved, this would require citizen participation in the decision-making processes and would therefore give citizens a voice in how their taxes should be spent and that they are spent according to their preferences. In such an environment, as citizens become an integral part of the institution and the political dialogue, they will increase their level of tax compliance, thus increasing citizens' tax ethics and a tax compliance culture.

Second, one of the rationales for fiscal decentralisation is that it moves government closer to people. This feature is closely related to the features mentioned earlier. If citizens have no faith in how the government will spend collected revenues, this would reduce tax compliance. By bringing government closer to people, fiscal decentralisation will help increase the trustworthiness and credibility of local governments as empowered citizens are able to observe how public officials carry out their responsibilities and have a perfect knowledge of whom they can hold accountable for the poor quality of local service delivery in their jurisdiction.

Suggestions For Action

The Civil society organizations, faith-based organizations and the media can contribute to the formulation and implementation of tax policies which would lead to accountability and good governance on the part of the state and better tax compliance from citizens, ultimately strengthening and deepening the democratisation process in Africa by playing the following roles:

- Help inform the public about taxation and tax issues or improve taxpayers' education and understanding on taxation issues in general.
- Help citizens understand the bargaining power that comes from complying with taxes obligations and the virtuous circle of benefits (such as effective and accountable state, better governance, greater democratisation efforts) derived from establishing an enduring fiscal social contract.
- Help citizens understand that as taxpayers they can make their voice heard, they could actively take part in public policy decision-making processes about how taxes are collected and spent on public services and thus hold governments accountable and increase their political participation.
- Help elected officials and civil leaders understand the enormous advantages of promoting quasi-voluntary compliance rather than coercion to increase domestic resource mobilization; advantages such as: incentive to increase state capacity to collect and administer taxes effectively, stable and predictable tax revenue streams that could be used as a basis for borrowing in domestic and international markets.
- Get involved in tax debates and produce reports and articles on tax issues with the following goals in mind: to provide adequate sources of funding for poverty reduction programs, to influence income redistribution policies and to increase government transparency and accountability.
- Take part in and influence the different stages of the budget process (formulation, legislative, implementation and assessment stages).

Elected leaders could also contribute to greater tax compliance, accountability, good governance and democracy in Africa by doing the following:

- Simplify and make tax systems more transparent.
- Improve tax administration.
- Widen the tax base.
- Improve efficiency in public service delivery.
- Increase reliance on domestic revenues through a broadly-based taxation which would increase government's responsiveness to citizens' needs and would promote broad economic development.

1 Introduction

In the context of the recent global economic crisis, it has been made clear that the African continent's heavy dependence on external financial flows could become a great impediment to its development agenda in the future. Indeed, the reduction in foreign aid flows, the decrease in commodity and natural resources prices and in export revenues have seriously shrunk the means on which Africa mainly relies for the financing of economic development and poverty reduction.

Consequently, increasing public resource mobilisation, namely taxation, is becoming crucial in Africa. Unfortunately, taxation is in general poorly understood on the African continent and is considered a complex field that is usually left to experts.

The objective of this educational material is to bridge the knowledge gap on taxation among elected and civil leaders, civil society organizations and the African public at large. The present document aims at increasing the information about taxation and its importance in strengthening the relationship between governments and their citizens. Specifically, it highlights that, historically and especially in Europe and America, bargaining over taxation has lead to the emergence of a virtual "fiscal contract" on the basis of which the relationship between taxpayers and the state was redefined. On the one hand, it offered the taxpayers the opportunity to hold governments accountable of the quality of public goods and services and to increase citizen representation in decision-making processes as well as tax and spending policies; which would contribute to building a democratic political system and promote better governance.

On the other hand, taxation also provided governments with incentives to develop the necessary capacities to build strong, capable, and stable institutions. The purpose of highlighting this historical experience is to suggest that in our African context, the higher the share of tax in government revenue and the larger the tax base the more conducive it is for the emergence of a rights holder and duty bearer relationship between African governments and African Citizens. In short, the purpose is to encourage a debate within African Civil Society as to how tax could propel the process of empowering citizens and building capable states.

2 Taxation and Democracy: Overview

2.1 Defining taxation and democracy

Taxation is the study of government revenue raising activities through taxes. Among the various sources of finance for government expenditures (public goods and services provided by governments), taxation is the major source of government revenue in most developed countries. But what is a tax? A tax is defined by economists as an "involuntary payment to the government that does not entitle the payer to a quid pro quo benefit or to an equivalent value of goods and services in exchange" (Bruce 2001).

In that regard, a tax should not be confused with other forms of transfers to government such as user charges or fees (e.g. tuition, toll roads, and business licenses). A user fee is a price one pays when one chooses to use a government service. In general, the price we pay will cover the cost of the service we receive and if we do not use the service, we do not pay for it.

With regard to a tax however, it differs from a user fee in that paying a tax is not voluntary and there is not a quid pro quo benefit linked to the tax, meaning that what one pays is not tied to what one receives.

In addition to taxation, other important sources of government revenue are:

- **User charges and administrative fees**

Charges and fees are prices a government charges for the delivery of certain public goods and services for which exclusion of those who do not pay for them is possible. For example, user charges include toll roads, public swimming pools, ambulance services, university education (tuition), parks and recreational facilities, business licenses, television licenses, fishing licenses, motor vehicles licenses, parking tickets, and so on (Calitz, Steenekamp and Black 2009).

- **Government borrowing**

A government's budget deficit is the amount by which a government's spending exceeds its revenues in a given year. When a government has a budget deficit, it must borrow an equal amount to finance its outlays. The concept of deficit must be distinguished from the concept of debt. A government's debt at a given time is the sum or the accumulation of all past budget deficits; it is therefore the accumulated borrowing from all past deficits run by a government.

According to the "Golden Rule" of borrowing, over an economic cycle, a government should borrow only to finance capital expenditures and not to fund current expenditures. Capital expenditures are expenditures for durable assets that yield services over a long period of time, such as dams, radar stations, and aircraft carriers. Current government revenues (that is, own collections and transfers) should be enough to finance current or recurring expenditures such as compensation of public servants and purchases of goods and services like computers and vehicles, that do not result in asset creation (Bruce 2001, Rosen 1998).

- **Seigniorage and Inflation tax**

Seigniorage is the net revenue a government derives from printing money. It increases the money supply available in the economy which eventually raises the overall price level. The inflation tax is a related source of revenue and arises when an increase in the price level reduces the real value of a government's debt to the public. In other words, when the government is a debtor, the reduction in its debt resulting from an increase in the rate of inflation may also be an important source of revenue (Calitz, Steenekamp and Black 2009).

The following example illustrates the inflation tax:
Consider that the annual inflation rate in the United States is 10 percent. This year, one dollar will buy $1 worth of goods and services, but the following year, it would require $1.10 to buy the same basket of goods or services. In other words, inflation erodes the purchasing power of money. This is effect is similar to a 10 percent annual tax on cash holdings, provided there are no price reducing factors at play such as economic growth.

Although taxation is the major source of government revenue in most developed and developing countries, it is a widespread conception in Africa that taxation is a complex field that is best left to experts.

Not only is taxation in general poorly understood in Africa, it is also underutilized and underrated as a tool to establish capable and responsive states (state-capacity building role of taxation) and for the development of representative democracy in Africa *(Bräutigam 2008a)*. In 1989, Curtis stated the following: "taxation is probably the most significant political phenomenon that political scientists have left relatively unexplored" *(Curtis 1989)*.

This lack of information and understanding with regard to taxation among several stakeholders in Africa (elected leaders, citizens, civil society organizations,

"It's true, a fool and his money are soon parted... But that doesn't refer to paying taxes..."

the media, faith-based organizations, etc.) constitutes, on the one hand, an impediment to greater tax resource mobilization by African states needed to finance their development agenda in a context of global financial crisis and shrinking official development assistance (ODA) (*African Economic Outlook 2010*). On the other hand, it is also an impediment to the advocacy for sound tax regimes that are also crucial to building representative democracy, good governance and accountability in Africa.

Democracy is a political form of government where governing power is vested in the people and exercised by them either by direct referendum (direct democracy) or by means of elected representatives (representative democracy).

In a direct democracy, citizens participate in government directly. They would form an assembly to make laws, veto laws, elect or dismiss government officials, and so on. However, most democracies today are representative, that is, where governing power is exercised by groups of people chosen on the basis of an election.

With regard to government debt, if we assume that the government borrows $2000 from a taxpayer and inflation is 10 percent, then the following year the real value of the debt is reduced to $1800 that is $2000 –$2000*10% = $1800.

In many representative democracies, all citizens can directly participate in the decision-making process by means of any of the following three pillars of direct democracy: a) a citizen's initiative, where a petition signed by a certain number of registered voters would force a public vote on a proposed statute or policy. The initiative is currently used in Switzerland, in a few states in the United States, and in the European Union; b) a referendum or plebiscite or ballot question, where an electorate is asked to vote on a particular proposal by either accepting or rejecting it. A referendum could be either mandatory or facultative and binding or non-binding; and c) a recall election where voters can remove an elected government official from office through a referendum initiated when a sufficient number of voters would sign a petition. For example, recall elections are defined by law in Canada (British Columbia province), a few states in the United States and in Venezuela (*Scrutiny of Acts and Regulations Committee 2005*).

In general, democracies are characterized by the following dimensions: a) citizens' rights to freedom of speech, freedom of association and freedom to vote in free and fair elections; b) institutions of representative and accountable government that determine law and order and enforce them; c) active civil society which includes NGOs and bodies of active citizens independent from government and working in tandem to find solutions to common problems and to advance and defend their interests. Indeed, it is not enough for citizens in a democracy to simply elect a government and withdraw from the political scene; they ought to actively and constantly engage with said government to ensure that it continually takes into account its people and their needs; d) political parties indispensable to readily narrow down and promote the choices of the constituency; and e) the media essential to keep the constituency informed about government's actions and policies and playing the role of " watchdog" against abuse *(Beetham 2007)*.

2.2 Exploring the link between taxation, state-capacity building and democracy

Taxation plays an important role in state-building, where state-building is defined as "the process of increasing the administrative, fiscal and institutional capacity of governments to interact constructively with their societies and to pursue public goals more effectively" (*Bräutigam 2008b*).

When focusing on taxation, as an important component of state-building, we examine two principal areas: a) taxation as a factor in fostering representative democracy and b) taxation as a factor in state capacity and institutional building.

At this stage, it is important to note that this section is mostly based on the historical experience in the North regarding the role of taxation in state building and emergence of representative democracy and does not attempt to suggest that:

a) taxation was the only factor that led to these results and

b) this is a model trajectory that should and could be followed in Africa.

The purpose of this section is simply to suggest that it is worth the while to learn from the historical experience in the North and establish a link between taxation, state building and accountable governance.

2.2.1 Taxation as a factor in fostering representative democracy

The fundamental rationale for taxation as fostering representative democracy is as follows: historically and especially in Europe and America, the origins of representative governments are intricately linked to the need for taxation. War, the threat of war and military competition would increase the cost of warfare and thus the cost of direct taxation required to finance the war. However, to increase taxation in certain sectors, governments would have to bargain with taxpayers and obtain their consent. This led to the inception of assemblies of elites formed to negotiate this consent.

This is the beginning of the fiscal contract which stems from a classical collective action problem: governments' interest is to maximize revenue whereas taxpayers' goal is to minimize tax payments. Uncoordinated actions between the two parties would not result in the best possible outcome each could achieve. Therefore, it is in the best interest of the two parties to come to a mutually beneficial agreement, in other words, to enter a fiscal contract where the government would offer representation, accountability, adequate and efficient provision of public goods and services in exchange of quasi-voluntary tax compliance (*Bräutigam 2008b*):

- **Representation**

Taxpayers would have the ability to participate in and influence the political process through elected officials who would represent their interests, speak for them and bargain on their behalf over taxing and spending policies with the government. In effect, taxpayers who believe they have a "voice" and that their interests are represented in a democracy would be politically involved and more willing to pay taxes and thus uphold their part of the fiscal contract. This (quasi-) voluntary compliance over tax payments would greatly improve the administrative efficiency of tax systems by reducing both tax payment and tax collection costs and improving the predictability of revenue streams. This increased predictability and stability of tax revenues, would in turn enable governments to better plan in the long-run and encourage business investment opportunities. Furthermore, taxpayers, because they pay taxes would be made aware that they are entitled to representation (Moore 2008, OECD 2008).

The latter has been cornered in the famous slogan of "no taxation without representation" addressed to the British Parliament by the British colonists in America between 1750 and 1760, and which was one important rallying cause of the American revolution. The British colonists argued that because they were denied direct representation in the British Parliament in Great Britain, that is, their fundamental right as Englishmen, the implementation of laws taxing their colonies was deemed unconstitutional (Bell 2009a, 2009b, 2009c).

- **Accountability**

The virtual fiscal contract compels governments to bargain with taxpayers over taxing and spending; and as taxpayers' compliance cannot be ensured by coercion alone, taxpayers are in a position to exert pressure on governments to be accountable to citizens for the use of their money.

- **Provision of public goods and services**

When citizens pay taxes, they are aware of their right to representation and will express their opinions on tax and spending policies directly or through their elected representatives, and this includes advocating for adequate and efficient provision of public goods and services by governments.

In conclusion, governments' dependence on domestic revenues through a broad-based taxation is conducive to a participatory political process based on negotiations, bargaining and balancing conflicting interests. Citizens as taxpayers would come together to negotiate tax demands and oversee the collection and use of tax revenues through public expenditures, thus making government more accountable. They would ask for representation to have a greater say in public policy in exchange for voluntary tax compliance (Moore 2008, OECD 2008).

2.2.2 Taxation as a factor in building state capacity and institutions

Some theories have emphasized the role of war, threat, military competition and taxation in explaining state capacity building, institutional development and bureaucratic modernization mainly in Europe and America (Bräutigam 2008b).

The argument about taxation and state capacity building in these countries stems from the fact that an increased demand for tax revenue (or the revenue imperative), whether due to warfare or military competition, promotes reforms of tax systems that would lead to the development of a permanent revenue infrastructure. As the need to rely on a growing and consistent source of revenue intensifies, these bureaucracies would in turn require a skilled and knowledgeable workforce, thus professionalising the tax administration and generating the need for and the development of formal education systems.

Furthermore, the bargain between taxpayers and rulers regarding the level and allocation of taxes would give rise to property rights systems and the rule of law to protect and enforce them.

Additionally, as rulers begin to issue bonds on private capital markets using reliable and stable sources of tax revenue as collateral, financial markets would start to emerge and develop, and governments would begin to invest not only in the military but also in sectors such as water, sanitation, and health that would boost the standard of living of citizens.

Consequently, institutions that originally emerged to finance war or the threat of war would ultimately become engines of economic development and growth (Bräutigam 2008b). In other words, the dependence on tax as a main revenue source serves as an incentive to governments in compelling them to nurture the goose that lays the proverbial golden eggs instead of devouring the eggs.

In the 1960s, as many African countries gained independence from former colonial powers, (Kaldor 1963) highlighted the link between taxation and state capacity as follows: "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" (Kaldor 1963). Schumpeter expressed a similar idea when he argued that taxes, in addition to help creating the state, would also help to form it (Bräutigam 2008b).

In conclusion, to carry on with the rationale described in the previous section, governments' dependence on domestic revenues through a broad-based taxation is conducive to participatory political process. Citizens as taxpayers would come together to negotiate tax demands and oversee the collection and use of tax revenues through public expenditures, thus making governments more accountable.

Their political representation would have a greater say in public policy in exchange for citizens' quasi-voluntary tax compliance. As tax compliance increases, governments would develop strong and capable tax administrations with the ability to collect and administer taxes effectively, thus building and improving state capacity. As revenue streams from domestic broad-based taxation become stable

"Why do they call it tax returns? I think it's because it returns to make our lives better..."

and predictable, governments would have incentives to foster their citizens' prosperity, thus generating more revenues (Moore 2008, OECD 2008).

2.3 Taxation, state-capacity building and democracy: historical experience

We will review hereafter some historical case studies illustrating how consolidated tax systems have contributed to state-capacity building and strengthening democracy around the world.

One seminal case study is that of Great Britain during the late seventeenth and eighteenth centuries where it is said that a radical increase in taxation constituted one of the most important drivers of the early rise of the British state between 1688 and 1783 (Brewer 1989).

During what is often referred as the "Second Hundred Years War", the costs of war increased dramatically in Britain, with the state's military sector becoming the largest borrower, lender and employer in the economy. As such, Britain became a "fiscal-military state" essentially focused on financing the escalating costs of its hundred-year war. The increasing costs of warfare led to a drastic increase in British taxes which by the time of the Napoleonic Wars were at around 25 percent of the national income. However, the substantial increases in tax revenues during that period were mainly made possible through consent of and bargaining with the British society's elite. This led to the rise of Parliament in Great Britain, which is a central institution of democracy (Beetham 2007)4. In other words, the process of state-society revenue bargaining in Britain contributed to democratisation. The role of the Parliament or Legislature in Britain was to hold the British government accountable for the use of citizen's tax revenues. In turn, from demands for accountability by the Parliament stemmed increasingly skilled and sophisticated administrative structures in charge of collecting the information requested by the Parliament. At the same time, the fiscal-military state significantly improved its ability to assess and collect taxes efficiently in order to effectively fund and wage a prolonged war against the French, thus developing a large and competent tax administration system (Brewer 1989).

Another example relates to how broad taxation contributed to state- capacity building and strengthening democracy in Argentina. Gervasoni (2006) studied the levels of democracy at the sub-national government level in Argentina and argued that tax revenues collected by the federal government and redistributed to sub-national levels of government would operate as natural resource rents (such as rents produced by oil) in rentier states and would therefore hinder democracy. The author called the tax revenues collected by the federal government federal redistribution rents. In particular, he found that a fundamental factor explaining variance in sub-national democracy across provincial governments in Argentina was the extent to which provincial incumbents benefited from fiscal transfers from the federal government. Specifically, underdeveloped provinces, quasi-independent from local citizen/worker - and firm-taxpayers (or domestic private economy in general) and receiving large fiscal transfers and resource rents (such as oil) would be characterized by low levels of democracy and low levels of fiscal accountability to provincial business - and citizen - taxpayers. In this case, these provinces would dominate their local society because of their easy access to substantial resources that are independent from broad-based local taxation. As a result, the more a state relies on domestic businesses and Parliaments "embody the will of the people in government, and carry all their expectations that democracy will be truly responsive to their needs and help solve the most pressing problems that confront them in their daily lives." Additionally, they "have a unique responsibility for reconciling the conflicting interests and expectations of different groups and communities through the democratic means of dialogue and compromise" (Beetham 2007).

These provinces would be characterized by low levels of democracy because of their ability to stifle pressures for democracy. workers or on the general taxation of all sectors of the domestic economy for its economic survival, the less power it wields and it must consequently bargain with and obtain the consent of economic actors to obtain its revenues (Gervasoni 2006).[5]

In the 1980s in Argentina, the share of taxes collected by the federal government and redistributed among provinces approximated 50 percent. This large federal redistribution and resource rents (or "unearned" resources) allocated to provinces encouraged "rentier behaviour" among provincial incumbents such as: weakening of opposition and applying forms of repression such as firing of public officials opposed to them to increase chances to remain in power; usage of "unearned" resources to maintain the status quo; awarding contracts as favours for votes rather than on the basis of efficiency and so on (Gervasoni 2006).[6]

In general, government officials' rentier behaviour in developing countries is transmitted to civil servants and society in general with devastating consequences on their productivity and work ethic: absenteeism from work; people leaving the private sector with a vested interest in capturing rent for themselves in the government; proliferation of wasteful rent-seeking activities, and so on (Yates 1996).

3 Taxation, state-capacity building and democracy in Africa: issues related

It is important to note that the state-building role of taxation highlighted above through a fostering of representative democracy and a contributing factor in state capacity building and institutional development was developed from the perspective of developed countries, especially the United States and countries in Europe. Evidently, the significant differences between developing countries and developed countries will render the state-building role of taxation theories developed in subsequent sections somewhat inapplicable in developing countries in general and Africa in particular.

3.1 Taxation and state building in Africa

With regard to taxation and state capacity building, Africa faces some factors that could explain why the conventional state-building role of taxation theories may not be applied in the African context.
A rentier is someone whose income consists primarily of fixed unearned resources.

- **War, threats, and military competition**

As mentioned before, theories of state-building in developed countries pointed to war, threats, and military competition as crucial factors explaining the development of effective tax bureaucracies and related institutions.
Yet, in Africa, particularly in sub-Saharan Africa where internal and external threats have been numerous, we mainly observe state collapse and weak institutions rather than state-capacity building and strong institutions. Moore (2008) explained the rupture of the link "war/threat-taxation-state capacity building" in the case of sub-Saharan Africa by the nature of the taxable resources available in these countries. In particular, he argued that in order for the connection between war, taxation and capacity to function, governments facing threats need a source of revenue that is actually taxable (Moore 2008).

Moore's (2008) rationale is as follows: unlike developed countries, many developing countries heavily rely on one or several sources of revenues (resource-based economies). For example, copper in Chile, agriculture in Mauritius, copper in Zambia and oil in Nigeria and Angola. These resource-based economies obtain a substantial share of their revenues from supplying scarce and valuable commodities such as oil, gas, diamonds and various minerals on international markets. Due to the scarcity and value of these commodities, resource-based countries which control and export these commodities would derive considerably large rents, that is, substantial profits from these commodity exports.

When a country heavily relies on natural resources rents and other forms of rents as sources of revenue, it is able to readily generate reliable revenues through taxation of foreign corporations. Therefore, the need to bargain over taxes with other potential taxpayers or other producers in the economy is less urgent and critical. This results in overspecialised and small tax bureaucracies, weak institutional development throughout the country and low fiscal accountability towards taxpayers. Additionally, the price instability that characterizes natural resources in the world market could erode the taxable base. All these factors contribute to the phenomenon known as the "resources curse" in sub-Saharan Africa (Moore 2008).

- **Historical legacies**

The historical legacies in Africa could also account for why taxation has not resulted in state capacity building in sub-Saharan Africa. The colonial systems of taxation inherited by many African countries were in general based on coercion rather than consent and established in such ways that there were no real incentives to develop tax bureaucracies and related institutions (Bräutigam 2008b, Moore 2008).

- **Socio-economic structure**

Sub-Saharan Africa is also characterised by overall stagnate economies mainly based on wealth extraction in enclaves and without value addition. In these countries, wealth and employment are often not linked to the preponderant and heavily taxed fragmented subsistence economy. These inherent aspects of the socio-economic structure in most Sub-Saharan African countries may also account for the disconnection between taxation and state capacity building.

- **Foreign aid**

International experts from bilateral and multilateral donor agencies, international conditionality and foreign aid greatly influence taxation and its potential impact on state capacity building in sub-Saharan African countries. In particular, aid-dependent African countries would be hampered in their effort to develop strong and effective tax bureaucracies and consequently other institutions in their economy. In fact, these countries receive without much effort "unearned" revenues from foreign aid which would reduce government revenue generation, reduce the need of bargaining with taxpayers and thus weaken their extractive capacity. Furthermore, the lack of harmonization and alignment among international donors often put a great administrative burden on governments and weaken their already fragile institutions (Moore 2008).

In conclusion, some sub-Saharan African countries are heavily dependent on natural resources and other rents, they are the product of a colonial system that influenced their revenue bureaucracies, and are aid dependent. These factors create incentives different from those countries' that have to rely for their revenues on taxes from their taxpayers. In the latter, governments will have stronger incentives to develop their revenue-extracting infrastructures in order to maximize their revenues, thus improving their state capacity.

3.2 Taxation and representative democracy in Africa

In Africa, and particularly in sub-Saharan Africa, the impact of taxation on bargaining, representation and accountability will also be very different from the one in developed countries for various reasons.

As already broached in the above sections, compared to developed countries, governments in developing countries are more independent of their domestic taxpayers for revenue. In other words, states are often characterized by a limited dependence on taxes as well as an extensive informal sector that is hard to tax. In addition, they have generally and on average recourse to natural resources and foreign aid as sources of revenue. This reliance of natural resources rents and foreign aid rather than taxation in Africa is not conducive to revenue bargaining commonly associated with more representative, responsive and effective governments (Moore 2008, OECD 2008).

Natural resources rents and foreign aid inflows in Africa are in general associated with low levels of tax revenues due to limited support for revenue-raising efforts, low quality of government institutions, and ineffective and unaccountable governments characterised by an absence of representation for taxpayers in the tax policy process. These arguments leadtothe conclusion that taxation is a necessary condition for the quality of governance (Moore 2008, OECD 2008).

"Are you sure you want to pay lower taxes? Because the best way to do that is to reduce your salalry"

3.3 Review of the current situation in Africa: some Case Studies

In many developing countries today, the taxation-accountability-governance link is often not displayed. Governments in many African countries for the most part do not depend on domestic taxpayers for revenues, but mostly rely heavily on foreign aid, natural resource rents, and few large taxpayers such as multinationals. As mentioned in previous sections, this situation is not conducive to bargaining and building a social contract between state and citizens. On the contrary, what we generally observe in these countries is a "state-society imbalance", where the state has considerable power over society because it mainly gets its revenues from a source largely independent from the domestic or local economy; as such, it could therefore resist democratic pressure and could afford to be unresponsive to its citizens. Reactively, citizens' willingness to pay taxes decreases as they perceive that governments are not responsive to their needs and as poor service delivery becomes prevalent. Furthermore, citizens as taxpayers lose the motivation to be politically interested and participatory. Some avenues to economic development and political stability in developing countries might thus be compromised (Gervasoni 2006, OECD 2008).

Below, we describe some case studies in Africa illustrating the above mentioned argument.

In a study on South Africa, Fjeldstad (2004a) attempts to identify the factors explaining widespread non-payment of services charges in many municipalities. He found that, if non-compliance can only be explained by factors such as poverty (especially among African and Coloured groups) and a culture of entitlement stemming from the apartheid period, it would not explicate huge variations in compliance existing both within poor communities and between communities with similar socio-economic characteristics.

Fjeldstad, therefore, concludes that other important factors may well be at work to explain low levels of compliance across municipalities in South Africa. He argues that these factors are related to trust relations between state and society and within local communities. More precisely, he refers to the lack of trust in local governments to use revenues to deliver adequate public goods and services, lack of trust in local governments to collect and redistribute revenues fairly, and lack of trust in other citizens to comply with services charges, as potential determinants of compliance behaviour at the local government level in South Africa (Fjeldstad 2004a).

In October 2003, Fjeldsta*d (2004b)* conducted a survey on the views of ordinary citizens on local government taxation in Tanzania. The survey comprised 1260 respondents from 42 villages in Tanzania. It asked respondents questions on their views regarding the following matters: taxation and tax evasion; who pays and why; service delivery; major problems in tax collection; who is to blame for poor tax collection; and measures required to improve revenue collection.
The survey results show that in Tanzania people between 30 and 49 years of age paid more taxes than both people between 18 and 29 years of age and people over 50 years old. This is not surprising given people in the first group are more likely to have a larger taxable income. In addition, people who have completed college or university paid more taxes than people with any other level of education (such as no formal schooling, primary education, secondary education, or vocational

Case Study

Another interesting case study is about local revenue mobilization in Uganda. A project funded by the United Nations Capital Development Fund (UNCDF) in 2001 revealed that two of the most important factors accounting for low rates of revenue mobilization across councils in Uganda were the unwillingness to pay tax and the lack of taxpayer education on the purpose and value of paying taxes. In fact, the government in Uganda is so far removed from people in villages that they do not see how their taxes are spent on public services; whereas people in urban areas do not perceive the link between taxes paid and public services received. Specifically, the unwillingness to pay tax was mostly explained by a poor linkage or disconnect between tax paid and services delivered, by the lack of trust in a non-transparent tax administration, by an inflexible collection timetable and by poverty (UNCDF 2001).

or adult education). With regard to the question of why people pay taxes, most respondents in the oldest age group (50 years and above) said they paid taxes because they anticipated public services.

In identifying major problems in tax collections, over 58 percent of respondents estimated that there was not a direct link between taxes collected and benefits received. Regarding tax compliance and service delivery, the majority of the respondents replied that poor tax compliance was mainly explained by poor public services. Furthermore, 51 percent of all respondents were of the opinion that people should refuse to pay taxes until services improve, while 73 percent of all respondents stated they would be willing to pay more taxes if public services were improved. When asked whom to blame for poor tax collection, 53.7 percent of the respondents perceived that (dishonest) tax collectors were to blame while 49.3 percent blamed council employees.

4 Citizenship, representation, good governance and accountability

Concerning perceived actions to undertake in order to reduce misuse of tax revenue, almost 64 percent of all respondents believed that reporting the misuse of tax revenue to a journalist would help reduce it; while 40 to 50 percent of the respondents stated that reporting the misuse of funds to other levels of government or to the police would be pointless mainly because "all civil servants are corrupt and they protect each other" (Fjeldstad 2004b).

These case studies show that tax and expenditure policies can not be separated. Citizen's willingness to pay depends upon effective service delivery. It is essential that citizens have a better understanding of how their taxes are being used. They should perceive that they receive tangible benefits in return for the taxes they pay and that tax revenues are used to improve welfare for all.

4.1 Definition of concepts

According to social contract theory, citizenship is defined as the relationship between an individual and a nation or a particular social or political community, recognized legally and which entails rights and responsibilities prescribed by law, such as the right to vote and the responsibility to pay taxes and so on. A related concept is the notion of active citizenship which refers to a philosophy according to which citizens should strive for the betterment of their community through civil, political, socio-economic, and cultural or collective work, which constitute the four dimensions of citizenship **(Hébert and Sears 2001).**

Representation, often called representative democracy, is a form of government where elected officials represent the people and speak for them in the legislature. In other words, representation is the process by which citizens' voices, opinions, preferences and perspectives are brought forward in the public policy making processes by elected individuals acting on their behalf (Pitkin 1967).

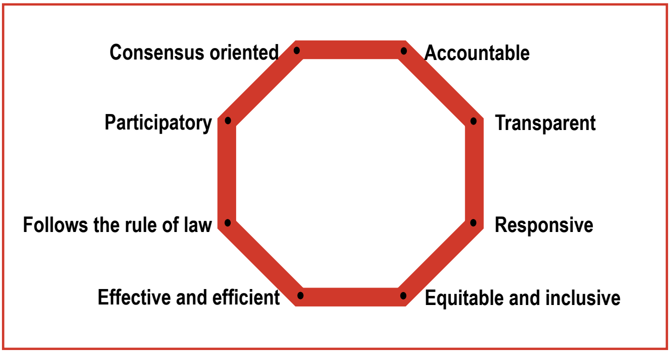
The concept of governance refers to the "the process of decision-making and the process by which decisions are implemented (or not implemented)." The notion of governance therefore encompasses the formal (government, civil society) and informal actors involved in decision-making and implementing processes as well as the formal and informal structures within which decisions are made and implemented (UNESCAP 2010).

It is generally accepted that the good governance concept rests on four major characteristics or pillars: accountability, transparency, predictability, and participation (Schiavo-Campo and Tommasi 1999). The quality of governance in a country has been recognized as an important determinant of development and growth (OECD 2008).

Accountability is a key requirement for governance and refers to the capacity to hold public officials responsible for their actions. Transparency refers to the capacity to access relevant information at low costs. Predictability is achieved when law and regulations are clear, known in advance and uniformly and effectively enforced. Finally, participation, another key component of good governance, is essential to provide reliable information (such as information about the needs and concerns of the most vulnerable in society) and to act as checks and balances for government actions (Schiavo-Campo and Tommasi 1999).

More generally, good governance in a country would ensure that corruption is curbed and the views of minorities and voices of the most vulnerable are taken into account in decision-making processes. It also implies that institutions and processes are responsive to the needs of society as a whole (UNESCAP 2010). The broader characteristics of good governance are represented in the figure below.

Figure One: Characteristics of Good Governance



Source: (UNESCAP 2010)

4.2 Exploring the link between the concepts

As mentioned in previous sections, government revenue raising activity through taxation is one of the most essential drivers of the relationship between states and their citizens. In effect, the emergence of tax systems, their structure and performance are closely linked to the formation of accountable and effective states.

Historically, the bargaining process between citizens and states over taxing and spending led to the creation of a virtual "fiscal social contract" that was crucial to the emergence of representative government and democracy and a path to better governance in Western Europe and the United States. Specifically, in that virtual "fiscal social contract", citizens would willingly accept to pay their tax obligations in exchange of rights to be represented in decision-making processes about how tax revenues are raised and spent[7], accountability, and effective provision of public goods and services. This would create incentives for governments to put in place strong bureaucracies capable of collecting and administering taxes effectively as well as information systems enabling bureaucracies to carry these functions efficiently. Additionally, strong incentives to generate more revenues woul compel states to foster economic growth that results in the well-being, the quality of life and prosperity of their citizens.

Concurrently, taxpayers in Parliaments would implement structures to oversee revenue-raising and hold states accountable for the use of tax revenues (OECD 2008).

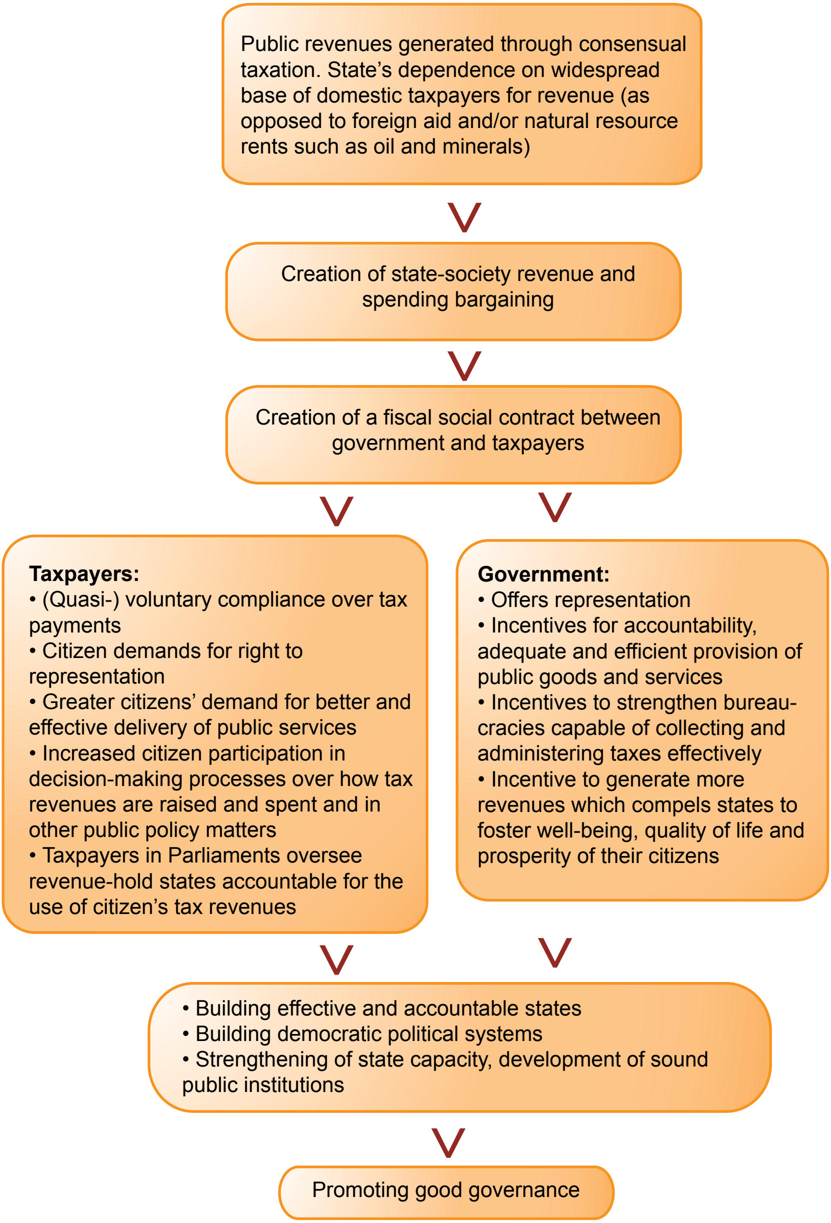
To put it more succinctly, this would amount to a non-zero-sum game where both parties, state and citizens, could win: because of their citizenship and mainly because they have accepted their obligations to pay taxes, taxpayers are entitled to express their views on public policies directly or through their elected representatives and therefore advocate for better service delivery from states.

The link between taxation, democracy and good governance is illustrated in the figure overleaf. Revenue mobilisation at the regional and local levels has been an important aspect of decentralisation efforts in Africa over the past twenty years.

4.3 Fiscal Decentralisation, citizens' participation and accountability

Local taxation refers to study of revenue raising activities through taxes at the sub-national tiers of government. Revenue mobilisation at the regional and local

Figure 2: Link between taxation, democracy, accountability and good governance



levels has been an important aspect of decentralisation efforts in Africa over the past twenty years.

Decentralisation is broadly defined as the *devolution* of power, responsibilities and resources from the national level to sub-national governments. Devolution, which represents the most complete form of *decentralisation*, should not be confused with *deconcentration* (that is, the shift of decision-making power to central government officials that are located outside the capital) or *delegation* (that is, the shift of fiscal powers responsibilities to sub-national governments that are ultimately fully accountable to the centre) (Dickovick 2005, Ndegwa 2002).

In general, we distinguish between three forms of decentralisation in the literature: political, administrative and fiscal decentralisation (Yao 2006, Bahl 2005, Dickovick 2005).

- Political decentralisation refers to the political power given to sub-national officials through popular elections, political accountability to their local constituents, and political independence from the centre once elected.
- Administrative decentralisation connotes discretionary power and autonomy of sub-national government officials in managing local affairs (local civil service, local regulatory framework, and sub-national financial management).

- These two forms of decentralisation set up the foundation for fiscal decentralisation which entails the devolution of fiscal decision-making power and management to sub-national governments, that is, transfer of tax authority to sub-national governments as well as guaranteed intergovernmental revenue transfers from the central government. The four fundamental pillars of fiscal decentralisation are:
  - Assignment of functions and expenditure responsibilities
  - Assignment of revenue sources to sub-national governments
  - Allocation of intergovernmental fiscal transfers
  - Rules on sub-national government borrowing.

Today, fiscal decentralisation is defined as the "fiscal empowerment of people by the fiscal empowerment of their local governments" (Bahl 2005).

Key features of a successful fiscal decentralisation system, which entails the transfer of tax authority to sub-national governments (i.e. the power to raise local taxes), can lead to greater downward accountability to local people and increased levels of citizen representation which effectively plant the seed for democracy.

"They say that the truth hurts... But when filling tax return forms we should tell the truth because it's lies that will hurt..."

First, popularly elected local council, locally appointed chief officials, and locally approved budget constitute some of the most crucial requirements of a decentralized system. If local government officials are appointed by higher levels of government rather than popularly elected, they will be accountable to the centre rather than to local populations. Therefore, popularly elected local councils would ensure true downward accountability and persuade public officials to be responsive to the needs and interests of their constituents. Furthermore, if budgets are locally approved, this would require citizen participation in the decision-making processes and would therefore give citizens a voice in how their taxes should be spent and that they are spent according to their preferences. In such an environment, as citizens become an integral part of the institution and the political dialogue, they will increase their level of tax compliance, thus increasing citizens' tax ethics and a tax compliance culture.

Second, one of the rationales for fiscal decentralisation is that it moves government closer to people. This feature is closely related to the features mentioned earlier. As mentioned in section three, if citizens have no faith in how the government will spend collected revenues, this would reduce tax compliance. By bringing government closer to people, fiscal decentralisation will help increase the trustworthiness and credibility of local governments as empowered citizens are able to observe how public officials carry out their responsibilities and have a perfect knowledge of whom they can hold accountable for the poor quality of local service delivery in their jurisdiction.

The following examples show how a successful fiscal decentralisation system and hence local taxation would increase accountability, strengthen involvement of citizens in decision-making processes at sub-national tiers of government and improve the efficiency of public service delivery.

In South Africa, the government structure is as follows: central government, nine provincial governments and 284 local governments divided into six metropolitan municipalities, 46 district municipalities and 232 local municipalities.
All metropolitan, district, and local municipalities are governed by an elected council whose work is coordinated by a mayor elected by the council. Each council is composed of ward councillors and proportional representation councillors. In all municipalities, ward councillors are required to work with ward committees that involve citizens and give them a more direct say in the local decision-making process involving policies, the annual budget and the framework for development plans and service delivery. The integrated development plans are specifically designed to be powerful instruments for participatory and accountable planning and resource allocation, unfortunately they are not always successful at the local level in South Africa (Shah 2006).

Local governments in Uganda are autonomous corporate entities with legal status and as such, can sue, be sued and be held legally accountable. They are managed by chairs who are elected through universal adult suffrage and secret ballot. In order to improve the democratic legitimacy and accountability of local governments, the decentralisation system in Uganda has laid down minimum quotas of women, youth, and people with disabilities who should be represented in councils. Furthermore, the decentralisation process allowed for a committee system made out of a joint participation of elected councillors and civil servants to ensure the democratic control of local government decisions involving service delivery and management (Shah 2006).

5 Conclusion and suggestions for action

The objective of this educational material is to bridge the knowledge gap on taxation among elected and civil leaders, civil society organizations and the African public at large. It aims at increasing the information about taxation and its importance in strengthening the relationship between governments and their citizens in Africa. Specifically, it highlights that historically bargaining over taxation has created a virtual "fiscal contract" whereby a functional relationship evolved between taxpayers and the state based on reciprocal dependency. On the one hand, this virtual "fiscal contract" offered taxpayers the opportunity to hold governments accountable for the quality of public goods and services and to increase citizen participation in decision-making processes as well as tax and spending policies; which contributed to building a democratic political system and promoted better governance. On the other hand, taxation also provided governments with incentives to develop the necessary capacities to build strong, capable, and stable institutions.

The Civil society organizations, faith-based organizations and the media can contribute to the formulation and implementation of tax policies which would lead to accountability and good governance on the part of the state and better tax compliance from citizens, ultimately strengthening and deepening the democratisation process in Africa by playing the following roles:

- Help inform the public about taxation and tax issues or improve taxpayers' education and understanding on taxation issues in general.
- Help citizens understand the bargaining power that comes from complying with taxes obligations and the virtuous circle of benefits (such as effective and accountable state, better governance, greater democratisation efforts) derived from establishing an enduring fiscal social contract.
- Help citizens understand that as taxpayers they can make their voice heard, they could actively take part in public policy decision-making processes about how taxes are collected and spent on public services and thus hold governments accountable and increase their political participation.
- Help elected officials and civil leaders understand the enormous advantages of promoting quasi-voluntary compliance rather than coercion to increase domestic resource mobilization; advantages such as: incentive to increase state capacity to collect and administer taxes effectively, stable and predictable tax revenue streams that could be used as basis for borrowing in domestic and international markets.
- Get involved in tax debates and produce reports and articles on tax issues

with the following goals in mind: to provide adequate sources of funding for poverty reduction programs, to influence income redistribution policies and to increase government transparency and accountability.

- Take part in and influence the different stages of the budget process (formulation, legislative, implementation and assessment stages).

Elected leaders could also contribute to greater tax compliance, accountability, good governance and democracy in Africa by doing the following:

- Simplify and make tax system more transparent
- Improve tax administration
- Widen the tax base
- Improve efficiency in public service delivery
- Increase reliance on domestic revenues through a broadly-based taxation which would increase government's responsiveness to citizens' needs and would promote broad economic development.

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